



**PORTFOLIO NOTES**

**APRIL 2022**

*To our Business Partners:*

- **"TOP DOLLAR FOR TOP DOLLAR."** This phrase was coined by John Hussmann of the Hussmann Investment Trust. It describes stocks at elevated levels of valuation – high price/earnings ratios combined with high profit margins (profit margins are earnings as a percent of a company's revenues). While high profit margins are usually a good thing, and owning highly-profitable companies is always a goal, they are quite often difficult to sustain.

Most companies, over time, experience variability in their margins due to competition and/or economic cyclicality. The last several years have been unique in that margins have been generally rising, in some cases significantly. Most of the factors affecting margins, like a better mix of products or services, cost-cutting, or restructuring, have moved in a favorable direction. Looking forward, however, one could argue that additional improvements will be hard to come by, and even be reversing. The current bout of price inflation in the economy will provide a significant headwind for many companies.

Valuation multiples – price-to-earnings, price-to-sales, price-to-cash flow, price-to-asset value, price-to-dividends – also remain near record highs. Thus, investors may be indeed be paying "top dollar for top dollar" at a time when the second component, profit margins, are under pressure. Historically, under these conditions, subsequent investment returns have been well below average. It is particularly important to pay attention to these measures in this environment, and remember that price is the most important consideration in buying stocks. As Warren Buffett has said, "PRICE is what you pay; VALUE is what you get."

- **PORTFOLIO VALUATION.** Speaking of price to value, 86 cents buys a dollar's worth of our group of widely held stocks\*. That's not good enough for new money, so we continue seeking better values in the marketplace. We miss the good old days in early 2008 when a dollar's worth of our group\* could be bought for around 44 cents.
- **RECENT RESULTS.** The popular stock market indexes rebounded in March, with large company stocks performing better than small cap. The S&P 500 and the NASDAQ Composite rose 3.6% and 3.4%, respectively, while the smaller cap indexes rose around 1%. For the first quarter, all indexes still show losses in the 4-9% range, with the NASDAQ down the most. Over the past twelve months, the large company indexes still maintain an advantage over the smaller companies, but the gap has narrowed. Some of the smaller cap indexes, however, have declined over the trailing twelve months. So far in 2022 and over the past year, our equity composite\* has registered positive returns and compares favorably to the market indexes.

*Steve Nichols, CFA*      *Bill Warnke, CFA*

\*The group of "portfolio stocks" -- our Equity Composite for the purpose of evaluating investment performance -- consists of 19 stocks that are held in our clients' accounts. Portfolios might hold some or all of these stocks, depending on investment guidelines unique to each client, the timing of purchases and sales, and start dates of accounts. The performance of this group of stocks is a good proxy for our equity performance but might vary widely among accounts. Of course, past performance is not necessarily indicative of future results.

We hereby offer to deliver to you without charge a copy of our current Form ADV Part 2, in accordance with the U.S. Securities and Exchange Commission's "Brochure Rule." Please contact us if you would like us to send you a copy.

*Investing with a margin of safety.™*