Warnke/Nichols Ltd.
Investment Management

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PORTFOLIO NOTES **JUNE 2022**

To our Business Partners:

- ***HOPE ON TOP OF HOPE.*** Your writers believe that the speculative stock market bubble that has been building up over the last several years has finally burst. Among the companies in the NASDAQ, where most of the hottest tech issues are traded, severe damage has already been done. Over half of the companies are 50% or more below their 52-week highs; some are over 90% off their highs! Many of these high-flying tech stocks peaked back in February 2021. Remarkably, prices of the heavyweights in the index, notably Apple, Microsoft, Amazon, Alphabet (Google), and Tesla, have not collapsed (yet) and have masked the carnage within the index.

  Drilling down a little deeper, we find that nearly 60% of NASDAQ companies are unprofitable and generate negative cash flow. It has truly been a highly speculative period, fueled by cheap money (ultra-low interest rates) and a long bull market. As bull markets get extended, investors(?) tend to get more venturesome and careless, pushing prices up even further.

  We have always been amazed at the lengths some go to justify their bullish positions. It happens EVERY cycle, as traditional measures of value are tossed aside in favor of, "disruptors," "innovation," "extreme opportunities," "scalable," website "eyeballs," "high-growth," blah, blah, blah. Since these types of companies are not yet making any money, "analysts" have to come up with something to justify the outrageous stock prices.

  Now, given the big declines that have occurred, some are equating good value with how much the stocks have declined from their highs. While this is one factor in evaluating a stock's attractiveness, there's way more to consider. A company's value is based on the earnings and cash flow it produces, which is then compared to its price. Comparing the price now to the price 16 months ago simply is not a measure of value. With the economic tailwinds all but gone, many of these companies remain overvalued, no matter how much they've already declined.

- ***PORTFOLIO VALUATION.*** Our group* of portfolio stocks has held up better than most but is still 80% of value. Happily, we're finding more bargain-priced stocks to consider adding to portfolios as the U.S. economic and stock market declines play out in the coming months.

- ***RECENT RESULTS.*** Don't believe what you read in the media! The idea that a "bear market" is defined by an arbitrary 20% decline off highs is absolute nonsense. The market began peaking in November-December last year and came unglued beginning in January. Recently, the indexes were mixed in May, with the large cap indexes flat, small/mid-cap up a little, and NASDAQ down a little. For the year to date, NASDAQ is off close to 23%, while most of the other indexes we monitor are down 10-13%. Year-over-year ended May, everything is down, ranging from 1% for the S&P (thanks to the heavyweights mentioned above), to 12% for the NASDAQ, to 18% for the small caps. Our equity composite* has done quite well compared to the popular stock indexes over the three periods discussed.

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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.

Investing with a margin of safety.™

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