CAPITAL INVESTMENT COUNSEL

The Columns

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I loved bowling with my son when he was little. The bowling alley usually set up lanes for kids and put inflatable bumpers in the gutter. With bumpers, everyone's a winner. It was impossible to put the ball in the gutter and you were definitely going to knock down some pins. I look at the Federal Reserve's actions over the last two years and those inflatable bumpers come to mind. I see people bragging about their investment wins on Twitter. Who needs a job when you can just invest in crypto or meme stocks like Gamestop? It feels like those E*trade ads from 2000 about making your own raise. What could go wrong?

We were all in a tough spot in early 2020. The pandemic was raging, and the world shut down. What would happen next? The Fed came to our rescue and did a wonderful job of propping up the economy and the consumer. But, like a party guest who stays too long, the Fed didn't take the hint that it was time to take their stimulus and go home.

I remember going to the Wrightsville Beach years ago. Looking around, Keri and I determined that we were the only 2 people on the beach without tattoos or visible piercings. To be clear, I wanted neither a tattoo, nor a piercing but I felt strangely out of sync. Was I that old? Had things changed that much? The Covid market of the last 2 years felt similar. What was I missing? Seeing unprofitable companies selling at 30 times revenue was unusual. Twilio was 32 times sales in February at $400 a share. It trades at $200 now. Fastly, Inc was nearly 40 times sales and $133 a share. It's barely $30 now. Reality seems to be setting in for the speculative part of the market. Turns out, I wasn't out of touch at all, and I didn't even have to get a tattoo.

Fast forward to 2022 and inflation is at levels not seen since the late 70's. Finally, the Fed is scaling back their stimulus and interest rates are set to rise later this year. I'm not sure what took so long, but markets got the message. The inflatable bumpers have been removed and kiddie hour is over. Investors are learning that valuation does matter. I feel that's a healthy development as it could direct investment money back into companies that actually make money.

Goldman Sachs constructed an index comprised of non-profitable tech stocks. That index peaked in February 2020 at 470. It's been all downhill since. After a 48% haircut, the index currently trades at 228. Rising rates don't appear to be kind for non-profitable stocks trading at lofty prices.

On Tuesday, January 4th, the stocks in the S&P 500 with the highest valuations dropped 2.8% while the lowest PE stocks gained 2%. That's an almost 5% swing between the two groups. Thanks to Bespoke Invest for the stat. One day doesn't make a market but the trend has carried on since then.

Finergy has been one of our favorite trades since November 2020. I love new words, especially made-up ones and Finergy is the finance and the energy sector. Year to date, the NASDAQ large caps are down 7.5%. The financials *are up* 3% and energy is up 18%. We've talked in the past few months about some of the energy stocks finally catching up with the high price of crude oil and that appears to be happening. There's good news out there if you know where to look.

The economy is rolling along nicely at present. Omicron has been a speed bump from a growth standpoint and consumers appear to be able to stand on their own now. Some are worried about a lack of stimulus, but government payments to consumers are roughly flat over the last 8 months. Despite that lack of free money, consumers are still spending at an 11% growth rate. (Tom Graff) My take is positive. The economy is growing and we're at full employment for those who want to work. Let's not forget that it's a mid-term election year and those tend to be volatile. Using history as a guide, mid-terms also tend to end well. The 4th quarter return has been 4% in mid-term years since 1950. I caution you not to get too negative.

Pick out companies you'd like to own. Set the price you want to pay and if it comes along, take advantage. If you have any comments, feel free to contact me at heddins@capital-invest.com or call me at 919-656-0836.

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