SMEAD capital management

Missive

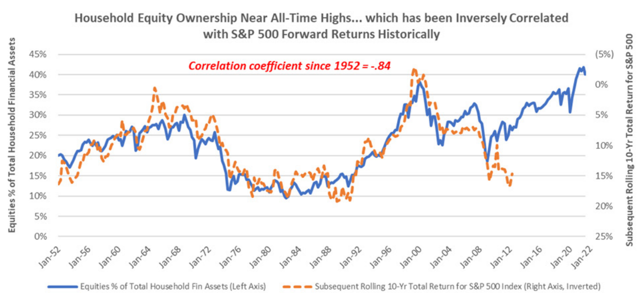
AUGUST 23, 2022

Do As I Say

Dear fellow investors,

The current stock market circumstances have created an incredible contrast between what investors say they think about the stock market versus what they are doing with their capital. The chart below shows that most investors are heavily committed to stocks even though in sentiment polls, they show themselves to be quite bearish.

This is a problem because U.S. investors have over-capitalized stocks in the last four years more than we did at the height of the Dotcom bubble of 1999-2000. This matches the confidence seen at other major junctures like 1929, 1966, 1972, and 1999.



Source: Federal Reserve Economic Data, Bloomberg.

How is this likely to play out? The stock market is likely to shake out the confidence among asset allocators and cause it to match the bearishness expressed in sentiment polls before we hit a meaningful long-term bottom. Think back to the financial crisis bear market in 2007-2009. There were as many as four significant spikes in bearishness and only the last one marked the end of the bear market.

This bear market is designed to cleanse the sins of what Charlie Munger called the "biggest financial euphoria episode of his career [75 years] because of the totality of it!" The bear market of the financial crisis was very punishing because we stared into the abyss and the economy's transmission system was badly damaged. Therefore, there was a complete lack of economic confidence, and it bottomed because the future was being priced too cheaply in March of 2009.

This bear market is designed to punish mass foolishness in everything from FAANG stocks, glam tech stocks, high price-to-sales up and comers, meme stocks, SPAC/IPOs, cryptocurrencies and the list goes on! We even revived the meme trading in the recent bear market rally. Why are we sure it is a bear market rally? It was led by the same foolishness that triggered the bear market in the first place. Investors are gluttons for punishment in this cycle.

What are investors to do? Recognize the heart of the difficulty for the stock market (inflation and interest rate normalization) and organize investments around those factors. We believe investors should do as we do: get the 1970s playbook out and enjoy a long-term bull market in commodities and property that could get valued higher in an inflationary era. And as we always say, fear stock market failure.

Warm regards,

Bill Smead
Chief Investment Officer

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