



Missive

JANUARY 23, 2024

Stock Market-Interest Rate Rhymes

Dear fellow investors,

Warren Buffett regularly reminds his shareholders that interest rates are a gravitational pull to stock prices. History shows that the movement of stock prices and interest rates don't necessarily happen simultaneously but play out over time. Where are we now in this continuum between long-term interest rates and stock prices?

Thankfully, John Authers shared his thoughts at *Bloomberg* and provided the following chart:



The CAPE ratio is the cyclically adjusted price-earnings ratio. By averaging earnings over a ten-year period, Professor Robert Schiller attempted to give investors a view of stock prices that took out any short-term earnings movements. Its purpose was realism, and with the stock market riding a multi-decade run of growth stock success, realism hasn't done investors a whole lot of good.

However, this chart compares long-term interest rates to the CAPE earnings. A few observations. First, 1921, 1930, 1940, 1981 and 2009 were very good times to be aggressive with your common stock purchases, as the overall market was low in relation to interest rates. Second, the absolute best time to buy stocks in my adult lifetime happened to be in 1981-1982, when I started in this business. This sounds great in theory, but as you can see, Treasury bills and bonds were offering 14% to 15%. Equity ownership, as measured in the Fed's Z-1 report, was at a lifetime low of 8% of household assets. Just so you know, investors were afraid to buy those bonds because of double-digit inflation. Therefore, they sat in interest-bearing CDs and money market funds, rather than locking in those rates for the long-haul.

Second, stocks got disconnected from interest rates in 1901, 1929, 1966, 2000 and 2021. We have had the weirdest feeling to start this year because of how similar our large cap value strategy is trading in relation to the S&P 500 Index, much like it did in the early 2000 time period. You could almost hear the song, "Happy Days Are Here Again" playing in the background last week as the glamour growth stocks roared again.

Lastly, what did you want to buy in common stocks in 1966 and in 2000 with the money you kept in those expensive stock markets? The answer was oil and gas/commodities. In the first case, the inflation of the 1970s and higher oil prices made energy the only game in town as an S&P 500 Index sector. The same kind of phenomenon happened in the 2000-2010 period as the growth in the nation of China led to dramatic increases in oil and other commodity prices.

Stock Market-Interest Rate Rhymes

If you were wondering why we are sitting through a major correction in our oil and gas stocks Occidental Petroleum (OXY), ConocoPhillips (COP), Orintiv (OVV), APA Corp. (APA) and Devon Energy (DVN), look no further than the chart of the S&P 500 CAPE ratio versus long-term interest rates. Hear the rhyme and fear stock market failure.

Warm Regards,



Bill Smead
Chief Investment Officer

The information contained in this missive represents Smead Capital Management's opinions and should not be construed as personalized or individualized investment advice and are subject to change. Past performance is no guarantee of future results. Bill Smead, CIO wrote this article. It should not be assumed that investing in any securities mentioned above will or will not be profitable. Portfolio composition is subject to change at any time and references to specific securities, industries and sectors in this letter are not recommendations to purchase or sell any particular security. Current and future portfolio holdings are subject to risk. In preparing this document, SCM has relied upon and assumed, without independent verification, the accuracy and completeness of all information available from public sources. A list of all recommendations made by Smead Capital Management within the past twelve-month period is available upon request.

©2024 Smead Capital Management, Inc. All rights reserved.

This missive and others are available at www.smeadcap.com.



smeadcap.com

2777 East Camelback Road
Suite 375
Phoenix, AZ 85016

Sales Desk US 877.701.2883
Sales Desk UK +44 (0)20.8819.6490
info@smeadcap.com