



Newsletter

SMEAD US VALUE — 4TH QUARTER 2023 (12/31/2023)

Outlook 2024: Crossing the Stock Market Bar

We recently released an episode on our podcast, A Book With Legs, discussing a book called *Graveyard of the Pacific*. The author explained how dangerous the Columbia River Bar is to cross and why it is the deadliest waterway in the U.S.

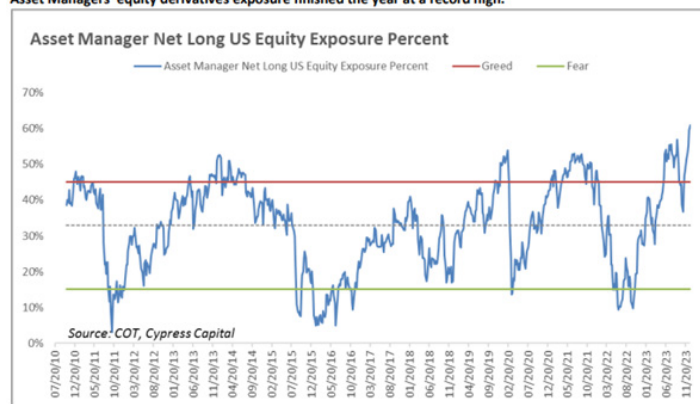
Having crossed over it 100 times in my life to catch a summer salmon, I am well aware of the risk. Guarded by the very able U.S. Coast Guard, boaters are instructed on the level of danger each day.

While navigating the waters with my father, a master ship pilot, we never took unnecessary risks. Whenever the Coast Guard signaled a high danger level, we heeded their advice and remained onshore. The principle held true: even the most adept seamen understood that some risks weren't worth the potential rewards, regardless of our eagerness to reach our fishing grounds.

If there was a Coast Guard for the U.S. stock market, we believe they would be issuing a warning to owners of the S&P 500 Index and popular common stocks. Let us share the data that the stock market Coast Guard would use to urge caution.

First, both individuals and professional investors are as heavily involved in stocks as they have ever been (fishing like never before):

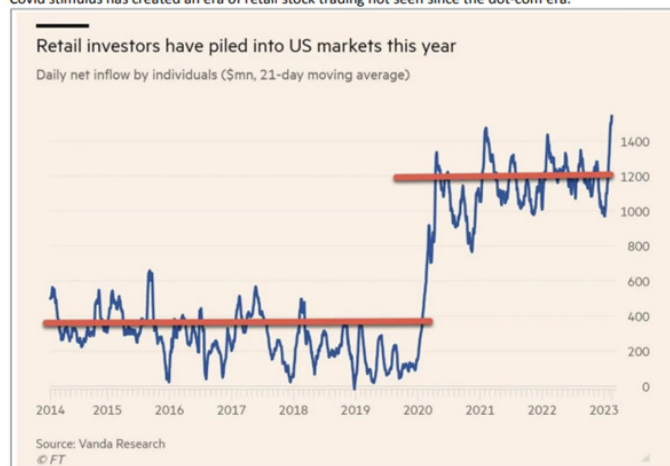
Asset Managers' equity derivatives exposure finished the year at a record high.



Second, the most aggressive investors are filled with confidence in the face of small craft warnings:

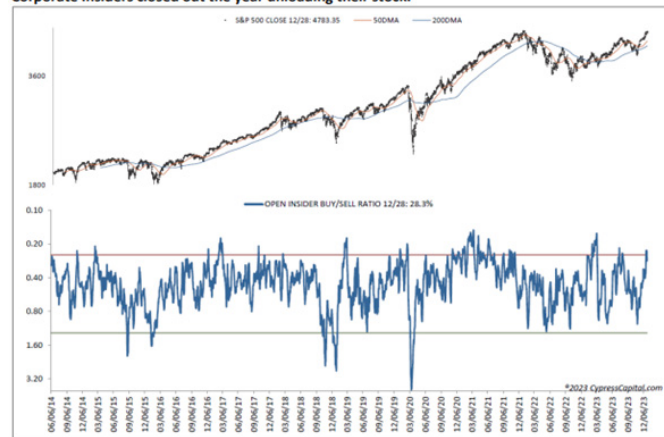
Retail went all-in on the Fed pivot trade.

Covid stimulus has created an era of retail stock trading not seen since the dot-com era.



Third, corporate insiders are selling like there will be a wave coming which can knock over big boats:

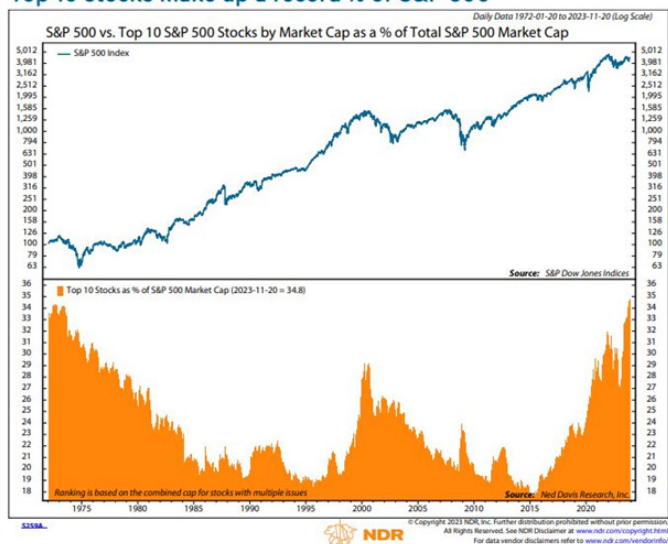
Corporate Insiders closed out the year unloading their stock.



Fourth, the recent explosion in stocks has front-run the Federal Reserve Board cutting short-term interest rates in 2024. In other words, the fisherman had limited out in late 2023.

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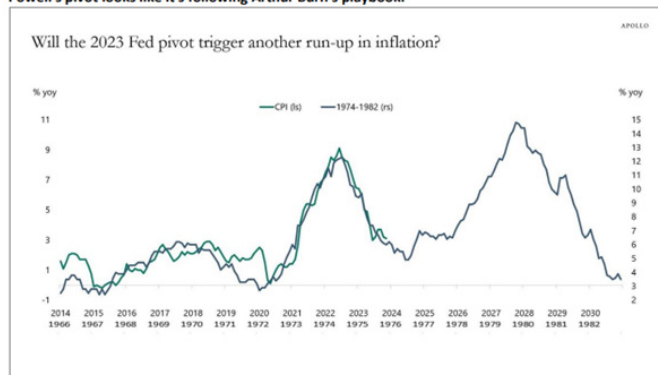
Top 10 stocks make up a record % of S&P 500



Source: S&P Dow Jones, Ned Davis Research, NDR. Data for the time period 1/20/1972-11/20/2023.

Lastly, we believe the stock market has misconstrued the incoming tide of inflation. The assumption is that inflation is licked, just like it was assumed in 1973 and 1977:

Powell's pivot looks like it's following Arthur Burn's playbook.



Source: Apollo. Data for the time period 1/1/1966-9/30/2023.

We believe a well-piloted portfolio would lean into the inflation possibilities to own plenty of oil and gas production (OXY, OVV, APA, DVN, COP). As investors, we'd like to help U.S. citizens buy a new home (DHI, LEN and NVR). Lastly, we would like to take advantage of a stronger-than-expected economy to own necessity providers like banks (JPM, BAC, AXP, WAL, FITB, MTB) and consumer stocks (UHAL, HD, TGT).

We would like to thank our investors for their confidence and trust as we crossed over our anniversary to become a 16-year-old strategy in early January.

Fear stock market failure,

Bill Smead
Chief Investment Officer

Cole Smead, CFA
CEO & Portfolio Manager



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Sales Desk 877.701.2883 | info@smeadcap.com

The recent growth in the stock market has helped to produce short-term returns for some asset classes that are not typical and may not continue in the future. Margin of safety is the difference between the intrinsic value of a stock and its market price. The price-earnings ratio (P/E Ratio or P/E Multiple) measures a company's current share price relative to its per-share earnings. Alpha is a measure of performance on a risk-adjusted basis. Beta is a measure of the volatility of a security or a portfolio in comparison to the market. Growth investing is focused on the growth of an investor's capital. Leverage is using borrowed money to increase the potential return of an investment. Momentum is the rate of acceleration of a security's price or volume. The earnings yield refers to the earnings per share for the most recent 12-month period divided by the current market price per share. Profit margin is calculated by dividing net profits by net sales. Quality is assessed based on soft (e.g. management credibility) and hard criteria (e.g. balance sheet stability). Value is an investment tactic where stocks are selected which appear to trade for less than their intrinsic values. The dividend yield is the ratio of a company's annual dividend compared to its share price.

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smeadcap.com

2777 East Camelback Road
Suite 375
Phoenix, AZ 85016

Sales Desk - 877.701.2883
info@smeadcap.com