SMEAD INVESTOR OASIS // SMEAD CAPITAL MANAGEMENT

A Reason Carried Too Far

Presented by:
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Chief Investment Officer

AVOIDING STOCK MARKET FAILURE

Roaring 1920's

Past performance is no guarantee of future results. Source: Radio Corporation of America.

2020 24

AVOIDING STOCK MARKET FAILURE

Go-Go 1960s

Gerald Tsai

Past performance is no guarantee of future results.

BUFFETT ON THE GO-GO 1960S

"I believe the odds are good that, when the stock market and business history of this period is being written, the phenomenon described in Mr. May's article will be regarded as of major importance, and perhaps characterized as a mania. You should realize, however, that his "The Emperor Has No Clothes" approach is at odds (or dismissed with a "SO What?" or an "Enjoy, Enjoy") with the views of most investment banking houses and currently successful investment managers. We live in an investment world, populated not by those who must be logically persuaded to believe, but by the hopeful, credulous and greedy, grasping for an excuse to believe."

The discomfort kept on increasing through 1968. While he delivered an exceptional 58.8% return compared to 7.7% for the Dow, he was nervous. He penned his thoughts as follows…

JANUARY 1969 LETTER QUOTE:

"Some of the so-called "go-go" funds have recently been re-christened "no-go" funds. For example, Gerald Tsai's Manhattan Fund, perhaps the world's best-known aggressive investment vehicle, came in at minus 6.9% for 1968. Many smaller investment entities continued to substantially outperform the general market in 1968, but in nothing like the quantities of 1966 and 1967.

The investment management business, which I used to severely chastise in this section for excessive lethargy, has now swung in many quarters to acute hypertension. One investment manager, representing an organization (with an old established name you would recognize) handling mutual funds aggregating well over $1 billion, said upon launching a new advisory service in 1968:

"The complexities of national and international economics make money management a full-time job. A good money manager cannot maintain a study of securities on a week-by-week or even a day-by-day basis. Securities must be studied in a minute-by-minute program."

This sort of stuff makes me feel guilty when I go out for a Pepsi. When practiced by large and increasing numbers of highly motivated people with huge amounts of money on a limited quantity of suitable securities, the result becomes highly unpredictable. In some ways it is fascinating to watch and in other ways it is appalling."

Finally on May 29th, 1969, Buffett 'threw the towel' and brought the curtains down on his investment partnership.

A LOOK AT THE PAST

Past performance is no guarantee of future results. Source: Bloomberg. Data for the time period 12/31/1964 – 12/31/1974.

NIFTY FIFTY AND TRULY NIFTY FIFTY

The usual moral of the Nifty Fifty story is that investors became too enamored with growth stocks in the early 1970s and pushed the prices of their favorites to unjustified heights.

The Terrific 24 stocks that were on both lists did substantially worse than the S&P 500. An investor who bought these 24 stocks at the end of 1972 would have had 50 percent less wealth at the end of 2001 than an investor who bought the S&P 500.

TABLE 7–1

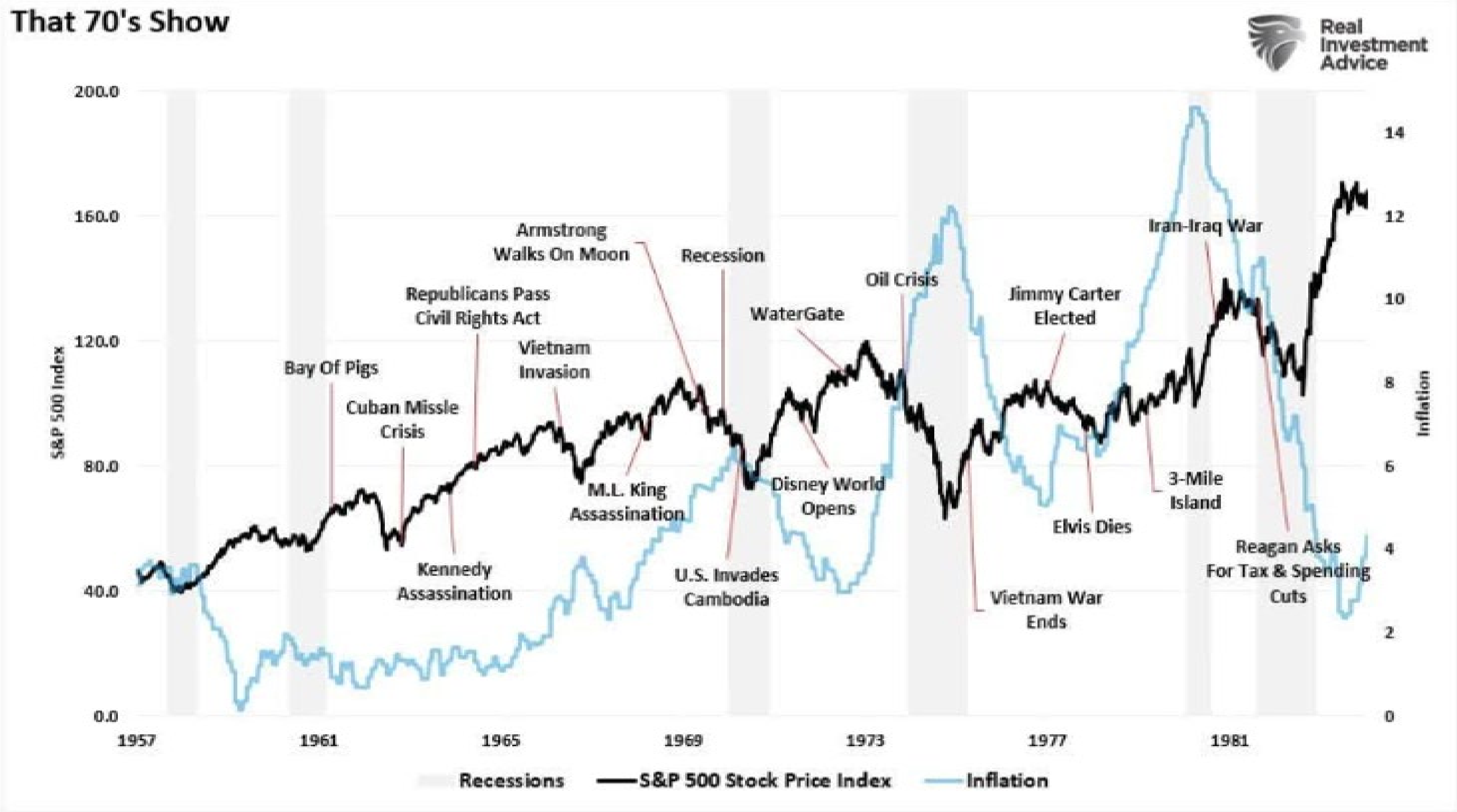
Nifty Fifty Returns from Market Peak, December 1972 to June 1997

	Annualized Return (%)	1972 Actual P/E Ratio	Warranted P/E Ratio	EPS Growth (%) (through 1996)
Philip Morris Cos. Inc.	19.9%	24.0	78.2	17.9%
Gillette Co.	18.3%	24.3	54.5	10.4%
Coca-Cola Co.	17.2%	46.4	92.2	13.5%
Pfizer Inc.	16.9%	28.4	54.9	12.2%
Pepsico Inc.	16.7%	27.6	52.4	11.2%
Bristol-Myers	16.7%	24.9	46.4	12.7%
Merck & Co. Inc.	16.1%	43.0	74.4	15.1%
Heublein Inc.	16.0%	29.4	47.5	n/a
General Electric Co.	15.4%	23.4	34.7	10.9%
Squibb Corp.	15.3%	30.1	45.1	n/a
Lilly Eli & Co.	13.8%	40.6	46.7	10.9%
Procter & Gamble Co.	13.7%	29.8	33.6	13.9%
Schering Corp.	13.7%	48.1	54.4	12.9%
Revlon Inc.	13.3%	25.0	26.9	n/a
American Home Products Corp.	13.1%	36.7	38.1	10.5%
Johnson and Johnson	12.9%	57.1	56.8	14.2%
Cheesebrough Ponds Inc.	12.4%	39.1	36.2	n/a
Anheuser-Busch Inc.	12.3%	31.5	28.7	12.3%
First National City Corp.	12.3%	20.5	18.9	9.3%
Schlumberger Ltd.	12.2%	45.6	40.3	11.5%
McDonald's Corp.	12.0%	71.0	59.2	17.5%
Disney Walt Co.	11.7%	71.2	56.4	14.6%
Dow Chemical Co.	11.5%	24.1	19.5	12.2%
American Express Co.	11.1%	37.7	28.4	9.6%
American Hospital Supply Corp.	10.9%	48.1	34.1	n/a
Minnesota Mining & Manufacturing Co.	10.5%	39.0	27.2	8.7%
Upjohn Co.	9.5%	38.8	22.8	11.3% (a)
AMP Inc.	9.3%	42.9	22.5	9.5%
Lubrizol Corp.	9.1%	32.6	18.4	9.4%
Texas Instruments Inc.	9.0%	39.5	19.4	12.7% (b)
Int'l Telephone & Telegraph Corp.	8.7%	15.4	9.2	2.7% (a)
Sears Roebuck & Co.	8.3%	29.2	15.7	4.5%
Int'l Flavors & Fragrances	8.3%	69.1	33.2	9.4%
Halliburton Co.	8.3%	35.5	16.8	3.9%
Baxter Labs	8.3%	71.4	30.1	10.5%
Penney J.C. Inc.	8.1%	31.5	15.8	5.0%
International Business Machines	7.1%	35.5	15.4	6.6%
Schlitz Joe Brewing Co.	6.6%	39.6	15.0	n/a
Xerox Corp.	6.3%	45.8	18.3	5.1%
Louisiana Land & Exploration Co.	5.5%	26.6	9.8	1.2%
Eastman Kodak Co.	5.5%	43.5	15.6	5.9%
Avon Products Inc.	4.7%	61.2	22.8	3.3%
Simplicity Patterns	4.7%	50.0	7.8	n/a
Digital Equipment Corp.	3.8%	56.2	7.2	-12.6% *
Black and Decker Corp.	2.6%	47.8	10.1	3.4%
Kresge (S. S.) Co.	2.0%	49.5	9.6	1.2%
Polaroid Corp.	1.7%	94.8	16.5	-2.9%
Emery Air Freight Corp.	-1.0%	55.3	8.8	n/a
Burroughs Co.	-3.9%	46.0	4.2	-16.6% *
M. G. I. C. Investment Corp.	-8.6%	68.5	4.8	n/a
Rebalanced Portfolio	12.7%	41.9	40.5	11.0%
Non-rebalanced Portfolio	12.4%	41.9	38.6	11.0%
S&P 500	12.9%	18.9	18.9	8.0%

* Companies had negative EPS in last year measured -- used $0.01 / share to calculate EPS growth.

(a) earnings growth through 1994; (b) earnings growth through 1995;

INFLATION



Past performance is no guarantee of future results. Source: Real Investment Advice.

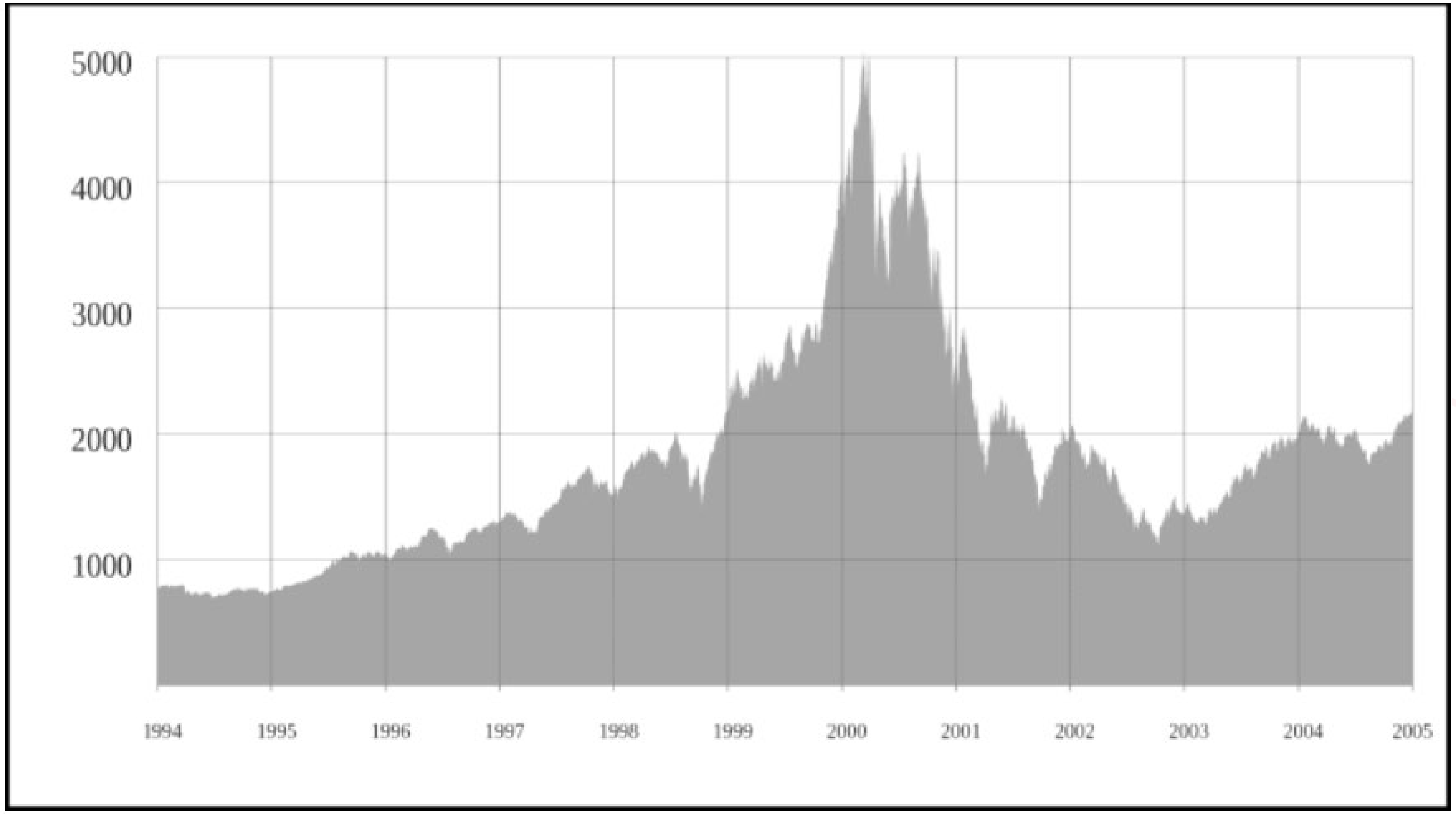
HOW DID THE DOT-COM BUBBLE FORM?

In the early 90s, the advent of web browsers made the internet much more accessible for the average consumer. Once rare, computers began to appear in more and more households in the U.S., eventually becoming somewhat of a necessity. As the popularity of computers and the internet grew, many new web companies emerged to carve out their slice of the rapidly expanding information technology and online commerce industries.

In the late 90s, low interest rates made speculative equity investments more attractive than bonds, and at the same time, innovative internet companies grew in popularity among retail investors, professional traders, venture capitalists, and alike. When the Taxpayer Relief Act of 1997 passed, the top capital gains tax rate was lowered, providing yet another incentive for equity speculators to pour money into the fledgling internet industry.

2024

DOTCOM BUBBLE



This graph of the value of the tech-heavy Nasdaq Composite index shows the dot-com bubble forming around 1995 and gathering value until early 2000 when it began to burst, portending a two-year bear market and mild recession.

[Lalala666; Public Domain via Wikimedia Commons]

Past performance is no guarantee of future results.

DOTCOM BUBBLE

Past performance is no guarantee of future results. Source: Bloomberg.

SMEAD INVESTOR OASIS

2024

FINANCIAL EUPHORIA

2023 is setting a record for top-heavy performance in the cap-weighted S&P 500.

Annual S&P 500 Contribution of 10 Largest Weights During Positive Performance Years

Year	Top 10 as % of Total	S&P 500 % Perf.
2023 YTD	**96.5%**	**11.7%**
2007	78.7%	3.5%
2020	58.9%	16.3%
1999	54.5%	19.5%
2021	45.0%	26.9%
1998	36.8%	26.7%
1996	33.9%	20.3%
2017	33.3%	19.4%
2019	32.8%	28.9%
1991	28.6%	26.3%
2006	27.6%	13.6%
2016	26.6%	9.5%
2003	23.6%	26.4%
1995	22.3%	34.1%
2014	22.2%	11.4%
2004	21.1%	9.0%
2005	20.5%	3.0%
2010	19.6%	12.8%
2012	19.2%	13.4%
1997	19.1%	31.0%
2013	17.6%	29.6%
2009	15.5%	23.5%
1992	14.9%	4.5%
1993	12.2%	7.1%

Source: @jessefelder, @nateGeraci, @Todd_Sohn

Past performance is no guarantee of future results. Source: Strategas.

TECH VS. S&P 500

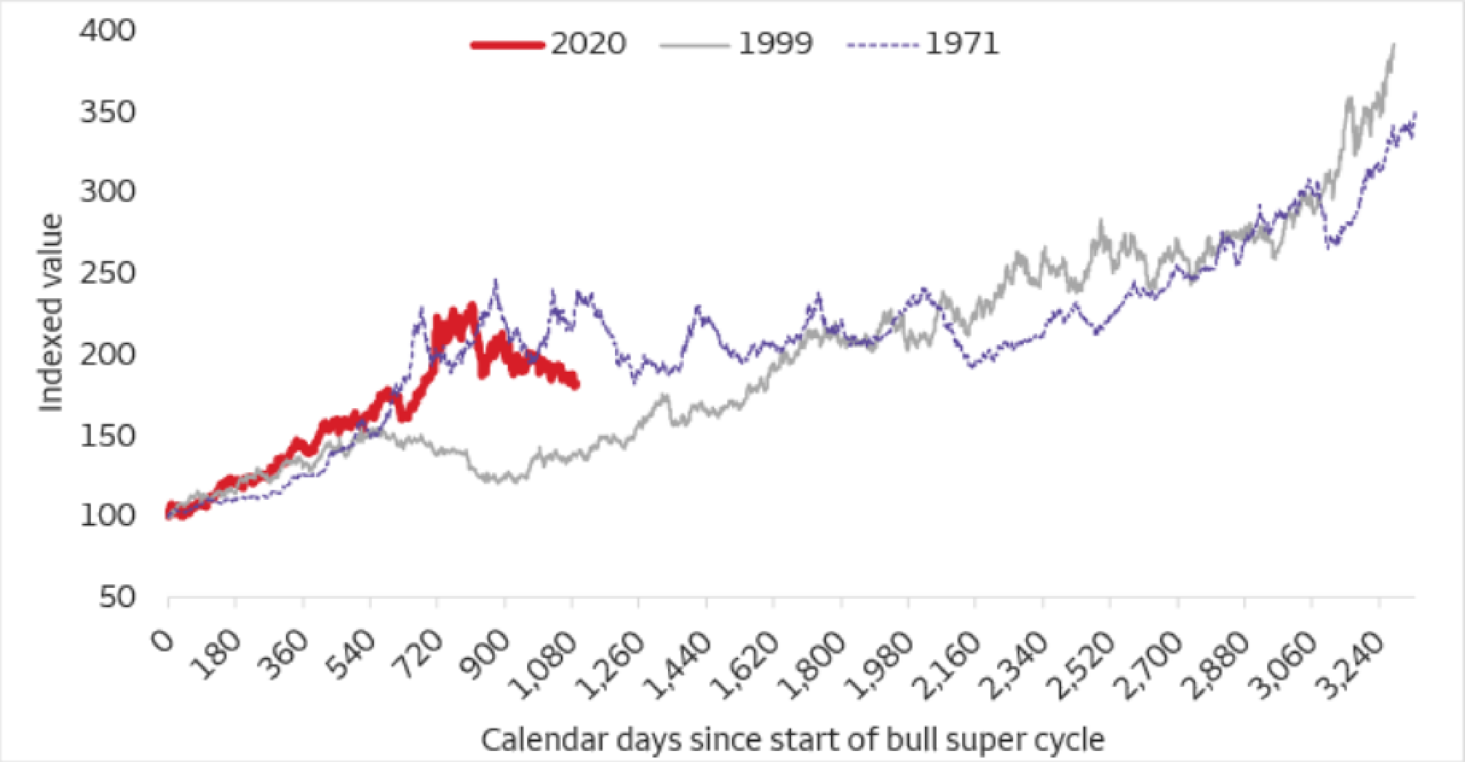
Past performance is no guarantee of future results.

BANKS VS. S&P 500

Past performance is no guarantee of future results. Source: BofA Global Investment Strategy, Bloomberg. Data for the time period 1/1/1941 – 12/31/2022.

INFLATION

Chart 8: Modern commodity bull super-cycles



Sources: Bloomberg and Wells Fargo Investment Institute. Performance measured from October 4, 1971 – November 20, 1980; July 13, 1999 – July 2, 2008; and March 18, 2020 – March 13, 2023. Commodity performance measured by our Commodity Composite. See page 13 for Commodity Composite definition. An index is unmanaged and not available for direct investment. **Past performance is no guarantee of future results.**

Past performance is no guarantee of future results. Source: Bloomberg and Wells Fargo Institute. Data for the time period 10/4/1971 – 3/13/2023.

Questions & Answers

Definitions:
Forward Price/Earnings (P/E): the ratio of a firm's closing stock price & its forward 12 months' earnings/share.

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