



Missive

SEPTEMBER 11, 2025

Back to Basics

Dear fellow investors,

As summer comes to a close and life adjusts back to normal for most of us, we thought it was a great time to get back to basics and take a look at the current U.S. stock market. Our basics include owning strong companies that fit our eight criteria for stock selection, primarily in industries that are out of favor, as well as multi-year winners that we allow to compound for years. As we have echoed Warren Buffett for years, sins of commission hurt (buying losers 30% of the time), but sins of omission can hurt long-term results and affect long-term returns immensely more than losing duds.

History

U.S. stocks as represented by the S&P 500 Index are very expensive on a price-to-book value basis:

Chart 2: It better be different this time
S&P500 price-to-book value ratio



Source: BofA Global Investment Strategy, Bloomberg

Therefore, we want to make all the money we can in stocks without getting caught in the process which we believe will level the playing field.

Economics

Household balance sheets are strong as the lateness of marriage, childbearing and home buying has kept leverage down among those under 50 years of age. Americans over 50 own most of the common stocks, and their consumer behavior has been as positive as it can be. You should see the houses built in Phoenix by Boomers. A large amount of the money is coming out of stock market wealth and confidence. This contrasts with unusually low activity among 25 to 40-year-old Americans. The single largest population age in the U.S. is 33 years old. As eternal optimists and believers in T. Rowe Price's theory ("Change is the only certainty"), we wonder if a more difficult economy could trigger economies of household scale (more people in each home).

Math

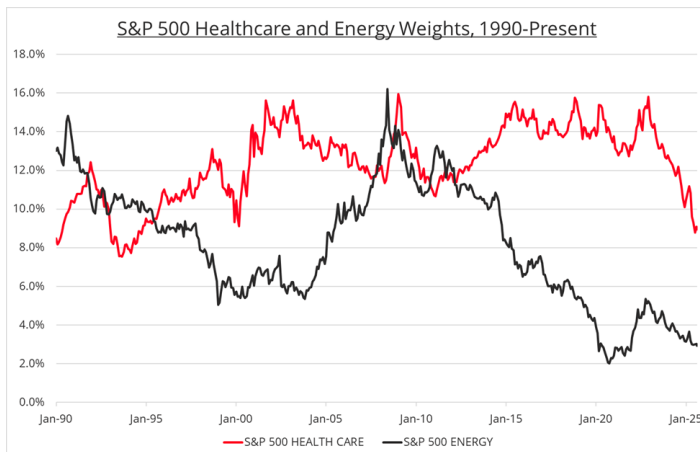
The stock market has never been more concentrated, with 59% in the top 10 stocks. On a price-to-book value basis, stocks have recently exceeded the March 2000 high. While you could make the argument that there is not as much capital tied up in today's economy, Nvidia is trading very similarly to what RCA Corporation did on a relative basis as the radio business moved from 1% household penetration in 1923 to 75% in 1937. Its stock peaked in October of 1929 and bottomed out in 1940-1941, when it looked like we were losing WWII. Did I mention that Russia sent drones to Poland recently?

In case you are wondering, it would take a decline in the S&P 500 Index of over 50% to get anywhere near where Buffett wrote, "Buy American, I Am!" We could provide a litany of statistics which explain Buffett's massive cash position and the contrast between the most aggressive investors and the 50–80-year-olds that own most of the common stocks.

Psychology

Obviously, tech stocks are extremely popular, but growth stocks are trading at the highest multiples of my 45 years in the industry. Stocks like Walmart and Costco trade for nosebleed multiples of earnings. This contrasts with whatever industries have been caught in President Trump's crosshairs, like healthcare and energy. Here is a chart showing how those industries have traded versus the S&P 500 Index historically:

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Source: Bloomberg.

While stock pickers are fewer than in the past and the index is light in these categories, the Bank of America survey shows that the remaining stock pickers hold record low cash positions (back to 1999), in an attempt to keep up with the momentum in the S&P 500 Index. This reminds us that the top ten stocks in worldwide market capitalization at the end of each decade rotated constantly in the last 50 years. Oil dominated the 1980 list, Japan had 8 of the 10 largest cap stocks in 1990, the DotCom bubble stocks owned the 2000 list and the Brick trade filled the list in 2010. FANG stocks led the list in 2020, but its composition is already being turned over.

In conclusion, we are very optimistic about our portfolio, especially versus the risk we are avoiding among historically popular common stocks. We will continue to lean on our four academic disciplines and our eight criteria for stock selection.

Play The Long Game,

Bill Smead

Chairman & Chief Investment Officer

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