

*This letter was written by Philip McCauley IV in December 2020*

**Transcendent:** be or go beyond the range or limits of a conceptual field

2020 was a transcendent year. The stock market is up ~15% YTD and is at all-time highs<sup>1</sup>. While unemployment remains at a troubling 6.7% and GDP is expected to decline 3.7% for the year<sup>2,3</sup>. I will spare you a cumbersome hypothetical analysis, but I believe that the stock market would be lower today if we did not have a pandemic. No pandemic, no rate-cuts, no stimulus.

Stocks are trading at record valuations<sup>4</sup>. Treasuries offer negative real returns. Heck, highly rated corporate bonds now offer no real returns<sup>5</sup>. A tidal wave of capital has already flooded into alternatives, eagerly waiting to bid on anything that comes to market. This leaves a lot of us asking: What are we to do now?

### **Own a few more**

Benjamin Graham gave us the fabled Mr. Market investing parable. To summarize, Mr. Market comes to you every day with the opportunity to buy from him or sell to him. Some days Mr. Market is exuberant and wants to buy your investments. He offers to buy your investments at high prices and you have to offer very high prices to buy from him. Some days Mr. Market is distraught and he will sell you his investments at low prices and he doesn't want to buy anything from you. Translating this parable to 2020 changes things. Mr. Market comes to you every day with his partner, Mr. Fed, and Mr. Fed is always in a buying mood.

The Fed's buying pushes capital to riskier assets, bidding up prices. Most investments still have the same expected outcomes, we just have to pay more. Higher prices today means lower returns tomorrow, *ceteris paribus*. In this backdrop, I believe we should be selective with our additions. I do not think we should follow the now "conventional" wisdom of owning everything (i.e. index funds). It is tempting to own a piece of every ship crossing the ocean when the skies are clear. When the tide turns turbulent, you want to own the ships built for high seas operated by an experienced crew. In 2020's market, a speed boat of spring breakers could have crossed the ocean.

Even in an optimistic market, you can achieve solid investment returns if you concentrate and you are right. The companies with underlying performance that outpaces expectations will reward you handsomely. Easier said than done. The expectation bar is high for most companies going into 2021, especially factoring in the economic backdrop. Some companies will achieve strong results and pole vault over those expectations. For these few, paying the high valuation will be worth it. Others will miss expectations and valuation will fall to the mat with them.

It sounds crazy, but investing in quality companies with low expectations has become an unconventional strategy. Unconventional and boring. Stable slow growth at a reasonable price doesn't get a lot of retweets. Academics tell us to own everything and Robinhood Nation tells us to invest in disruptors. We are finding a few attractive opportunities in the void. Good companies that aren't in hyper speed. Yes, many tech companies are going to outgrow them, but the premium price for that expected growth means the bull case is the base case. We are looking for underappreciated companies that can low-grow our way into high returns (well... relatively high returns).

Thank you for your confidence and please contact us with any questions or discussions,

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<sup>1</sup>SP 500 YTD performance as of 12/16/20 according to WSJ <https://www.wsj.com/market-data/quotes/index/SPX?mod=mdstrip>

<sup>2</sup>U.S. Bureau of Labor Statistics <https://www.bls.gov/charts/employment-situation/civilian-unemployment-rate.htm>

<sup>3</sup>FactSet Estimate 12/16/20

<sup>4</sup>GIC Weekly <https://mssbcie.ms.com/MSSBServices/ContentService.svc/Report/DB8CDC5F-E342-4DDE-AF3F-240D764D638A?action=download>

<sup>5</sup>WSJ Article <https://www.bls.gov/charts/employment-situation/civilian-unemployment-rate.htm>

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