

The Times They Are A-Changin’

“For the loser now
Will be later to win
For the times they are a-changin’”

– Bob Dylan, “The Times They Are A-Changin’” (1964)

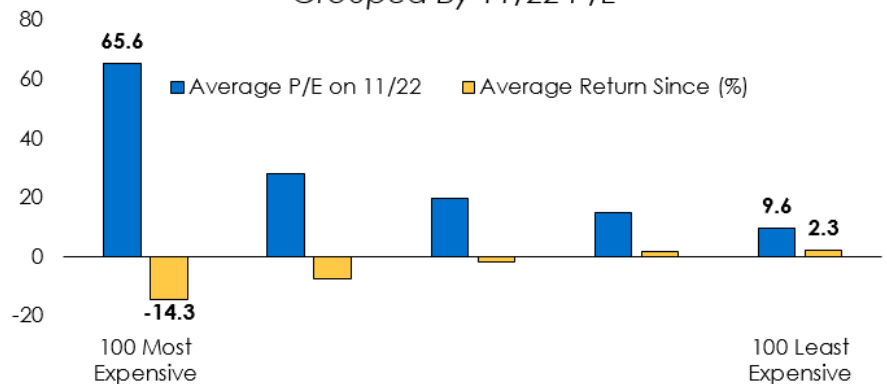
No – we’re not using Bob Dylan’s lyrics as an excuse to talk about the unexpected trip to the Super Bowl for our hometown Cincinnati Bengals, though they definitely apply (WHO DEY!!!). Instead, the times do indeed seem to be changing for the stock market, where a long-awaited leadership shift from expensive “growth” stocks to less-expensive stocks appears to be underway.

The “growth” heavy NASDAQ 100 Index peaked on November 22 of last year. Leading up to that point, more expensive stocks had led the market higher and continued to get more expensive as investors continued to chase returns.

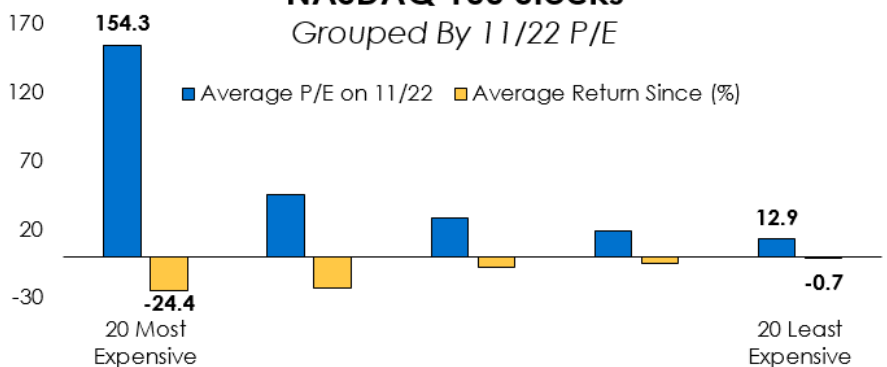
Since that day, there appears to be an inverse relationship between price-earnings (P/E) multiples on that day and price returns since. As you can see in the charts at right, the most expensive quintile of stocks (top 100 in the S&P 500, top 20 in the NASDAQ 100) have performed the worst since late November.

To the contrary, the least expensive quintile of stocks on November 22 has far outpaced the most expensive cohort.

S&P 500 Stocks
Grouped By 11/22 P/E



NASDAQ 100 Stocks
Grouped By 11/22 P/E



Source: Factset, YCAG Research. Price return data as of 1/28/22.

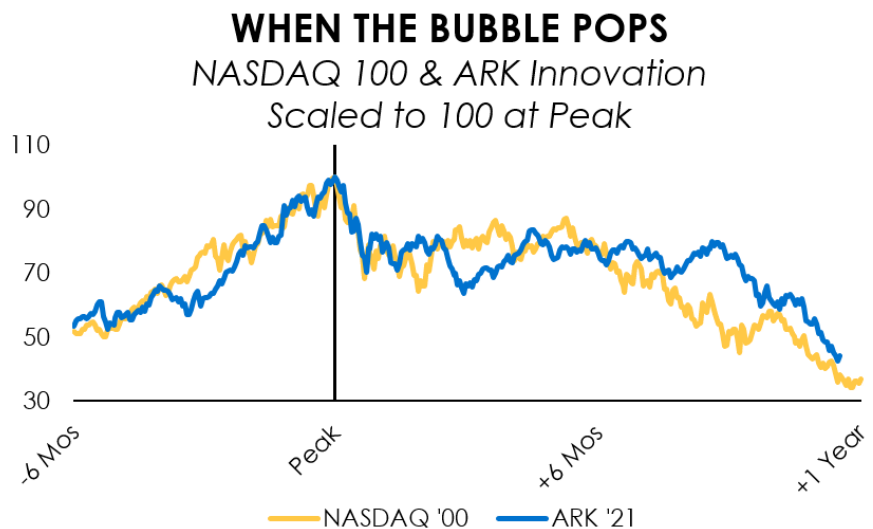


This dramatic pullback from the priciest parts of the market just goes to show that chasing returns of high-flying stocks is always a dicey proposition. While it may work some of the time, it usually ends badly. After all, Icarus was flying along just fine until he got a little too close to the sun.

One specific example of a high-flyer that has come crashing down to earth is the ARK Innovation ETF – a stock market darling coming out of the pandemic bear market.

The ARK Innovation ETF invests in companies “that rely on or benefit from the development of new products or services, technological improvements and advancements in scientific research relating to the areas of: DNA Technologies and the “Genomic Revolution”, Automation, Robotics, and Energy Storage, Artificial Intelligence and the “Next Generation Internet”, and Fintech Innovation” (source: ARK website). In other words, the exact types of stocks that offered investors sky-high growth rates to go along with sky-high valuations.

As we said earlier, sky-high valuations eventually come crashing back down to Earth. And the ARK Innovation ETF is no exception. In fact, its exponential rise and rapid decline is very reminiscent of the Tech Bubble of the early 2000’s (see chart at right).



So much hope and optimism is baked into the assumptions “justifying” stratospheric valuations that things usually can’t help but turn out badly. Take, for instance, this quote from Scott McNealy, who in 2002 was CEO of Sun Microsystems (itself a high-flying darling of the Tech Bubble):

“Two years ago we were selling at 10 times revenues when we were at \$64 / share. At 10 times revenues, to give you a 10-year payback, I have to pay you 100% of revenues for 10 straight years in dividends. That assumes I can get that by my shareholders. That assumes I have zero cost of goods sold, which is very hard for a computer company. That assumes zero expenses, which is really hard with 39,000 employees. That assumes I pay no taxes, which is very hard. And that assumes that you pay no taxes on your dividends, which is kind of illegal. And that assumes with zero research &



development for the next 10 years, I can maintain the current revenue run rate. Now, having done that, would any of you like to buy my stock at \$64? Do you realize how ridiculous those basic assumptions are?"

And that's coming from a CEO who benefitted from such valuations.

We would expect that the "growth to value" leadership transition will continue through this year. Another transition that's already happened in 2022 has been a rebranding for First Financial Wealth Management. Now known as Yellow Cardinal Advisory Group, this change was brought about to emphasize the unique connection we share with our clients and how, just as a yellow cardinal is a one-in-a-million occurrence in nature, we aim to treat each client as if they too are one-in-a-million.

Despite the name change, our investment philosophy remains the same. Focusing on three main tenets of diversification, flexibility and an emphasis on "quality", our philosophy encourages "time in the market" instead of "timing the market" so that our clients can see the wealth they've worked so hard to accumulate work for them in achieving their investment objectives.

Our commitment to our investment philosophy means that we will not abandon our principles to chase returns. While going after "the next big thing" can often result in investment gains, the overly optimistic assumptions and irrational exuberance that drove those stocks higher don't stick around forever.

Refusing to chase returns can hurt relative performance over the short term, but over long time periods avoiding the most expensive parts of the market usually winds up being a wise decision. That's how we intend to provide competitive returns over time – especially on a risk-adjusted basis. By focusing on "quality" and avoiding the worst parts of the market (instead of trying to find the high-flyers), we aim to participate in "up" markets and protect client capital in "down" markets.

We continue to believe that the macroeconomic picture is one of robust – yet moderating – growth and inflation. As such, we will continue to focus on "value" and "quality" as this economic cycle matures. Throughout the past year, we have trimmed "riskier" assets in client portfolios (stocks and alternatives) in order to maintain a relative balance with lower volatility securities, like fixed income and hedges against market volatility.

We have become more neutrally positioned across equity classes, though we continue to slightly favor smaller companies in the US as well as "value" and "quality" within the large-cap domestic market.



In the fixed income area, we remain focused on more credit-sensitive securities (with less exposure to the more cyclical areas of the market) with shorter maturities as a hedge against potentially rising interest rates.

Within the alternative market segments, we have maintained an emphasis on “real assets” (think commodities and real estate) as a hedge against the potential for continued inflation. We have also maintained our exposure to the diversified alternative sector as a hedge against market volatility.

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