

April 3, 2023



Clients,

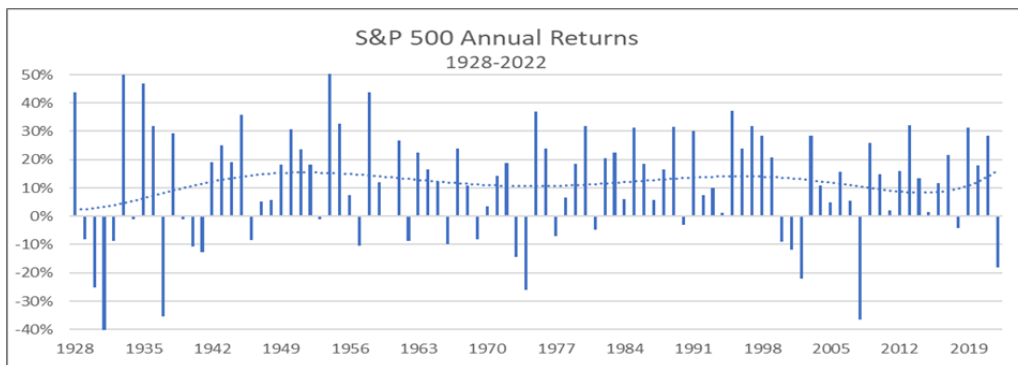
I've been very intent for the past days, should we say weeks, writing a paper about how to compare income investments to investments purchased for potential price gain. It has been mostly to structure my thinking.

There is a story of a pig and chicken walking past a café with a window ad for ham and eggs. The pig says, "For you it's just a one-off daily thing, but for me it's a one-time event."

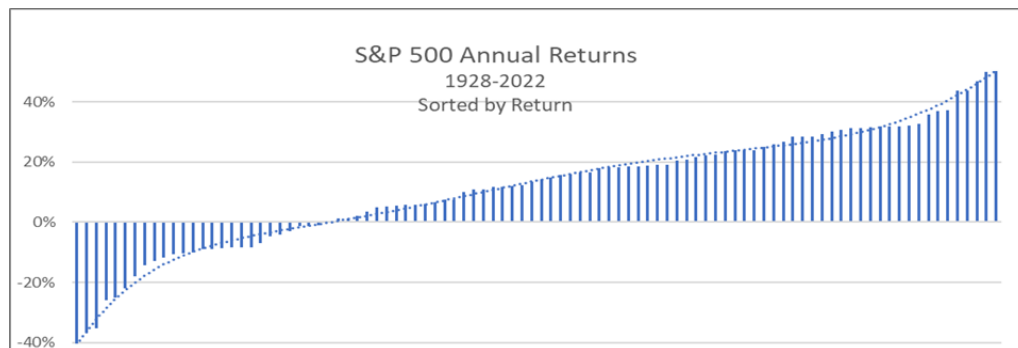
Many investments, besides stocks, such as owning rental property or a business, have an income component and a trading or speculative component dependent upon the price when sold being higher than the purchase price. I've felt a need to zero in on this because it is so crucial to the decisions about how much of your assets should be invested in fixed income, such as preferred stocks, and how much in the market and dependent upon price fluctuations. Most advisors are adamant that the allocation decision is more important than the individual stock selections.

*Comparing Gains to Income, Converting Yields to Returns* is on my website under Papers, then Methodology or Preferreds. Warning: the middle sections in particular get into the weeds. I will highlight here the beginning section on buying stocks for gain. It was an eye-opener for me. I welcome any feedback or discussion.

The chart below gives annual returns for the S&P 500 since 1928. Note that the bars are mostly up (73%) but otherwise inconsistent. There is absolutely no correlation from one year to the next. Even between five-year periods there is neither a statistically significant momentum up or down, or a reversal pattern.



I sorted the bars in ascending order. Half the distance on the X axis gives us the median at 13.9%. Excluding eight years at the top and eight at the bottom, the tops form a pretty straight line. There is little clustering with increased frequency at a certain return.



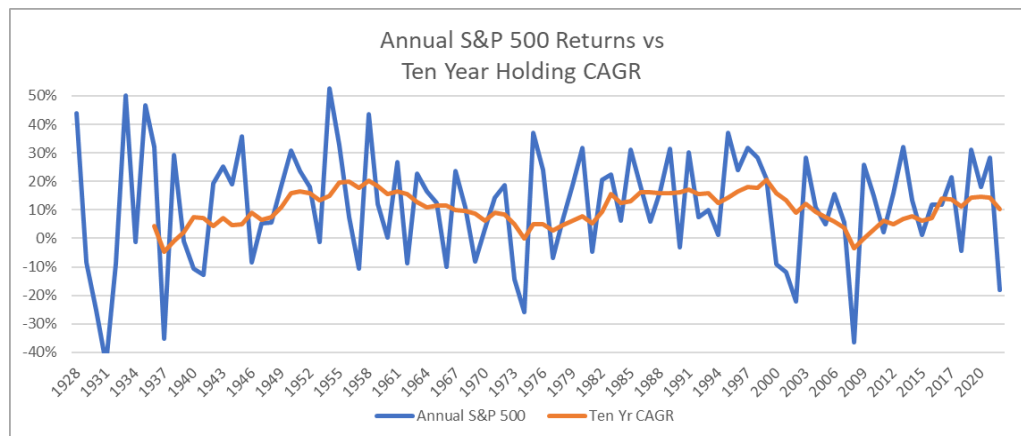
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If you invested in 1928 and sold 1/1/2023, the annual compound rate would be 9.66%. However, not many of us are investing for 100 years.

I'll show one more chart, massaging the data.



The bars have been changed to a blue line. The orange line is the compound annual growth rate (CAGR) of the preceding ten years. (It's like an exponential ten-year moving average.) Three times the ten-year returns were negative. That is a long time to wait and come out not only with less money than was invested, but not having kept pace with inflation, which over the past 100 years has a CAGR of 6.6%. We need 6.6% to stay even with purchasing power.

With the indexed products flooding the market, it is very hard to pick a diversified stock portfolio that will do 3% or 4% better or worse than the market in a given year, to say nothing about over time. I have done extensive research with software that looks for patterns in databases of a million rows and maybe 80 columns, lining up clusters of variables each with specific ranges that predictably give higher returns. Inevitably, the overall market is the most predictive. The problem is that it is contemporaneous.

Long-term market returns are about the same as dividend yield from preferred stocks. The big difference is in the certainty of yields for the next year. In addition to the certainty, preferred stocks have gains when preferred stocks are called. With common stocks we don't know where the prices will go. With preferreds, we know that eventually they will gravitate to \$25.

Based on that, I'm inclined to continue shifting your assets to income and away from price-dependent stocks. Let me know if you want something else. The limited price-appreciation portfolios will probably shift to small-cap stocks under \$5, expecting to take advantage of dramatic growth and limited liquidity like we see with preferred stocks.

As always, I welcome meeting and hearing what is happening in your lives and making sure that our investment strategies match your preferences. I like to make sure you have some understanding of what I'm doing, and why.

Sincerely,

*Lee*