# Quarterly Point of View
## *Remarkable Decade*

January 14, 2020

Well, that was quite a decade for stocks! In the ten years just ended, the S&P500 produced a cumulative total return (including dividends) of 257%, for a mighty 13.6% average annualized gain. The index finished in positive territory nine out of ten years, the only loss being a small decline of 4.2% in 2018, while three separate years saw returns exceed 20%, including last year.

The decade also did not experience a bear market. Typically defined by a loss of 20% or more, the S&P500's maximum retreats were over 19% at points in both 2011 and 2018, but never crossed the 'bear market' threshold, joining only the 1990s in the stock market history books as decades without one. Economically speaking, the 2010s were also the first decade in at least 170 years, or just prior to the Civil War, that the United States did not experience a single recession[1]. Very clearly, this was a remarkable ten years.

The past period stands in stark contrast to the previous decade. The 2000s were a breathtaking period for different reasons, as we lived through two recessions coupled with two severe bear markets that saw stock prices cut in half each time. The last recession and bear market was such a debacle it garnered a name and acronym, the Global Financial Crisis (GFC), a period marked by the worst economic crisis since the Great Depression. Cumulatively, the market lost 9.1% during the 2000s, for an average annualized loss of -0.95%.

As equity investors, it's very clear the past decade was much more joyful than the previous, and something we'd prefer to see continue. The future is of course unknowable, however, particularly when it comes to markets that are affected by the whims of its participants in the short and intermediate terms. And though standard practice in this line of work seems to be to make forecasts around milestone dates, like the turning of this decade, we prefer to be reminded of Economist John Kenneth Galbraith's famous saying, "We have two classes of forecasters: Those who don't know and those who don't know they don't know."

With that in mind, let's instead seek some context that may help us in decision making as we view the 2020s. Below are several major themes that have developed over the past decade, represented in chart form, that we think are essential to review.

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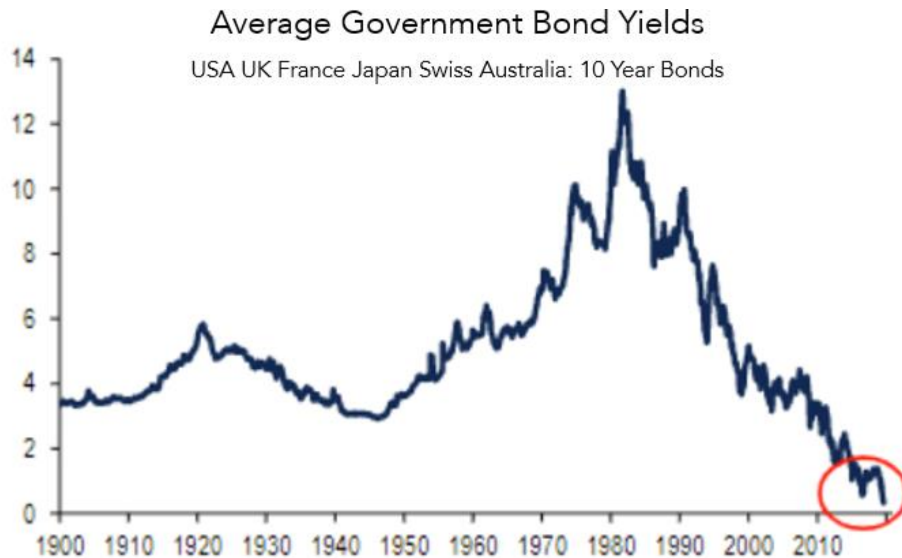
## Global Interest Rates Nearing Zero

The chart below is a simple average of equal-weighted 10-year government bond yields from six large global sovereign issuers, including the United States, looking back 120 years. This 'snapshot' of average yields was taken this past August, so might look ever-so slightly different now, but the point remains the same. Global yields are approaching ZERO, and it's clear we are in the historical 'wilderness' in this regard.

This development has implications for virtually everything in markets and finance, as it's a representation of the cost of money. In addition to the crucial impact on decisions relating to the allocation between stocks and bonds, it also likely provides clear evidence that central bankers around the world – who have used rate reduction as a stimulative tool for so long - are about out of fire power with this weapon. Yes, yields can go lower than zero, meaning negative, which has happened broadly throughout Europe the last several years and remains the case today, but this is not a valid solution or legitimate tool in our view. It is simply a dangerous experiment being played with the financial system.



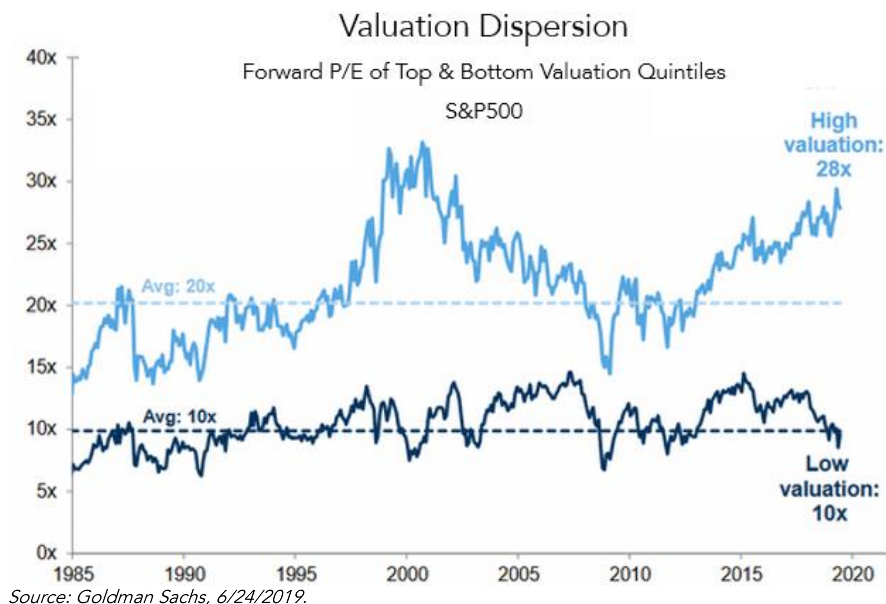

*Source: Bank of America Merrill Lynch Global Investment Strategy, Bloomberg Global Financials Data, 8/8/2019.*

In looking at this global interest rate scenario purely from an equity investor's standpoint, a couple of potential conclusions arise: 1) Stock dividends, particularly those that grow, will continue to be prized as an attractive relative source of income, and 2) price to earnings multiple expansion, which has been fueled in large part by a decline in the cost of money (interest rates) and has contributed a large portion of the past decade's price return for stocks, cannot be relied upon to do the same this next decade when starting from a base near zero.

## Wide Valuation Dispersion Between Stocks

The second important theme which is illustrated in the next chart is the very wide valuation discrepancy that has come to exist between the most-prized and least-prized stocks. This analysis takes the top quintile by forward price to earnings multiple (P/E) within the S&P500 and compares it to the bottom quintile's P/E multiples. What can be seen is that over the past 35 years the top quintile has averaged a P/E of 20, while the bottom averaged 10. At the start of the last decade, that relationship remained true to historical form – in fact the dispersion between the two segments was tighter than normal at that point, meaning many stocks were valued relatively similarly. Today, we see the least expensive basket

of stocks trading close to their three-plus decade average, even after a very long bull-market, while the most expensive group is now 40% above its average levels. In our view this is not necessarily a negative scenario, as it seems to suggest (and our bottom-up analysis of individual stocks tends to validate) that there are pockets of the market that remain attractively priced, offering investable opportunities. It might be expected after a historically long bull-market that most all segments of the market would be trading above their normal valuation ranges, but that does not appear to be the case, which is constructive.



*Source: Goldman Sachs, 6/24/2019.*

Additionally, it may also leave open a good probability the next market downturn won't treat all segments of the market with the same disdain. Though a bit wider gap in the relationship existed around the turn of the century, as the Technology/Telecom bubble was in full bloom, the discrepancy between the top and bottom quintile was similar to the current environment. As that bubble broke in early 2000, and P/E's for the most expensive group collapsed from their peak, the less expensive baskets of stocks outperformed. Using the Russell 1000 Value Index as a proxy for such a group of stocks, it's interesting to note the outperformance in subsequent years versus the S&P500. In the three years starting at the beginning of 2000, the value group outperformed by almost 10% annually, and when broadened to include the entire decade, the Russell 1000 Value outperformed the S&P500 by 56% through the end of 2009.

## Value versus Growth

The final chart is a cousin to the valuation discrepancy illustration above and is just one of many different options to illustrate this theme over the past decade, as evidence appears everywhere, no matter how the data is parsed. The comparison below specifically tracks the relative performance between the MSCI World Value Index to MSCI USA Growth Index over the trailing ten years and clearly defines one of the most unbreakable trends of the period – the dominance of growth stocks based in the United States.

Other areas have done well on an absolute basis, in fact the World Value index was up 141% for the decade, but that is just 45% of the return garnered by USA growth stocks over the same period.

*Source: Factset, MSCI Inc., 12/31/2019.*

The impact of growth stocks that reside within the S&P500 has also greatly influenced its performance, given the capitalization weighted structure of the index. Currently, the top 5 holdings in the S&P500, which are all classified as growth stocks, make up almost 18% of its weighting, the heaviest influence since 1999[2]. Looked at another way, just 1% of stocks in the index have a 18% representation, and in 2019 accounted for almost 25% of the index's return production.

With momentum firmly intact for growth stocks, their leadership position could endure well into 2020 and beyond. That doesn't change the fact, however, that this growth over value outperformance is incredibly long-in-the-tooth based on historical observation going back to the 1930s[3]. Given the potential relationship between this outperformance and the valuation we discussed for the expensive quintile of stocks in chart #2, it would be wise for investors to contemplate what a change in leadership might mean for those holdings. Additionally, given the value index we analyzed here is global in nature, we would contend that opportunity likely exists for investment in markets outside of the Unites States.

The past decade was remarkable in many ways, and we are extremely thankful to those that have entrusted us with their capital along the way. It is a sincere privilege serving you, and we look forward to many years of fruitful partnership as we head into the '20s.

Please feel free to call or email with questions you may have regarding our strategies or Martin Capital Partners in general. You can also find information on our website at www.martincp.com.

Respectfully,

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Martin Capital Partners, LLC

1. Business Insider, *For the first time in US history, a decade will pass without the country falling into a recession*. 12/8/2019.
2. Morgan Stanley Research, Factset, Bloomberg, 1/13/2019.
3. Kenneth R. French Data Library, Wall Street Journal, 7/14/2019.

Statistical and analytical data provided by Factset.

If you would like additional information on how Martin Capital Partners, LLC conducts business, we can provide a copy of our SEC Form ADV part II, firm brochure.

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