April 21, 2021

THE BORING PATH TO BETTER RETURNS

"The people who have gotten rich quickly are also the ones who get poor quickly."
--Sir John Templeton

In January, a man that goes by the name of "Roaring Kitty" helped bring a $12.5 billion hedge fund to its knees. Later, in March another man lost a reported $20 billion—yes $20 *billion*—in only two days. In the midst of it all, the bond market posted its worst quarterly loss in decades. All of this in only three months' time. Nevertheless, most indexes are up in 2021, with some even touching fresh records. The former market events were wild enough to transcend the financial media and capture the public's imagination. In reality though, GameStop and Archegos should only remind us that despite technological advances, the role of human nature in the financial markets is reliably clumsy. For those of us waiting to pounce, we give thanks.

Take for instance the GameStop short-squeeze. GameStop is barely a footnote compared to the creation of Cornelius Vanderbilt's railroad fortune built through first cornering, and then squeezing short sellers in the New York & Hudson and Harlem lines; thereby launching his eventual monopoly of the rail lines lying between New York and Chicago during the mid-to-late 19th century. The Archegos meltdown represented a sudden evaporation of $20 billion in capital, but it will (hopefully) be difficult for anyone to top the labyrinth of counterparty exposures Long Term Capital Management exposed the markets to in 1998 with its $129 billion in assets and notional derivatives exposure of $1.25 trillion ($210 billion and $2.0 trillion in today's dollars).

Aside from the high stakes trading drama, it was perhaps fixed income investors that got the biggest 2021 surprise (to date) as the 10 Year Treasury Yield rose from 0.9% to 1.75% from December 2020 through March 2021. Improving economic fundamentals in 2021 and the corresponding optimism led to a -3.4% return in the Bloomberg Barclays Aggregate Bond Index, providing one of its worst quarters dating back to the early 1980s.

Despite the attention-grabbing media headlines, we believe the impact of these events on our portfolios lies somewhere between almost none to mostly positive. More specifically, the GameStop and Archegos events were mostly entertaining distractions, but the rise in interest rates was somewhat positive for our holdings as it extended into March. Incidentally, the disruption in the fixed income markets made for strange bedfellows. Conspicuously high-flying speculations in certain tech stocks (ARK Funds, Tesla et al) as well as SPACs, received a (well-deserved) slap on the wrist thanks to the rise in interest rates.

The rise in rates led stock speculators to second-guess the attractiveness of far distant earnings (and payback periods) that are implicit in the horde of tech stocks trading in excess of 100x earnings and 20x sales. The brief dustup was a healthy sign in our opinion as investors weighed the appeal of an approximate 1.8% yield in the 10 Year Treasury Yield as more valuable than the nonexistent earnings and cash flows found among popular speculations. Moreover, SPACs declined greater than 20% from their highs in the February-March period, yet another likely result of the rise in interest rates. In our opinion, March represented a return to

normalcy for our portfolios, as the more speculative dynamics of January and February succumbed to higher interest rates and therefore, rational perspectives on valuations and fundamentals.

In our previous commentary (Are *You* Different this Time?) we discussed the speculative valuations in certain technology shares (i.e., 718 shares trading over 20x sales), and how they reminded us of the dotcom mania of the late 1990s. At first blush, the potential risk in these shares should sound alarms, but that analysis is incomplete. It is important to recall that the crowding of investor interests into a narrow section of the market means there should be neglected shares, and potentially bargains, elsewhere. We discussed this phenomenon in the context of the dotcom mania in a chapter from *Investing the Templeton Way* titled "When Bonds Are Not Boring." In 2000, Sir John reasoned that the NASDAQ could potentially fall 50% or more from its high, and that 30 Year Treasury Strips with an implied yield of 6.3% were far more attractive. As many observers will concur in the twenty years since, opting for 30 Year Strips in lieu of NASDAQ stocks in 2000 was a shrewd move, even if they had not funded the purchases through borrowed Yen (as Sir John had). Fast forward to today, we look towards the 30 Year Treasury yield of 2.29% and are left unconvinced one is not moving from the frying pan into the fire. However, we believe there are suitable alternatives.

There are relatively straight-forward financial comparisons to be made between dividend yielding stocks and long-term bonds. In our view though, a growing dividend is far more valuable than a bond coupon, especially if the underlying company has a disciplined nature towards capital allocation, and even better—long-term, under-appreciated growth opportunities. We would even take it a step further and argue that the dividend yields available on certain shares fitting the description above, are significantly undervalued relative to the Ten Year Treasury Yield. Could you imagine though if we took our enthusiasm for current dividend yields to the infamous "wallstreetbets" board on Reddit, and started talking up Unilever's dividend? We suspect there would not be much of an audience, and if there were it would include a fair amount of heckling. Coincidentally, we think that is a good way to confirm you may have found a bargain. The simple fact is that in today's world of Roaring Kitty, Archegos, Tesla, Dogecoin, and ARK Funds, dividends are far too boring to compete for attention. For the rational investor, this is a good thing.

For example, let us return for a quick look at Unilever, a company we also highlighted in our prior commentary as a potential bargain. From a dividend yield perspective, Unilever's 3.7% forward dividend yield is 2.3x higher than the current 10 Year Treasury Yield. Interestingly, Unilever's dividend yield has only traded at more than 2x the 10 Year Treasury at one other time (July 2012) in the past twenty years. For anyone who feels their eyes beginning to roll with talk of a boring dividend payer such as Unilever, first, stop and consider that over the past *thirty-years*, the growth rate on Unilever's dividend per share has been 13.2% annualized. Of course, no one can be sure that the company will sustain that growth rate going forward (but we like its chances with +60% of its business in the emerging markets). At the same time though, we are even less sure that many of today's darling share issues changing hands at over 100x earnings and 20x sales will even exist in 30 years' time. Last, we would argue that Unilever is not an outlier in the dividend space, and that it has several boring potentially double-digit annualizing friends worth a look too.

In closing let us take a moment to reflect on this time last year. If you will recall, the majority of investors 12 months ago were selling their shares as fast as possible. You may also recall that we were aggressively "accommodating the sellers" as Sir John liked to say. Today, it is somewhat remarkable to see investors once again buying shares as fast as possible; but such is the allure of "getting rich quick" in the markets. These

qualitative markers are helpful, but our practice is to simply follow the numbers, and as of late, the most exciting numbers seem to be found in some pretty boring stocks.

Happy boredom hunting,

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