Alpesh Patel OBE Newsletter

Exclusively for ShareScope Alpesh Patel Special Edition Subscribers

14 December 2021

Overview

What a year it's been.

% change 1 day candles
NASDAQ 100
Index
IXND
16399.24
30/4/20
Jul
Oct
'21
Apr
Jul
Oct
30/11/21

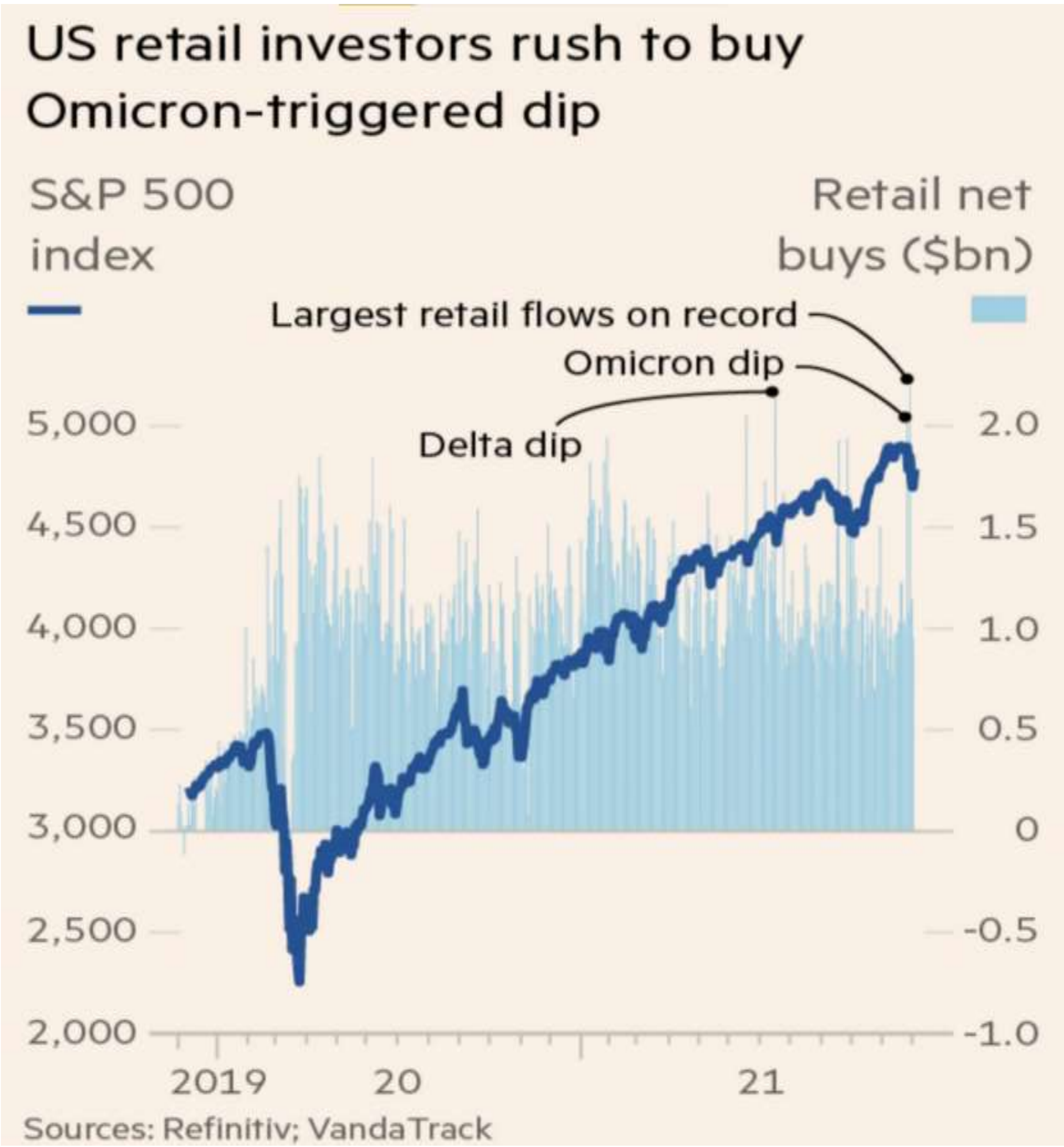
% change 1 day candles
Dow Jones Industrial Average
Index
DJI
30/4/20
Jul
Oct
'21
Apr
Jul
Oct
30/11/21
13, 26 MACD (9 sig) - Bars

This is S&P 500 year to date performance.

This is the S&P by price to forward profits. As you can see from pockets of green – we are not crazy overvalued. Of course this is too simplistic. But valuation is a theme I will share.

If you were top down, you may say healthcare and energy are undervalued (and drug manufacturers).

The image below confirms a lot of retail money willing to buy dips.



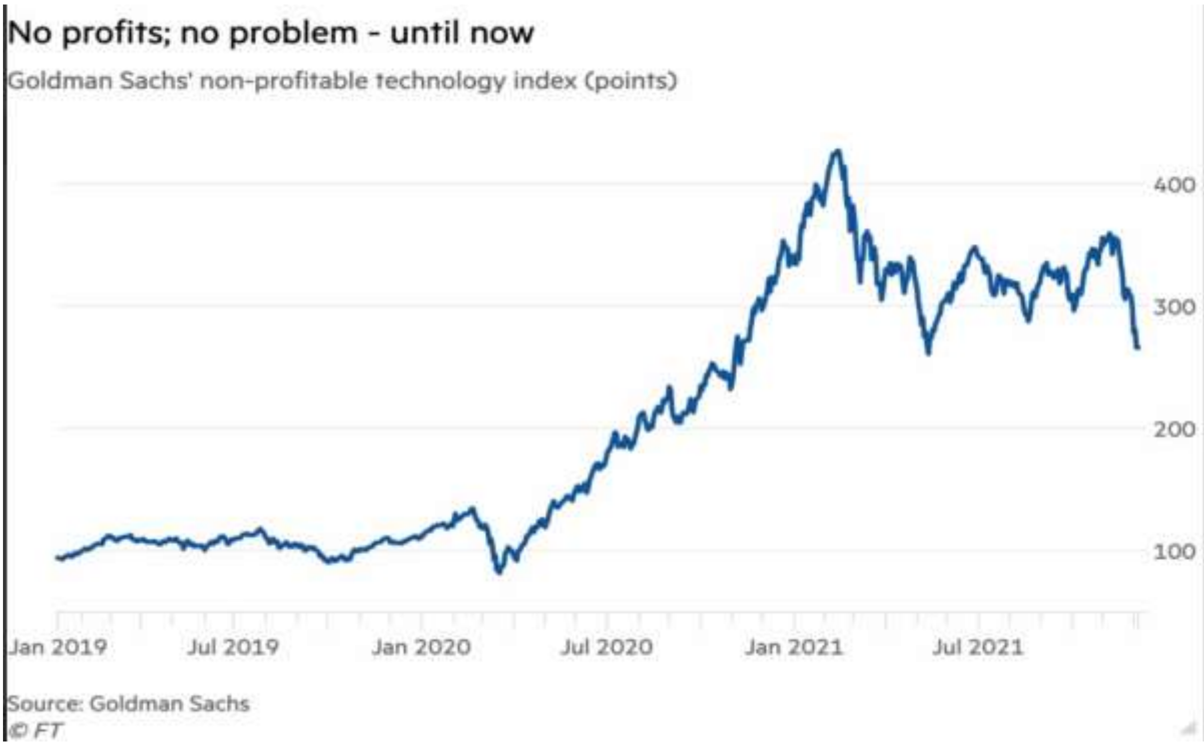
But yes there are reasons as these graphs show to believe we are overvalued overall. Point being, we pick our stocks carefully and know investing does not equal the safety of a bank account.

Exhibit 4: SPX P/E Still Has 12% to Fall, We Think...

Source: Bloomberg, Morgan Stanley Research

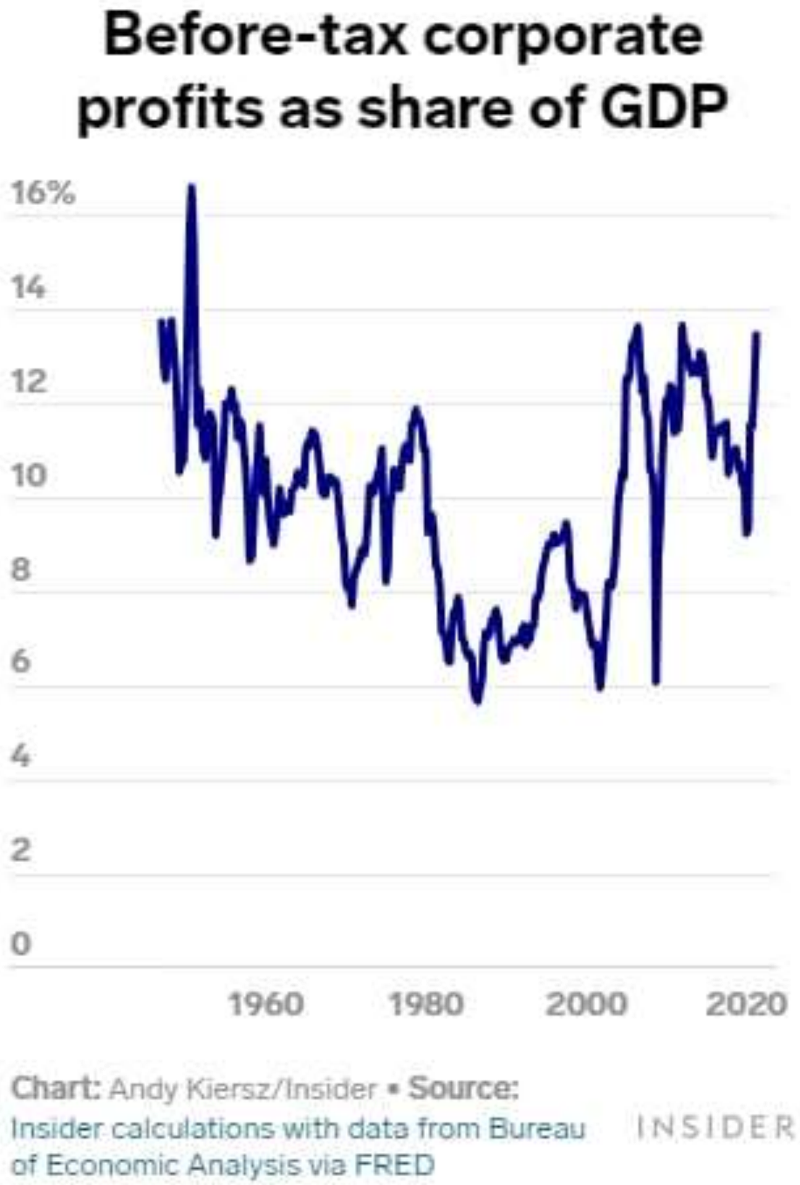
Morgan Stanley

For me, a lack of profits is a huge risk – see next image:



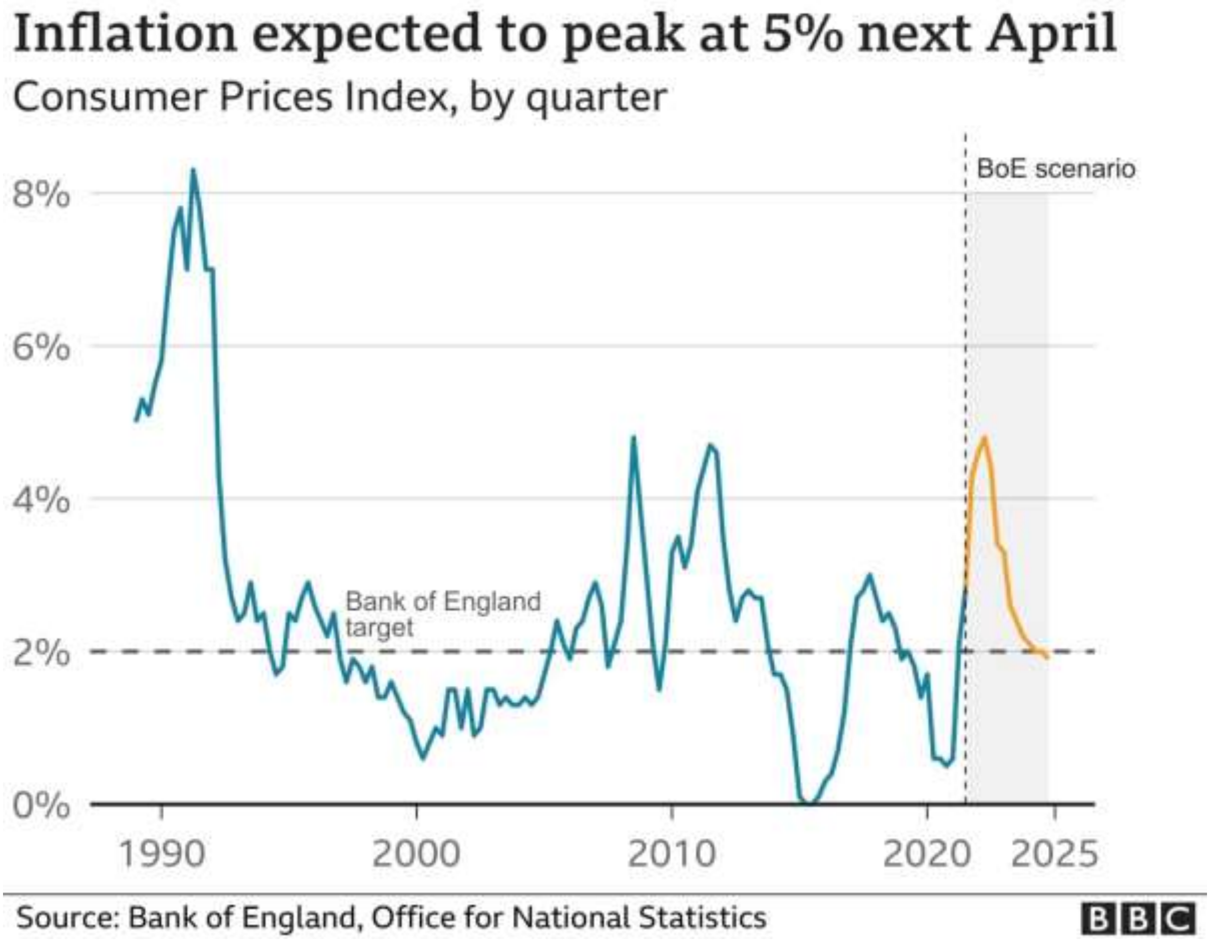
And I think these two images next tell you why I am so bullish:


US before-tax corporate profits
$3T
2.5T
2T
1.5T
1T
500B
0
1960
1980
2000
2020
Chart: Andy Kiersz/Insider • Source: Bureau of Economic Analysis via FRED
INSIDER



For those sitting on big gains, I created this image which as a suggestion of what to do may assist you.

Inflation Concerns



This is every ETF with inflation in the title and the money flowing into them. Well it's big business marketing inflation isn't it?

Ticker		1D Flow (M USD)	1W Flow (M USD)	YTD Flow ↓
Sum		+82.06	+966.73	+35,536.51
1) TIP	US	+13.00	+399.91	+9,895.26
2) VTIP	US	+84.61	+136.81	+8,029.62
3) SCHP	US	.00	+306.16	+7,329.97
4) STIP	US	+26.54	+132.40	+4,642.71
5) IVOL	US	-45.42	-46.68	+2,699.23
6) SPIP	US	.00	+3.15	+1,122.68
7) INFL	US	.00	+13.37	+835.45
8) TIPX	US	.00	+10.58	+440.26
9) GTIP	US	.00	.00	+131.17
10) WIP	US	.00	.00	+85.63
11) MUSI	US	.00	.00	+80.10
12) FCPI	US	+3.34	+5.00	+73.84
13) LQDI	US	.00	+3.04	+52.50
14) PBTP	US	.00	.00	+41.71
15) RINF	US	.00	+2.98	+34.04
16) VBND	US	.00	.00	+30.93
17) RAAX	US	.00	.00	+8.35
18) THY	US	.00	.00	+3.06

These ETFs have 'inflation' in their names and money is flowing into them. Might be smart money. Might not!

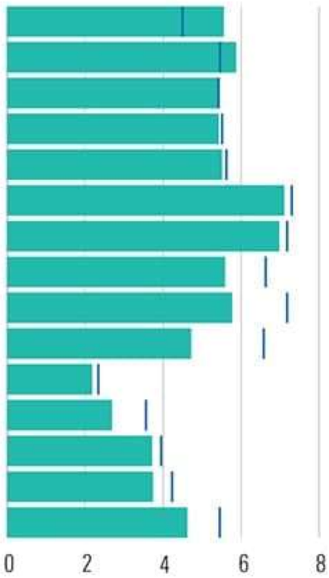
Some of you have asked me about PayPal. It's one of those that due to it's volatility yet strong financials, I have no problems extending stop loss to 30%. Very few stocks as you know I do this with.

Risk Management

For me the best way to mitigage the risk of inflation and an overvalued market is to select lower volatility stocks.

Less Volatility Means Better Results

Broad Category Group	Std Dev Quintile	Investor Return	Total Return	Gap
Allocation	1	5.56	4.5	1.07
	2	5.87	5.46	0.41
	3	5.45	5.42	0.03
	4	5.43	5.51	-0.08
	5	5.51	5.62	-0.1
Equity	1	7.11	7.30	-0.19
	2	6.98	7.18	-0.20
	3	5.59	6.63	-1.04
	4	5.77	7.18	-1.41
	5	4.72	6.58	-1.86
Fixed Income	1	2.18	2.34	-0.16
	2	2.69	3.56	-0.86
	3	3.72	3.95	-0.23
	4	3.74	4.23	-0.49
	5	4.62	5.45	-0.83



We grouped funds by their trailing three-year standard deviation and then tracked their results over the following 10-year period. We show the least volatile quintile first down to the most volatile quintile. As you can see, the less volatile funds tended to have higher investor returns and smaller gaps between investor returns and total returns. The reason is your entry and exit timing is less important for less volatile funds and such funds don't make investors behave emotionally.

2022 Outlook

Well the bright minds and big banks are all over the place.

Here is a summary of some analysts' forecast for the index at the end of 2022:

BROKERAGE NAME S&P500 TARGET

@ END 2022

Morgan Stanley (NYSE:MS) 4,400

Wells Fargo (NYSE:WFC) 5,100-5,300

Goldman Sachs (NYSE:GS) 5,100

* Morgan Stanley: "While earnings for the overall index remain durable, there will be greater dispersion of winners and losers and growth rates will slow materially... 2022 will be more about stocks than sectors or styles, in our view."

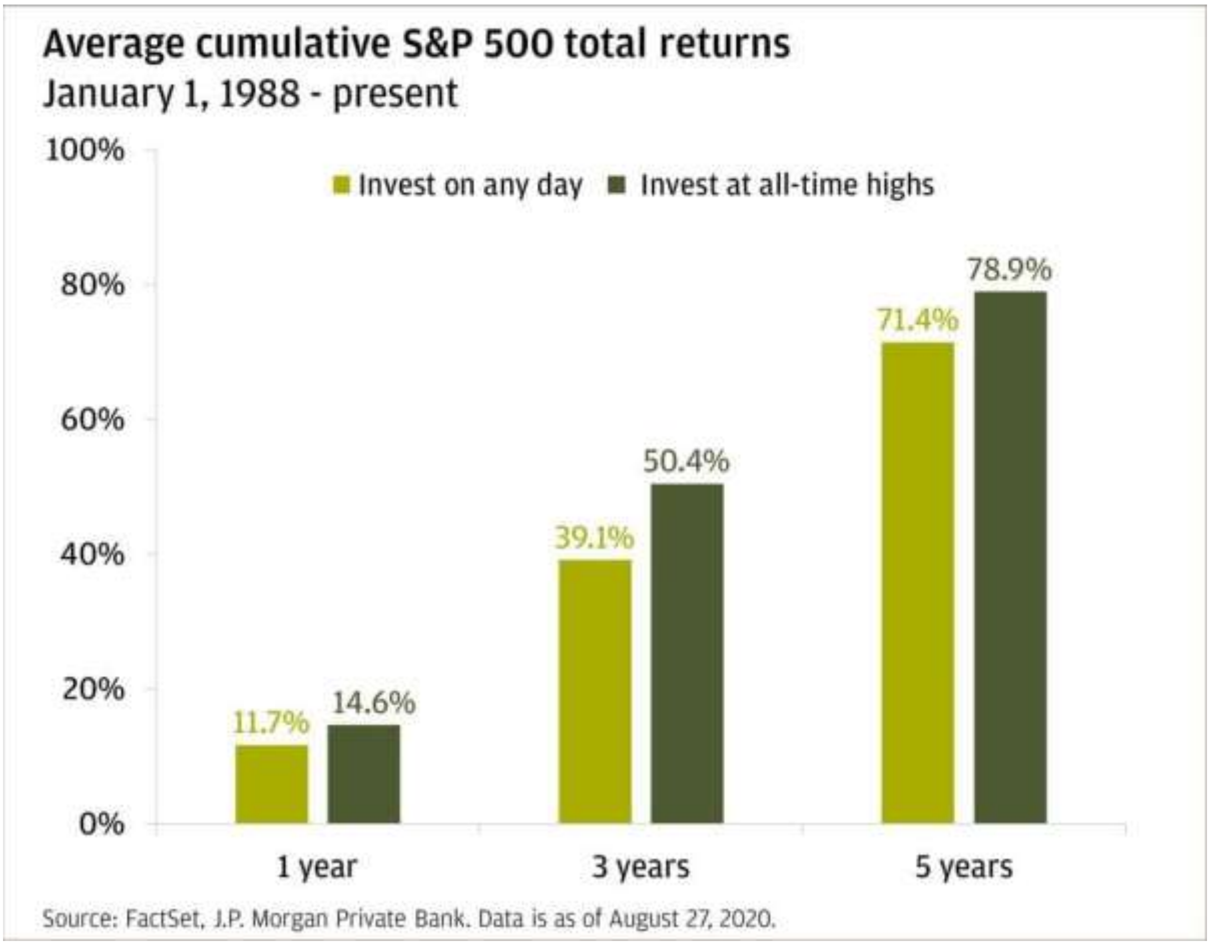
* Wells Fargo: "Persistent supply shortages and inflation pressures lead us to adjust the magnitudes of some 2022 targets, but we believe the global economy should still mark an above-average pace next year. More importantly, our tactical preferences for the next 6 to 18 months are nearly all unchanged."

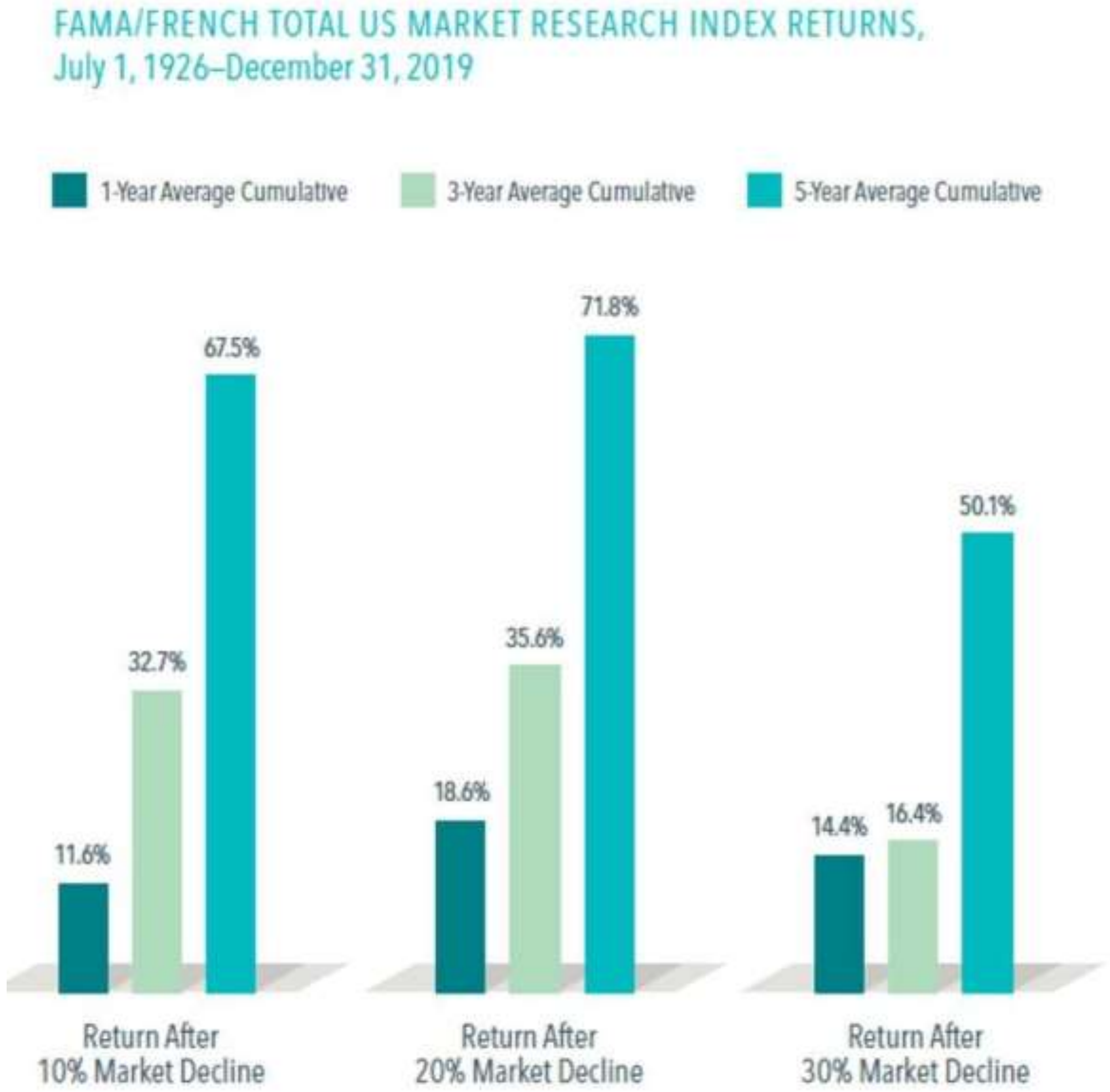
Goldman Sachs: "Decelerating economic growth, a tightening Fed, and rising real yields suggest investors should expect modestly below-average returns next year."

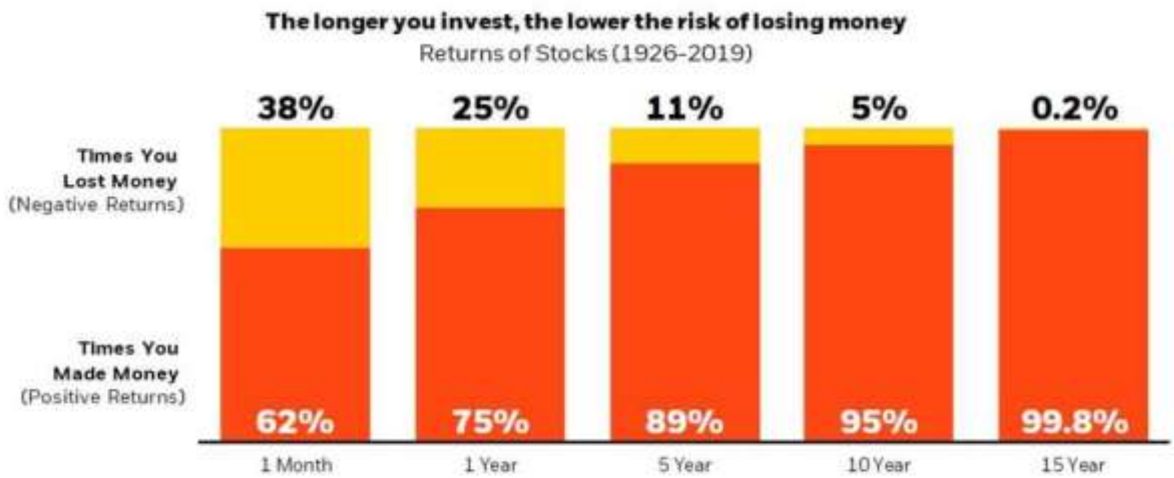
"In contrast with our expectation during the past year, corporate tax rates will likely remain unchanged in 2022 and rise in 2023. Corporate earnings will grow and lift share prices. The equity bull market will continue."

The factors above contribute to lofty equity valuations. The forward price-to-earnings ratio for the S&P 500 is 21.71.[2] This is up from the 16.81 average over the last 25 years. Current valuations are a factor in future returns. Based on the forward P/E ratio and historical data, J.P. Morgan estimates average annualized returns for the S&P 500 could be flat over the next 5 years.

Should You Invest at All Time Highs?




FAMA/FRENCH TOTAL US MARKET RESEARCH INDEX RETURNS,
July 1, 1926–December 31, 2019
1-Year Average Cumulative
3-Year Average Cumulative
5-Year Average Cumulative
11.6%
32.7%
67.5%
18.6%
35.6%
71.8%
14.4%
16.4%
50.1%
Return After 10% Market Decline
Return After 20% Market Decline
Return After 30% Market Decline


The longer you invest, the lower the risk of losing money
Returns of Stocks (1926-2019)
Times You Lost Money (Negative Returns)
Times You Made Money (Positive Returns)
38%
25%
11%
5%
0.2%
62%
75%
89%
95%
99.8%
1 Month
1 Year
5 Year
10 Year
15 Year

Headlines to Catch My Eye

Bank of America says buy these 42 stocks across the clean-energy and industrial sectors poised to benefit most from the bipartisan infrastructure bill

Of the 42 stocks they name - these made my cut:

1. Fortive
2. Enphase Energy Inc
3. Essential Utilities Inc
4. FirstEnergy Corp
5. MDU Resources Group Inc
6. PG&E Corp

US Debt Worries Again

Learn The Truth About How U.S. Debt Impacts US Stocks?

On October 12th, the U.S. House of Representatives approved legislation that temporarily raised government borrowing limits to $28.9 trillion. This action has staved off the prospect of debt default until December.

President Joe Biden will sign the measure into law before October 18th, which is the day the Treasury Department calculated it would no longer be able to pay U.S. debts without congressional action.

But how did it get to this? And what does this mean for the broader economy and U.S. stocks?

What is the U.S. Debt Ceiling?

Late September and early October 2021 have been anxious times for the U.S. economy. Congress faced a tricky task: reach a deal on the U.S. national debt ceiling, or the government would run out of money to pay its bills. Failure to do so could lead the U.S. to default on its debt, which has never happened before.

While this prospect has been put off until December, a solution needs to be found. So far, Republican and Democratic lawmakers have been at odds over raising federal borrowing limits, also called the debt ceiling.

Before the temporary agreement, the debt ceiling stood at $28.4 trillion. However, the national debt, which is the total that the government owes creditors, was $28.43 trillion.

With the October 18th deadline looming, a stopgap bill was required to prevent the first default. Failure to reach an agreement would have meant that the federal government would default on its obligations, including Social Security and payments to veterans.

The debt crisis was causing some nervousness in the U.S. markets. Republicans had been expected to block a third attempt to raise the debt ceiling. However, fears eased slightly once Mitch McConnell, the Senate Minority Leader, indicated his party would support the debt ceiling extension into December. Additionally, McConnell's announcement caused yields on one-month Treasury bills to drop.

What Would Happen If the U.S. Defaulted?

Congress may have kicked the debt ceiling down the road for now, but an agreement still needs to be found. Otherwise, the U.S. faces the prospect of a government shutdown.

Stock investors won't be delighted about this prospect. Several headwinds are swirling at the moment, like Federal Reserve tapering. Analysts at Goldman Sachs have suggested that shutdowns don't necessarily spell bad news for the market. However, several other factors could affect stocks.

> *Goldman's analysis shows that government shutdowns have historically failed to have a meaningful impact on equity returns. There have been 14 government shutdowns since 1980. During these shutdowns, the S&P 500's median returns were:*
> *– -0.1% on the day of the shutdown*
> *– 0.1% during the shutdown*
> *– 0.3% on the day of the resolution.*

The only exception was the most recent shutdown during December 2018. During this time, the S&P 500 dropped by 2%. However, as Goldman notes, this decline was more likely driven by investors' fears about Fed tightening.

While budget expiry doesn't have a considerable effect, debt limit deadlines do affect some parts of the market. Government revenue exposed stocks — like industrials and health stocks — underperformed the market during the 2011 and 2013 debt limit deadlines.

If the government can't find a debt ceiling solution by December, these stocks could be affected again.

What Else Could Rattle Equities?

Goldman strategists suggested that the macroeconomic picture is a better predictor of how the equity markets would respond. During the 2011 and 2013 debt limit shutdowns, the S&P fell in 2011 but rallied in 2013.

The big difference between these two was the broader economic situation. In 2011, there was declining economic growth, the S&P had downgraded U.S. sovereign debt, and the European debt crisis. By contrast, the conditions in 2013 were more favorable.

The macro picture is causing some concern heading towards the fall. Global markets rose last week as the U.S. waited for Labor Department data. However, it don't can't doesn't investors '500's Goldman's here is hope for the broader economy.

Conclusion

Historically, debt limit deadlines don't have a significant impact on the S&P 500. However, some caution is the market should be expected if Congress struggles to reach a more permanent solution to the borrowing limits problems. For now, though, the biggest fears for equities come in the form of the energy crisis, Fed tapering, and concerns about GDP.

Reasons Why Ethnic Minorities Fall Behind on Investing

Ethnic minorities in the UK and US do not invest as much as they should. Their lack of participation in the financial markets compounds the existing pay and wealth gap. If we want to live in a fairer, more equal world, we need to solve this issue. So what are the options?

What are the Figures for Ethnic Minority Investment?

The latest CNBC/Momentive Invest in You survey found that almost half of Black Americans didn't have any investments. For Black women, the number is even higher, at nearly 60%.

In the UK, things aren't much better. The Office for National Statistics (ONS) released data that demonstrated the severe differences in pension uptake across the country.

The report looked at median private pension wealth for ethnic groups. Bangladeshi, Black African, Chinese, "any other ethnic group" households had pensions of less than £5000. White British-headed households had £80,000.

What are the Reasons Behind the Pension Gap?

There are a complex set of factors that contribute to the pension gap. One commonly cited reason is the labor market. Ethnic minorities, on average, earn less, have higher unemployment rates, and are more likely to be self-employed.

Not having the liquidity to invest in a pension is a big problem with few easy solutions. Additionally, many ethnic minorities have come from jurisdictions where public trust in institutions is low. Education can help people understand the benefits of pensions and investment and explain the checks and balances involved.

Barriers with Ethnic Minority Investment

The financial industry has a fair way to go to achieve equal outcomes. Over the years, many big firms have made significant diversity pledges. However, when it comes to actions, they've fallen short.

In a recent City of London Race to Equality report, a shocking 66% of ethnic minorities said they had experienced workplace discrimination due to their background. A further 4 in 10 believed that their employers weren't doing enough to create an inclusive environment. At the same time, 28% said that discrimination was holding back their careers.

If discrimination holds back employees, it breeds mistrust. And a lack of trust is another significant factor in low ethnic minority investment participation.

Another aspect that affects trust is a lack of transparency. Only 13 members of the FTSE 100 released their ethnicity pay gaps. Those that have published revealed ethnic pay gaps as high as 27% (British Land).

A lack of career progression means a lower income to invest. Investing gives everyone a chance to grow their money. Since the 2008 financial crisis, saving interest rates have been typically lower than 1%. If savers want to beat inflation, they need to consider investing. When you consider that average 10-year stock market returns are historically over 9%, the importance of investing becomes clear.

Not investing widens the wealth gap. It exacerbates existing labor market forces and structural inequalities. If we are to make headway on these issues, ethnic minorities must be encouraged to participate further in investments and pensions.

Solutions to the Investment Gap

There is no magic pill that can solve this issue overnight. However, there are several actions we can all take to closing the investment gap.

#1. Outreach

Ethnic minorities and women often feel the investment industry fails to engage them. A recent report from White Marble Consulting supported by Schroders cited "historic and ongoing exclusion" as barriers to entering investment. One solution recommended in the report is to leverage social media personalities and influencers to encourage participation.

In many avenues, social media influencers have taken the role of traditional advertising. However, this type of engagement can go beyond just selling products. Funds could use it to build trust, educate, and increase financial literacy.

#2. Diversity Initiatives

Closing the pay and investment gap will require uplifting specific communities. More jobs, mentoring, and clearer career progression paths are needed. Some banks are doing the work and matching promises with action. Associations have an essential role to play in increasing workplace diversity, especially in the finance industry.

#3. More Investment in Minority Businesses

Saving and investment require liquidity. For many ethnic minorities, this is a barrier to investment. A recent report into how venture capital (VC) money has been invested into new UK startups painted a disheartening picture.

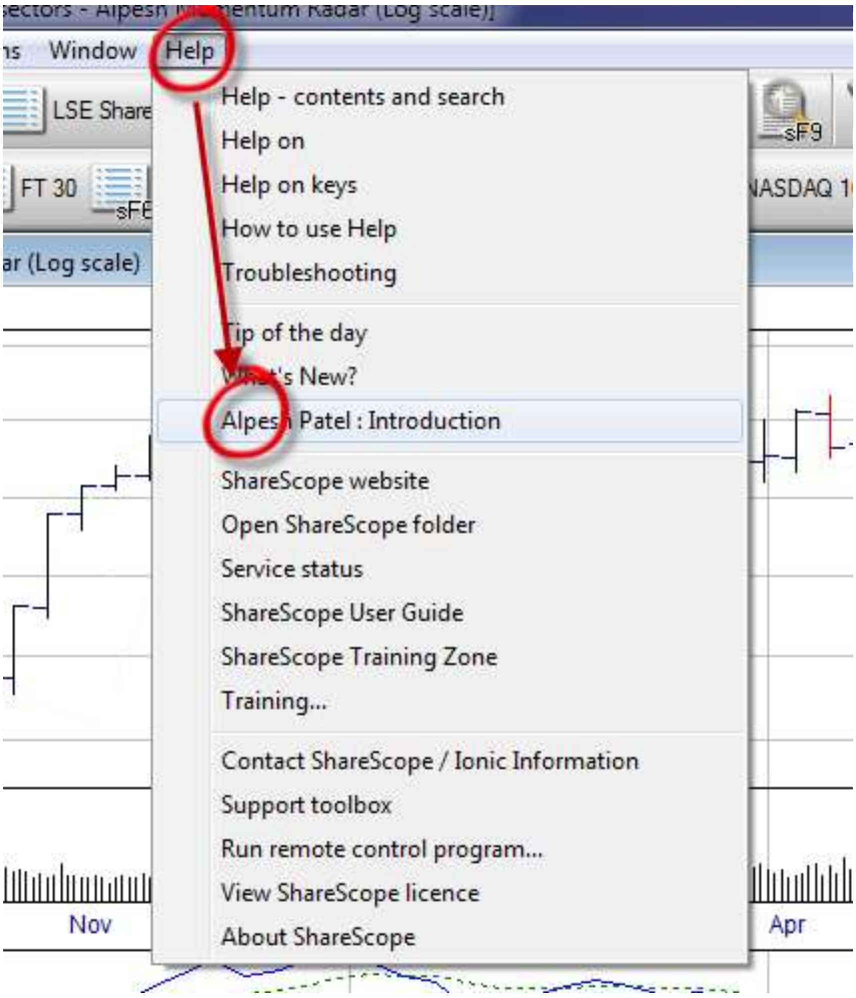
Despite ethnic communities making up 14% of the UK population, all-ethnic teams received only 1.7% of VC funds between 2009 to 2019. Better investment for everyone will lead to more liquidity and opportunity.

Some funds are taking the lead. Citi announced a $200 million investment fund to target historically underfunded teams. More needs to follow.

#4. Pension Reform

The People's Pension has some interesting thoughts on how pension reform could solve these issues. They suggest lowering the eligibility criteria for workplace pensions from £10,000 to £6,136. That change would bring in 1.2 million workers, 15% of whom are ethnic minorities. Additionally, they believe pension contributions should count from the first pound not use the current £6,136 threshold.

Help Page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Personal

I had lunch at my alma mater

And a talk at Finance Magnates:

And the Business Show:

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