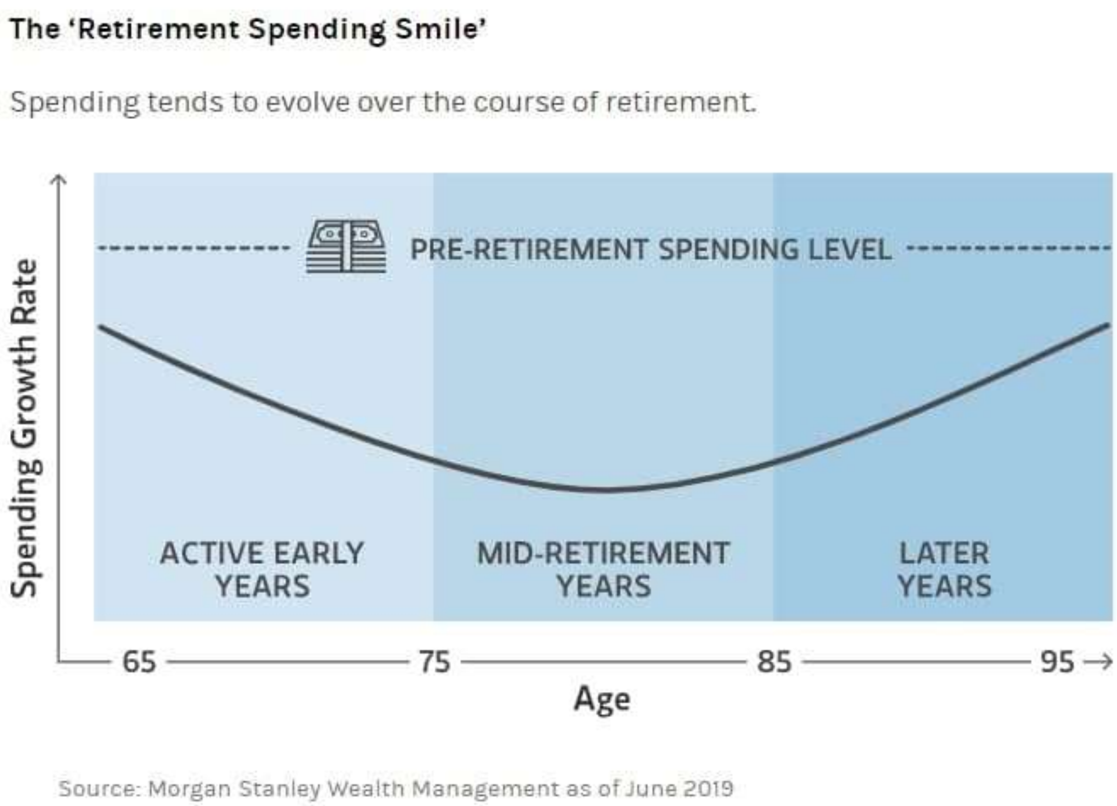
Alpesh Patel's Newsletter

Exclusively for ShareScope Alpesh Patel Special Edition Subscribers

09 February 2022

Overview

What a horrible January. Doesn't exactly put a smile on your face if you're planning for retirement. Speaking of smile – I liked this from Morgan Stanley. PayPal recently reported fourth-quarter earnings results that came in $0.01 below consensus estimates at $1.11 per share. Revenue that grew 13% year over year to $6.92 billion exceeded expectations. Stock fell around 25%! This market is punishing. That tells us there is more downside risk than upside potential.

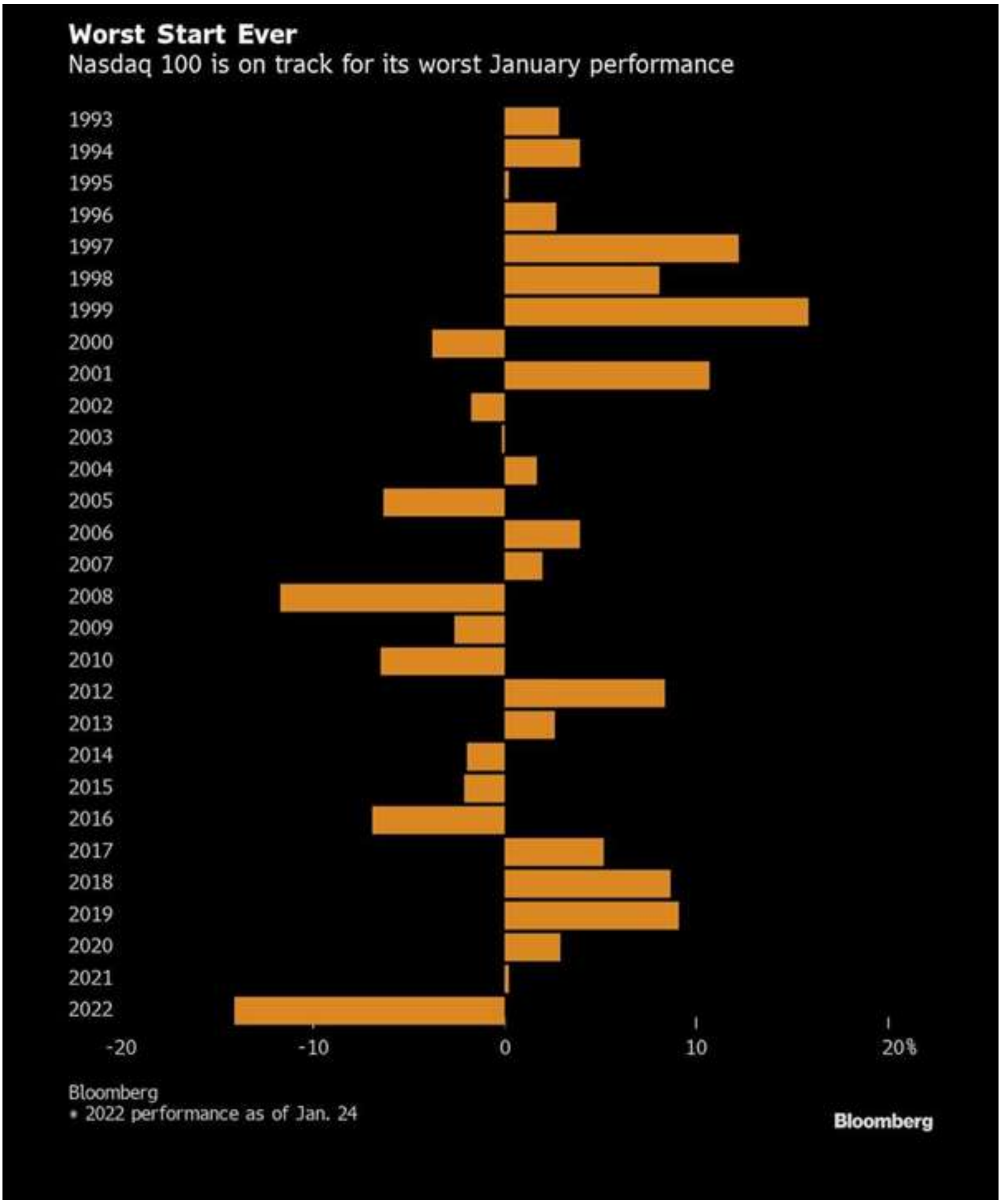


Stock Picks

Now last month, as per usual I gave my 12 month picks. But not as per usual, they were for the 1st time since 2004 when I started doing the annual picks, not exclusievly or largely UK companies. In fact they were largely US. Some of you have asked for a UK centric list as I've always been providing. So here it is and we will monitor going forward both. So this is the mainly UK from Feb 8th (Date of this newsletter) to end Dec 2022.

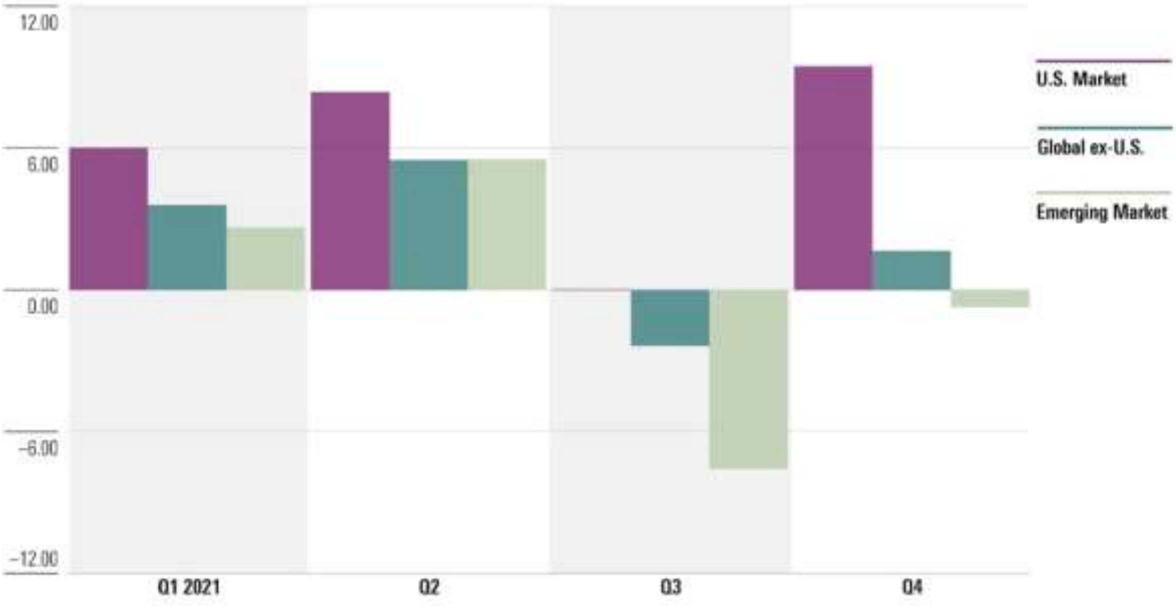
1. Airtel Africa PLC
2. GlaxoSmithKline PLC
3. National Grid PLC
4. Beazley PLC
5. British American Tobacco PLC
6. Imperial Brands PLC
7. Investec PLC
8. Plus500 Ltd
9. River And Mercantile Group PLC
10. BP PLC
11. Carr's Group PLC
12. Centamin PLC
13. Residential Secure Income PLC
14. Rio Tinto PLC
15. Severfield PLC
16. Shell PLC


S&P 500 Index
Drawdown (%) (SPX) -10.0906
Level
2017
2018
2019
2020
2021
Source: Bloomberg


Worst Start Ever
Nasdaq 100 is on track for its worst January performance
1993
1994
1995
1996
1997
1998
1999
2000
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010
2012
2013
2014
2015
2016
2017
2018
2019
2020
2021
2022
-20
-10
0
10
20%
Bloomberg
* 2022 performance as of Jan. 24
Bloomberg

We had become spoilt in 2021 and now want to be in denial.

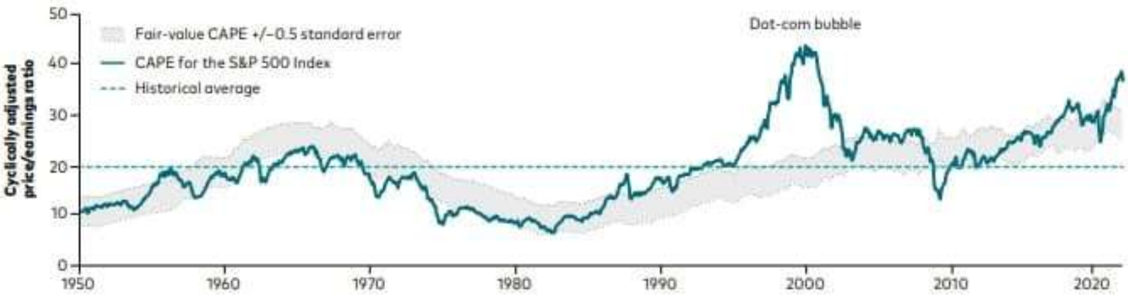
Quarterly Returns



Source: Morningstar Direct.

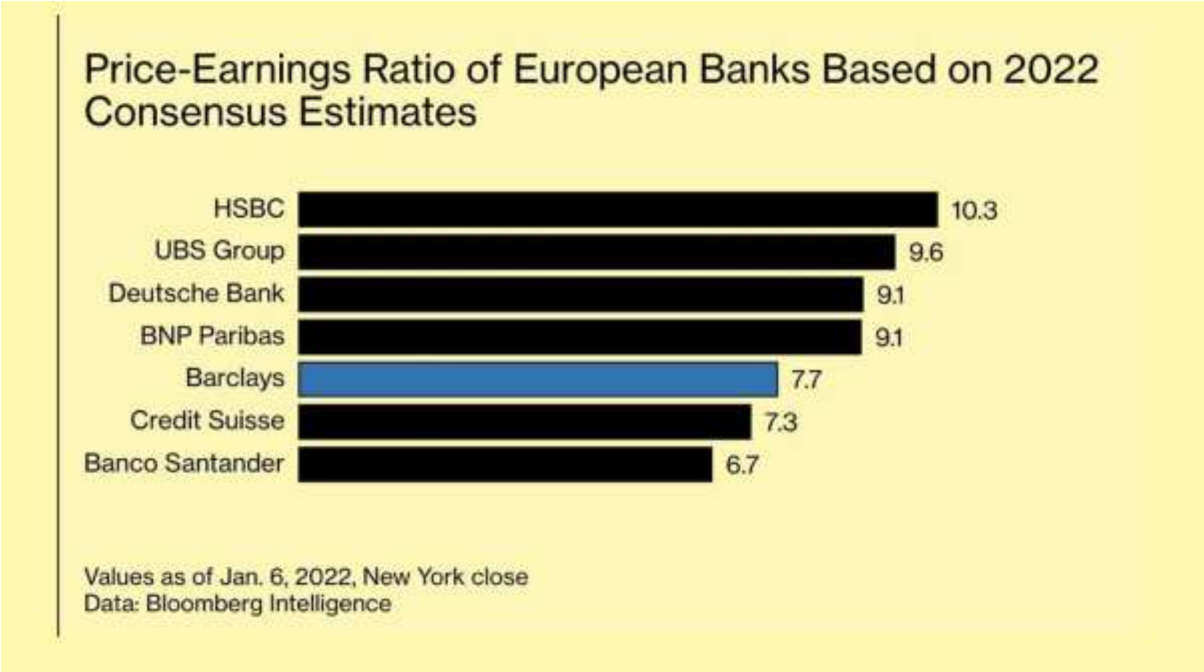
And given the overvaluation, any excuse to sell is on the cards – as with Meta's results.

U.S. equities have not been this overvalued since the dot-com bubble

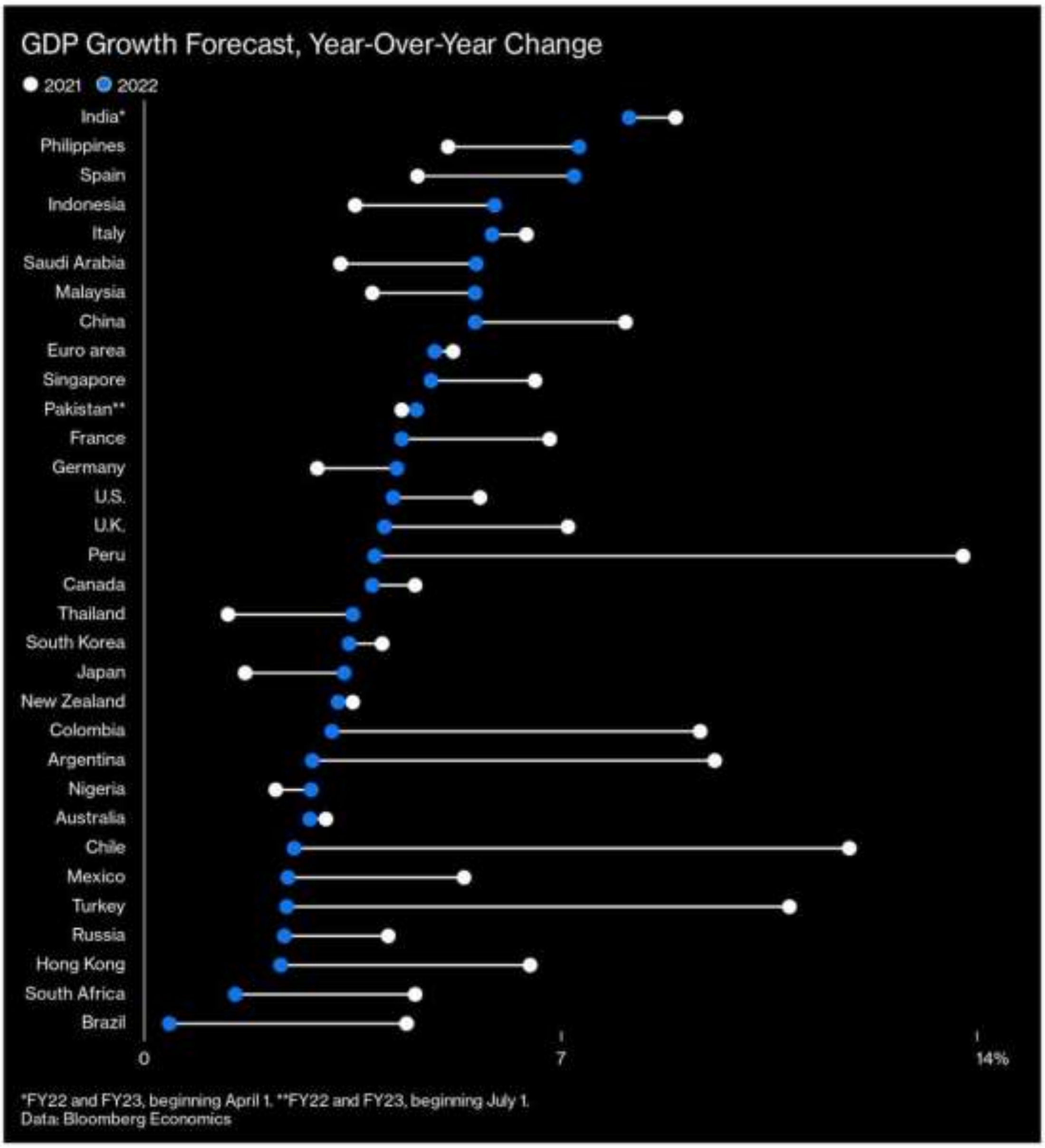


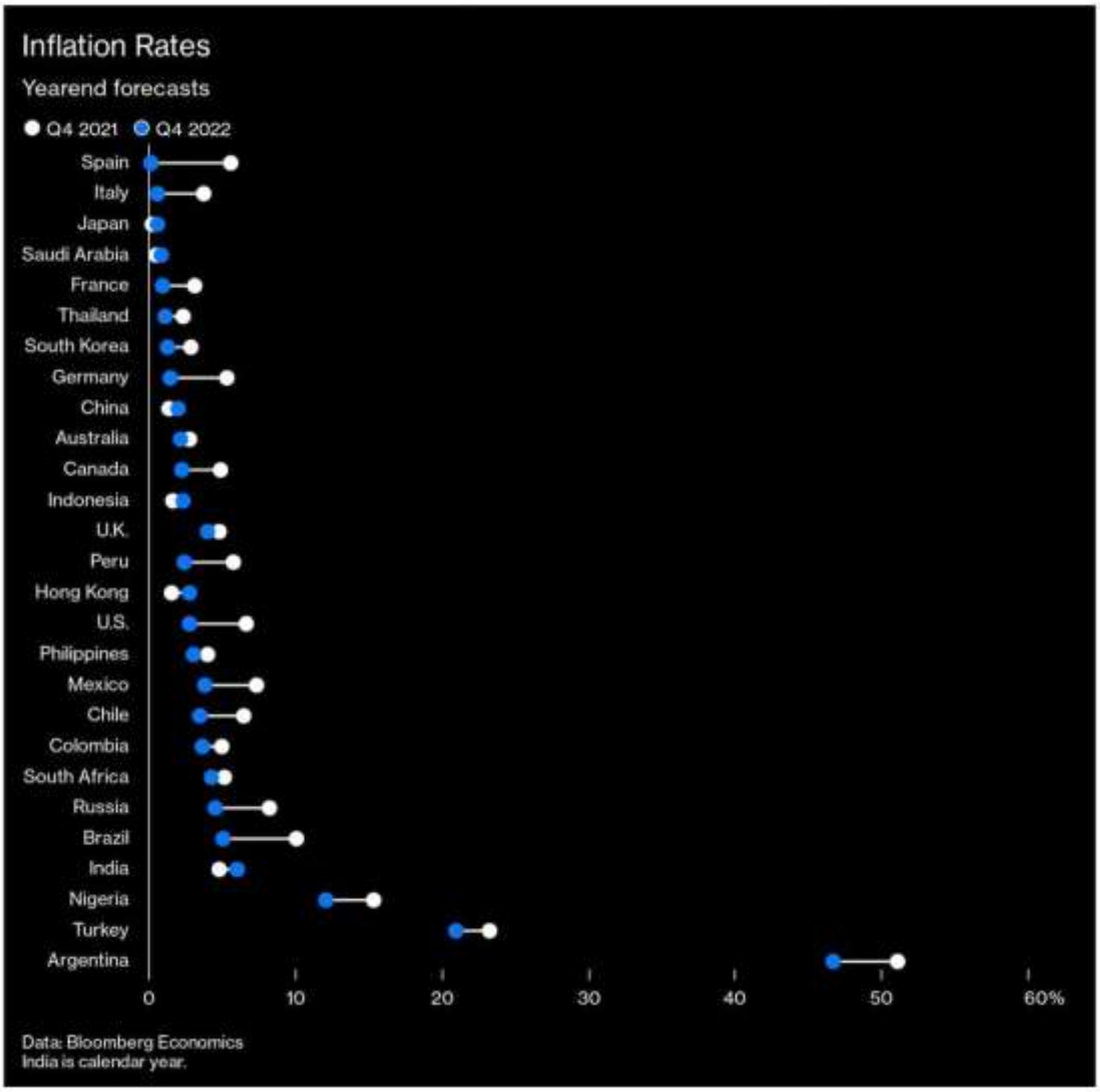
Notes: The U.S. fair-value CAPE is based on a statistical model that corrects CAPE measures for the level of inflation and interest rates. The statistical model specification is a three-variable vector error correction, including equity-earnings yields, 10-year trailing inflation, and 10-year U.S. Treasury yields estimated over the period January 1940 to September 2021. Details were published in the 2017 Vanguard research paper *Global Macro Matters: As U.S. Stock Prices Rise, the Risk-Return Trade-Off Gets Tricky* (Davis, 2017). A declining fair-value CAPE suggests that higher equity risk premium (ERP) compensation is required, while a rising fair-value CAPE suggests that the ERP is compressing.
Sources: Vanguard calculations, based on data from Robert Shiller's website, at aida.wss.yale.edu/~shiller/data.htm, the U.S. Bureau of Labor Statistics, the Federal Reserve Board, Refinitiv, and Global Financial Data, as of September 30, 2021.

Some are looking for value in European banks…



Others are looking in emerging markets growth with lower inflation…


GDP Growth Forecast, Year-Over-Year Change
2021 2022
India*
Philippines
Spain
Indonesia
Italy
Saudi Arabia
Malaysia
China
Euro area
Singapore
Pakistan**
France
Germany
U.S.
U.K.
Peru
Canada
Thailand
South Korea
Japan
New Zealand
Colombia
Argentina
Nigeria
Australia
Chile
Mexico
Turkey
Russia
Hong Kong
South Africa
Brazil
0
7
14%
*FY22 and FY23, beginning April 1. **FY22 and FY23, beginning July 1.
Data: Bloomberg Economics



Me? I focus on my approach (more on this later) but for now let me share some thoughts of others:

Barron's Stock Picks for 2022

We have identified these 10 as among the best candidates to outperform the market next year.

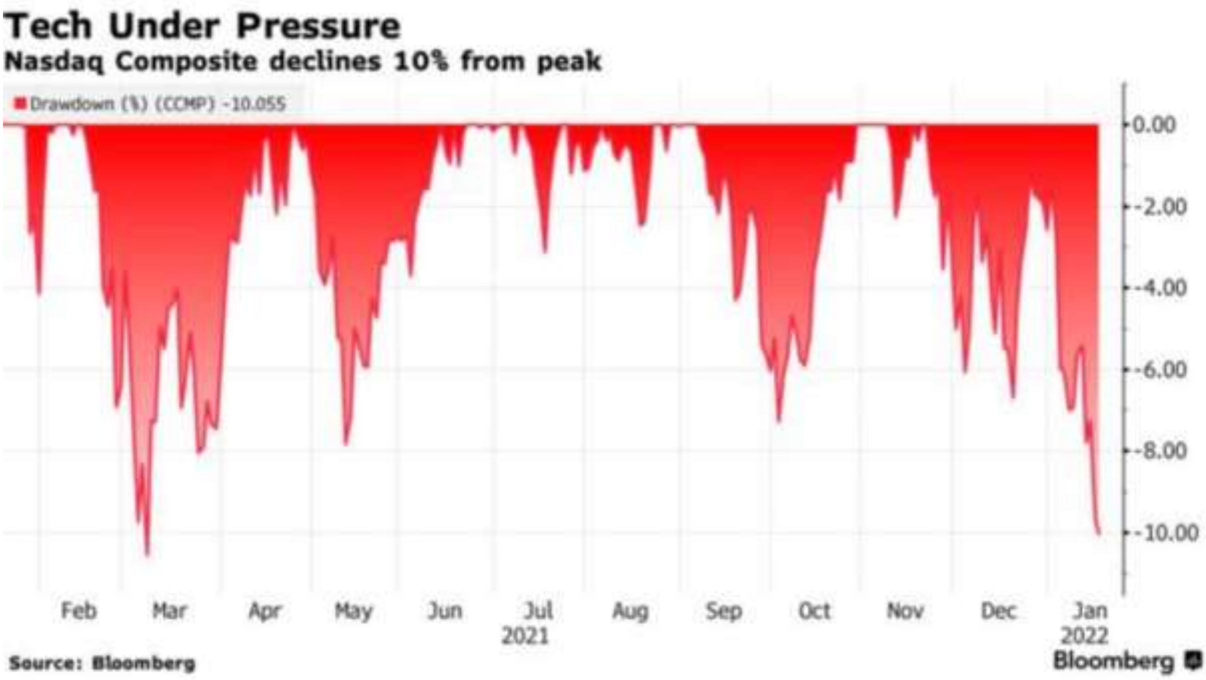
Company / Ticker	Recent Price	YTD Change	2021E EPS	2022E EPS
Amazon.com / AMZN	$3,377.42	4%	$41.11	$51.37
AT&T / T	23.71	-18	3.38	3.17
Berkshire Hathaway / BRK.A	454,550.00	31	17,466.30	18,928.50
General Motors / GM	58.39	40	6.73	6.93
Hertz Global Holdings / HTZ	21.01	-22*	4.02	2.55
IBM / IBM	125.93	5	10.05	11.04
Johnson & Johnson / JNJ	173.01	10	9.83	10.38
Nordstrom / JWN**	20.05	-36	1.27	1.99
Royal Dutch Shell / RDS.B	42.82	27	4.86	6.19
Visa / V***	214.37	-2	5.91A	7.04

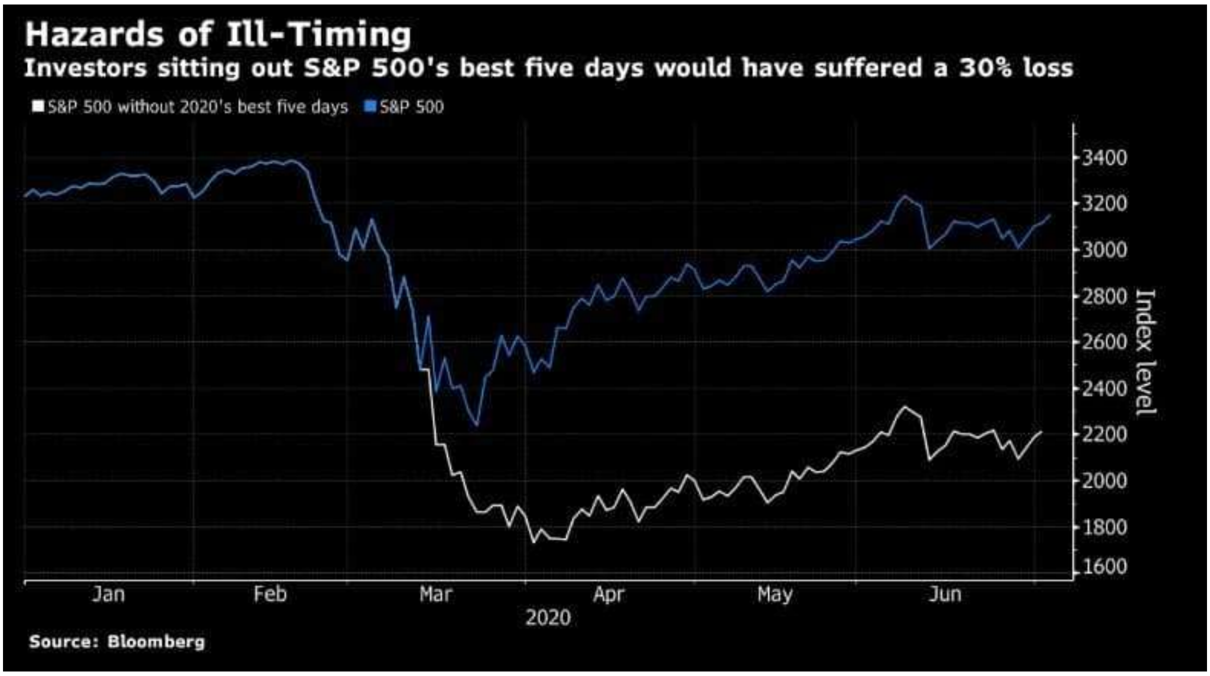
*Since July 1. **Estimates for Jan. 2022 and Jan. 2023 fiscal year ends. ***Sept. fiscal year end. E=estimate. A=actual.

Source: FactSet

We certainly know individual investors are getting into the market but they may get a bit scared by 20-25% falls of Paypal and Meta.


Monthly net purchases of U.S. equities by individual investors
$30 billion
20
10
0
2018
'19
'20
'21
Source: VandaTrack


Tech Under Pressure
Nasdaq Composite declines 10% from peak
Drawdown (%) (CCMP) -10.055
0.00
-2.00
-4.00
-6.00
-8.00
-10.00
Feb
Mar
Apr
May
Jun
Jul
2021
Aug
Sep
Oct
Nov
Dec
Jan
2022
Source: Bloomberg
Bloomberg


Hazards of Ill-Timing
Investors sitting out S&P 500's best five days would have suffered a 30% loss
S&P 500 without 2020's best five days
S&P 500
3400
3200
3000
2800
2600
2400
2200
2000
1800
1600
Index level
Jan
Feb
Mar
Apr
May
Jun
2020
Source: Bloomberg

Here is my take…

Option a. Keeps to trend. Probability 15%.
Option b. Keeps to longer term trend. Probability 60%.
Option c. Falls back more sharply eg Russia goes into Ukraine - market over-reacts. Probability 15%.
Option d. Bigger fall. Many bargains abound. Probability 10%.

And in case you think if there is a crash there would be anywhere to hide – I think not.

Today's Dow 30 Companies How Did They Do In the Last Crash

Lessons:

1. Very Few Went Up
2. Even The Biggest Companies Can Drop 50%+
3. Most People Underestimate How Much a Giant Can Fall or That It Can Bounce Back
4. Yes They Rebound Often
5. Fallers May Have Nothing To Do With The Cause of the Crash
6. Those Linked Most to the Crash Are Most Likely To Fall Most

Name	EPIC	Price% 2 weeks ago	Price% between 1/1/08 and 31/12/08
Chevron Corp	CVX	2.62	-20.7
UnitedHealth Group Inc	UNH	0.92	-54.3
Amgen Inc	AMGN	0.71	24.4
Coca Cola Co (The)	KO	0.68	-26.2
Merck & Co Inc	MRK	0.54	-47.7
Procter & Gamble Co	PG	-0.45	-15.8
Travelers Companies Inc (T	TRV	-0.60	-16.0
Boeing Co (The)	BA	-0.70	-51.2
Walgreens Boots Alliance Ir	WBA	-1.23	-35.2
Visa Inc	V	-1.29	
Verizon Communications Inc	VZ	-1.60	-22.4
Dow Inc	DOW	-2.22	
Salesforce.com Inc	CRM	-2.37	-48.9
Walmart Inc	WMT	-2.56	17.9
Intel Corp	INTC	-2.62	-45.0
International Business Mach	IBM	-2.94	-22.1
Honeywell International Inc	HON	-3.17	-46.7
Caterpillar Inc	CAT	-3.43	-38.4
3M Co	MMM	-3.55	-31.8
Microsoft Corp	MSFT	-3.96	-45.4
Apple Inc	AAPL	-4.45	-56.9
Cisco Systems Inc	CSCO	-4.99	-39.8
Johnson & Johnson	JNJ	-5.02	-10.3
McDonalds Corp	MCD	-5.26	5.6
Walt Disney Co (The)	DIS	-6.54	-29.7
American Express Co	AXP	-7.78	-64.3
Nike Inc	NKE	-9.04	-20.6
Home Depot Inc (The)	HD	-11.20	-14.6
JPMorgan Chase & Co	JPM	-11.70	-27.8
Goldman Sachs Group Inc	GS	-12.39	-60.8

Cape ratio suggests stocks are still expensive

Shiller PE ratio by year

© FT

Index	YTD return	Index maximum drawdown from YTD high	Average member drawdown from YTD high	% of members with: Positive YTD return	At least -10% drawdown from YTD high	At least -20% drawdown from 52w high	At least -50% drawdown from 52w high
S&P 500	-8%	-8%	-10%	26%	47%	44%	2%
NASDAQ	-12%	-13%	-17%	20%	65%	75%	45%
Russell 2000	-12%	-13%	-17%	15%	70%	81%	33%

Source: Charles Schwab, Bloomberg, as of 1/21/2022. Indexes are unmanaged, do not incur management fees, costs and expenses and cannot be invested in directly. Past performance is no guarantee of future results. Some members excluded from second year-to-date return column given additions to indices were after January 2022.

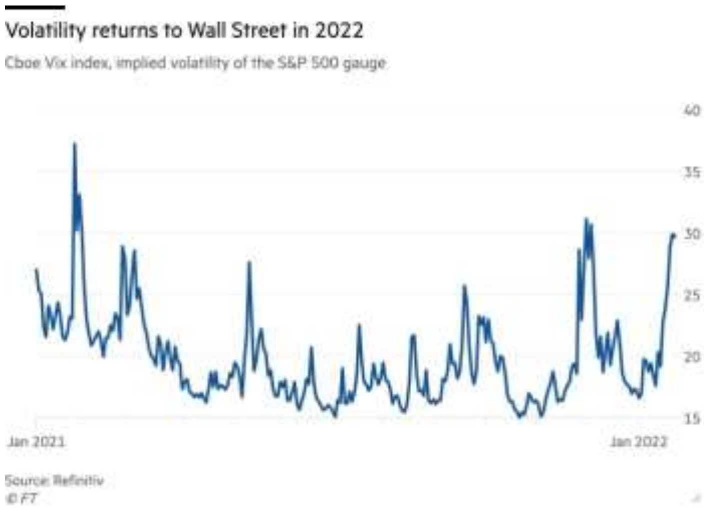
Index	January 2022 performance*	Worst month since (monthly performance)
S&P 500	-7.7%	March 2020 (-12.5%)
S&P 500 Equal Weight	-4.5%	March 2020 (-18.2%)
Big 5	-8.5%	September 2020 (-9%)
S&P 500 Info. Tech.	-11.4%	November 2008 (-11.4%)
NASDAQ	-12.0%	October 2008 (-17.7%)
NASDAQ 100	-11.5%	October 2008 (-16.3%)
Russell 2000	-11.5%	March 2020 (-21.9%)
ISPAC	-13.9%	Inception
Renaissance IPO	-22.9%	Inception
GS Retail Favorites	-15.1%	Inception

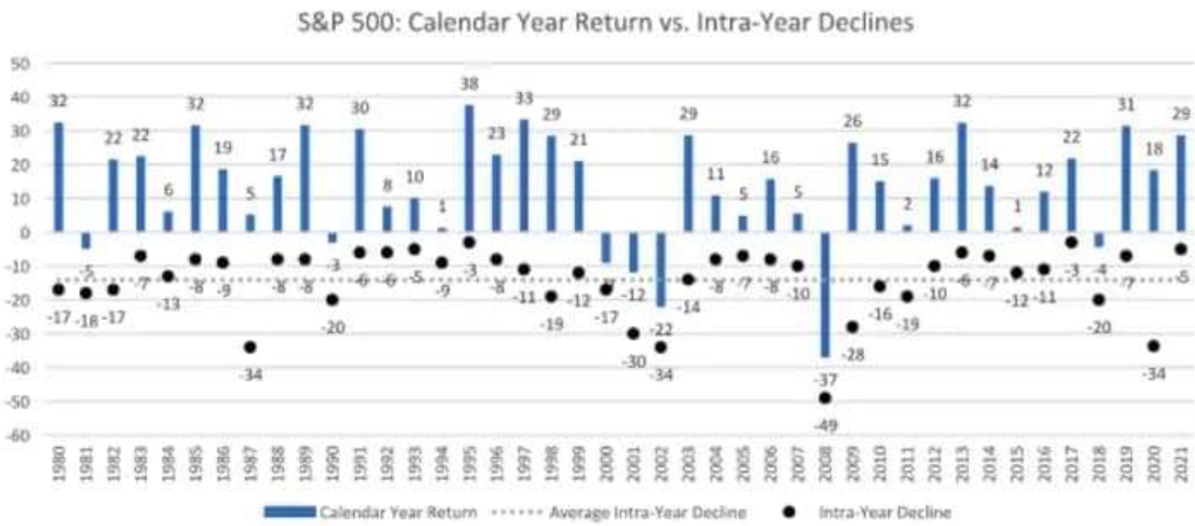
Source: Charles Schwab, Bloomberg, as of 1/21/2022. Big 5 stocks represent Apple, Amazon, Meta, Alphabet, and Microsoft. Past performance is no guarantee of future results. *January 2022 performance represents month-to-date performance. GS retail favorites basket consists of U.S. listed equities that are popularly traded on retail brokerage platforms. Renaissance IPO Index is a diversified portfolio of US-listed newly public companies that provides exposure to securities under-represented in broad benchmark indices. IPOs that pass a formulated screening process are weighted by float, capped at 10% and removed after two years. ISPAC Index is a passive rules-based index that tracks the performance of the newly listed Special Purpose Acquisitions Corporations ("SPACs") ex- warrant and initial public offerings derived from SPACs since August 1, 2017.

For those desperate to deploy cash into say Microsoft, for me I am happy to wait. If you are into timing buys and don't wait or pound cost average then the more difficult thing is using technical analysis eg see image. I need A to be rising and B to be flat before buying. Or keep it simple and 1. Wait or 2. Pound cost average in. Me, I'm waiting to deploy capital.

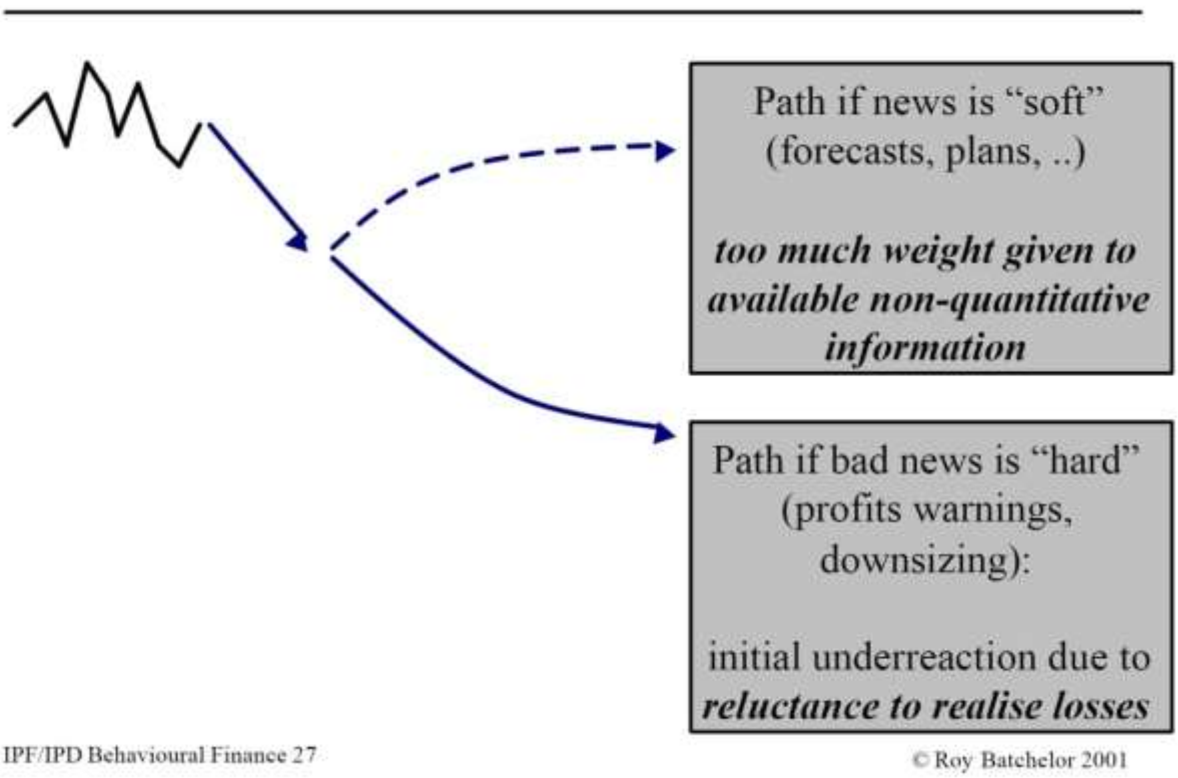
Microsoft's earnings growth once again topped 20 per cent in its latest quarter, beating Wall Street expectations, as demand for cloud services continued to buoy its performance.

However, shares in the US software company fell nearly 5 per cent in after-market trading following the earnings release, leaving the stock more than 20 per cent below the record hit late last year amid a broader retreat in tech stocks. The pullback came despite earnings and profit margins that were ahead of many analysts' expectations.

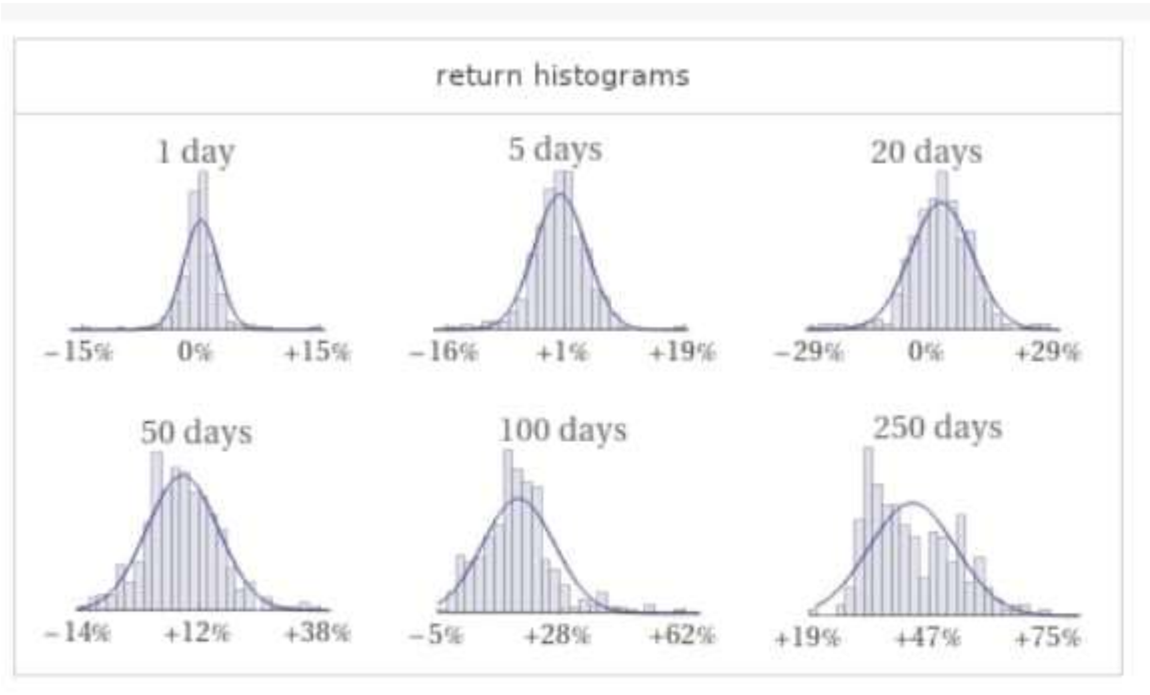




So how do we handle some of this volatility when it results in falls? Well, this document is helpful:



It's why we always try to pick companies which are less likely to have bad hard news. So even if they fall eg Microsoft because the market falls, they come back quick.



Microsoft. Past is no guarantee of future. But shows how much 20 day volatility can spook and panic.

Country ETFs Month to Date

Threats To The Stock Market in 2022

The occasional spot of volatility aside, 2021 was a fantastic year for stocks. The S&P 500 finished the year up almost 27%, far ahead of the average total annual return since 1980 of 11%.

However, investing never comes without risk, and a significant correction or crash could be around the corner. Let's look at the threats to the stock market in 2022.

Inflation

Inflation is a critical concern for 2022. The consumer price index is forecast to be around 7% for much of the year. The knock-on effect could be significant.

The Fed

Inflation is a concern for everyone, especially the Fed. Much of 2022 depends on what moves the central banks make, and if the news on January 6th is anything to go by, they plan to move aggressively against inflation. That announcement caused a sharp sell-off, and worse could follow.

With monetary policy set to tighten, and talk of three interest rate hikes throughout the year, this could be grim news for Growth stocks and the S&P 500 in general.

Indeed, increased interest rates could be the sort of issue that causes a 20% market correction during 2022. The increases will happen; how badly they affect equities is less clear.

Of course, not everyone believes that central banks will be able to control inflation. Some argue that globalisation and the rise of China reduced labour costs, and that trend is now being reversed.

Tech Stocks

For Tech and Growth stocks, rising inflation represents some significant issues. The price of many Tech stocks relies on future earnings, and if inflation continues to increase, these distant earnings will look far less valuable.

The early January correction that followed the release of the Fed's December minutes could be a sign of things to come.

End of Stimulus Packages

If the Fed does tackle inflation, it will spell the end of the COVID-19 stimulus. If we hit rate hikes during Q2, asset classes like equities and high yield bonds could perform well. However, depending on how much of the market recovery has been propped up by the Fed stimulus, some sectors could take a fall.

Lack of Diversification

A concentration of tech stocks was responsible for a lot of the S&P 500 growth last year. Apple, Microsoft, Nvidia, Alphabet, and Tesla have driven most of the gains since last April. When a market relies on a few big players, it's vulnerable to changing conditions. However, 2022 is likely to see some of the equities that lag behind Growth stocks find their feet.

Regulatory Risk

Regulatory changes could cause issues across several sectors. Midterm elections could see a more significant focus on drug pricing reform, which could hit Pharma. Travel could feel the effects of tightening carbon emissions regulations. At the same time, environmental and pollution laws could hurt the Energy sector.

But if one sector should be most concerned about 2022 regulations, it's Tech. The EU's Digital Services Act and Digital Markets Act could seriously disrupt Big Tech business models.

Labour Costs

The S&P 500's P/E hit 27.2 at the end of last year. It's the highest P/E since the stock market bubble. Many analysts suggest that this is fine because profits will keep rising. However, things might not be that simple.

Operating margins are rising, and the share of sales spent on operation costs is about 40% higher than 12 years ago. If labour costs consume more profits, equities look very expensive.

New Covid Variants
Both Delta and Omicron scares have come and passed. The market could absorb both these variants; however, it's unlikely that these will be the last form of coronavirus we hear about. A particularly bad strain could still damage and hurt already creaking supply chains.

Summary
The general consensus among financial institutions is that we are set for a steady year, albeit one without the enormous gains of 2021. For believers in the January Barometer (correct almost 85% of the time since the 1950s), the early sell-off may seem like a bad omen.

However, most of the significant threats to the stock market are familiar faces from 2021. Inflation, new coronavirus variants, and less favourable conditions for growth stocks could drag at the S&P 500. February's federal funding bill and another debt ceiling debate could also cause issues.

However, despite the numerous threats out there, opportunities will present themselves. And according to CNBC's Jim Cramer, everyone should keep an open mind about equities next year because the market might just keep on going up.

Analysis: Will It Be a Good or Bad Year for Stocks?

Now that January is underway, what will 2022 have in store for us? Will it be a good year or a bad year for stocks?

The mood in the equity markets has changed. Last year's stunning gains led to a heated, exuberant atmosphere. However, persistently high inflation has forced the Fed into action. They've suggested there could be three to four interest rate hikes this year, leading Wall Street analysts to pull back their forecasts.

Investors are jittery. Will equities continue to over-perform? Or is 2022 the year things finally grind to a halt? That said, this is the same market that has weathered several doom-laden predictions, a pandemic and new variants, and constant accusations of being overpriced.

The Fed, Inflation, and Stimulus Packages
A hawkish Fed will be a new experience for many investors. We haven't seen a full cycle of interest rate hikes from June 2004 – June 2006.

Equities, in particular Tech stocks, took a tumble in early January following news that the Fed would act aggressively to curb inflation by increasing interest rates.

Tech stocks are sensitive to high-interest rates, which has opened the door for other sectors to shine, like Energy and Banks. Of course, these aren't the only areas that investors can rotate into if the Fed can't tame inflation. REITs, Utilities, Consumer Staples, and Healthcare equities can all thrive in these conditions.

Of course, not everyone is convinced the Fed will follow through with three to four interest rate hikes. For some, it's far from a foregone conclusion, and there is precedent in the '90s that suggests the Fed could pull a few surprises.

Are Quants Back?
January also highlighted one area that could be promising in 2022. The Absolute Return fund, run by AQR Capital Management, had its best five-day period since it began 23 years ago. Is this a sign that the "quant winter" has passed?

Interestingly, the average quant equity fund outperformed the market and stockpickers last year. Their respective returns were:

- Average quant equity fund: 27.8%
- US stock market: 26.5%
- Average stock picker: 24%

Will Semiconductors Go Big?
Semiconductors had a good 2021. But 2022 could be even better. Electric vehicles, 5G rollout, and the growth of cloud computing all stand to increase the demand for semiconductors. KLA, Kulicke & Soffa, and Marvell Technology look like exciting bets.

How the Rising Dollar Will Affect Equities?
The dollar rose by 7% last year. While this extra purchasing power might seem attractive at first glance, it could significantly negatively affect the stock market. Strong GDP and job growth and comparatively high US treasury yields have attracted plenty of foreign money.

More foreign investment will flood into the US if the Fed goes through with interest rate hikes. As the dollar rises in value relative to foreign currencies, many US companies could take a hit because 40% of their trade comes from overseas markets.

In short, a strong dollar could lead to lower foreign sales and revenues, which may drag down US equities.

Cryptocurrencies
The CNBC Millionaire Survey suggested that more senior market participants don't expect big things from 2022. Only a little more than half of the millionaires surveyed think the S&P 500 will gain over 5% this year.

These figures suggest a shift from the optimism and risk-taking that have characterised the last few years. However, there is one group of investors with high hopes: Millennials.

52% of Millennial millionaire investors expect the S&P 500 to grow by 10% next year. At the same time, 39% of the same group are predicting a 15% rise.

This exuberance and positivity are visible in Millennials' attitudes to other assets. Half of all Millennials surveyed suggest that they will increase their cryptocurrency investments over the next year. So, where will the crypto market go?

It's been a tough few months for crypto. Since Bitcoin's November 2021 peak, it's down almost 40%. Other altcoins have taken a similar fall. A big driver of these losses is China's decision to ban crypto.

However, the CPC seems interested in blockchain and has signalled a move toward adopting state-run NFTs.

Summary
The markets are looking unpredictable at the moment. Interest rate hikes, supply chain issues, new COVID variants, and an unsettled job market are all threats to a runaway bull market.

However, this market has defied expectations for a long time. The signs point to a Tech stock slowdown, but that will create opportunities for other sectors, like Energy and Banking. It's unlikely that we'll see returns of 20%+ this year, but it's not time to worry about a crash just yet.

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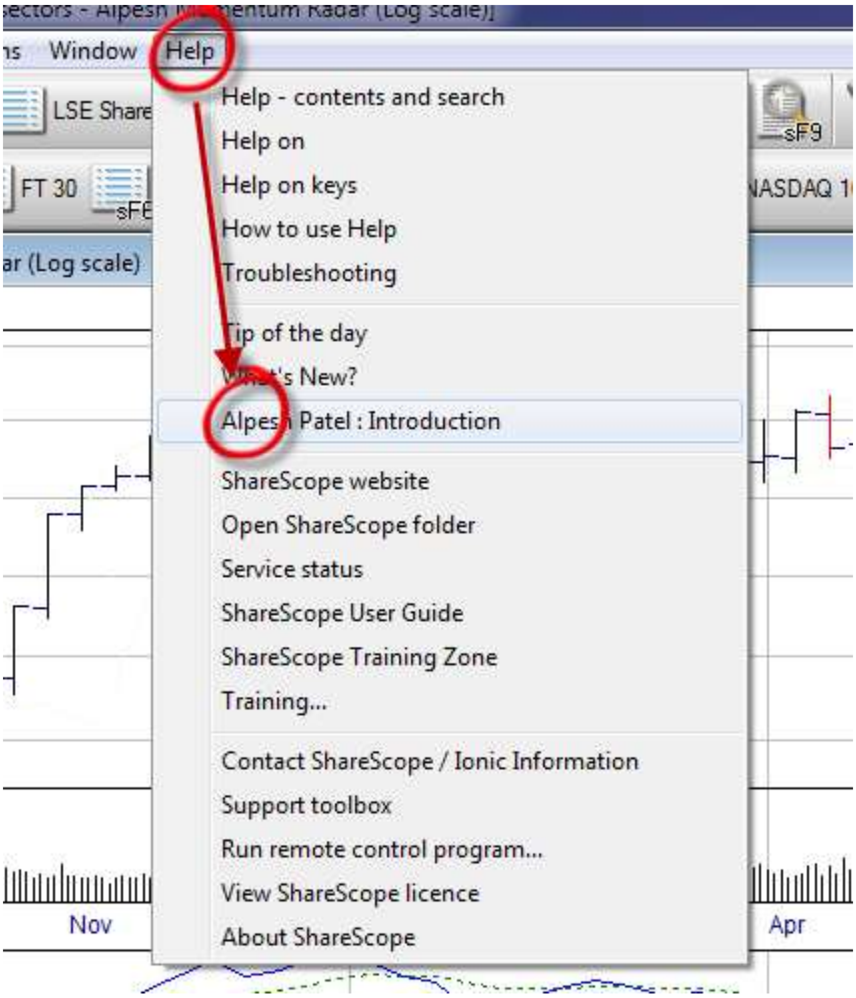

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