BROKERAGESELECT NEWSLETTER

Taxes

Retirement income from pensions, 401Ks and IRAs are often taxed more favorably than ordinary income by states. Retirees should be aware of the the way states tax retirement income.

Credit

There are several ways consumers today can make purchases without cash. Debit cards, credit cards and buy now-pay later all are available options. Consumers should understand the fees, terms and conditions of any payment or credit method.

Hobby Fraud

Sadly fraud is everywhere - even with hobbies. As many retire or have more time to enjoy non-work activities, people need to take care. From fake car parts to scam sewing machines to phony sports cards and memorabilia, collectors and hobby enthusiasts need to beware.

Perspectives

The earnings scorecard for the first quarter 2022 is complete and the profit picture looked pretty good. According to FactSet, 77% of companies in the S&P500 reported earnings per share (EPS) that exceeded Wall Street estimates. S&P500 earnings rose 9.2% year-over-year. This increase was much better than what analysts thought at the beginning of March when expectations called for 4.6% earnings growth. Stock prices are a function of earnings times a “multiple". While earnings increased, the S&P500 index nevertheless is down about 12.5% from the end of 2021. This is the result of a collapse in the price to earnings ratio (P/E), the multiple. The forward 12-month P/E of the S&P500 on January 1st, per FactSet, was approximately 21. It is now 17. The P/E ratio is a reflection of how investors value a company or index. The value is an estimate of the future stream of income and some end value for a company, either the result of a takeover or liquidation. For example, S&P500 estimated earnings for next year is about $245. Multiply this by 17 and you get the current price of the S&P500 index. The same calculation applies to individual stocks. The P/E is what investors are willing to pay above the expected level of profits. The P/E is influenced by interest rates and sentiment. In 2022 we have seen interest rates rise which, other things being equal, depresses the P/E. We have also seen a sharp decline in investor sentiment as worries about recession (a decline in profits) and geopolitics took center stage. Investors are cautious and not willing to pay much for future profits. Historically, we are below the 5-year average forward S&P500 P/E of 18.6. We are just about at the 10-year average of 16.9. It is impossible to know precisely what the “correct” P/E should be. Does a P/E of 17 discount, sufficiently, the future level of recession, inflation and interest rates? If the factors that depressed P/Es - interest rates, sentiment - do not stabilize or reverse, it will be up to company profits to move the stock market higher or at least keep prices stable.


"This next song's about spreading risk in a volatile market by diversification."

Something Else

While I enjoy Champagne, only recently did I learn some of the nuances of wines from this French region. Champagne is generally made from combinations of Chardonnay, Pinot Noir and Pinot Meunier grapes. The first is a white grape the other two are red grapes. When the bottle label reads "blanc de blanc", the bubbly wine is made entirely from white grapes. This could be 100% Chardonnay or Chardonnay with some other white grapes. If the label reads "blanc de noir" it means white wine from the dark grapes. Sugar content also varies. A "Brut Nature" contains zero added sugar in the fermentation process. "Brut" uses a low level of sugar. The less sugar, the drier the Champagne.

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Out Of The Box

Following the above discussion, P/E's represent the "discounting" or "premium" function for investors. In times of euphoria, investors bid up stocks, putting a premium on company prospects. In times of pessimism, investors sell off shares and discount perceived bad news. Above we looked at the S&P500 index but there are interesting stories within individual stocks. The collapse in P/E ratios for some stocks is dramatic. In many cases, this is appropriate however in others, the decline in P/E may be "over-discounting" the problems investors anticipate on the horizon. These are the times where nimble investors who do their homework can find bargains. The sentiment pendulum swings too far in both euphoric times and in negative times. With respect to fallen tech and e-commerce names, investors need to look at whether the company's business is broken and permanently impaired and thus deserves a dramatic mark-down in P/E or whether there is a real business there and that any decline in profits or reduction of company guidance is just temporary and the respective P/E is way too low. To illustrate (these are NOT recommendations) how to look at P/E's in the investment decision process let's look at Lennar (LEN), one of the largest home builders. With rates rising and home prices high, home affordability is an issue. Expectations for home builders have dropped substantially. LEN is now $81 per share down from a high of $117. The P/E has fallen from 8.9 to 4.8. Does a 30% drop in price and a 45% decline in P/E already discount the challenges LEN may face? A more dramatic example is Netflix (NFLX). On November 17, 2021 NFLX traded at $691 per share and had a forward P/E of 64.5. Today, NFLX trades at $199 and has a forward P/E of 18.2. These are declines of just over 70%. Is the NFLX business model permanently challenged by streaming competition? Does an 18.2 multiple accurately reflect future growth in a post-pandemic world? If overly pessimistic, then NFLX may be a bargain. If not, the shares may be fairly priced or possibly still over-valued at a price 70% lower than it was less than a year ago. Warren Buffett is attributed to have said, "Any asset at the right price." The P/E ratio is a tool to figure out the "right" price or at least if low enough, gives some "margin of safety" if you are wrong.
