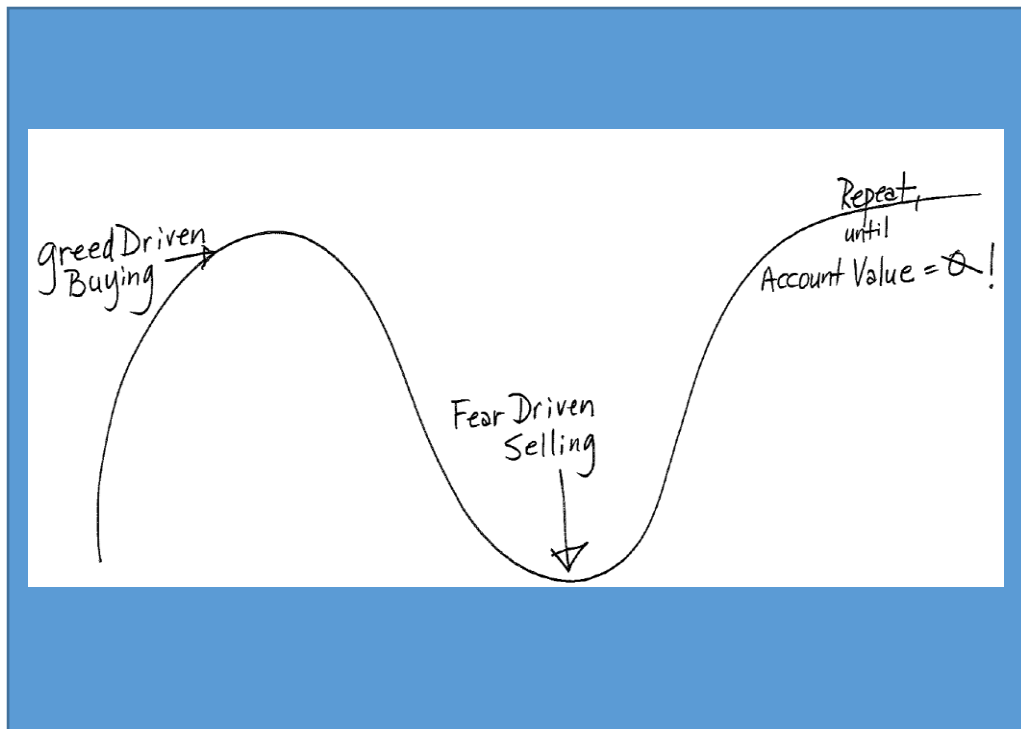


Laggards to Leaders, Just a Matter of Time



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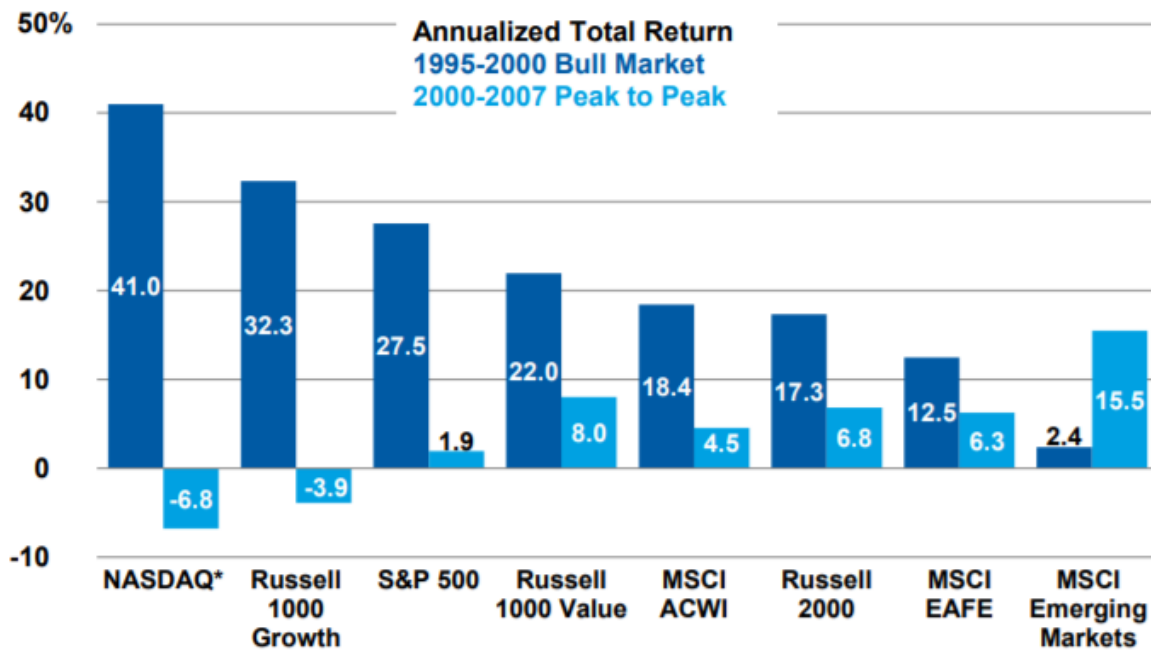
by Chris Briggs, CFP®

Laggards to Leaders, Just a Matter of Time

As many of you know, I spent over 20 years working for Wall Street firms as an advisor. One of the things I miss most is the access and exposure to good old fashioned research. I have friends who kindly forward me their firm’s insights. I found several observations Morgan Stanley made in its 4Q, 2018 preview to be worth sharing with all of you.

We are often creatures of believing the recent behaviors of assets will be how they will continue to behave. I hear it every day. Why do we own so much value if growth is doing so well? The US market is outperforming virtually every market worldwide. Why do I need to invest anywhere else? Consider the data from Morgan Stanley below.

Leaders in the Dot-Com Era Became the Laggards in the Subsequent Cycle



*Price returns only
 Source: FactSet as of Sept. 25, 2018

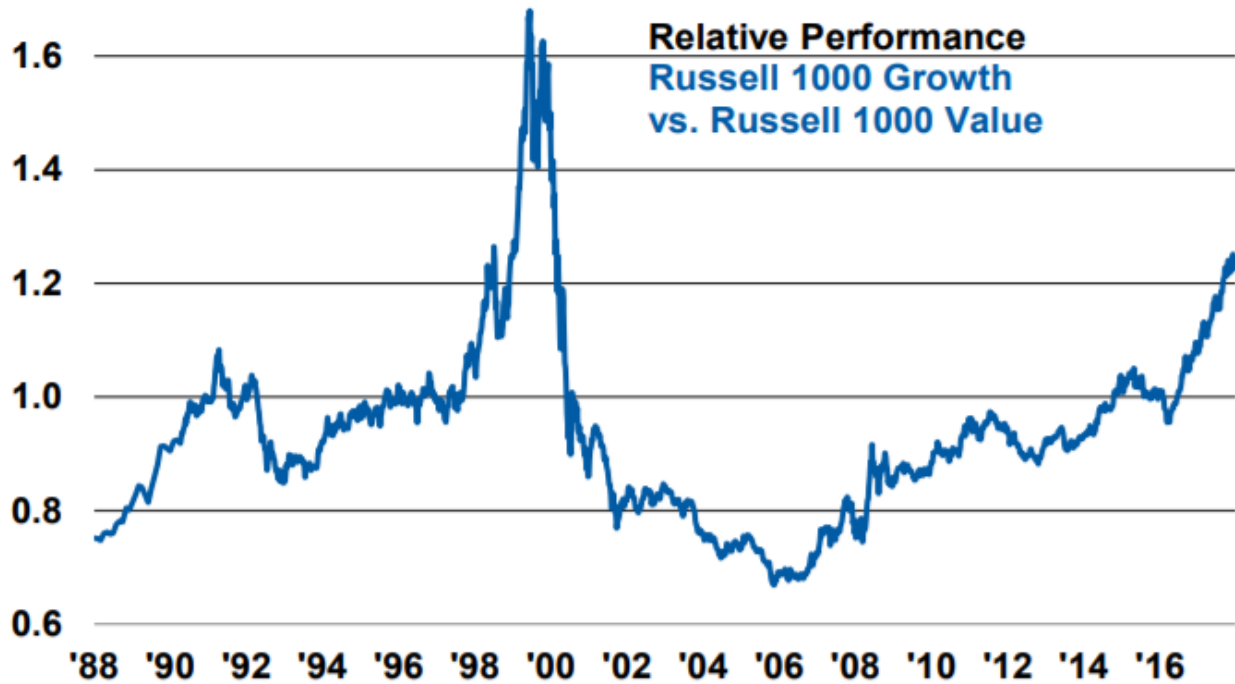
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¹ Morgan Stanley, “On the Markets” October 2018 https://hsl-pnw-downloadable-files.s3.amazonaws.com/1181/otm_oct_2018-0d305434c81a498aa513fe073c10caec.pdf

Technology and growth stocks were all anyone could talk about in the 1990s. They outperformed in a dramatic manner, as you can see. What is interesting to make note of is that many of the indices that outperformed during the dot-com era were the worst performers over the subsequent period. Morgan Stanley believes this is a pattern that will continue to repeat itself, with outperformers of today being the laggards over the next few years.² We have pointed this out in past issues of Triweekly, but it's nice to hear it from a research power house!

This chart shows you the relative performance of growth versus value during the growth (tech) run in the late 1990s and the current move. (Do you hear the train approaching?)

As in the Dot-Com Run-Up, Growth Stocks Have Far Outperformed Value



Source: FactSet as of Sept. 25, 2018

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In the current market move, growth has outperformed value as it did in the dot-com era. Growth is now at the highest level it has been in at least 30 years (on a relative basis except for the late 1990s). If you look at forward earnings estimates, growth is at the highest valuation it has been in 17 years. Morgan Stanley's Global Investment Committee has lowered its allocation to growth with the belief the current trend will reverse itself, pointing out in their report that chasing an overheated sector has been unwise

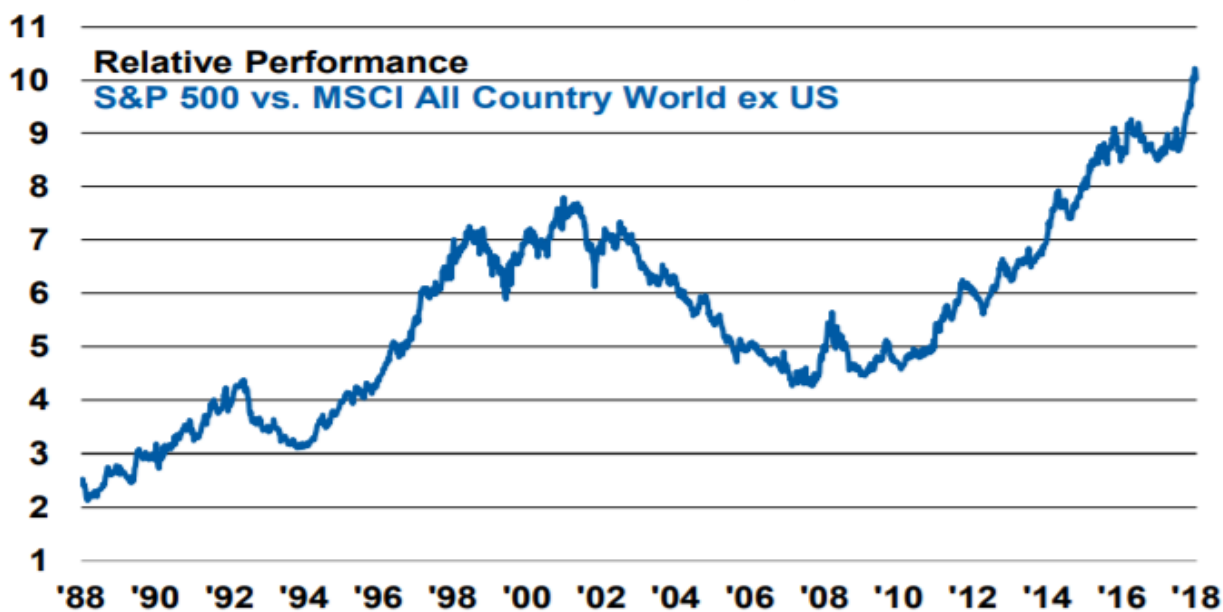
² Morgan Stanley, "On the Markets" October 2018 https://hsl-pnw-downloadable-files.s3.amazonaws.com/1181/otm_oct_2018-0d305434c81a498aa513fe073c10caec.pdf

³ Morgan Stanley, "On the Markets" October 2018 https://hsl-pnw-downloadable-files.s3.amazonaws.com/1181/otm_oct_2018-0d305434c81a498aa513fe073c10caec.pdf

in the past and suggesting allocating to value verses growth. As you are aware, LCA’s portfolios are overweight value verses growth.⁴

The report goes on to point out the US S&P 500®’s outperformance verses that of the MSCI All Country World Index. As we discussed just a month or two ago in this publication, the current period of US outperformance is the longest on record. We have been suggesting this trend is nearing its limits, and Morgan Stanley agrees. The move has been driven by a number of factors, such as trade wars, a strong dollar, weak emerging market currencies and an earnings growth cycle extended by the recent tax cuts. The US story can’t get much better, it’s too good perhaps. If you consider international equities from a valuation perspective, they look even more compelling. Looking at forward P/E as a valuation method for both US and international stocks, the disparity has never been this wide. This disparity in valuation makes international equities quite attractive on a relative basis.⁵ See the charts below.

US Stocks Have Far Outrun Non-US Stocks, Setting Up a Potential Reversal

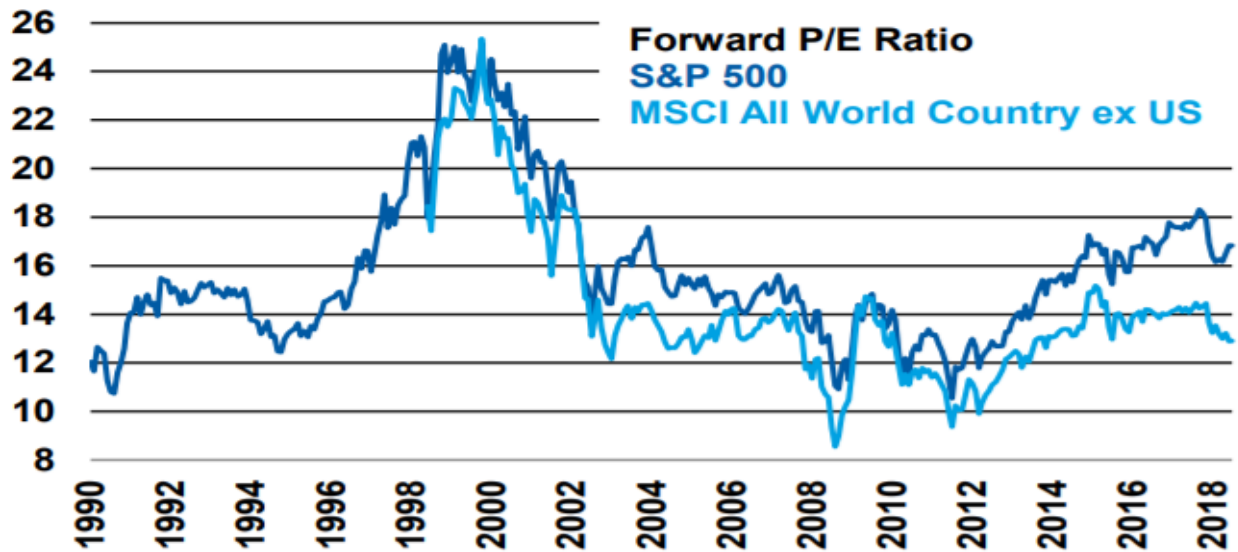


Source: FactSet as of Sept. 25, 2018

Valuation Disparity Suggests a Potential Greater Opportunity Outside the US

⁴ Morgan Stanley, “On the Markets” October 2018 https://hsl-pnw-downloadable-files.s3.amazonaws.com/1181/otm_oct_2018-0d305434c81a498aa513fe073c10caec.pdf

⁵ Morgan Stanley, “On the Markets” October 2018 https://hsl-pnw-downloadable-files.s3.amazonaws.com/1181/otm_oct_2018-0d305434c81a498aa513fe073c10caec.pdf



Source: FactSet, Bloomberg as of Sept. 25, 2018

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The portfolios we construct here at LCA maintain exposure to both domestic and international equities at all times. We also maintain exposure to growth and value at all times, overweighting value. We believe our disciplined rebalancing process provides our clients with an unemotional way of taking profits when parts of their portfolios outperform, committing these profits to assets they otherwise might avoid for all the reasons we discussed in this and past musings. Thank you for your continued support.

⁶ Morgan Stanley, "On the Markets" October 2018 https://hsl-pnw-downloadable-files.s3.amazonaws.com/1181/otm_oct_2018-0d305434c81a498aa513fe073c10caec.pdf

About LCA...

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Ask your Relationship Manager for a copy of "The Educated Investor" written by Robert Lindner.

For more information, call (770) 977-7779 or email portfolios@LindnerCapital.com.

Visit LCA's website at www.LindnerCapital.com

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