Olympiad
INVESTMENT MANAGERS

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STOCKS PROPERTY BONDS MONEY MARKET

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Dear Fellow Investor

BACK TO BASICS

Like Warren Buffett we dare not invest in expensive equities/stock markets.

Question:
Why not?

Answer:
As there is a high probability of losing a significant portion of our investment over many years to come. For example the Nasdaq composite index took from March 2000 to May 2015 and the S+P500 from March 2000 to Feb 2013 to break even and embark on a sustained uptrend. From March 2000 to March 2009 these two markets suffered two crashes of 45%+. (Source: Yahoo Finance.)

Question:
How expensive is the S+P500 today (23/06/2020)?

Answer:
The price-to-earnings (PE) ratio is the most common method to determine the expensiveness of a stock market. This ratio is the price you pay today for a share in e.g. S+P500 companies relative to the earnings of these companies over the last 12 months. Currently this ratio is **26.9** which is 67% higher than the historical average of 16.1. (Source: Shiller PE ratio/guru focus.) This means it will take 26.9 yrs to earn back every dollar you invest in the S+P500 should earnings remain the same as over the last 12 months. Should earnings decline then PE ratios will increase as explained hereunder.

The very high PE ratios of some shares e.g. Amazon (145), Netflix (106), Tencent (51) reminds me of 1999 pre-crash.

Question:
How does the current S+P500 PE ratio compare to ratios before or during prior stock market crashes?

Answer:
Dotcom Crash (1999-2002). PE ratio increased from 33.4 (March 1999) to 46.7 (March 2002) whilst the S+P500 crashed by 47.6% from 20/03/2000 to 30/09/2002.

Great Recession (2007 – 09). The PE ratio increased from 22.4 (1 Dec 2007) to 26.5 (1 September 2008) and then to 123.30 (1 June 2009) - highest in history. The S+P500 crashed by 56.13% from 1/10/2007 to 2/3/2009. (Sources: Yahoo Finance, Shiller PE ratio/guru focus.)

Question:
Why do PE ratios increase during a recession?

Answer:
Earnings drop faster than share prices during a recession. Daily share price movements give you a false

impression that share prices lead and earnings follow. Reality is the opposite. Note earnings are reported quarterly <u>in arrears</u> while stock markets try to look 12 months into the future.

<u>Question:</u>
The S+P500, Nasdaq and the JSE is going higher and higher, from their lows in March, should we not go along for the ride and get out before the next crash?

<u>Answer:</u>
No margin of safety. This will put us on a far more risky path as no person can tell you when exactly the next crash will occur nor how fast or deep it will be. For example on 19/10/1987 the Dow dropped by 22.61% and on 16/3/2020 by 12.93%.

Another dangerous sign is the rampant speculation/ trading on US markets since March. I have seen and experienced this type of speculation in 1999. It ended in tears as I wrote in the February newsletter which is available on our website. The success rates of individual and day traders are very low. Brazilian study showed only 3% of day traders actually make a profit and less than 1% more than the Brazilian minimum wage. University of California/Charles Schwab found that individual traders substantially underperformed the market over a six year period. Short term rich, long term poor.

Please contact me should you have any questions/comments.

Regards and Best Wishes

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