Argent Capital Management LLC

Market Overview – October 2022

The easiest way to make money is for someone to pay you more for whatever you produce without you having to make any changes to the product. That pure profit was part of the market's backdrop for a good chunk of the last decade. In investor parlance, that is known as P/E (Price/Earnings) multiple expansion. In other words, paying more for the same expected level of earnings – or more for the same product.

Not all of the P/E expansion the market realized was irrational. Think back to the 2012 era; investors were still reeling, or at least feeling, the hangover of the Great Financial Crisis (GFC) of 2008 and 2009. During the GFC, fear pervaded the market. Fear does not lend itself to P/E multiple expansion. As the housing crisis was slowly resolved and the banking industry gradually repaired, investors felt more comfortable buying stocks.

In addition, throughout that period, interest rates were low and frequently falling. With lower interest rates, investors had less incentive to buy bonds. A recurring response from clients was, "Why would I want to tie up my money for ten years to get a 2.5%, 2.0% or 1.5% return?" Low or declining interest rates led to an acronym in the investing world – TINA, meaning 'There Is No Alternative' to stocks. TINA boosted the attractiveness of stocks. The better stocks looked on a relative basis, the more stocks were bought. The more stocks were bought, the higher P/E multiples were pushed.

The graph to the left shows P/E multiple expansion reaching its heights in late 2020 through most of 2021. Since that time there has been a precipitous drop in the value of the market, and the P/E multiple investors are willing to pay for stocks. Coincident in that decline was the resurgence of inflation, a situation not seen since the late 1970s – early 1980s. Higher levels of inflation caused the Federal Reserve to react. The Fed used its tried-and-true weapon to try to curb inflation – raise interest rates.

With the Fed's actions, the concept of TINA was questioned. Suddenly, investors could get 4.0% interest on their government bonds. Given the risk-free nature of that investment, buying government bonds looked attractive and made investing in stocks less attractive. A less attractive backdrop for equity investing created the exact opposite situation as described above, less demand for stocks, pushing P/E multiples down.

Today, we are trading at/around the historic P/E multiple of the market. Some pundits have said this indicates the market has found a valuation bottom. Others have argued that further increases in interest rates will continue to depress P/E multiples, pushing down stock prices. How this will all play out remains to be seen, but we at Argent Capital will remain vigilant in this changing investment environment and continue to look for quality companies we can own for years to come.

As a reminder, we are 100% employee-owned and we thank you for your business and your interest. In addition, if you like our market letters, videos by Ward Brown and my podcast, 'Conversations with Ken,' we hope you will share them with friends. For information on our five equity strategies – Large Cap U.S., Dividend Select, Mid Cap U.S, Focused Small Cap U.S. and SMID Cap U.S., please contact clientservices@argentcapital.com.

Sincerely,

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