SCHAFER | CULLEN
CAPITAL MANAGEMENT

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Mid-Year Comments

For New Investors: The Casino is Open

The high-flying market honeymoon with the Biden Administration continues, propelled by easy money and low interest rates. The result has been an increasingly speculative environment for which firms like Robinhood have sprung into existence – offering commission-free short term trading on a massive scale. This, in turn, has produced speculative trading vehicles like SPACs, meme stocks and the excitement over companies with no earnings, appropriately sporting names like Snowflake.

The present market reminds me of the high flying mid-1960s when I started in the investment business at Merrill Lynch. More about this later.

For now, the S&P 500 and NASDAQ have been making new highs almost every day, even while stocks are selling at record high valuations. A speculative market like this one has historically favored growth stocks, as value does much better in a more challenging investment environment. And yet, as we have been pointing out since the announcement of the vaccine on November 6, 2020, value has dramatically outperformed, as you can see in the update below.

Value/Growth Performance

Since the Vaccine News on 11/6/2020
11/6/2020 – 6/30/2021

Value:	Schafer Cullen High Dividend	**+31.82%**	
Growth:	S&P 500	+23.68%	+814 bps
	Russell Growth:	+19.07%	+1275 bps

Year to Date
12/31/2020 – 6/30/2021

Value:	Schafer Cullen High Dividend	**+18.01%**	
Growth:	S&P 500	+15.25%	+275 bps
	Russell Growth:	+12.99%	+501 bps

Past performance does not guarantee future results. You cannot invest directly in an index.

Performance: What Happens When the Tide Goes Out?

The big reason why overall performance over time for many investors has not been good is because a reliance on the classic one-, three-, five-year measurements of performance doesn't take risk into account. History shows that in strong up-markets funds taking the most risk have had the best five-year performance and so bring in the most new assets. However, when the market changes direction, more often than not the top fund performers typically wind up being the worst performers. So in measuring performance, if risk is not factored in, it's like driving a car using the rearview mirror.

A simpler way to look at performance may be just observing what happens when the tide goes out -- seeing what happens when market sentiment changes and becomes more risk averse. The popular Vanguard High Dividend strategy can serve as a classic example, which was very successful in the bull market in both performance and raising assets. But that has changed since November 6, 2020, when the vaccine was announced. Since then, our High Dividend strategy has dramatically outperformed the Vanguard High Dividend strategy since the vaccine and year to date.

New Investors

Robinhood, SPACs, meme stocks, short term trading – there is a lot for new investors to get excited about. The excitement is a big surprise because a couple of years ago, the Millennial generation had zero interest in stocks.

For these new investors, optimism is extremely high. Jason Zweig, senior finance columnist for the *Wall Street Journal*, recently pointed out the dangers of excessive investor optimism. He cited a survey by Natixis Investment Management of 750 investors that showed they expected an annual 17.5% growth in their assets. This is actually double the return of stocks dating back to 1926. Excessive optimism has been a warning signal in past extended markets.

The Mid-1960's

We said earlier that the present market is similar to one of the mid-to-late 1960s. The market up to that point was very orderly. But by the middle of the 1960s, it was starting to heat up and public enthusiasm for stocks was reaching a feverish pitch. New investors then, as now, were completely oblivious to risk, with new issues and small cap stocks all the speculative rage.

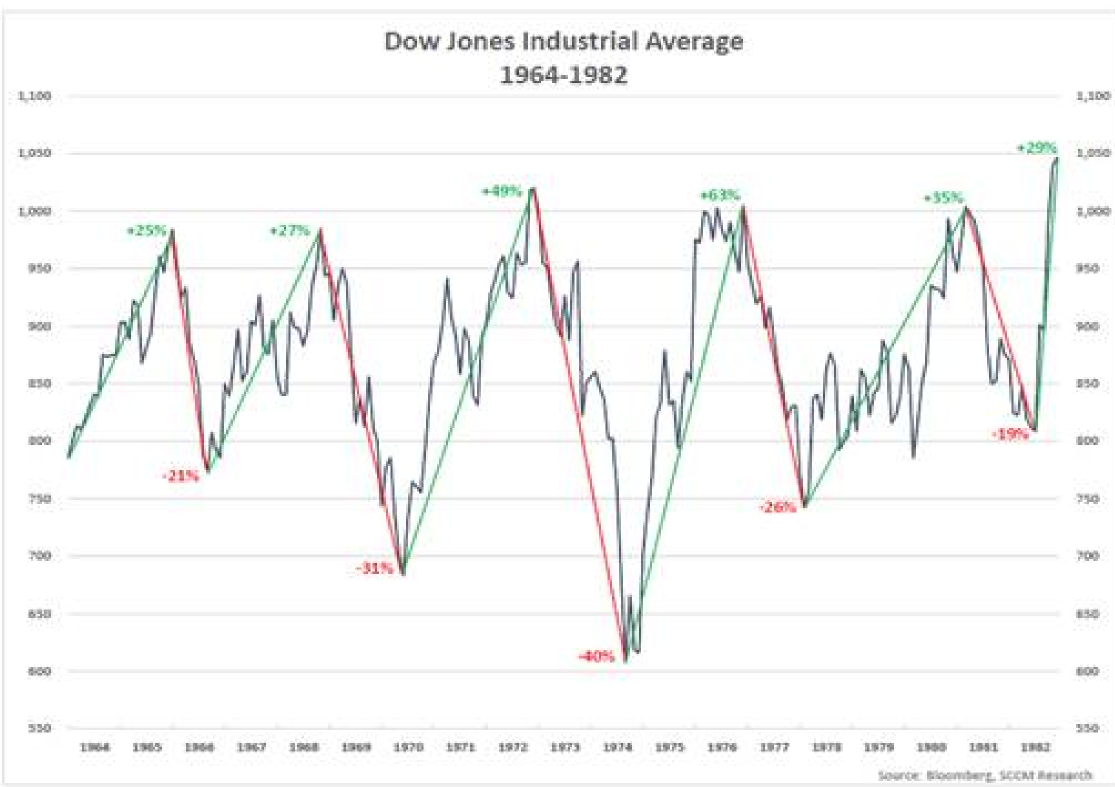
As a result, brokerage firms like Merrill Lynch and E.F. Hutton were opening up retail brokerage offices on Main Street all over the country. It was during this wild time that I began my career at Merrill Lynch at their new office on Wall Street. The place was so mobbed with investors every day that we had to set up a plexi-glass wall to separate the boisterous crowd from the brokers. Our office began to look like a British betting parlor.

If things weren't exciting enough, the most popular trading stocks at the time were highly leveraged, vulture-like companies that specialized in hostile take-overs. Called conglomerates, they were the darlings of the market traders and every day were the most actively traded stocks on the exchange. By 1970, money got tighter, the economy slowed, leverage became a negative, and the party ended. The conglomerates and the trading public got wiped-out and the Main Street brokerage offices were shut down.

1960s Aftermath

The message to investors from the chart below would seem clear: it was a challenging time to be in the market. For thirteen years, the Dow struggled to get through 1,000.

Actually, while the Dow Jones was flat over that fifteen-year period, the value stocks (bottom 20% on a P/E basis) went up a hard to believe 1000% over the same time period. The message here is that a tough market is not necessarily bad for stocks, but tends to be very bad for overpriced stocks.



Summary

Right now, our High Dividend Value portfolio is selling at one of the cheapest levels relative to the S&P 500 in years: 17.5x versus 22.5x. Also, we believe the stage is also set for dividend increases, which tends to be very positive for value stocks. In our view, a tricky market environment makes this an ideal time for long term investors to have exposure to a low risk dividend strategy.

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