ZANETTI FINANCIAL, LLC

Zanetti Monday Missive 2022.01.10
Is the Stock Market Overpriced?

“You can observe a lot by just watching.”
~ Yogi Berra

“No one goes there nowadays. It’s too crowded.”

~ Yogi Berra

We’ve had some interesting news stories and opinions from market leaders lately. Some of that news and those opinions have affected the markets. Some of them have not but have left us thinking.

First, let’s look at what has come to be called the “Buffett Indicator.” The Buffett Indicator is named after famed investor Warren Buffett. Over his lifetime of studying markets, he has come up with a simple calculation to value the stock market (measured by the Wilshire 5000 Total Market Index).

The premise is that the US Stock Market should equal the US economy (GDP). If the ratio is less than 100%, the stock market is undervalued and is a good buy. If it is above 100%, it is overvalued and not a good buy.

At the peak of the Dot.com bubble, the ratio was 150%. That was a good time to sell stocks. In 2001, after the bubble popped, Fortune magazine called the Buffett Indicator "probably the best single measure of where valuations stand at any given moment."

In 2007, right before the “Great Recession”, the *Indicator* was at 160%. Again, a foretelling ratio. Guess where it is today... Any guesses?

211%

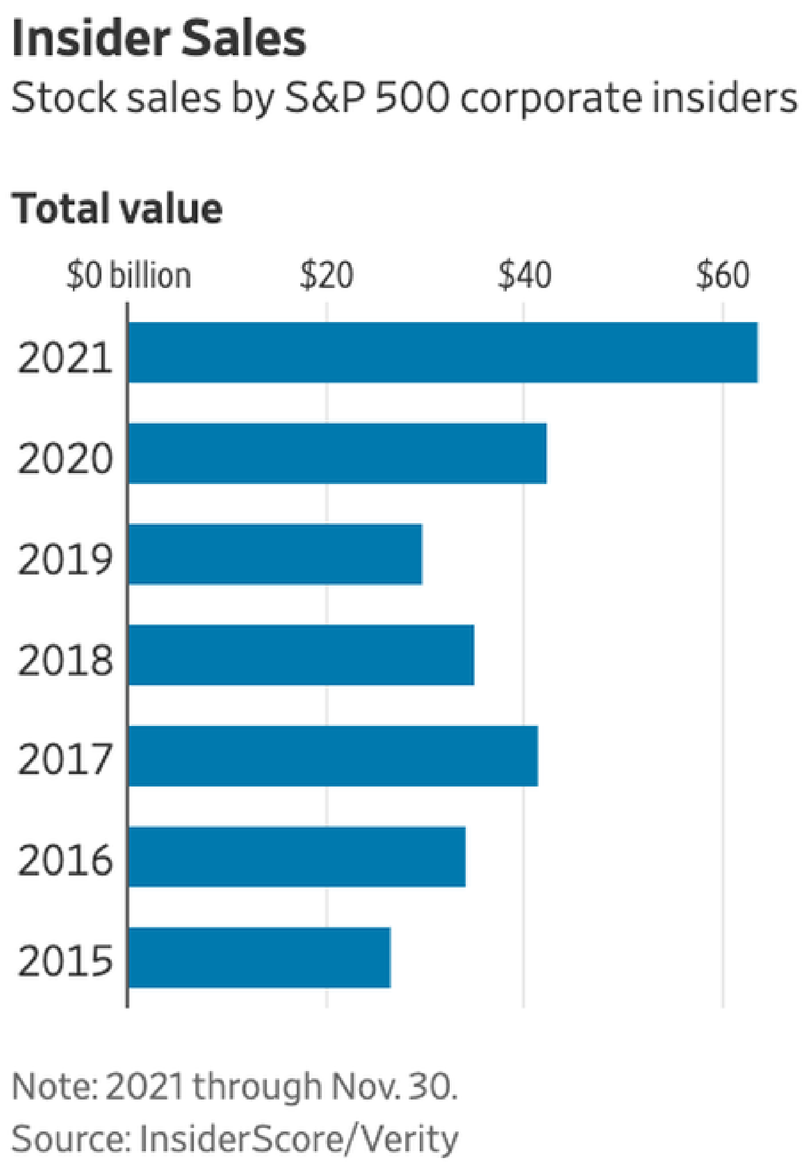
That’s right! The stock market is over twice the size of the US Economy.

Sometimes equations bore folks though, so let’s see if we can look past boring old calculations. When I can, I look at behavior and put greater emphasis on actions. Well, guess what? The actions on Wall Street have been noteworthy!

On Wall Street, company founders and leaders are unloading their stock at historic levels! In the past year, 48 top executives have sold at nearly four times the average for insiders from 2016-2020 – this according to the Wall Street Journal.

The wave has included cosmetics billionaire Ronald Lauder, Microsoft CEO Satya Nadella, Google co-founders Larry Page and Sergei Brin (who haven't sold a single share in over 4 years). And they're not alone! The Walmart Walton's, Mark Zuckerberg (Facebook/Meta), and Elon Musk have joined the selling party.

Daniel Taylor, an accounting Professor at the Wharton School of business says, "What you're seeing is unprecedented." He said the insider selling resembles a selling wave seen during the Dot.com bubble.



Are these insiders taking a cue from the Buffett Indicator? I think that's exactly what's happening.

The problem with insider selling is that these insiders are required to report when they buy or sell their own stock, but not anything else. So, we don’t know what they’re doing with their newfound profits. But we can make some educated guesses.

Are they taking their billions as cash and literally hiding it under their mattresses? I don’t think they make mattresses that big! So, no. Not there.

Are they taking their billions to their local credit union and putting it in savings? My guess again is no.

Are they paying off the mortgages to their mansions around the globe? Well, maybe, but with loan rates at record lows and the likelihood of rates climbing in the near future, they might feel the inflated economy will erode their debt more elegantly than paying it down themselves.

Well, let’s ask the money manager for many of these Fortune 500 CEOs. Ray Dalio is the President of the world’s largest hedge fund: Bridgewater Associates. Ray recently gave an interview that I found interesting.

In the interview, Ray is agreeing with what the Buffett Indicator is, um, *indicating*. I agreed with him when he said, "The most common mistake for investors is to think the markets that went up are good investments, rather than more expensive. Don't make that mistake." We won’t, Mr. Dalio!

A few of the salient points in his interview are that he discourages investors from holding cash and bonds to weather out this coming storm as inflation will erode them. He also warns against trying to time the market (which may explain why the insiders are selling now, versus waiting to see if they can grow their stock a tad higher).

The last point he made, which I strongly agree with is that "Over time, inflation-hedge assets are likely to do better." And what is an inflation-hedge asset? Think precious metals, building materials, energy, food staples, etc.

And with that, as you can see, Greg and I are constantly digesting every bit of financial news out there so that you don't have to. And that's how we make our investment decisions.

Your Yogi-Berra-Always-Cut-His-Pizza-Into-Four-Slices-Because-He-Couldn't-Eat-Eight-But-Eight-Sounds-Good-To-Me Financial Advisor, Walt

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