GREENROCK RESEARCH

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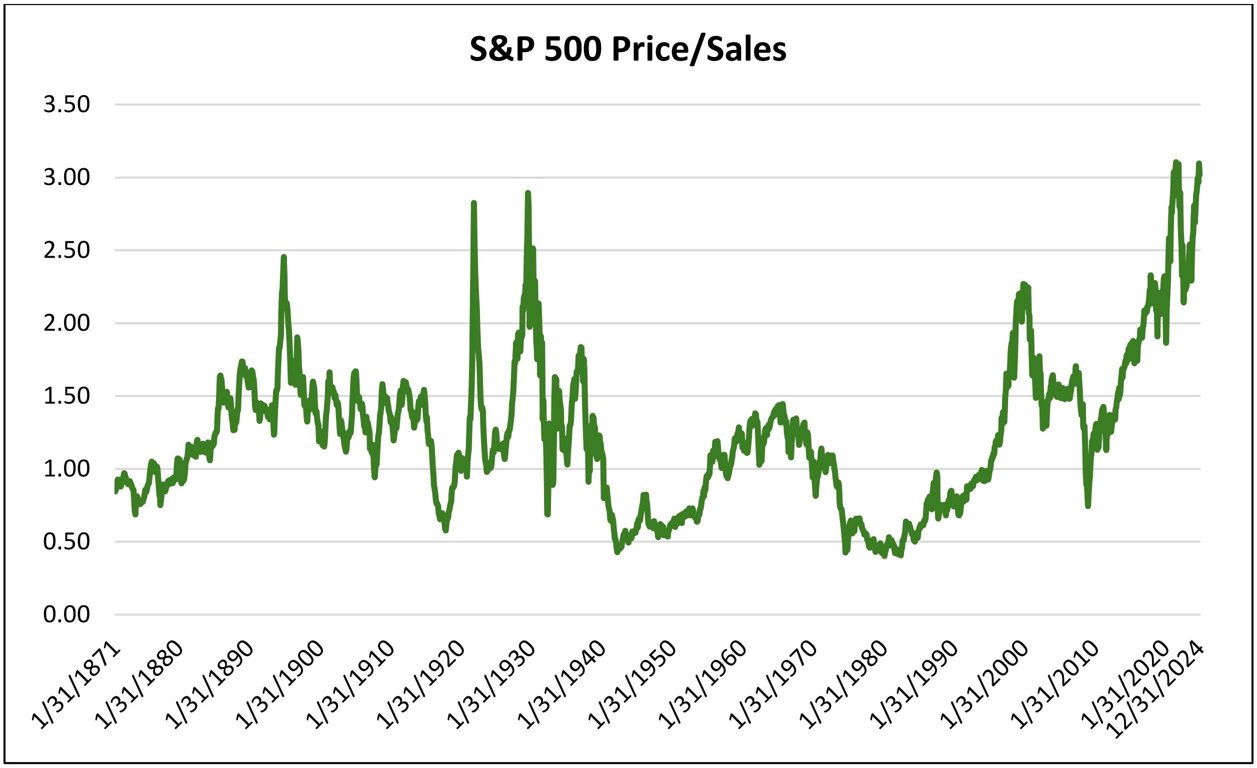
INVESTOR INSIGHTS – FIRST QUARTER 2025

A Tale of Two Forces

There are two things the stock market tends to dislike: policies with uncertain outcomes and overvaluation. Today, we have both. The current policies of the administration could make it difficult for GDP to rise in the near term. President Trump has confirmed this when he said that we may need to go through a recession in order to get to where we need to be. While it is true that these policies may work out fine in the long run, the thought of a recession is not one to which markets have historically responded well. This is especially true historically when the valuation of the stock market is high. So, let us look at these two factors and see where we are today.

Chart 1 shows the valuation of the domestic stock market over the last 154 years, ending at the close of last year.

CHART 1



The chart shows the price-to-sales ratio of the domestic stock market. Now, many analysts would use price-to-earnings, but we prefer price to sales for two reasons. The data on price-to-sales goes back much further than price-to-earnings and sales can be manipulated but not as easily as earnings.

As you can see from this chart, the P/S of large cap domestic equities is 3.02. That is the highest it has ever been. It is higher than it was in 1999 when it reached 2.27 times sales and in 1929, when it reached 2.89 times sales.

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Now, there can certainly be debate about policies that might cause a recession but may be beneficial in the long run. The difficulty is that when you couple a potential recession with extremely high valuations, the stock market will find it very difficult to go up. In fact, it will assuredly go down.

Ronald Reagan was elected President in 1980 and served in that capacity for two terms, from 1981 through 1988. Chart 1 shows the P/S of the market at the start of Reagan's first term was 0.45. President Reagan ran on a policy of improving GDP. While he accomplished that, we think the bigger factor of his success in improving the stock market return was the very cheap valuation he inherited. During his presidency, the S&P 500 was up 15.6% per year.

Today, our current administration is not dealing with an undervalued stock market but rather a dramatically overvalued stock market. While the wind was at President Reagan's back, the wind is in the face of President Trump.

What are Expected Future Returns of the Stock Market?

The best source of this data comes to us from Research Affiliates, a west coast investment firm and think tank. They publish projected returns on 20 asset classes 10 years out every day. As of April 1, their projected return for large cap domestic equities is 3% with a standard deviation of 15.

Now, it is worth pointing out how we analyze this projection. We do not assume it is a precise projection of the actual return we will experience over the next decade. Rather, we see it as a projection of low future returns. If you study the returns stocks have experienced over calendar decades, what you find is that there are dramatic differences. The return of the S&P 500 Index in the decade of the 2000s was negative 0.90% per year. $100 invested in the index at the beginning of the decade was worth $90 at the end of the decade. Conversely, the return of the S&P 500 Index in the following decade, the 2010s was 13.5%. $100 invested at the beginning of that decade was worth $355 at the end of the decade. Today, we are saddled with very high stock prices, so everyone's expectations should be that future returns will not be great. Will they be negative like they were in the 2000s? Well, that level of precision is impossible to tell, but one should not expect prospective returns from the S&P 500 that will solve the investment return needs of clients.

What investment strategies do well in high priced stock markets?

The answer will be no surprise to our clients and regular readers of our analysis and newsletters, dividend strategies do well. Now, it is worth pointing out that not all dividend strategies do well, but our high and growing dividend strategies will do well. The chart below shows the returns of our dividend strategies over the past 25.25 years and the 42 years of data developed by Jeremy Siegel prior to that period. The reason we start in 1958 is that this is when the S&P 500 Index started. The chart shows the returns for each calendar decade as well as the 1958-1959 period.

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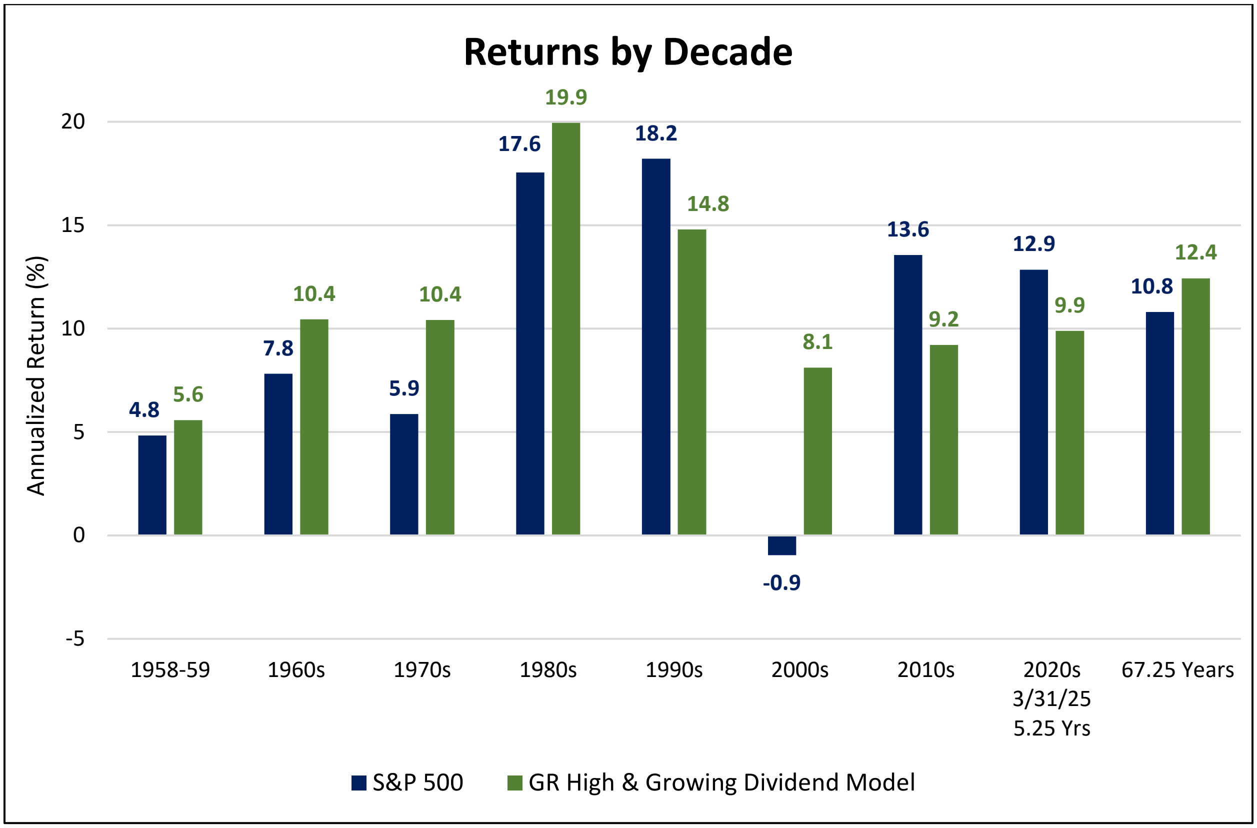
CHART 2



Source:

So, we will make the following observations about this data.

1. Growing Dividend Strategies outperform indices over long periods.
2. Growing Dividend Strategies provide reasonable returns even when indices do not.
3. There are 6 full decades of data, and dividend strategies outperform in four of them.
4. When stock prices are high like they are today, Growing Dividend Strategies significantly outperform.

Now, the fact that stock prices are high does not mean they cannot go higher, remember we urged caution one year ago. But prices at these levels require economic perfection to go higher, and one would be hard pressed to find any economist or analyst who would characterize today's economic conditions as perfect. It is likely we will see negative GDP in Q1 and or Q2, and no one would characterize that as perfection. Everyone would call that at best a period of retrenchment.

So, our advice is to fasten your seat belt and expect real volatility. A 20% decline from here would not surprise us, nor would a dramatic recovery from any decline. Remember that after 1929 during the recovery from the Great Depression we had three recoveries of over 50%. Also, remember that the best strategy in a highly priced stock market is a Growing Dividend Strategy.

What about Bonds?

The bond market's future is not as clear. The yield on the 10-Year U.S. Treasury on April 1 was 4.23%. Now, it is easy to make the argument that 4.23% is a good yield and one should grab it. It is also easy to make the case that rates are likely to rise and bond investors will experience losses. Our perspective comes from the absolute yield. If rates stay exactly where they are , investors will achieve a 4.23% return over the next 10 years. Our question is: will this return solve the investment return needs of your clients? We think the answer is that it will not solve the investment return needs of many of your clients. Now, if we thought the next 10-year period was going to show us returns in all other asset classes lower than 4.23%, we might settle for that return. The reality is we do not see that low return situation. We think we will get higher returns from the 3EDGE portfolios, and we will do so with similar volatility of the 10-Year. In addition, we think we will get much higher returns from our dividend strategy, although that will come with higher volatility.

Bitcoin

The history of Bitcoin is that it has risen in a 4-year cycle. We are in the year of that cycle where we would expect a rise. So, holding on today looks like a great idea to us.

Our focus is on the next cycle, 4 years from now. While it may seem a little dramatic to see the projections, the analysts we trust are projecting a Bitcoin price of over $1 million four years from now in their bullish case. It is certainly true that Bitcoin acceptance has dramatically expanded, and the projections that get the price to $1 million per coin assume that trend continues, perhaps even accelerates. Now, we do not make projections on the exact price in some future date, but we do think the $1 million price does not seem crazy to us, and even if it is half of that price, the annualized return is dramatic. The biggest factor during this rise in our analysis is the suggestion that Bitcoin will gain acceptance as liquid gold. As we move on that path, significantly higher Bitcoin prices seem very likely.

Illiquid Investments

We have written about the remarkably attractive illiquid investments we have available today. We have three portfolios with 6% yields and one with over 7% yield. All of them are simple, mundane businesses with understandable business plans and predictable returns. They also have very low minimums. Everyone should chat with us about these investments.

This Year

We expect dramatic volatility this year in domestic equity prices and in our political front. While reasonable expectations will be important as we go through the year, keep in mind that dislocation creates unique investment opportunities. As we sit here today, we have no insight into what they may be, but we will be on top of whatever comes to us.

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