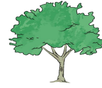

TIM
UNDERWOOD

Monthly Newsletter – January/February 2024

My son has recently written a paper for his university degree about the fall in share prices on Wall Street in autumn 1929 and it raised a few interesting points. Many of us have heard about it but I did not realise the US market did not bottom out until July 1931 concluding a 89% loss on the Dow Jones index over three years. Then the index did not recover to its 3 Sept 1929 peak until 23 Nov 1954, some 25 years later. There are no investors alive today to remember those years but a similar event happened in Japan and this I can remember. The Japanese stock market reached a peak in 1989 and it has taken until February 2024 to again reach the same level, some 35 years later.

Of course during these weak period some companies did thrive and investors who have been receiving good dividends, year in year out, will have also done well, but there is a tendency to jump into rising markets near peaks, driven by what is called FOMO or "Fear Of Missing Out". It is happening now with AI companies which have seen explosive rises in their share prices based on expectations about future sales. Problems will arise if those future expectation prove to have been far too optimistic. It was not always like this.

Prior to the late 1920s investors did not buy shares in companies, they were considered too risky. What were considered sensible investments were bonds, that is a loan to a company or government. There is only the loan term and interest rate to decide, both set at the begining, so it is very simple and the investor has first call on the assets of the company in bad times. Shares were only to decide who were the owners of a company and who controls the management. But in the late 1920s the FOMO tendency took hold and shares became very over priced, When they crashed it took decades for them to again become popular.

Eventually they did however and the concept of value investing became the main theme. People like Benjamin Graham and then Warren Buffet made this their investment style and the latter is still today is a powerful voice in the investment world. Pension funds which grew and grew in the 1960s and 70s invested in good value company shares for their dividends, which should increase with growth in the economy. Today however UK pension funds hold a much smaller allocation to shares while bonds have again become the core holding.

Value investing was then over taken by momentum investing. If a share is going up in price it has a "momentum" and therefore investors should buy more. That is the concept behind index tracking funds. No matter the valuation, if it is going up, buy more! That is especially the case at the moment in the USA with a handful of companies, especially the leading AI company Nvidia. It is now on a PE ratio of 65. That means if you invested $65,000 you benefit from $1,000 per year. Not a dividend of $1,000 because they do not pay cash dividends. The benefit is retained in the company to improve future growth is the idea. There was no AI in 1929, so maybe it will be different now.

Best wishes

Tim 3 March 2024

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