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Price vs. Value: Cash is King?

What is the difference between price and value? In simple terms, price is what we pay for something. Value, on the other hand, is harder to measure. It's based more on how useful something is to someone and how much it means to them. A business valuation can be evaluated by a variety of factors, including total assets, total liabilities, multiples of current earnings and projected cashflows, market M&A comparable transaction multiples, the perceived quality of the business model and potential for the market and company to grow. While there's no right way to determine valuation, it's a good idea to have it looked at from different perspectives and time periods.

Super Bowl Ads. For the second year in a row, the average *price* of a 30-second advertisement during this weekend's Super Bowl reached $7 million, according to Parade. The most expensive Super Bowl ads aired in 2020. They lasted for 90 seconds and cost the two companies that aired them $16.8 million for each of the time slots. The first time the cost of a Super Bowl ad topped $1 million was 1995. In 2023, a record 115.1 million viewers tuned in to watch Super Bowl LVII, making it the most watched telecast in U.S. history.

MJ Sneakers. Recently, Sotheby's dubbed six Air Jordan shoes the "Dynasty Collection." A collection of sneakers that Michael Jordan wore as he and the Chicago Bulls won six NBA championships. This set a new record *value* for game-worn sneakers.

Markets. Last week, stocks were up and bonds were down. The S&P 500 outperformed the MSCI EAFE (non-US developed) and MSCI Emerging Markets indices. The forward P/E *valuation* multiple on the S&P 500 was up on the week at 20.4x. The next 12-month earnings per share estimates were up to $246.83, the low was May 2020 at $141.99, and the high prior to the pandemic was $178.61 in February 2020.

The S&P 500 Information Technology and Communication Services sectors now account for 38.3% of the S&P 500's market capitalization. Collectively, the two sectors now account for 31.6% of S&P 500 earnings. This isn't a tech-led speculative bubble like the one of the late 1990s, so far, though it has the potential to be so. Back then, the two sectors accounted for about the same market-cap share (38%-40%), but the earnings share was only around 24%

High yield bond spreads rose in the week to 316 bps, still below their 20-year average of roughly 500 bps. As for fixed income, the 10 yr. Treasury yield rose 14 bps on the week to 4.17% and the 2year – 10year treasury yield spread flattened to -31 bps.

What we are seeing: Global PMIs improve, inflation readings muted, and earnings are coming in slightly encouraging.

The global purchasing managers' index (PMI, a metric that assesses economic health by measuring the manufacturing sectors output and employment intentions) data is accelerating, reflecting improving global growth. A reading at roughly 50 suggests stagnant growth, above 50 improving growth, and below 50 is a contraction. Manufacturing trends are improving, but now are reaching flattish growth and services are in expansion. The bond market is placing an 84% chance of a hold at the March Fed meeting and then a 52% chance of a cut in May, on the year the bond market is now pricing in 4-5 rate cuts instead of 5-6 before. If we get a relatively firm inflation print this week, combined with the strong U.S. economic growth, it likely means the Fed is in no rush to cut rates for the time being.

Eurozone Producer Price Index (PPI measures price changes from the seller's perspective) is negative month-over-month, China CPI and PPI are negative year-over-year, and the Atlanta Fed wage tracker continues to decelerate.

Q4 earnings growth rate for the S&P 500 for Q4 is now tracking +2.9%, making the 2023 overall earnings growth +0.9%. However, the 2024 earnings growth estimates have been trimmed from as high as +12.0% to now +10.6%. The earnings story is about margin compression, where costs have risen, but revenue growth has slowed. What we are hearing from companies right now is cost-cutting initiatives to fight back on margin compression.

Cash

The amount you allocate to stocks, bonds, and cash can be a major factor in your portfolio's long-term performance, so choose wisely. Feeling safe by holding excess cash may be *valuable* to someone but may come with an opportunity cost. The S&P 500 is up 40.5% since the start of the current bull market on October 12, 2022. Along the way, there was a 10.3% correction from July 31 to October 27, 2023. Since then, it has been a 22.1% appreciation through Friday's close. If you allocate too much to cash, you may not generate high enough returns to fund your retirement or other investment goals. But if you allocate too little to cash, you may have to sell some stocks or bonds at an unfavorable time to pay for an emergency. If you believe yields on cash, CDs, and money markets could fall in the not-too-distant future, consider buying intermediate-term bonds or private credit.

Here are three reasons why investors should be cautious about holding too much cash beyond their financial plan requirements:

1. Cash has usually delivered negative returns after inflation and taxes
2. Cash hasn't historically helped investors grow their wealth
3. Today's attractive interest rates may not be available tomorrow