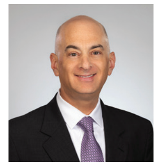
Fair Prices & Long Horizons



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What matters most in determining the price of an investment? It's an important question, and one that arguably has more incorrect answers than correct ones. My fellow co-managers of the **Davenport Value & Income Portfolio (VIP)** and I strive to separate the long-term "signals" from the short-term "noise".

We'd all be quite wealthy if we had a nickel every time we've heard that "all eyes" are focused on ... fill in the blank. Whether it's this week's jobs report, the upcoming Federal Reserve rate-setting meeting, the Presidential debate and election, and the list goes on. These topics are interesting, but not necessarily highly correlated to stock prices.

This week, we were similarly humored to read a Wall Street strategist offering contrasting predictions for the market's direction over the next two and four months. Perhaps such (futile) attempts at predicting hyper short-term outcomes is relevant for those with a time horizon equal to that of a mouse's life expectancy (roughly four months), but we do not believe this is the source of advantage that leads to generational wealth, via compounding of returns. Rising dividends is one such advantage, one that's particularly relevant for our Value & Income Portfolio, which we highlighted earlier this year in "Patience is a Virtue." So, too, are investing with a long-term perspective and paying a fair price for assets.

While we have no idea whether the stock market will be higher or lower two or four months from now, we have a reasonably decent sense that the stock market will be higher if we extend our time horizon sufficiently.

The accompanying graphic shows that over one year, the S&P 500® Index's annual return (since 1993) has ranged from a low of -37% (in 2008) to a high of +38% (in 1995) – a range wide enough to drive a truck through. Returns were positive in 25 of the last 31 one-year periods. Thus, it should come as little surprise that we have no idea what the market's return will be for a particular calendar year (let alone shorter time horizons). But if we let our eyes wander a bit further down the graphic, average annual returns over 6-year horizons have been a bit narrower, ranging from -1% to +24%. Returns were positive in all of the 11-year and longer periods. And if we scroll down to a 20-year horizon, average annual returns have ranged from +6% to +10%. That's a range narrow enough to drive a small convertible through, and one that might reasonably frame estimated future market returns.

31 Years of Stock Market Returns

# Years Forward	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
1	10%	1%	38%	23%	33%	29%	21%	-9%	-12%	-22%	29%	11%	5%	16%	6%	-37%	26%	15%	2%	16%	32%	14%	1%	12%	22%	-4%	31%	18%	29%	-18%	26%
2	6%	18%	30%	28%	31%	25%	5%	-11%	-17%	0%	19%	8%	10%	11%	-18%	-11%	21%	8%	9%	24%	23%	7%	7%	17%	8%	12%	25%	23%	3%	2%	
3	15%	20%	31%	28%	28%	12%	-1%	-15%	-4%	4%	14%	10%	9%	-8%	-6%	-3%	14%	11%	16%	20%	15%	9%	11%	9%	15%	14%	26%	8%	10%		
4	17%	23%	30%	26%	17%	6%	-7%	-5%	-1%	4%	15%	9%	-5%	-1%	-1%	-2%	15%	16%	16%	15%	14%	12%	7%	14%	16%	18%	13%	12%			
5	20%	24%	29%	18%	11%	-1%	-1%	-2%	1%	6%	13%	-2%	0%	2%	0%	2%	18%	15%	13%	15%	16%	8%	12%	15%	18%	9%	16%				
6	22%	24%	21%	13%	4%	4%	1%	-1%	3%	6%	2%	2%	3%	2%	2%	6%	17%	13%	12%	16%	12%	12%	13%	17%	11%	12%					
7	22%	18%	16%	7%	8%	5%	2%	1%	3%	-2%	6%	4%	3%	4%	6%	7%	15%	13%	14%	13%	15%	13%	15%	11%	13%						
8	17%	14%	10%	9%	8%	5%	3%	2%	-3%	2%	7%	4%	4%	7%	7%	7%	14%	14%	11%	15%	15%	15%	10%	13%							
9	14%	9%	12%	10%	8%	6%	4%	-4%	0%	3%	6%	5%	7%	8%	6%	7%	15%	12%	13%	15%	17%	11%	12%								
10	9%	11%	12%	9%	8%	6%	-1%	-1%	1%	3%	7%	7%	8%	7%	7%	8%	13%	14%	14%	17%	13%	12%									
11	11%	11%	11%	10%	8%	1%	1%	0%	1%	4%	9%	8%	7%	8%	8%	7%	15%	14%	15%	13%	14%										
12	11%	11%	12%	9%	3%	3%	2%	1%	3%	6%	10%	7%	7%	9%	7%	9%	15%	15%	12%	14%											
13	10%	11%	11%	5%	5%	4%	2%	2%	5%	7%	9%	8%	9%	8%	9%	10%	16%	12%	13%												
14	11%	11%	7%	6%	6%	4%	3%	4%	5%	6%	9%	9%	8%	9%	9%	11%	13%	13%													
15	10%	6%	8%	7%	5%	4%	5%	4%	5%	7%	10%	8%	9%	10%	11%	9%	14%														
16	7%	8%	8%	6%	6%	6%	5%	4%	5%	8%	9%	9%	10%	11%	9%	10%															
17	8%	8%	8%	7%	7%	6%	5%	5%	6%	7%	10%	10%	11%	9%	10%																
18	8%	8%	9%	8%	8%	6%	5%	5%	6%	8%	11%	11%	9%	10%																	
19	8%	8%	10%	9%	7%	6%	6%	5%	7%	9%	11%	9%	10%																		
20	8%	9%	10%	8%	8%	7%	6%	6%	7%	10%	10%	10%																			
21	9%	9%	9%	8%	8%	7%	7%	7%	8%	8%	11%																				
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29	11%	10%	10%																												
30	10%	10%																													
31	10%																														

Calendar-Year Annualized Forward Returns

Source: "31 Years of Stock Market Returns" Sept. 1, 2024 by Ben Carlson. A Wealth of Common Sense.
https://awealthofcommonsense.com/2024/09/31-years-of-stock-market-returns/

What else is reasonably knowable? Data going back multiple decades shows almost a direct, inverse relationship between the price paid for a stock (in the form of its valuation) and the subsequent performance of those stocks. Since 1980, the least expensive 10% of U.S. stocks outperformed the most expensive 10% of stocks by more than 1,000 basis points (10 percentage points) annualized*. Over long arcs of time, paying a bargain price has been a not-so "secret sauce" for achieving formidable returns.

As it pertains to the Davenport Value & Income Portfolio, we seek to take a long-term time horizon. This can be seen in VIP's average holding period of approximately five years. It's also evident in the dividend track record of many of the portfolio's holdings: 21 of VIP's constituents have raised their dividends annually for at least a decade. In addition to maintaining a longer-term perspective, we also intend to continue paying a fair price for good businesses. Over time, those actions should translate into a portfolio that can deliver a satisfactory return through market cycles.

Sincerely,

Adam Bergman, CFA®
Co-manager, Value & Income Portfolio

For the investor, a too-high purchase price for the stock of an excellent company can undo the effects of a subsequent decade of favorable business developments.

- Warren Buffett

***Source:** Ned Davis Research, as shown in this chart https://www.tswinvest.com/news/flavors-of-value-within-domestic-equity

Warren Buffett quote source: "To the Stockholders of Berkshire Hathaway Inc.:" March 3, 1983. https://www.berkshirehathaway.com/letters/1982.html