Palacios' Perspectives

October 1st, 2021

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From Wall Street to Main Street

Highlights from the past week

Market / Macro Economic Summary

This has been a rollercoaster of a week as there were several events that provided rationale for the "bears" to come out of the woodworks. Now, before I get started on those events and an explanation…. I'd like to provide my long-term opinion on these events. To start, markets tend to trade sideways each quarter-end as there is very limited news in the way of earnings. Also, with the markets having trended higher so far this year, we haven't really seen any type of 5%-10% correction, as they occur once or twice each year. I maintain that our markets have plenty of liquidity (cash in the sidelines) as well as the fundamentals remain intact to provide us more growth well into 2022. The Fed will keep the bond buying program in place even though they said they will begin to decrease their monthly purchases as early as November. The Federal Funds rate will remain at these low levels well into 2022 and there are divided opinions on whether we get the first-rate hike in late 2022 or early 2023. Either way, the Fed has said the rate hiking process will be very slow and methodical, so don't look for rates to immediately shoot higher. This backdrop is the reason for my optimism that the stock markets have room to go higher from here. Does this mean we may not have a short-term correction to the tune of 5%?? Absolutely not, I would even go as far as to say that it will be very good for the markets to have a correction…. because it's a sign of a normal, healthy market. As we've seen in the last 8-9 years, corrections have proven to be opportunities to buy more or invest cash as the trend of higher stocks remain intact. I believe this time will prove to be no different.

Now, to the topics this week that provided the bears some ammunition and triggered a short-term decline. China is still lingering from last week with their attempt to corral capitalism and reinforce their communist beliefs. This week they outright banned the ownership of crypto currencies. Another event was Federal Chairman Powell's renomination, which has been placed in uncertainty as several democrats, such as Senator Warren tried to put him on notice that they do not support him. Lastly, the bears pointed to the 10-year bond rates going higher to say that growth has seen its better days. Let me explain this a bit, since I think it's worth the lesson. When we value a company (its stock price), we take all of the future expected cash flows and use a default "discount" rate and bring those cash flows to get a "net present value" or current stock price. If rates go higher, the discount rate is higher and therefore the net present value should be lower. So, for companies with high growth, their cash flows are impacted more so than others thereby telling investors that their stock prices are overpriced at the moment if rates indeed go up. Here is the catch, if we have ultra-growth stocks…. stocks with no positive cash flow or positive earnings then those do indeed stand to get hit. But if we own Amazon, Facebook, Google…. those companies are still growth stocks but should do well even if rates slowly trickle higher. They are proven winner with cash flows that will not "go away" if rates rise.

I hope the commentary above does a lot of good in terms of calming any short-term fears. While the markets should ebb and flow as part of normal operations, we should keep our eyes on the longer term. There is nothing on the horizon that says the markets deserve to be 30% lower as I've heard some people say. These "talking heads" have been saying we would have a correction for the last 8-9 years. One day they might be right, but I don't believe there is anything at the moment that would even come close to justifying anything like that to happen!

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Company Specific / Micro Economic Summary

Micron (MU)
Shares slid as the company reported earnings that more than doubled from Q4 last year and revenues that increased by 30%! Why did that happen?? I will reference the previous discussions on cash flows and discount rates because they forecasted earnings in the coming quarter that fell short of expectations. So, since they said they wouldn't earn what Wall Street expected…as analysts review their discount models, they lower their price targets. I would argue that the lower forecast is due to supply constraints and not a shift in lower demand for their products. So, at some point they will add capacity and be able to provide more supply so business should improve. Time will tell.

Thor Industries (THOR)
Shares rose 9% as the company reported sales of $3.59 billion, which represents a 54% from the same time a year ago. Earnings per share of $4.12 were also way above the $2.14 the company reported a year ago. Management credited its employees for being able to meet higher demand for its RV's and navigating supply chain issues.

CarMax (KMX)
Shares dropped 13% as the company reported a mixed quarter. Earnings per share of $1.72 were short of the calls for $1.88. Revenues of $7.99 billion were ahead of the estimates of $6.909 billion. I believe the reason for the decline is Wall Street's realization that the growth the company has witnessed during the pandemic is not sustainable for much longer. Used vehicle prices are expected to decline from their elevated levels in the coming quarters.

Bed Bath and Beyond (BBY)
Shares got walloped (down over 20%) as the retailer reported issues with its supply chain and higher input costs eating into its margins. On top of that for the current quarter, CEO Mark Tritton also said these issues look to linger for the remainder of the year. The company reported earnings of 4 cents when Wall Street expected 52 cents! Revenues of $1.99 billion also fell short of the analysts' estimates of $2.06 billion.

Parting Thoughts

We welcome an opportunity to discuss the above detail and wish you much success in the rest of your week!

Regards,

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