MEDALLION WEALTH MANAGEMENT

February 2023 Market Commentary

Castles Made of Sand

And so castles made of sand
Fall into the sea
Eventually

Jimi Hendrix - https://www.youtube.com/watch?v=_JYkbmtvwjY

I've always been a huge Jimi Hendrix fan, mainly for the way he makes a guitar weep, but also for the way he paints a picture with his lyrics. *"Castles Made of Sand"* may not be his most popular song, but it has always been one of my favorites. The song is about the ephemeral nature of life, how people change, how dreams are dashed, but also how hope arises anew every day.

Yep, I'm a sandcastle guy. One of those guys who drags 5-gallon Home Depot buckets and landscaping shovels down to the beach to toil for four or five hours building a sandcastle. Then popping a beer and sitting back to watch the tide wash it away. Coming back to do it again the next day. I love the act of building, and I'm totally at peace with the fact that it's temporary. All of life is temporary, but that doesn't mean we shouldn't strive to build a new every day.

When I used to teach Security Analysis, we spent a lot of time talking about what characteristics made a "great" company. And even more importantly, understanding that a great company isn't always a great stock.

One of the key characteristics of most great companies is their ability to build a moat to defend their competitive advantages from attack. Warren Buffett was one of the first to popularize the concept of economic moats with his 2007 letter to Berkshire shareholders.

A truly great business must have an enduring "moat" that protects excellent returns on invested capital. The dynamics of capitalism guarantee that competitors will repeatedly assault any business "castle" that is earning high returns.
Therefore, a formidable barrier such as a company's being the low-cost producer (GEICO, Costco) or possessing a powerful world-wide brand (Coca-Cola, Gillette, American Express) is essential for sustained success. Business history is filled with "Roman Candles," companies whose moats proved illusory and were soon crossed.

Moats are great, but like medieval castles and my sandcastles, they oftentimes prove to be temporary. Medieval armies soon learned that the best way to attack a castle with a moat was to surround it, lob in stones and fire, and simply wait for those inside to starve and eventually surrender.

The truly great company is one that realizes that the best moats must constantly be reimagined through growth and innovation. Without growth and innovation your castle will slowly melt into the sea.

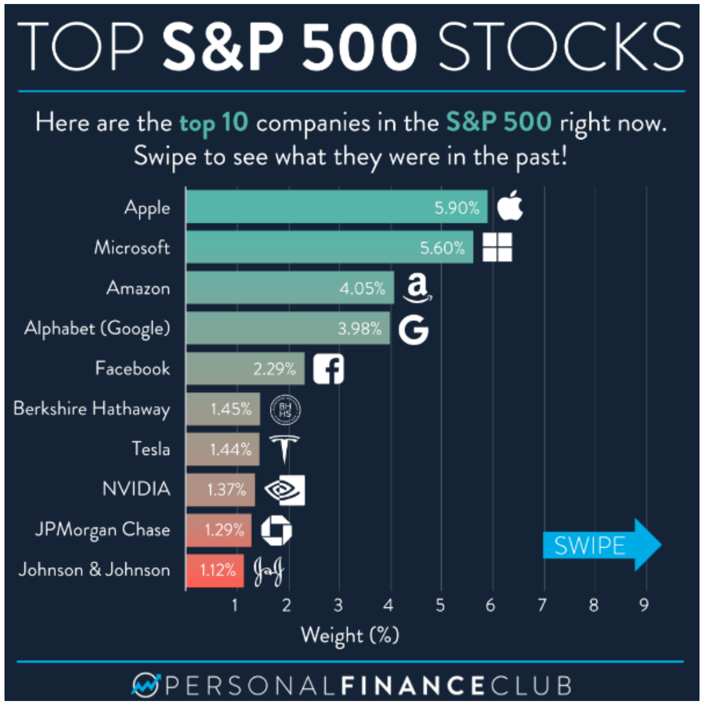
This is no different for individuals. Some of us are born with moats, we have loving parents who educate us and give us opportunities to succeed. But it's up to us to continue to grow less we stagnate and fall behind. Some are born without any moats, and must struggle to build their own. But again, whether you're born with a moat or build your own, it is up to you to continue to innovate and grow every day, lest you melt into the sea.

Creating a company with a lasting moat (competitive advantage) is much more difficult than you'd think. For example, let's take a look at the S&P 500. The S&P 500 was created in 1957 with the 500 largest companies trading in the United States. These 500 companies represent about 85% of the entire U.S. stock exchanges market capitalization. **Of those first 500 companies, only about 86 have survived to today, or just 17%.**

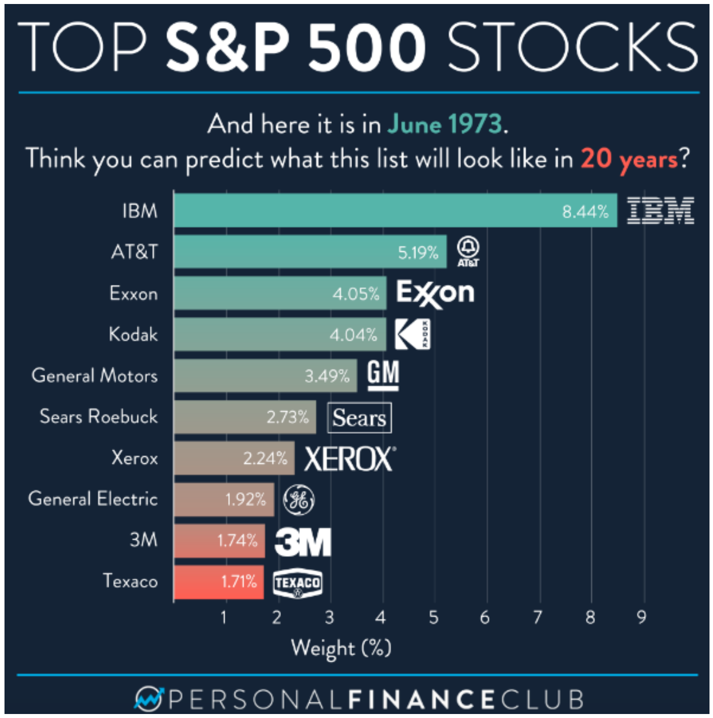
Think about that for a minute – These are not fly-by-night companies that hope that they make it to the next year. These are some of the world's largest companies, and yet less than 2 in 10 have managed to stay on the list for 6 decades. More than 900 companies have been added and deleted since the list was first compiled in 1957, or about 20 changes per year.

What's even more interesting, is that the tide that's surging in to wash away these castles is rising faster and faster (maybe it's climate change). The average lifespan of a company on the S&P 500 list is continuously dropping, and is now only 15 years compared to the 30 years it was in the '80s. It's anyone's guess as to what this list will look like in 60 years!

Here are a couple of graphics that show what the Top 10 Stocks in the S&P 500 were in October 2021, June 2000, and June 1973.


TOP S&P 500 STOCKS
Here are the top 10 companies in the S&P 500 right now.
Swipe to see what they were in the past!
Apple 5.90%
Microsoft 5.60%
Amazon 4.05%
Alphabet (Google) 3.98%
Facebook 2.29%
Berkshire Hathaway 1.45%
Tesla 1.44%
NVIDIA 1.37%
JPMorgan Chase 1.29%
Johnson & Johnson 1.12%
SWIPE
1 2 3 4 5 6 7 8 9
Weight (%)
PERSONALFINANCECLUB


TOP S&P 500 STOCKS
Here's what the list looked like in June 2000.
How many are still in the top 10 today?
General Electric 4.19%
Intel 3.59%
Cisco Systems 3.56%
Microsoft 3.38%
Pfizer 2.42%
Exxon Mobil 2.19%
Walmart 2.06%
Oracle 1.89%
AT&T 1.70%
Nortel 1.62%
SWIPE
1 2 3 4 5 6 7 8 9
Weight (%)
PERSONALFINANCECLUB



I loved showing charts like these to my students, and asking them to identify one of the current top 10 that they would bet on being there in 20 years. What moats/competitive advantages do they currently possess, and what do they need to do to make sure they stay on this list?

This is just step one in picking stocks, identifying great companies that will stay great. Step two is determining how much to pay for that greatness. That's for another newsletter. If you're curious as to what companies we think might have some sustainable moats, ask your advisor to show you our current Blue Chip Growth and Equity-Income portfolios.

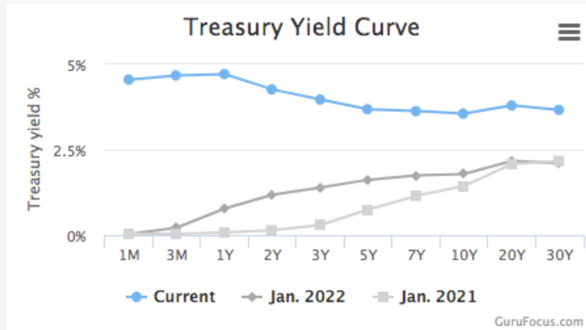
<u>Market Update:</u>

So far 2023 is off to a rip roaring start, with the S&P 500 up 6.02% YTD (1/27/23). What's clearly evident is that those stocks and sectors that performed the worst in 2022 have bounced back strongly to be the leaders in January 2023. And on the flip-side, those stocks and sectors that performed the best in 2022 are the laggards so far in 2023.

S&P 500 Sector	Year-to-Date (1/27/23)	One Year (1/27/23)
Communication Services	14.76%	-22.80%
Consumer Discretionary	14.45%	-17.88%
Info. Technology	9.84%	-10.74%
Real Estate	9.18%	-12.16%
Materials	7.34%	1.40%
Financials	5.84%	-6.01%
Energy	4.20%	40.80%
Industrials	2.93%	1.25%
Consumer Staples	-2.18%	-1.66%
Utilities	-2.29%	3.45%
Health Care	-2.37%	4.08%
S&P 500 Index	6.02%	-6.42%

On the interest rate front, the 10-year Treasury yield continues to fall even though the Fed keeps raising the short-end of the curve. The 10-year Treasury has fallen from 3.88% at year-end to its current 3.55%. The bond market is telling us that as the Fed has raised rates, inflation has fallen and the end of rate increases is near.

1-month yield	4.55%
1-year yield	4.714%
2-year yield	4.265%
10-year yield	3.555%
30-year yield	3.665%



I'm very impressed with the markets early rally this year, but given the valuations and the Fed's continued inflation fighting (as well as pending DC budget battle), I can't help but think that this advance is built on sand and as such will not last.

And so castles made of sand
Melts into the sea
Eventually

As always, be careful out there.

Chris Wiles, CFA

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