

## **Third Quarter 2019 Commentary**

Stocks posted another positive gain in the third quarter, making it three-for-three for 2019 so far. The S&P 500 index gained 1.7% and the Dow Jones Industrial Average returned 1.8%. For this calendar year through September 30, the S&P has returned a total of 20.6%, making for a seemingly great recent return. However, if we move the starting line back just three months to September 30, 2018, then the S&P's total return since that time is just a middling 4.3%.

Market participants have plenty of news to digest these days. On the political front we are witnessing an unfolding impeachment inquiry, on the economic front we have the oxymoronic juxtaposition of a strong economy and declining interest rates, and on the international front we have what seems like a new trade war with each passing week.

With so many interconnected variables, surprise Tweets, and possible unintended consequences, no one could possibly guess how the stock market as a whole will react to any of this. Which is why we're glad that you allow us to, by and large, ignore these big-picture events and focus on the individual companies and securities that make up your portfolio.

### **How the Mighty Have Fluctuated**

We write often about how crazy Mr. Market is. But sometimes it's helpful to take a step back and quantify just how crazy he is, because it can help instill that age-old aphorism from Warren Buffett himself: the market is there to serve us, not to guide us.

Do you remember that old Johnny Carson routine, where he would make a certain pronouncement and then look expectantly at his audience for a follow-up question? Everyone was in on the joke, so it would usually go something like this:

Carson: It was so hot today here in L.A.

Audience: Hoooooow hooooot waaaas it?

Carson: It was so hot that I wore my wrinkled clothes outside and got them steam-pressed for free!

So in that spirit, we're going to try that with you right now:

Us: Mr. Market is so crazy.

You: Hooooow craaaazy iiiiiiis he?

And for the answer, you'll have to read on, because we're going to try to quantify it for the umpteenth time but in a way we haven't done before.



## Top Ten List

Switching from the Tonight Show with Johnny Carson to the Late Show with David Letterman, we're going to try to quantify how crazy Mr. Market is using a Top Ten List. For this, we're going to use the Top Ten Largest U.S. Companies by Market Cap, and we're going to examine how wildly their stocks can swing from year to year. First, here are the ten companies in question:

<u>Company</u>	<u>Recent Market Cap (\$B)</u>
Microsoft (MSFT)	\$1,029
Apple (AAPL)	922
Amazon.com (AMZN)	890
Alphabet (GOOGL)	860
Facebook (FB)	511
Berkshire Hathaway (BRKA)	485
Visa (V)	441
Johnson & Johnson (JNJ)	342
JPMorgan Chase (JPM)	340
Walmart (WMT)	318

*source: Yahoo! Finance, www.sec.gov, Inkwel analysis*

These are the giants of all giants, behemoths of the behemoths, the biggest and best this country has ever produced. They are the stalwarts.

You would think, and you would be correct if you did so, that these companies—which are such large enterprises—probably do not grow their revenues or profits as quickly as some other much smaller companies. But the interesting follow-on to that fact is that the stocks of these ten companies can still do some pretty crazy things from time to time.

For example, take a quick look at Visa (V). Its market cap was recently a little above \$440 billion, down just a little bit from the high it reached in late July 2019 of \$463 billion. Its low, though, reached on Christmas Eve 2018—the day many U.S. stocks most recently bottomed out—was just \$310 billion. From that low point to its recent high, Visa stock went up 49%.

Forty-nine percent! In just seven months! For one of the largest enterprises on the planet! How is that possible? After all, Visa's revenues this year are expected to grow only around 11% or 12%. Its profits might increase about 16% or 17%. So how on earth did its stock go up 49% in just seven months?

### A Norway-Sized Fluctuation

If you compare each of these ten stocks' high point and low point over the last twelve months, Visa isn't even an outlier. Amazon's peak was 57% higher than its Christmas Eve low, Apple's was 64% higher, and Facebook's was 68%. For the group taken as an aggregate, their peak market cap of \$7.0 trillion was 45% higher than its trough market cap of \$4.8 trillion.



<u>Company</u>	<u>Peak Market Cap (\$B)</u>	<u>Trough Market Cap (\$B)</u>	<u>Peak – Trough (%)</u>	<u>Peak – Trough (\$B)</u>
MSFT	\$1,093	\$729	50%	\$364
AAPL	1,115	678	64	437
AMZN	1,031	657	57	374
GOOGL	970	731	33	239
FB	599	356	68	243
BRKA	551	459	20	93
V	463	310	49	153
JNJ	405	329	23	76
JPM	398	304	31	94
WMT	<u>332</u>	<u>251</u>	32	<u>81</u>
All Ten	\$6,958	\$4,804	45	\$2,154

*source: Yahoo! Finance, www.sec.gov, Inkwell analysis*

Sometimes it's fun to think about how Apple's or Microsoft's \$1 trillion-ish valuation compares to the GDP of certain countries. For instance, that \$1 trillion figure is about equivalent to the annual Gross Domestic Product of a smaller developed country like the Netherlands (whose population of 17 million is about 5% that of the U.S.) or a much larger developing country like Indonesia (whose 270 million is about 80% of our own).

That on its own is a pretty astonishing fact. But if we compare not the market caps themselves, but the *change* in market caps during one twelve-month period, then our minds could be even further blown. For instance, Apple's highest market cap was \$437 billion greater than its lowest market cap over the last year.

That figure is roughly equivalent to the current market cap of Visa! So Apple's value has fluctuated over the past year by one Visa, and Visa by itself is the 7<sup>th</sup> largest company in the country! Or, in GDP terms, that's about equivalent to one year of Norway's entire economic output.

Even the lowest number in the rightmost column of the above chart, the \$76 billion fluctuation belonging to Johnson & Johnson, is about the same as the GDP of the highest GDP-per-capita nation on Earth: Luxembourg. It's also about the same market cap as household names Goldman Sachs and Estee Lauder.

Imagine that. Johnson & Johnson, which has a few beauty brands of its own in Aveeno and Neutrogena, has fluctuated in price over the last year by the same amount that the market values Estee Lauder. Estee Lauder has been building its business since the 1940s, and its current valuation is just equal to the amount that JNJ stock moves up and down over the course of a year.

### **Mr. Market is Crazy, But We Don't Have to Be**

How are all these mind-blowing gyrations possible? It all comes down to Mr. Market. The hive mind of the stock market has some terrible built-in feedback loops. When bad news starts to come, CNBC and the Wall Street Journal publicize it, then people begin to sell their stocks and

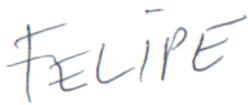


the prices start to fall, which cause CNBC and the Wall Street Journal to report on the fall in prices, which ..... On the other hand, when a group of companies reports a blow-out quarter those things also get publicized, then people begin to buy more stocks and the prices start to rise.

The lesson for us is to keep our heads on our shoulders and not take instruction from the wild price movements of the stock market. Our aim is to analyze a company and determine its intrinsic value, then have the courage to act when that value deviates significantly from the price quoted by Mr. Market.

We thank you once again for trusting us as stewards of your hard-earned money, and we look forward to reporting to you again next quarter.

Sincerely,



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INKWELL CAPITAL LLC



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