ACROPOLIS®
INVESTMENT MANAGEMENT

PORTFOLIO INSIGHTS

October 2023: Volume 22, Issue 4 // David Ott, Editor

In this Issue:

2 | Stock Market Summary
3 | Bond Market Review
4 | Thank You Short Sellers
6 | Inside the Economy
7 | You Better Think!
8 | The Big Picture

Contact us:

P | (888) 882-0072 (Toll Free)
| (636) 449-4900 (St. Louis)
F | (888) 453-1266 (Toll Free)
| (636) 778-2400 (St. Louis)
E | info@acrinv.com
A | 14567 North Outer Forty, Ste. 200, St. Louis, MO 63017

Acropolis was born from a simple idea:

In an industry where high quality, objective advice is hard to come by, we make a difference by putting the client's interests above our own.

SCIENCE, ART, AND PRACTICE

Some people in our industry say that investing is a science, but as the son of a physician, I've always felt a little uncomfortable with that description.

While we use a systematic and logical approach to observe and analyze data and create theories to explain and understand the data, the scientific description suggests too much precision and certainty.

Investors don't have universal laws, no absolute right or wrong, and controlled experiments are almost impossible because you can't turn back time to evaluate hypotheses under identical conditions.

Markets are emotional, beyond greed and fear, because markets are made up of people who are unpredictable at best (just ask a psychologist or psychiatrist).

The art of investing is about subjectivity and interpretation. Investors can see the same facts and data and draw multiple conclusions, just as we might look at a painting or sculpture, see different things, or react differently.

Investors each have their own risk tolerance, and while we have equations to measure risk, what matters more is how investors react to the risks that continually rise and fall over time.

The concept that investing is both art and science isn't new. Famed investor Benjamin Graham wrote about the importance of quantitative and qualitative analysis in his 1949 classic, The Intelligent Investor.

I recently read that investing is a practice: regular, almost habitual activities and behaviors based on principles, methods, and techniques. That makes sense because it incorporates both the art and science of investing, just like practicing medicine combines scientific knowledge with the clinical reality of patients.

If we take the science we have, use our best judgment, and continue the practices that have served us well for more than 20 years, we believe that clients will continue to be well served.

STOCK MARKET SUMMARY

By David Ott

The bear market in the S&P 500, which started in January of 2022, hit bottom in October 2022 after falling -24.5 percent.

By the end of the second quarter, it had recovered 80 percent of the loss and was only down -4.9 percent from the market peak.

At the end of July, the recovery continued, and the peak-to-trough loss was less than two percent as investors pushed the anticipated recession into 2024 and wondered whether we could avoid a recession altogether.

However, August and September were tough months, with the S&P 500 losing -6.3 percent and taking the peak-to-trough decline to -8.0 percent.

This back-and-forth is pretty typical for bear markets.

We maintain a unique database that measures the market's daily performance, including dividends. Most of the time, daily data doesn't include dividends, which means that you have to use monthly data to get the dividends. Our data set avoids that, which provides a more precise measure of market downturns and recoveries.

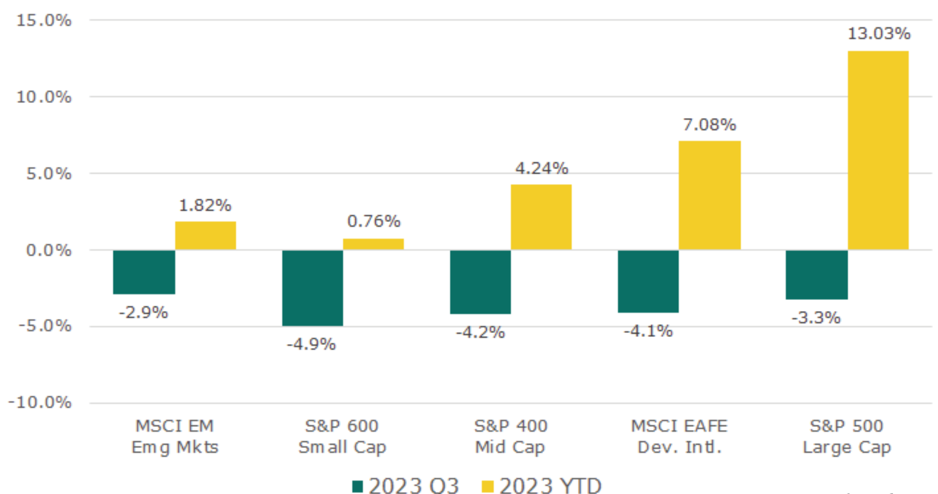
Using this data, we find that in all bear markets since 1948, the average peak-to-trough decline takes about 1.2 years. The shortest was at the outset of the coronavirus selloff at 0.2 years, and the longest was 2.1 years when the tech bubble burst in 2000.

On average, recoveries take about the same amount of time, about 1.5 years. The fastest recovery was in 1982 when the recovery was only 1.5 months, but they can be several years, like the four-year recovery from the tech bubble bursting (for a start to finish time table of six years).

Assuming the bottom was last October, we haven't passed the one-year mark yet. Half of the recoveries took between 1-2 years, which puts the current recovery on track. Of course, anything can happen from here, but if history is a reasonable guide, the hard part is behind us.

"Mediocrity knows nothing higher than itself, but talent instantly recognizes genius."

- Sir Arthur Conan Doyle, British Author



Data Source: Bloomberg

BOND MARKET REVIEW

By Ryan Craft, CFA

The bond market struggled in the third quarter as the market narrative began to pivot. The Bloomberg Aggregate index fell three percent from July to September as yields rose 60 bps—the move in rates equally hurt Treasuries, mortgages, and corporate bonds.

Compared to last year, different factors drove this quarter's poor performance. In 2022, rates reflected a higher premium due to higher expectations for future inflation and the Federal Reserve aggressively raising short-term rates.

While the Federal Reserve raised the Fed Funds rate an additional 25bps in July, most investors believe they are at or near the peak for overnight rates. However, the Fed's message has changed to "higher for longer."

Until recently, the market has expected the Fed to reverse course and cut rates soon, which has helped to keep long-term yields low. This began to change as long-term rates have increased by 80 bps over the past three months, conceding that the Fed is unlikely to cut rates anytime soon.

While inflation has increased rates over the past 18 months, real interest rates are now rising.

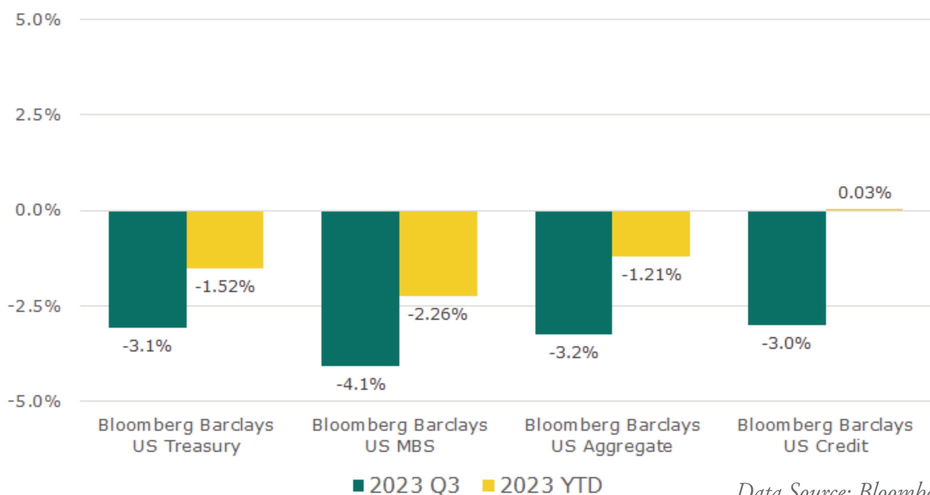
A bond yield can be broken down into several primary factors: a real yield + inflation premium + credit premium. Inflation expectations and credit spreads have remained relatively stable this year. Real yields have spiked and are the highest since 2007.

This implies that the Federal Reserve has reached a restrictive monetary policy level. Real yields will reflect the supply/demand dynamics of the market. In addition to higher short-term rates, the Federal Reserve has been reducing its balance sheet and letting its bond portfolio roll off. This combination of weaker demand with increased supply has caused real interest rates to move dramatically higher, just as they teach in Econ 101.

The good news is that bond yields are very attractive. If monetary policy is restrictive, inflation should continue to fall, with a bottom for this bond bear market on the horizon.

"No amount of skillful invention can replace the essential element of imagination."

- Edward Hopper
American Painter



Data Source: Bloomberg

THANK YOU SHORT-SELLERS

By David Ott

Growing up, my best friend's father was a pilot for Ozark Airlines. He seemed like a pretty happy-go-lucky guy who loved flying and golfing when he wasn't working.

His demeanor changed markedly when Carl Icahn's backed TWA bought Ozark. I didn't understand it much then, but I heard terms like 'corporate raider' and 'asset stripping' at the time.

To my friend's dad, Icahn was a true villain who borrowed money to enrich himself while ruining the companies he bought and sold. I didn't have much of an opinion but knew better than to say as much when I had dinner at their house.

I didn't pay much attention to Icahn after that, except when he got into a 30-minute fight on CNBC with another activist investor named Bill Ackman in 2012.

At the time, Ackman sold short stock in Herbalife, a company he claimed was a Ponzi scheme. Short selling is a way to profit from a stock's decline.

An investor who wants to short a stock borrows it from an investor who owns it and pays them some interest for the privilege. The short seller then sells the borrowed stock to the market. The short seller then hopes to repurchase the stock at a lower price and return the shares to the investor that they borrowed them from.

A short seller buys low and sells high, but not in the usual order.

Herbalife was a multi-level marketing company selling shakes and vitamins that encouraged their customers to sign up their friends as salespeople and become distributors.

Ackman sold the stock short and then went on an extensive media campaign to lower the stock price. For reasons I don't know, Icahn thought Ackman was off base and took the other side by aggressively buying the stock, hoping to hurt Ackman since a higher price makes it more expensive to repurchase the stock.

The fight between Ackman and Icahn is fun to watch (you can see it on YouTube), and the journalist on CNBC who was there for the fight, Scott Wapner, ultimately wrote a book about the episode.

Herbalife is still in business, and as far as I know, both Ackman and Icahn claimed to make money on the stock even though they were on opposite sides.

In May, the tables turned on Icahn because a prominent short seller, Hindenburg Research, published an article saying that Icahn's company, Icahn Enterprises, was vastly overvalued and accused Icahn of running a 'Ponzi-like economic structure.'

Some of Hindenburg's other shorts have worked out very well, so Icahn Enterprises fell about 40 percent initially, continued to drop, and ended the quarter down about 55 percent since the news broke.

Icahn is now 87 years old, and the falling stock price cut his net worth by billions of dollars and forced him to scramble to preserve his empire. I love Wall Street soap operas: I don't have a dog in the hunt, it involves enormous personalities, and it's unclear how it will turn out.

And, to me, it's a reminder that short sellers are a vital part of the ecosystem.

"It is not certain that everything is uncertain."

- Blaise Pascal
French Mathmatician

ANATOMY OF A SHORT SALE

01 **Short Seller Borrows Stock**
Short sellers borrow stock from long-term investors and pay interest to the owner.

02 **Short Seller Sells the Stock**
The short seller sells the stock they borrowed in the open market and gets cash in exchange.

03 **Short Seller Buys Back the Stock**
If the short seller buys the stock back at a lower price, they earn a profit.

04 **Short Seller Returns the Stock**
Regardless of whether they profited or not, the short seller returns the borrowed stock.

When we first launched Acropolis, short seller Jim Chanos was taking down Enron. Chanos researched the company, realized it was a fraud, and profited from his insights.

In addition to scoping out fraud, short sellers help our bottom line in two ways.

First, the funds we own – Vanguard, iShares, and the others – all loan stock to short sellers. As shareholders in the funds, we collect the interest the short sellers pay to borrow the stock.

Second, short sellers provide liquidity to the market at times when others may not. When a stock has an incredibly high valuation, short sellers sell it because they think it will fall, which might help contain the valuation.

If the stock falls, they're out repurchasing it when others are trying to sell. They're doing the opposite of the overall market, which provides liquidity.

Short sellers are often portrayed as villains, beyond the dinner table at my friend's house. Some people think it's un-American to bet on stocks falling, and there is a little manipulation when someone builds a short position and then talks the stock down in public. And in times of market panic, the government has stopped them.

Although there are undoubtedly some unscrupulous short sellers who try to manipulate stock prices, that happens plenty on the long side, too.

You can bet that I will keep watching what happens with Icahn Enterprises, including buying the book that will inevitably come out when the drama concludes, and there are clear winners and losers.

"Charity begins at home, but it should not end there."

- Thomas Fuller, American Slave and Mental Calculator

INSIDE THE ECONOMY: EARNINGS

By: David Ott

Over the past 25 years, earnings for the S&P 500 have grown about 5.8 percent per year, matching the long-run average of six percent and the last five years' rate of 5.6 percent.

Like everything related to investing, the growth rate hasn't been smooth, which makes sense given everything that's happened in the last five years.

In 2018 and 2019, the basic earnings per share for the S&P 500 were $159.8 and 162.9, respectively. That two percent earnings growth was evidence that the economy was slowing and one reason investors thought a recession was likely.

Of course, the pandemic came along in 2020, and earnings fell substantially in the second and third quarters before stabilizing in the fourth quarter. For the year, earnings were $143.1 per share, a -12.2 percent decline.

As the economy recovered and the government injected massive stimulus, profits came roaring back, which is where the chart below begins. In 2021, earnings were $196.7 per share, a 38.9 percent increase from 2020.

Of course, the stimulus money was spent, the economy started to settle back into a regular routine, and the profit growth slowed. In 2022, earnings were 222.3, which was still a healthy 11.9 percent growth rate.

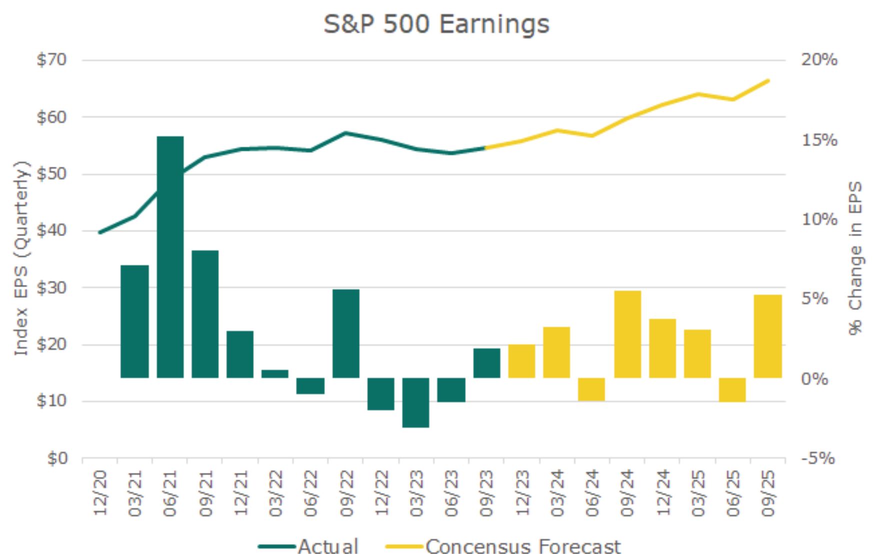
Assuming the fourth quarter comes in as expected, earnings should come in this year at 220.3, a one percent decline from last year.

As you can see from the chart below, where earnings forecasts are highlighted in yellow, Wall Street expects profits to grow at about 11 percent per year over the next two years, although not in a straight line.

A recession does not appear to be built into earnings, making the market vulnerable if a recession seems more likely and estimates are marked down accordingly.

"There is no such thing as simple. Simple is hard."

- Martin Scorsese,
American Film Director



Data Source: Bloomberg

YOU BETTER THINK!

By: David Ott

The Queen of Soul, Aretha Franklin, died in August 2018. Five years later, the battle over her estate ended after a two-day lawsuit that allowed her estate to finally settle.

Franklin left two wills behind, both handwritten (one tucked in a notebook under a couch cushion), and they were contradictory.

Initially, her four surviving adult children thought there was no will since they couldn't find one. Dying without a will is called intestate. According to Michigan law, her estate would be divided equally among the four children.

Within a few months, however, two wills were located. The first will, written in 2010, provided allowances for each of the children and said that two of them had to take business classes before they could collect money from the estate.

In the 2014 will, three of her sons would receive equal shares of her music royalties (the fourth son has an unspecified mental illness and wouldn't receive the royalties but will receive support from the other three brothers).

One of the three sons to receive the royalties would also receive her house, cars, and other personal property worth $4.1 million.

Ultimately, a jury concluded that the 2014 will was valid, even though it was the one found in the couch and was signed, in part, with a smiley face.

Interestingly, Franklin's estate was worth $18 million, not including the value of future earnings from her music catalog. However, besides not having a formal estate plan, Franklin died with substantial IRS debt. In 2021, the estate agreed to pay off $8 million in back taxes and penalties (to be paid from revenue from future royalties).

I'm not a lawyer, but there is a lot we can learn from the ninth greatest artist of all time (according to Rolling Stone, although the list seems off with Little Richard at eighth).

First and foremost, hire a lawyer and have a formal estate plan.

While it's true that her estate plan 'worked,' she could have saved her family a lot of time, trouble, and money if she had a formal estate plan.

According to the New York Times, the brothers didn't make eye contact after the trial and stopped speaking to their cousin, the original executor.

It's been five years of fighting, and although I never read the legal fees, I am sure they were substantial.

Will the brother with special needs be taken care of? Perhaps so, but there could be further strife if the brothers disagree on how to support him. A trust could have resolved this potential issue.

Much of this could have stayed private if an estate lawyer had drawn up a trust. Trusts are private documents, whereas wills are public.

Many people, including celebrities, don't keep their estates in order despite what's at stake.

You have to think about unpleasant things, but it seems worth it to prevent your family from fighting and ensure your wishes are taken care of. It's worth the time and money to do it right.

"Our greatest glory is not in never failing, but in rising every time we fall."

- Confucius
Chinese Philosopher

Major Indexes	2023 YTD
Dow Jones	2.73%
S&P 500	13.06%
S&P 400 Mid-Cap	4.24%
S&P 600 Small-Cap	0.76%
MSCI EAFE (Intl)	7.08%
MSCI Emerging Mkt	1.82%

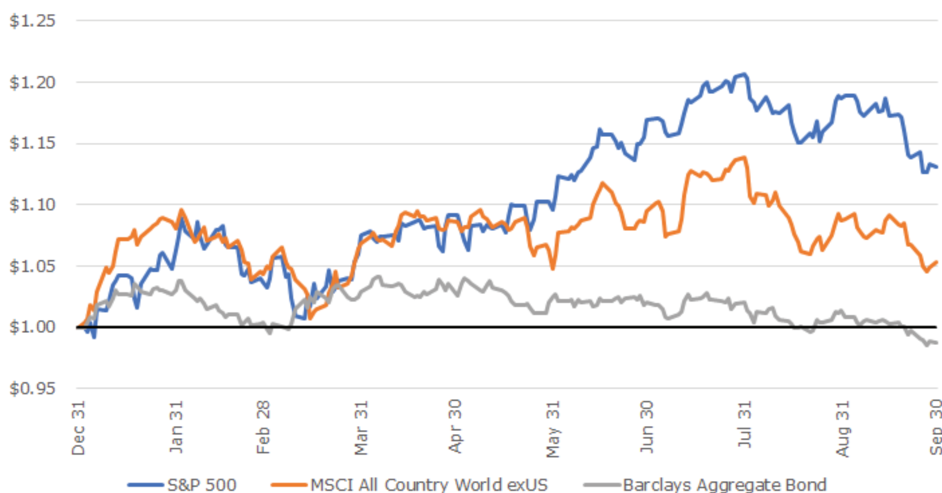
Equity Styles	2023 YTD
S&P 500 Growth	21.24%
S&P 500 Value	12.13%
S&P 500 Quality	15.16%
S&P 500 Momentum	2.74%

S&P Sectors	2023 YTD
Basic Materials	2.61%
Communications	40.43%
Consumer Discretion.	26.58%
Consumer Staples	-4.76%
Energy	5.99%
Financials	-1.65%
Healthcare	-4.09%
Industrials	4.50%
REITs	-5.51%
Technology	34.72%
Utilities	-14.41%

Interest Rates	2023 Q3
Fed Funds	5.50%
Prime Rate	8.50%
3-mo. Treasuries	5.45%
2-yr. Treasuries	5.05%
5-yr. Treasuries	4.61%
10-yr. Treasuries	4.57%

All Data as of 09/30/23

THE BIG PICTURE



FAST FACTS: AI EDITION

77 Percent: The percent of devices that already use artificial intelligence for actions such as answering questions on your Alexa, showing ads on social media, or highlighting traffic problems on your navigation apps.

10 Percent: The percent of trading done by fundamental, discretionary investors. Quantitative algorithms do the remaining 90 percent, sometimes powered by artificial intelligence.

1955: The year that computer scientist John McCarthy first used the term artificial intelligence. He coined it while at Dartmouth but spent most of his career at Stanford and won numerous awards, including the Turing Award, the National Medal of Science, and the Kyoto Prize.

Two Months: The time it took for ChatGPT to acquire 100 million users. Twitter took five years, Instagram was 2.5 years, and YouTube was 1.5 years. Instagram Threads holds the current title, taking just two days.

$50 billion: The value of global investment in AI in 2020. China and the US are the top investors. The value is expected to reach $190 billion in 2025.

Notice to Clients

Please remember to contact ACROPOLIS® Investment Management, LLC if there are any material changes to your financial situation or investment objectives or if you wish to impose, add or modify any reasonable restrictions to our investment management services. A copy of our current written disclosure statement as set forth on Part II of Form ADV continues to remain available for your review upon request.

Legal Disclaimer

This publication is provided as a service to clients and friends of ACROPOLIS® Investment Management, LLC solely for their own use and information. The information in this publication is not intended to constitute individual investment advice and is not designed to meet your particular financial situation. You should contact an investment professional before deciding to buy, sell, hold or otherwise consider a particular security based on this publication. Information in this publication has been obtained from sources believed to be reliable, but the accuracy, completeness and interpretation are not guaranteed and have not been independently verified. The information in this publication may become outdated and we are not obligated to update any information or opinions contained in this publication.

© ACROPOLIS® Investment Management, LLC 2023. All rights reserved.