



**TRUMP BROKE THE SHILLER
P/E. HERE'S OUR SIMPLE FIX**

Agenda: Shiller P/E

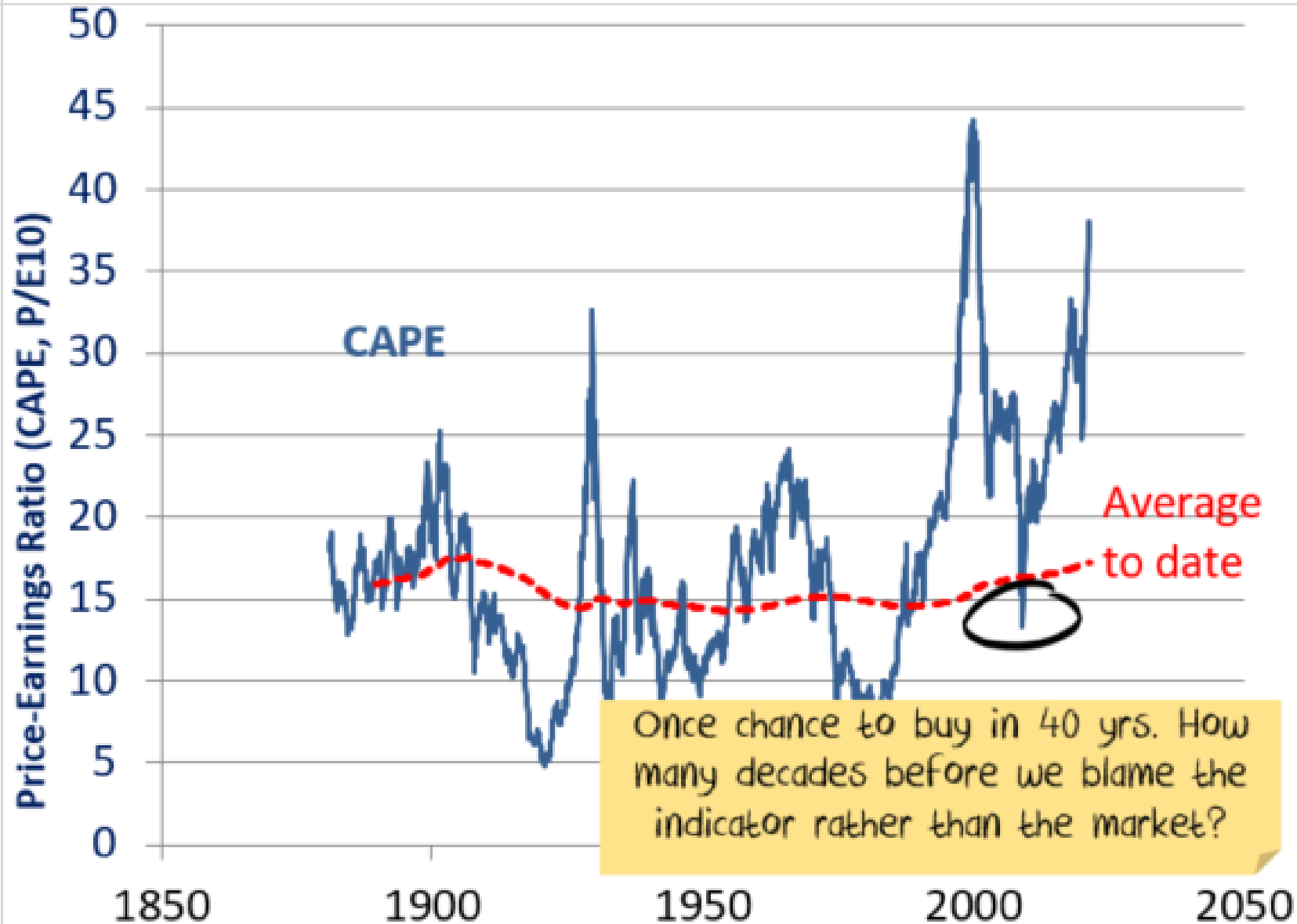
- Background
- The simple changes
- The complex changes
- Investment outlook

Background - Shiller P/E



Source: Nucleus Wealth, <http://www.econ.yale.edu/~shiller/data.htm>

Background - Shiller P/E



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Simple Change 1: Tax Rate Changes

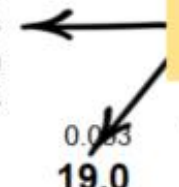
- Last 10 years have had 6 years of 35% corporate taxes, 4 years of 21%
- Switch to
 - Average pretax profits
 - Apply today's tax rate

Simple Change 1: Buy Back Adjustment

DIVIDEND Index Fund: Payout everything as a dividend

		Year 0	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10	CAPE	CAPE 2.0
Shares	m	100	100	100	100	100	100	100	100	100	100	100		
Real Earnings	\$m	5.3	5.3	5.3	5.3	5.3	5.3	5.3	5.3	5.3	5.3	5.3		
Real Earnings per share	\$	0.05	0.05	0.05	0.05	0.05	0.05	0.05	0.05	0.05	0.05	0.05		
P/E of Fund	x	19	19	19	19	19	19	19	19	19	19	19		
Share Price	\$	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00		
Cumulative Dividends	\$m		3.7	7.4	11.1	14.7	18.4	22.1	25.8	29.5	33.2	36.8		
10y Average EPS	\$												0.053	0.053
Shiller P/E	x												19.0	19.0

Under the dividend only, CAPE = CAPE 2.0 = trailing P/E



BUYBACK Index Fund: Payout everything as a buyback

		Year 0	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10	CAPE	CAPE 2.0
Shares bought back	m		3.7	3.5	3.4	3.3	3.2	3.1	2.9	2.8	2.7	2.6		
Shares	m	100.0	96.3	92.8	89.3	86.1	82.9	79.8	76.9	74.1	71.3	68.7		
Real Earnings	\$m	5.3	5.3	5.3	5.3	5.3	5.3	5.3	5.3	5.3	5.3	5.3		
Real Earnings per share	\$	0.05	0.05	0.06	0.06	0.06	0.06	0.07	0.07	0.07	0.07	0.08		
P/E of Fund	x	19	19	19	19	19	19	19	19	19	19	19		
Share Price	\$	1.00	1.04	1.08	1.12	1.16	1.21	1.25	1.30	1.35	1.40	1.46		
Cumulative Buybacks	\$m		3.7	7.4	11.1	14.7	18.4	22.1	25.8	29.5	33.2	36.8		
10y Average EPS	\$												0.065	0.077
Shiller P/E	x												22.4	19.0

Under the buyback only, CAPE 2.0 = trailing P/E

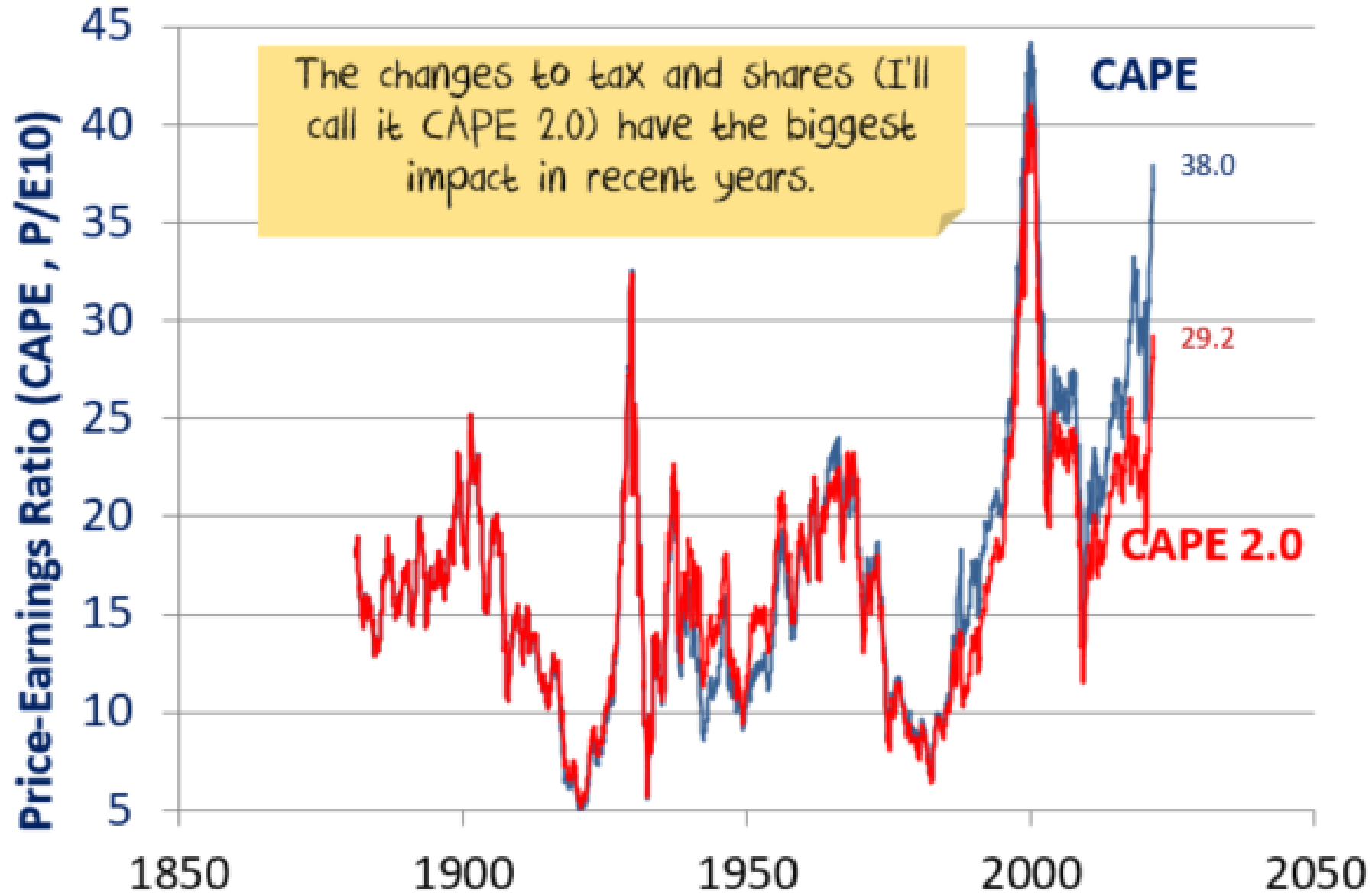
But CAPE P/E is way higher



Source: Nucleus Wealth

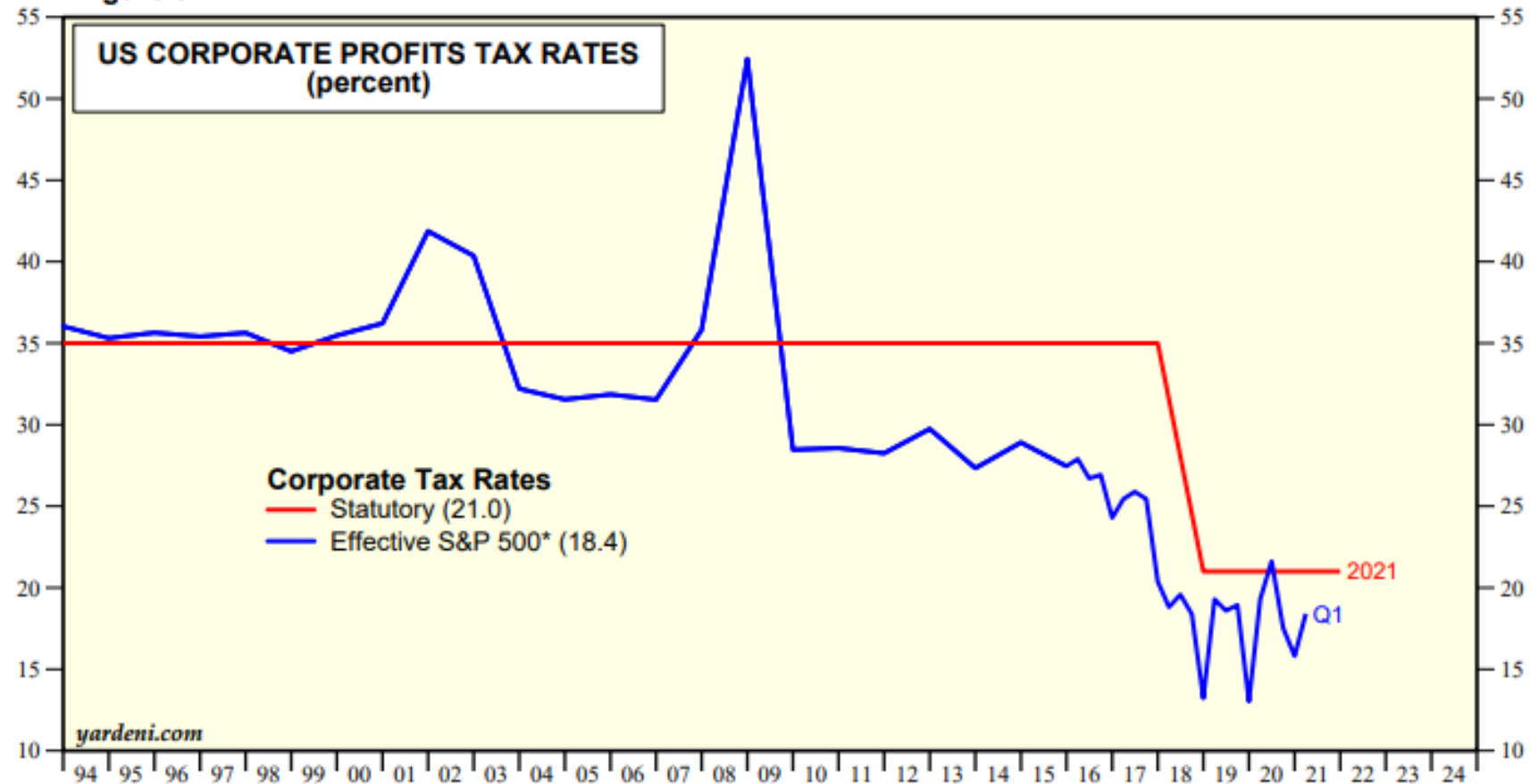
- Use average profits (not per share)
- Apply today's shares

Simple Changes: Net Effect



Complex Change 1: Tax Rates

- International tax
- Actual vs statutory
- Expectations



* Includes US federal taxes and taxes collected by other domestic and foreign taxing authorities. Derived from S&P Analyst Handbook, where tax rate is income tax as percentage of pre-tax income.
Source: Internal Revenue Service and Standard & Poor's.

Complex Change 2: Accounting Standards

- Pandemic: 1919 vs 2020
- Example company with \$100 per year in earnings:
 - It buys an asset for \$50, earning \$5 per year.
 - Now company earnings are \$105.
 - Then the asset hits trouble, and the earnings fall to -\$1.
 - The asset gets written down to zero.
 - Company earnings are $\$100 - \$1 - \$50 = \49 for one year and then \$99 after that.
- Investors only care about \$99 and current capital structure

Complex Change 2: Accounting Standards

- Fake Writedowns
- Sources of Data
- Goodwill Amortisation
- Pre 2000 data.
- Effect: P/Es less extreme around crises

Complex Change 3: Depreciation and inflation

- Profit overstatement
- If capex and inflation constant, doesn't matter
- Harvard survey 1977:

Exhibit V

Effect on stockholders' equity and net income
(dollar figures in billions)

	Historical cost	Replacement cost	Increase (decrease)	Percentage increase (decrease)
Stockholders' equity	\$ 208.1	\$ 346.8	\$ 138.7	66.7 %
Net income	\$ 30.9	\$ 20.0	\$ (10.9)	(35.3)%
Rate of return on stockholders' equity	14.9%	5.8%	(9.1)%	(61.1)%

Complex Change 4: Trading and spreads

- Pre-fee return or post fee
- Diversification ease?
- Trading volumes

Figure 3. Average commissions on round-lot transactions in NYSE stocks
(based on fixed schedule pre-1968 and member commission revenue thereafter)



Figure 1. Bid-ask spreads on Dow Jones stocks
(all DJ stocks 1900-1928, DJIA stocks 1929-present)



Complex Change 5: Negative Earnings

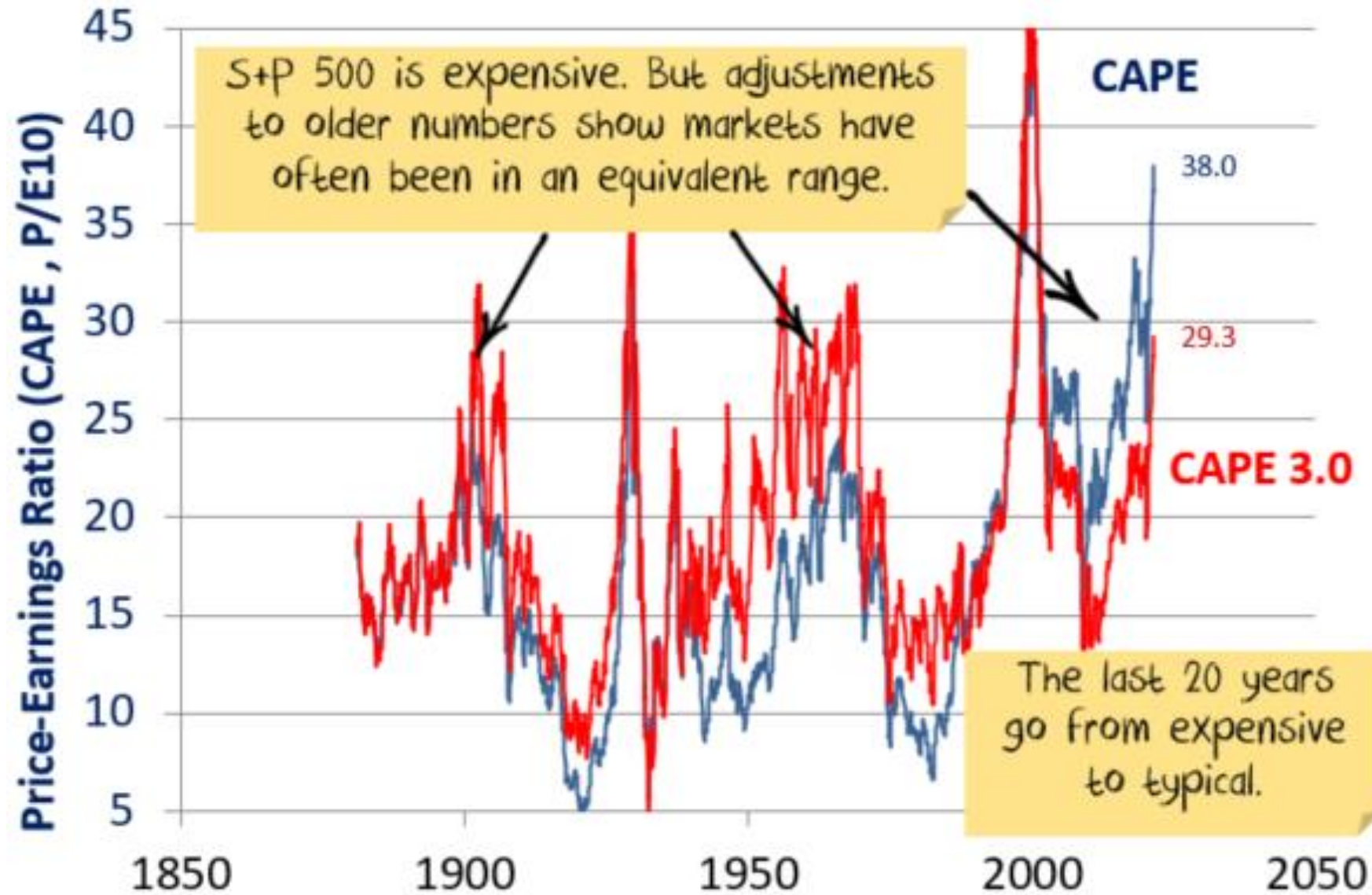
Portfolio of 3 stocks: A, B, C.

- If A&B make \$100 each, C loses \$100, net earnings are \$100.
- Put that on 20x earnings and portfolio is worth \$2,000
- But what happens if C goes broke? Now net earnings are \$200.
- Should the value of my shares in A and B be worth more because C went broke? That doesn't make sense.
- Or is it just that my portfolio should be still worth \$2,000 and it is now on 10x earnings?

Complex Change 6: Re-investment

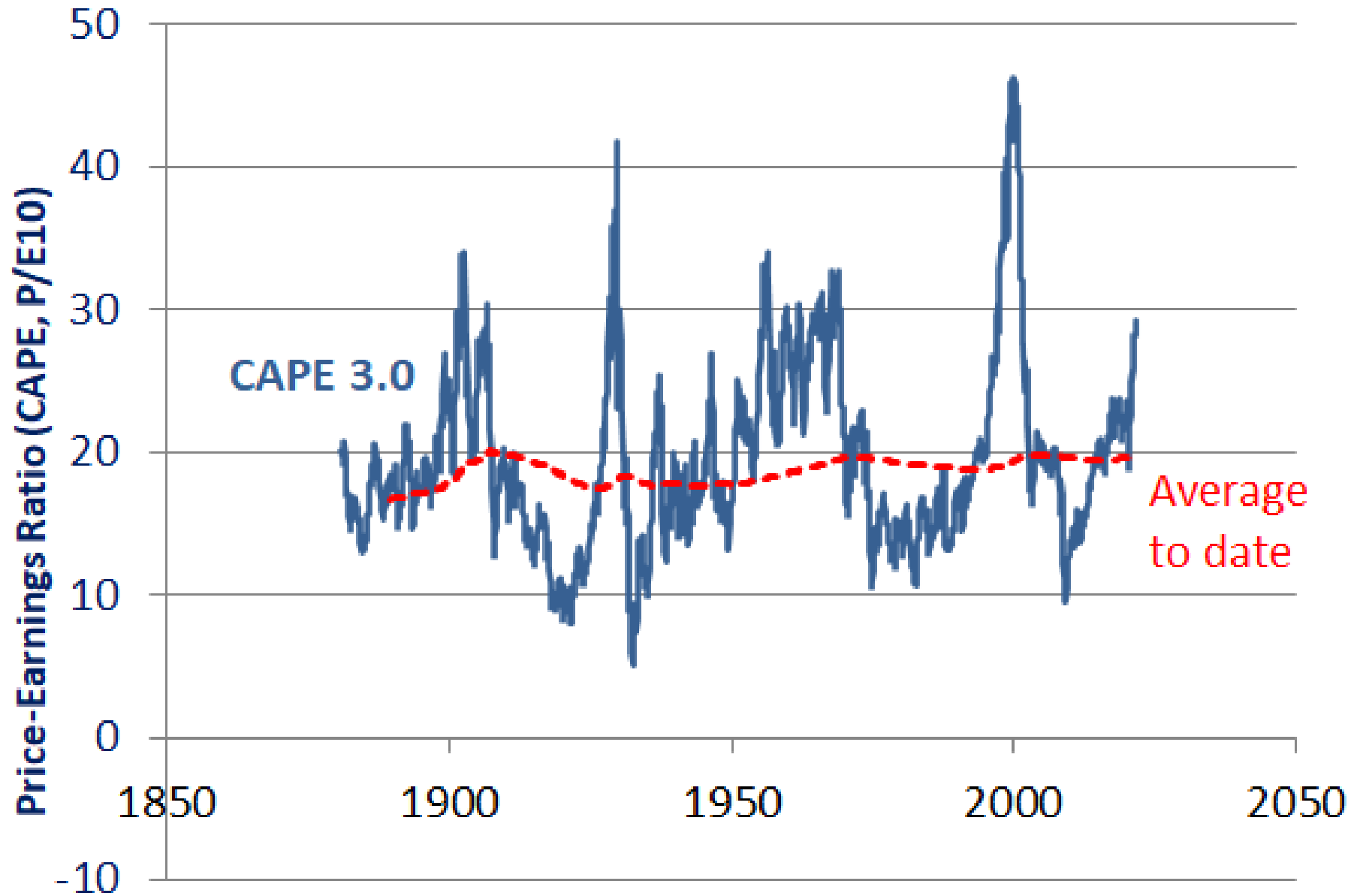
- Some say if companies retain capital by paying lower dividends, future growth should be higher. I disagree.
- Companies, A, B and C. All make \$100 in earnings in year 0 and want to make an investment of \$75 in year 1:
 - A: \$25 dividend, retains \$75 for investment
 - B: \$50 dividend, buyback \$50, borrows \$75 for investment
 - C: \$100 dividend, raise \$75 of new shares for investment
- Need to adjust consistently.

Investment implications

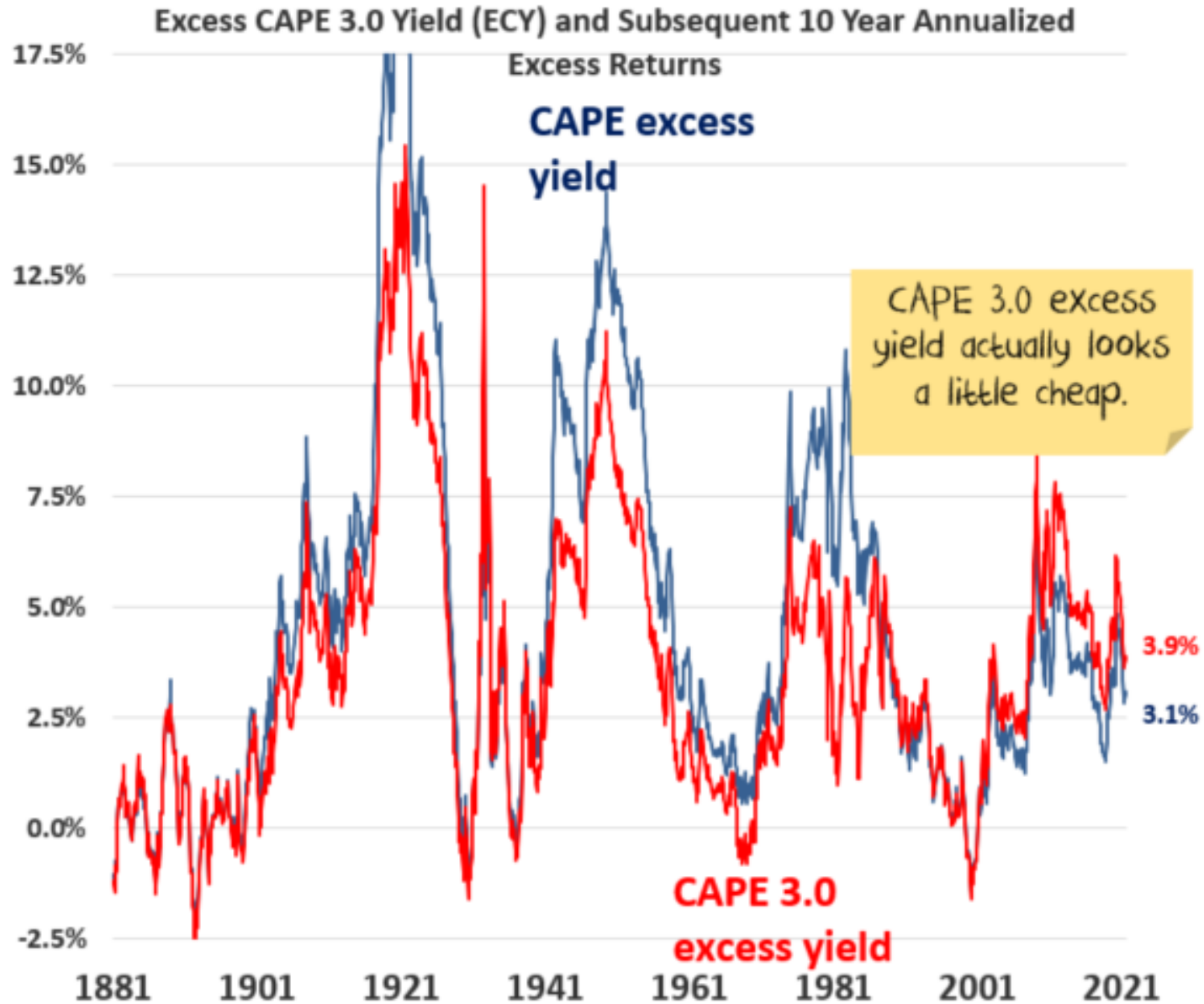


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Viewer question of the week:

Does valuation even matter anymore?

Drop your answers in the comments

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