EQUITY INVESTMENT CORPORATION

Insights from EIC's Quarterly Letters

The Large-Cap/Tech Bubble (1999 - 2001)

Date	Quotations	Further Comments
Q4 1999	"Owning high P/E stocks has not been a sound **long-term** investment strategy. ... There have been periods when high P/E stocks outperformed, but these periods have been short lived. Therefore, we do not plan to change our approach." "our competitive and rapidly changing world economy makes it difficult for any company to sustain growth unchecked. Inevitably growth stories that seem unstoppable prove vulnerable with time. Therefore, a dose of realism, or conservatism, should be applied when projecting a company's future growth, and in determining its Value, and the price one is willing to pay."	As 1999 closed, the mania for growth stocks, particularly technology and internet stocks, was reaching its climax. As money flow moved away from value managers, toward high P/E growth investors, it became increasingly difficult for value managers to stick to their disciplines. Most of the growth stories that appeared inevitable in 1999 proved to be vulnerable with time.
Q3 2000	"For several quarters we have discussed the upside-down nature of the market, namely, that the stocks with the highest P/E ratios were rising, while low P/E stocks were falling. ... The question is whether these prices [of high P/E companies] are justified by the high growth opportunities among new technologies, or whether they represent another example of over-optimism. The 1920's witnessed a similar debate, as new technologies created dramatic improvements in productivity. ... These improvements resulted in unparalleled growth (and as a sidenote, expectations of large federal government surpluses to come). In retrospect it is easy to look at the 1920's as mania-driven and forget the compelling visions of growth that must have provided *rational*-izations for the prevailing high prices. The same will probably prove true of today."	The *rational*-izations for high prices, namely expectations of unending growth, did prove to be overly optimistic extrapolations (as were the hopes for future government surpluses). As a result, growth stocks in general (and tech stocks in particular) performed poorly when the bubble burst in 2000 – 2002.
	The Credit/Building Bubble (2004 - 2007)	
Q1 2005	"our primary message ... the economic recovery has been unbalanced, overly dependent on unsustainable debt-based spending (from consumers and the U.S. government) and an aggressively stimulative monetary policy from the Federal Reserve. These policies have created once-in-a-lifetime earnings in certain sectors (homebuilding, lending, building materials) that have been the mainstay of the markets during this time. However, our view remains that these sectors' earnings and prices are at risk when the monetary and credit-driven stimulus diminishes, which it inevitably must."	Trade deficits and borrowing led to excess consumption and building, resulting in once-in-a-lifetime earnings in certain sectors (building and lending). We felt such earnings were low quality and unsustainable and thus should not be capitalized.
Q1 2006	"We accept this difference between our holdings and those of the indices as part and parcel of what we do for clients. To be clear, we do not believe our role is to simply generate the highest returns for clients in a given quarter or year … . Nor is it our role to track a style-box index … . Instead, our goal is to provide strong absolute and relative returns over a market cycle, while doing so with relatively low risk, as defined by frequency and magnitude of loss."	We avoided investing in certain sectors with growing risks and trailed the market indices as a result. Nevertheless, portfolios were well positioned for the ensuing credit crisis.

The Credit/Building Bubble (2004 - 2007) (cont'd)

Date	Quotations	Further Comments
Q1 2007	"Meanwhile, economic strength was built upon strong monetary and spending stimulus by the government, along with consumer borrowing based on low interest rates and rising house prices. None of these seem likely to be as stimulative going forward when compared to the last five years. Our experience has shown that protection has to be built into portfolios long before it is needed."	Rather than predict when it would end, we tried to protect against the inevitable downturn.
Q3 2007	"We often say that 95% of our decisions are never seen, because they are decisions *not* to buy something that *looks* cheap. Among these was our decision *not* to buy companies whose earnings were benefiting from excessive consumer borrowing, or whose balance sheets were contingently exposed to credit risks through either their investing or lending activities. We viewed the borrowing boom as unsustainable and potentially dangerous and sought to minimize our exposure. That is why we decided *not* to buy subprime lenders such as Countrywide, Citigroup and H&R Block, asset-backed guarantors such as Ambac and MBIA, and investment banks such as Bear Stearns and Goldman Sachs. … we sold our position in Allstate due to concerns regarding the quality of their investment portfolio … ."	In 2007, the sins of the past years finally began to surface, and we stressed the importance of avoiding those sectors in the eye of the storm, even though prices *looked* cheap.
The Growth/COVID Bubble (2019 - 2022)		
Q4 2019	"little earnings growth coupled with significant valuation expansion – leaving the market poised for modest (or worse) longer-term returns. … This backdrop colors the current investment environment … . It bears more than a passing resemblance to the market of the late '90s … . "	Q1 2020 was extraordinary in the speed and breadth of the stock market decline. We believe the ferocity of the first quarter volatility is likely, in part, a rapid and partial unwind of a decade of complacency.
Q1 2020	"One of the unique aspects of the market action in this quarter was the extreme outperformance of growth versus value. While our valuation model allows us to pay a premium for growth characteristics, we ultimately have limits regardless of the merits of the business. The future is uncertain, and we don't believe we can forecast cash flows as far into the future as necessary to justify owning expensive growth stocks."	While value outperformed growth in Q4 2020, it remains deeply out of favor across all capitalization sizes. In fact, value has trailed growth for the better part of 14 years, its longest period of subpar performance in history. As a result, value's cumulative shortfall relative to growth now exceeds that of the tech bubble.

The Growth/COVID Bubble (2019 - 2022)(cont'd)

Date	Quotations	Further Comments
Q1 2021	"Within the growth universe, there is significant variation in the degree of over-valuation … . Mega-cap growth companies with dominant market positions, many of which are in the information technology, communication services, and consumer discretionary sectors, are all fully- to over-valued in our estimation. Smaller but proven growth names with revenues and/or cash flow, such as in the software and consumer discretionary space, appear to sport more extreme valuations. Finally, there is a large cohort of "concept" companies, with electric vehicle listings coming public via special purpose acquisition companies (SPACs) as most representative of this group. These companies are often pre-product and pre-revenue, and in our view, have nonsensical valuations."	Despite growth stocks' poor performance in Q1 2022, they remain richly priced compared to history, with valuations still trading well above long-term averages. As we have detailed in past commentaries, history and shareholder-return math continue to suggest that growth should meaningfully underperform value from these lofty valuation levels
The Artificial Intelligence / Magnificent 7 Bubble (2023 - ?)		
Q2 2023	"There is also a large-cap stock effect heavily boosting returns and valuations on the growth side. The current seven largest companies in the market — Apple, Microsoft, Alphabet, Amazon, NVIDIA, Tesla, and Meta Platforms — accounted for a significant share of market performance year to date.... these seven companies now comprise nearly 24% of the Russell 3000® Index yet account for less than 15% of the index's earnings. Moreover, these seven now comprise more than 45% of the Russell 3000® Growth Index (R3000G), a record high. Remarkably, any newly registered mutual fund or ETF tracking the R3000G today may technically not meet the SEC's definition of 'diversified'."	Shortly after this was written, the NASDAQ announced an off-cycle "special" rebalancing of the index in response to elevated concentration levels. Growth-oriented investors—particularly those focused on large- and mega-cap names—continued to benefit from heightened speculation around the long-term potential of artificial intelligence (AI).
Q3 2024	"Today, the risks are extreme in growth stocks — valuations based on 10-year average cyclically adjusted P/E (CAPE) earnings match all-time peak levels. Likewise, the spread between growth and value is also near all-time peak levels. At today's starting valuation levels, history suggests value stocks could outperform growth stocks by as much as 6–8% per year for the next decade — the value index is priced to deliver mid-single digit annual returns, while the growth index is priced for flat or negative annual returns."	Despite growth stocks poor performance in Q1 2025 they are still richly priced compared to their long-run median. Based on history, from these levels, growth investors should continue to expect disappointing returns over the next decade. Meanwhile, value stocks are more reasonably priced, with expectations for positive returns.