



Value is What you Get (7-31-2025)

Nowadays, many commentators in the financial news media seem to have forgotten a thing or two about the basic English Language. So let me refresh everyone on what Merriam-Webster says - **Price**: the amount of money given or set as consideration for the sale of a specified thing. **Value**: the monetary worth of something. **Cheap**: purchasable below the going price or the real value. Warren Buffett sums it up nicely when he says: “Price is what you pay, *value is what you get.*”

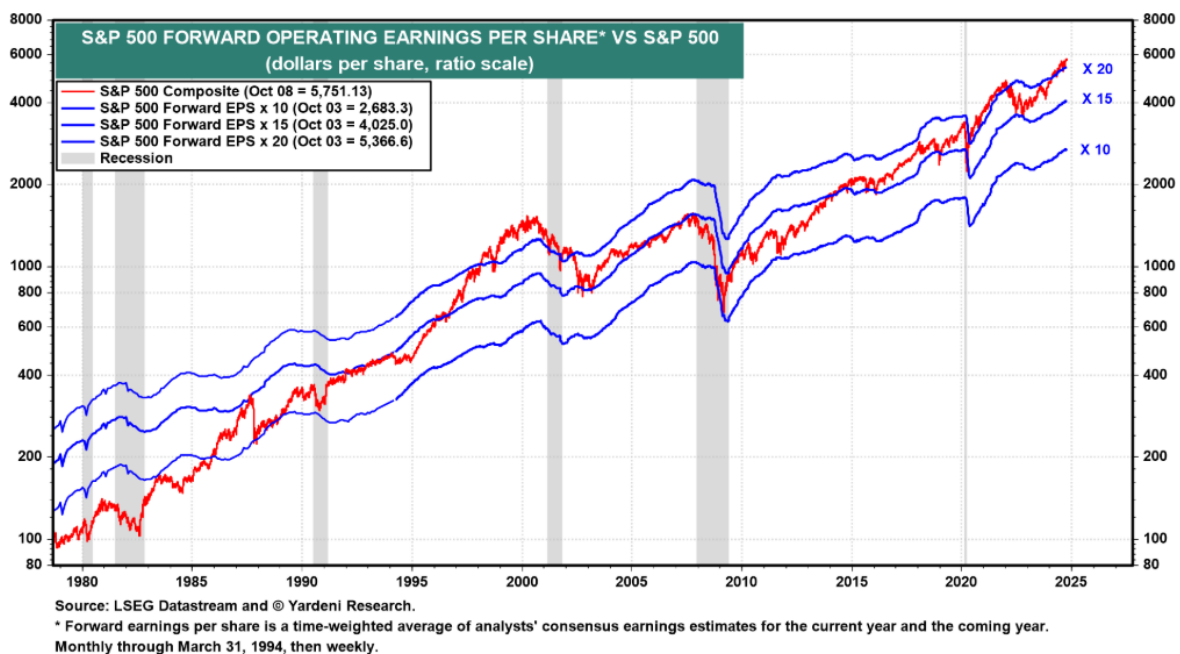
In other words, buying something does not imply any guaranteed future value. And the value that you eventually realize may be far less than the price you paid. In the stock market, this introduces the concept of opportunity cost. See, old school value investors have it wrong. Many will mistakenly assume that when they purchase a low-priced stock, or even a stock with a low price-to-earnings multiple, they have some type of superior “margin of safety.” A margin of safety is the theoretical amount of spread between the price you bought for and the true intrinsic value of the asset. What they fail to understand is that buying something for a low price does not imply it is cheap, because cheapness implies that the value is higher than the price.

Assets in the stock market may be valuable for any number of reasons: a) the discounted future value of cash flows is higher than the price, b) the security is more marketable than its competitors and thus more susceptible to being bought (also known as price momentum), c) it may have characteristics that make the likelihood of its future cash flows more likely to remain resilient in a variety of economic scenarios (think of the waste management industry, or an electric utility) d) it may offer a superior growth rate in revenue and free cash flow that is currently being underestimated by the remaining market participants, e) it may be the candidate for an impending takeover that investment bankers and insiders are aware of, but is unknowable to the general investing public at large, f) there are a variety of other factors, but most undervalued stocks are likely to fall into one or more of the prior categories.

In none of those factors did I see, “*the price was low and therefore is likely to mean-revert higher.*” In fact, earnings, which are correlated to stock prices, are basically the opposite of mean-reverting, they are highly likely to increase nearly monotonically.



Ed Yardeni points out that since the early 1980's stock prices have increased 40-fold, and over that exact time period, earnings of those same companies have also increased 40-fold. Accident? That leaves the “mean-reversion” argument to be handled by the price-to-earnings multiple. In this, also, there is little if any evidence of mean-reversion. In fact, there is recent evidence that the market simply now trades at a higher earnings multiple because the companies comprising the index now sport higher net-margins and higher operating-margins than they ever have before. More profits = higher cash flows = more justification to buy stocks in the index. Even if you look within the index itself, you can observe that the largest and most profitable companies tend to have the highest margins. Accident, or self-fulfilling prophecy?



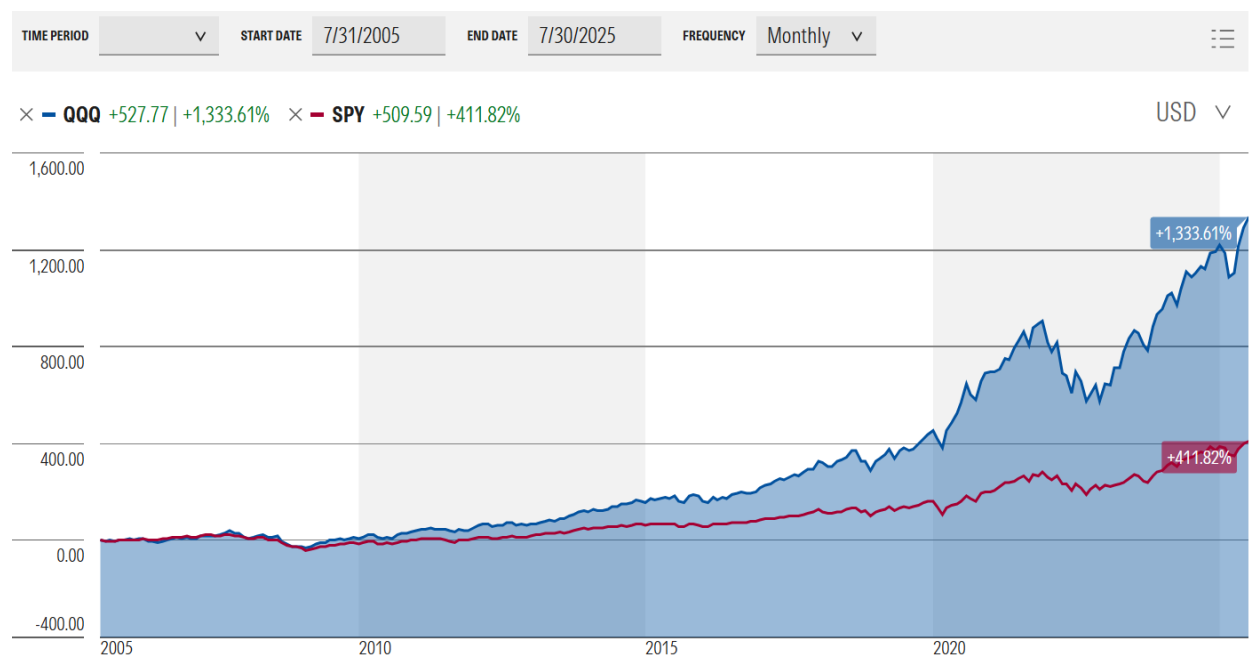
(YardeniQuickTakes.com)

Let's circle back to this idea about an opportunity cost, because it is so central to the idea of modern asset management, but so underappreciated in the market. When you are stock market participant, anytime you engage in a purchase, you are signing up for some future, unknown stream of returns. However, you're also forgoing the nearly infinite return streams you could be getting with your finite capital. For many retirees or those institutional clients with pre-defined return requirements, it is probably okay



to forego some potential upside, in exchange for the near-certain outcome of getting a future payout that is slightly above inflation (or in some cases, slightly below it.) It makes sense, when thinking about an asset-liability matching framework. Plan ahead for your future liabilities.

Where it becomes murky is in the vast in-between. Most financial advisors underestimate the longevity risk their clients will be subjected to, and which is likely to become the most dominant risk in the market, significantly greater than black swan risk. The best asset class for fighting longevity risk is US mega cap growth stocks. Many investors don't know this, but the Nasdaq 100 has outperformed the S&P 500 by about double over the past 20 years.



(Source: Morningstar) To Ed Yardeni's point, Nasdaq companies tend to have superior earnings, which tends to lead to superior stock performance. If growth is likely to outperform value or core by 2x, shouldn't it get double the importance in a portfolio? At Kaizen, we believe that's exactly what it means.

Many in the financial media, and many Chief Investment Officers will, from time to time, espouse bearish views about the market – implying their own ability to forecast tactical market conditions that only they can foresee. Keep in mind, these folks have



short-shelf lives, they are often hired by asset management firms purely because of their utility and disposability in the case of a hard-downturn that the true decision-makers failed to foresee, and most of them have never been actual money-managers. But keep in mind, broken clocks are only right twice a day – and in that time when they're trying to persuade you to keep cash on the sidelines, all the smart-money is making hay while the sun is shining. In the market, being tactically bearish, especially when doing so consistently, is not a nice moniker to live by. While most people are afraid of bears, it will prove to be more fortuitous to ignore them, and truly fear the reality that you may not be long-term bullish enough.

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