Wealthpin Pro

OCTOBER 2022

Well, this month started off with a bang.

The U.N. called on the Fed, and other central banks around the world, to cool down on the interest rate hikes.

You see, many (actually, most) nations in the world are in extreme amounts of debt to the U.S..

We lend money to these countries in order to help them develop.

But like any loan, these countries have to pay back that money with interest.

And now that the Fed is hiking interest rates at such unprecedented speed, it's wreaking havoc on these debt repayments.

The U.N. estimates that every percentage point rise in the Fed's interest rate lowers the economic output in developing countries by 0.8%.

And in developed countries, it lowers the economic output by 0.5%.

In response to the U.N. request, the markets jumped 5% the first two days of trading.

After all, Jerome Powell surely wouldn't continue the aggressive rate hikes would he?

Especially once he knows what it's doing to the global economy?

Oh, how wrong they were.

THE MONEY PRINTER GOES BRRR NO MORE

Even while the market was soaring, San Francisco Federal Reserve President Mary Daly was clear:

The Fed will continue to raise hikes until "we are truly done" with getting inflation under control. She also reiterated that she doesn't see any rate cuts in 2023. To top it all off, she also "sees more rate increases as necessary."

Of course, the markets resumed tanking after these Daly's statements.

But none of this should have been a surprise.

In every Fed meeting for months, the verdict from Jerome Powell and other Fed heads has been clear:

They are willing to inflict maximum pain on the economy in order to bring inflation back to their 2% target.

Yet, everyone keeps hoping for that elusive Fed pivot.

The moment when the Fed will look at the situations and think:

"That's good enough."

But the truth is, we're nowhere near that moment yet. And equity prices still haven't come to grips with the truth.

During an appearance on Bloomberg, Peter Oppenheimer, Chief Global Equity Strategist at Goldman Sachs, said that stocks typically fall 30% during a bear market.

At the time of this writing, the S&P 500 is down 23%.

So, if this goes the way of a normal bear market, we could expect at least another 7% drop.

But that begs the question:

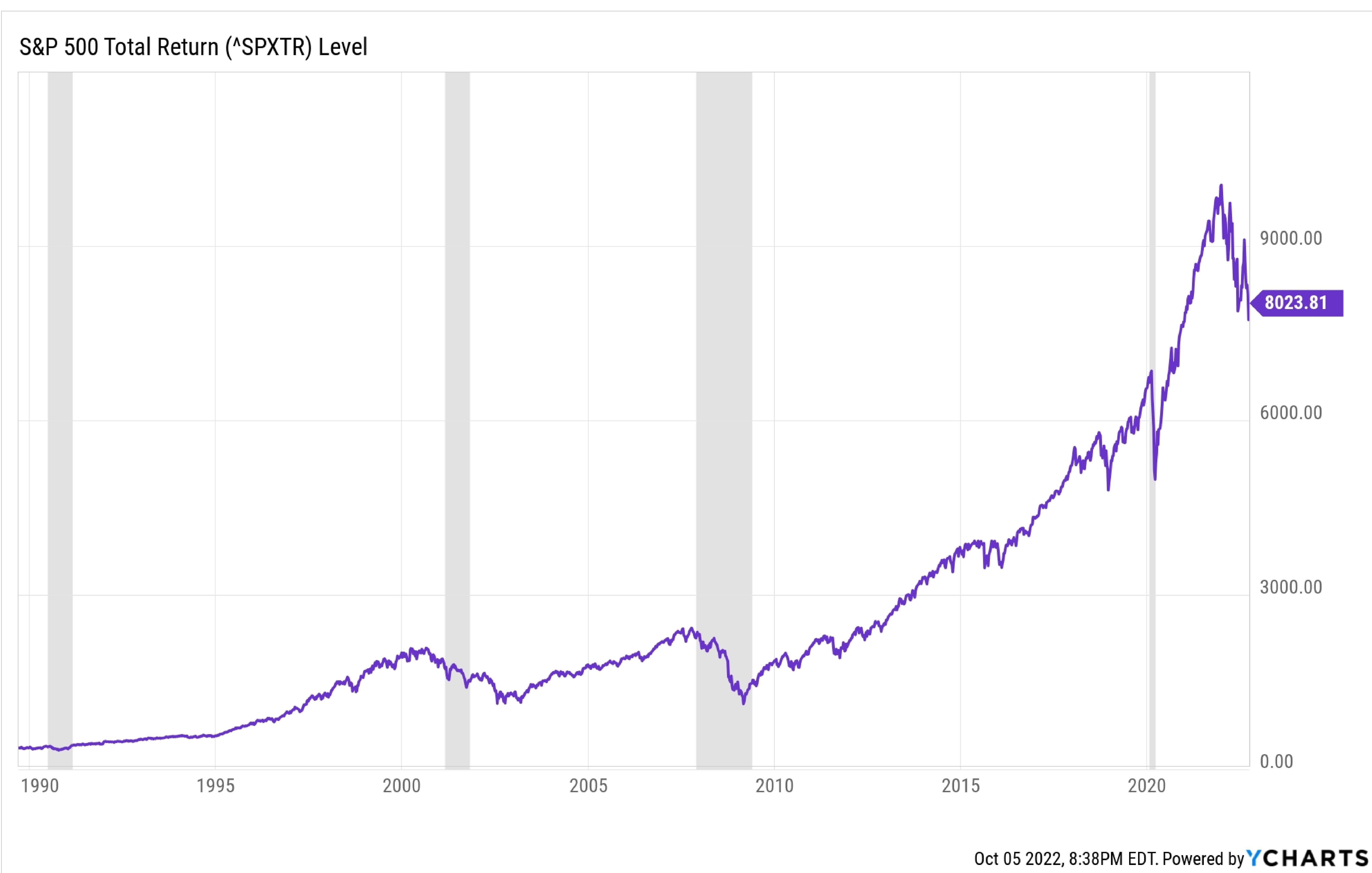
Are we in a normal bear market?

BIG BEAR OR LITTLE BEAR?

Minus the COVID downturn of 2020, we haven't had a bear market since 2007-2009.

The Fed's quantitative easing policies, combined with low interest rates, helped boost equities to unheard of heights faster than ever before.

Just look at that slope starting in '09.



We could argue all day about how much of that was real growth, fueled by fundamentally well-operated businesses...

And how much was artificial growth, i.e. fueled by low interest rates and loose monetary policy.

But the most important thing for us to wrap our head around is this:

How much farther will equities fall?

And when will they start to recover?

Ben Carlson of the Animal Spirits podcast recently posted a very interesting study on his blog that may help us answer this question.

When the S&P 500 is Down 25% or Worse Since 1950

Peak	Trough	% Decline	+1 Year	+3 Years	+5 Years	+10 Years
12/12/1961	6/26/1962	-28.0%	31.2%	69.2%	94.8%	171.1%
11/29/1968	5/26/1970	-36.1%	32.2%	44.3%	27.9%	97.5%
1/11/1973	10/3/1974	-48.2%	1.4%	23.8%	42.0%	188.4%
11/28/1980	8/12/1982	-27.1%	43.9%	81.2%	238.6%	403.9%
8/25/1987	12/4/1987	-33.5%	14.7%	34.1%	96.8%	387.1%
3/24/2000	10/9/2002	-49.1%	0.2%	1.9%	21.5%	38.3%
10/9/2007	3/9/2009	-56.8%	-6.9%	3.7%	61.2%	209.6%
2/19/2020	3/23/2020	-33.9%	56.4%	???	???	???
1/3/2022	9/30/2022	-25.2%	???	???	???	???
Averages		**-37.6%**	**21.6%**	**36.9%**	**83.3%**	**213.7%**

Data: Ycharts

Ben found that in every instance except one...

When the S&P 500 has dropped -25% or more, it's recovered from that loss within a year.

What's most interesting about this study, is that Ben started tracking the potential returns one-month after the markets hit that -25% loss.

Which means in many instances, there was an additional leg down, sometimes as much as another 30% leg down, before the markets began to recover.

But even with that 30% drop, you would still have made the above returns.

Of course, there's no guarantees when it comes to investing.

And there's plenty of tailwinds to consider. A Federal Reserve that seems psychopathically-dedicated to crushing the economy; the deteriorating geopolitical situation with Russia; our own political leadership (or lack thereof).

Reading the room, it seems most of the pros think that equities still have room to fall.

How much is up for debate. But I would say there's at least room for the S&P 500 to fall 10% more.

Especially as we enter October, which is typically the worst performing month for equities.

Of course, that could be optimistic.

During the dot-com crash, stocks fell 25%.

But once we do reach that bottom, the next question will be:

How long until we're out of the bear market?

If the Fed can't get inflation under control, and have to keep interest rates elevated, then the bear market may be here to stay for awhile.

Speaking at an investment conference in September, famed investor Stanley Druckenmiller said he predicts the markets won't be much higher 10 yeasr from now.

In other words, a lost decade.

But look at the table above again. If you were a betting man or woman, what would you say is likely to happen based on the data?

Druckenmiller is great. But even he admits he has a bearish bias. And I would trust his actions more than his words.

He said something similar immediately following the Global Financial Crisis, then went on the make millions upon millions of dollars for himself during the bull run of the last ten years.

Of course, it's impossible to know the future. The best you can do is play the odds.

And after every single bear market in U.S. history, stocks have recovered to all-time highs eventually.

So, we're not doomers here at Wealthpin. If you really think that it's all over and there's no hope, well, there's not much point reading an investment newsletter, is there?

But if you're like us, and understand that bear markets are part of the natural cycle, and you want to use that as an opportunity to load up on cheap shares...

Well, we have just the thing for you.

TO SURVIVE, SOMETIMES YOU HAVE TO SIN

When the economy gets worse, households cut their budget. Nights out on the town, vacations, unnecessary household purchases – all these things are reduced or eliminated entirely.

But some things you just can't skimp on. Toilet paper, food, water, gas – people have to buy these things, no matter what.

But you know what other types of products also do well, regardless of the economy?

So-called "sin" products.

Things like alcohol and tobacco. Not only do these products sustain their demand during recessions, but the demand for them often grows, as people seek more outlets of relief for economic stress.

So, today, we're going to be looking at one of these "sin" stocks.

ALTRIA GROUP INC. (NYSE: MO)

Altria

Price At Recommendation: $42.75

Market Cap At Recommendation: $77.26 Billion

Shares Outstanding: 1.8 Billion

52-Week Range: $40.36-$57.05

If you haven't heard of them, Altria is one of the Big 3 tobacco companies in the U.S..

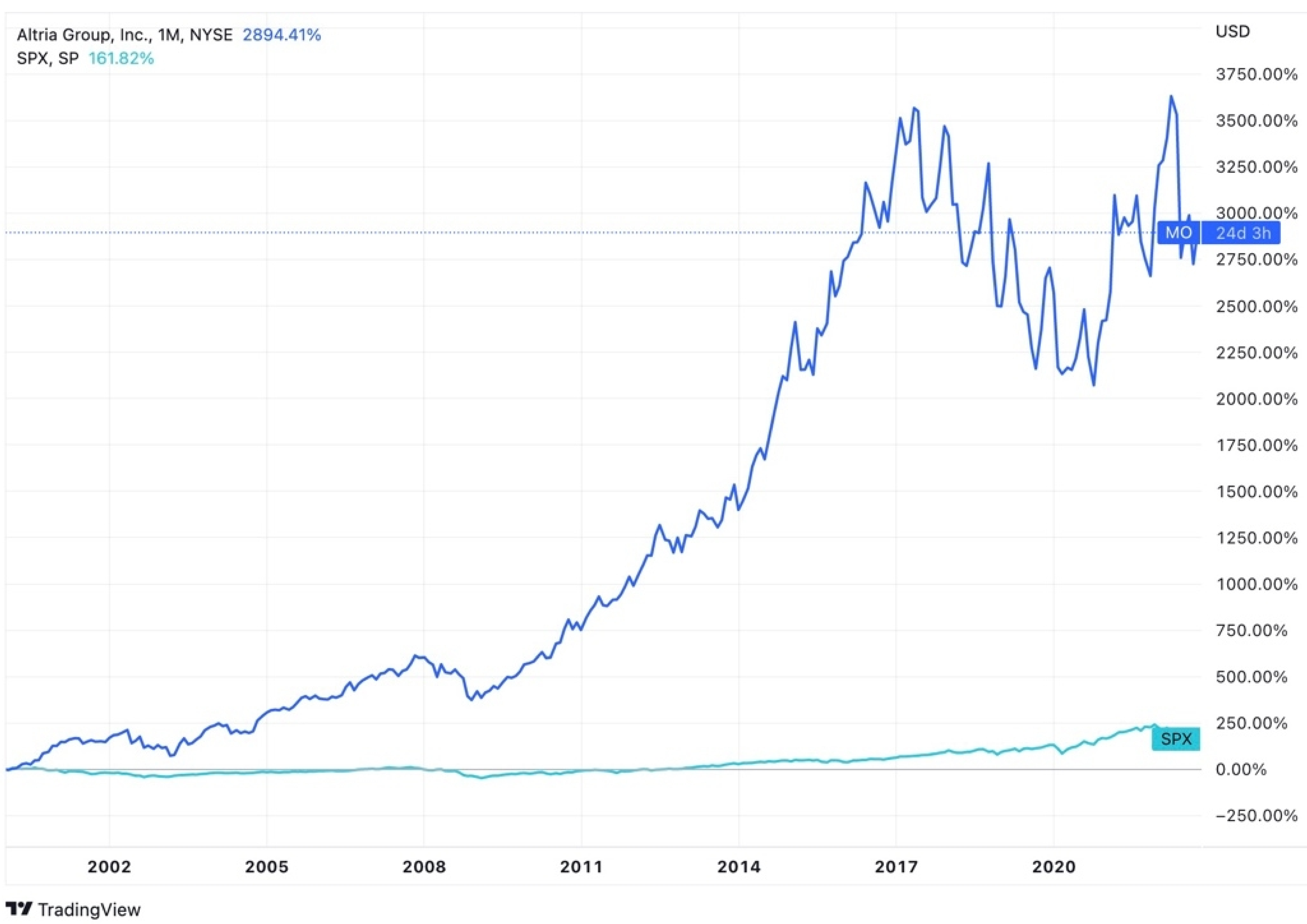
They hold many of the most popular cigarette and nicotine brands under their umbrella, including Marlboro, Black & Mild, Copenhagen, and Skoal.

ELEVATOR PITCH

Altria offers a perfect trifecta for investors during a recession. A hefty dividend, flush operating cash flow, and a business model that promotes loyal customers and long-term demand.

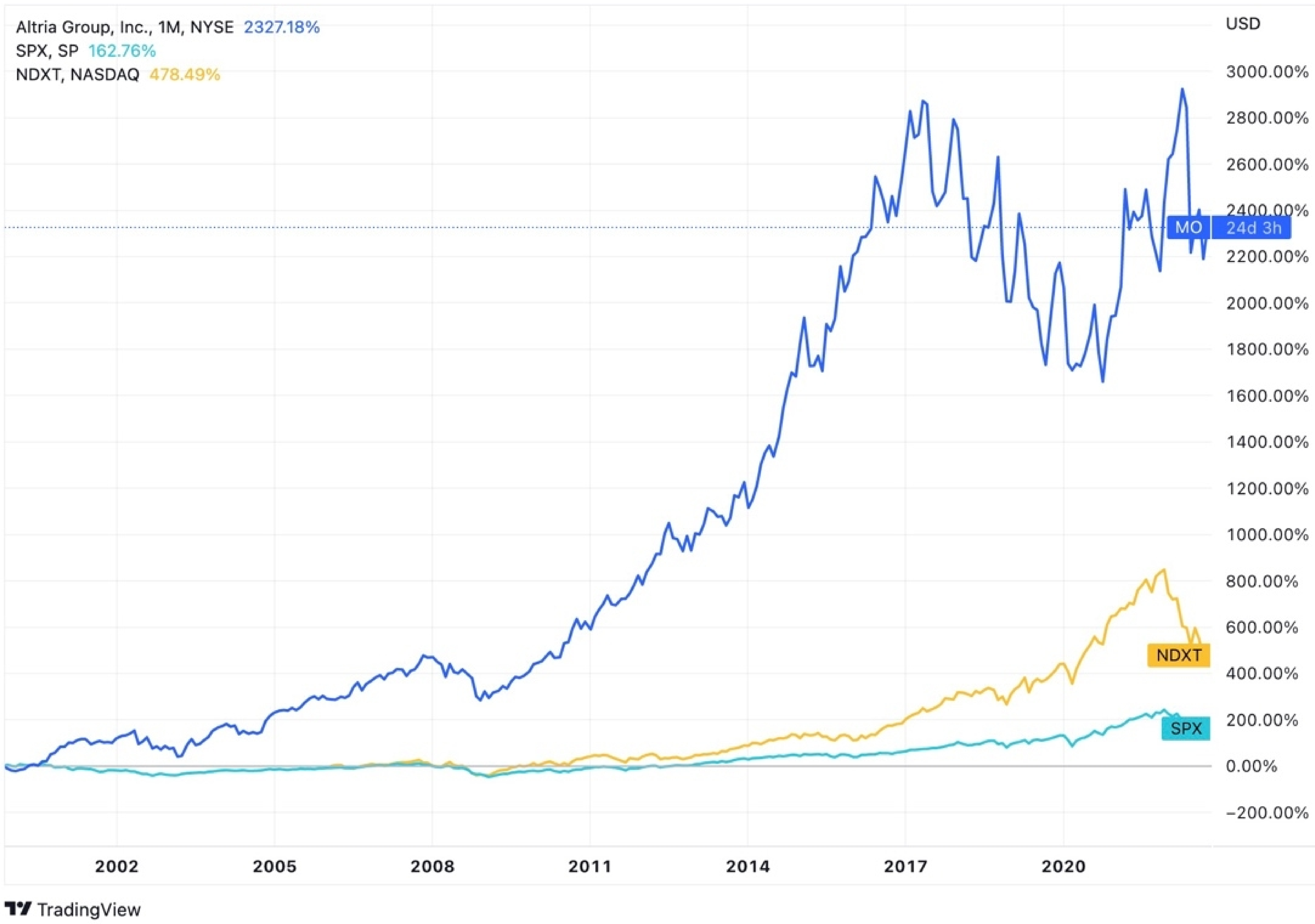
ALTRIA'S ROCK SOLID PERFORMANCE

Before we talk about where Altria will go in the future, let's look at where it's been.



Since 2000, Altria has more than 10X'ed the return of the S&P 500.

It even outperformed the top 100 tech stocks.



However, the picture gets less rosy as we zoom in. Over the last 5 years, Altria has return an annualized gain of -1.10%.

While the S&P 500 has delivered 9.61%.

The recent jitters are multifold. In 2018, Altria took a $13 billion stake in e-cigarette maker JUUL. Subsequently, JUUL has been run through the ringer – they recently lost their FDA operating license and have been battling multiple lawsuits for deceptive marketing practices.

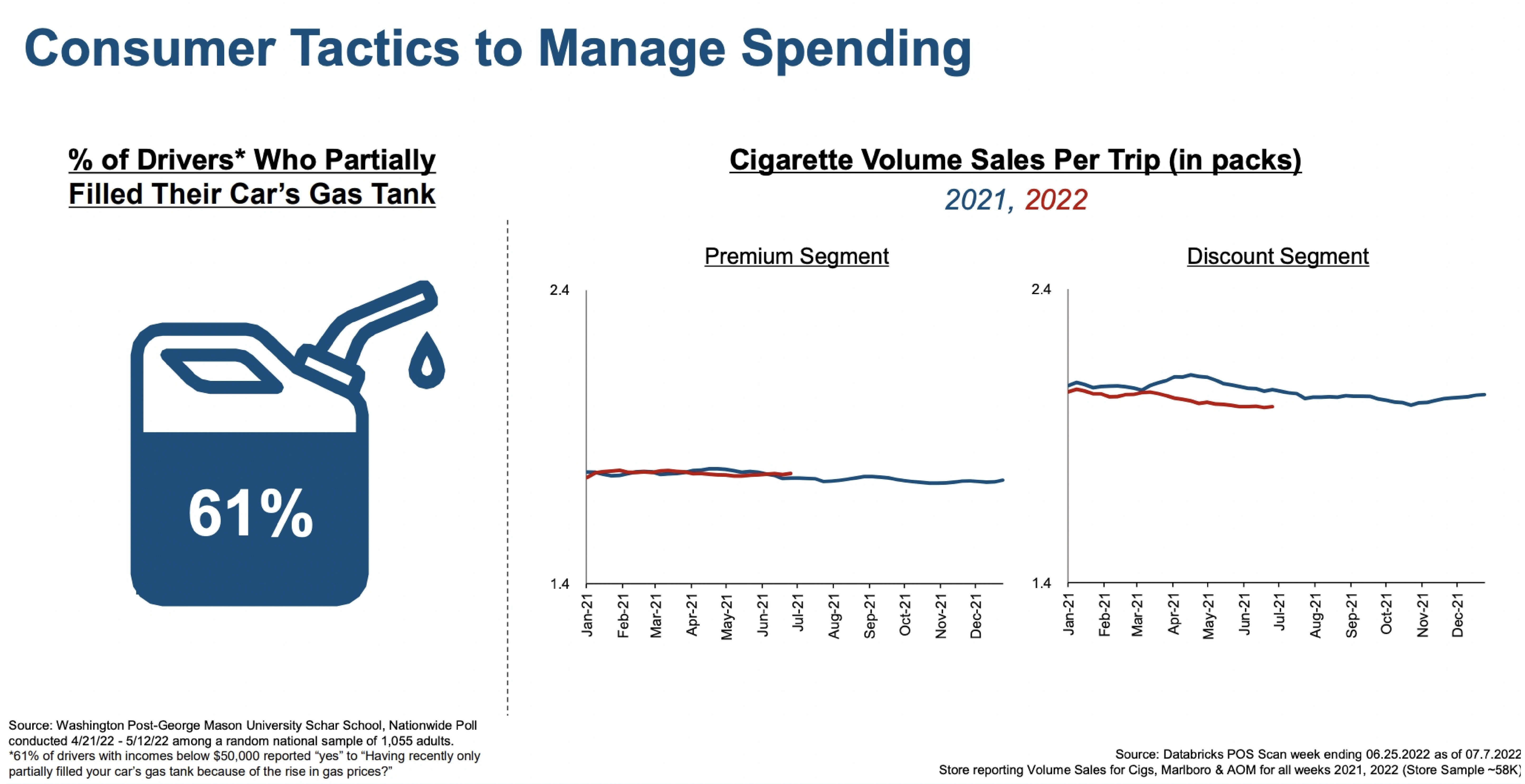
Not just that, but Altria tried to break into the legal weed business by taking a $1.8 billion stake in the pot company Cronos. That was a poor choice. For a variety of reason, Cronos stock is down 90% from all-time highs.

Of course, the big reason for the stock's underwhelming performance has been the cigarette market itself. In 2005, 21% of all adults smoked. Now, that number has fallen to just 12.5%. This number isn't as bad as it seems. I'll show you why later.

But needless to say, the last couple of years have seen Altria venturing into new business avenues, and dealing with some big headaches. But as we speak, they're firmly retrenching themselves, learning from their mistakes, and ready to deliver big value to shareholders over the coming years.

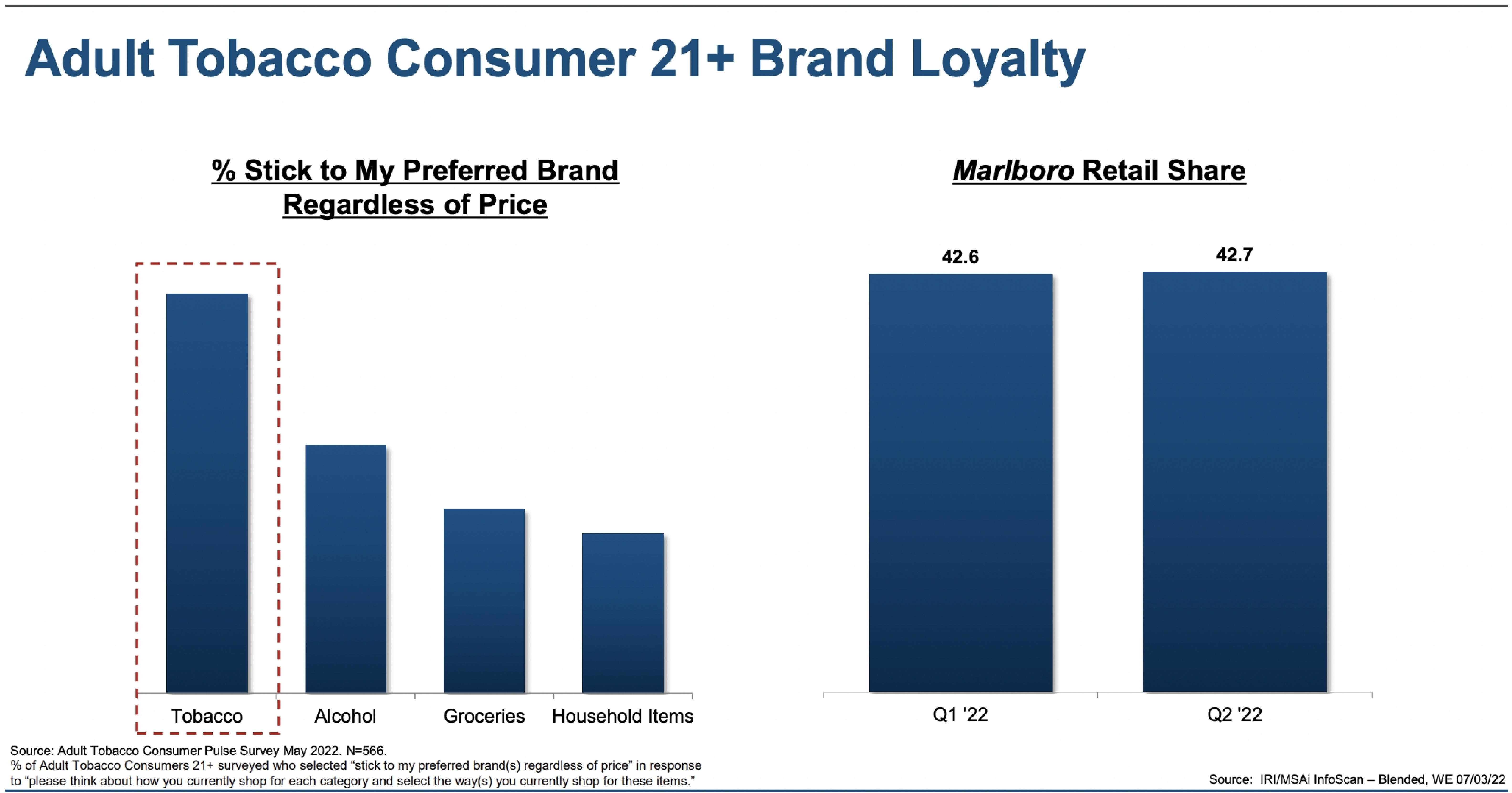
AN UNSTOPPABLE BUSINESS MODEL

Cigarettes are addictive. If you didn't know that already. I'm not a smoker myself (except the occasional cigar) but according to Altria's latest investment report, customers are going without a full tank of gas, rather than give up cigarettes.



Not just that, but Altria is such a staple consumer brand, that there will never be much surprise when it comes to their customers.

Just like they've been for a very long time, they maintain roughly 50% of the cigarette consumer base.



So, it’s not that inflation doesn’t affect their customers. In fact, more people are buying discount packs now than they were before.

It’s just that cigarettes are one of those resilient products that can weather tough macroeconomic conditions better than most things.

And even though the domestic market may be declining, there are still growth tailwinds for Altria.

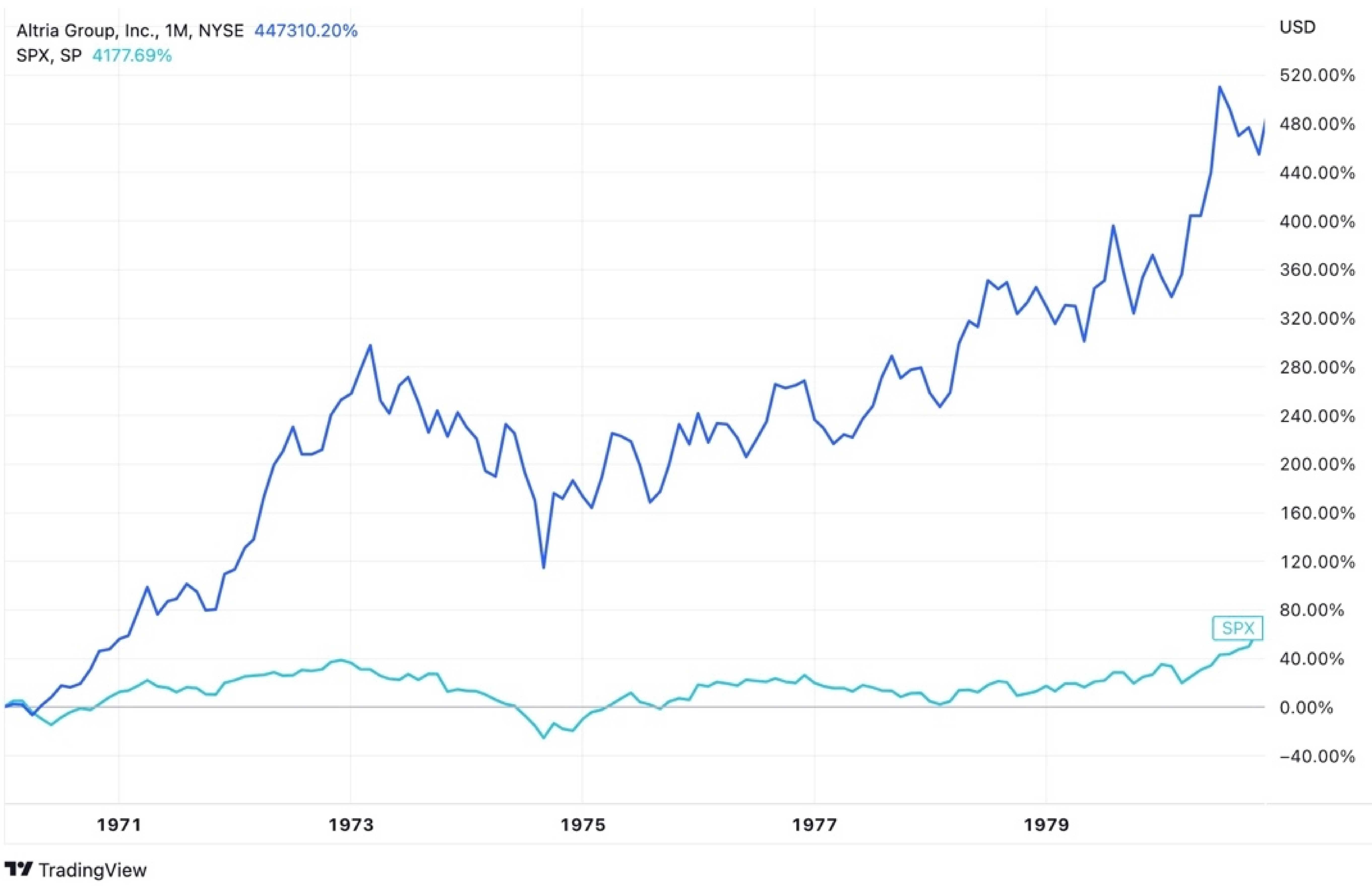
The tobacco market is expected to grow 3.4% CAGR through 2030. On top of that, Altria is focused on adapting to the times.

They still haven’t abandoned JUUL. And they’re also working to expand their heated tobacco and oral nicotine product lines. This is all part of a move to “tobacco harm reduction” which will hopefully mitigate some of the negative health consequences of tobacco.

AN UMBRELLA FOR THE RECESSION

From 1970 to 1980, when the U.S. was facing a similar inflation scenario, Altria stock returned 480%.

Even while the S&P 500 sputtered.



We can only draw so much inference from that performance. But the point I'm trying to make is that, compared to many other equities, Altria isn't as sensitive to inflationary pressures.

As inflation gnaws at our economy over the next few years, Altria will be in a good position to outperform the broader market again.

Here's why:

While its stock price may have been embattled recently, the last few years also seen Altria beef up its internal financials and place itself on extremely firm footing.

One of the most important numbers is the Return on Capital Employed (ROCE). ROCE is helpful because it actually measures how a company's revenue performs against its outlays and liabilities.

To put it plainly, Altria is a cash-cow. Over the last ten quarters, their ROCE has ranged from 23%-36%.

To put that in context, Apple – the most valuable company in the world – has maintained roughly the same ROCE.

And with gross margins hovering around 55%, Altria has plenty of money to play with. In 2021, their net revenues were $26 billion. And they paid out a whopping $6.4 billion in dividends.

SPEAKING OF DIVIDENDS

For a company as stable as Altria, it pays a fat dividend of 9%. To make it even better, Altria has increased its dividend 30 out of the past 33 years. And the company recently announced that it is targeting a dividend payout of 80% of its adjusted EPS.

Altria's expected adjusted EPS this year is between $4.79-$4.93. So, based on their guidance for the rest of 2022, this means they could deliver a 4-7% dividend increase next year.

And similar raises are likely to come in the following years, as well. Juul recently $440 million legal settlement clears the way for a significant rebound. The vaping market is only growing, and could present Altria with significant growth potential near- to mid-term.

ORDERING A SIDE OF UPSIDE?

As of this writing, Altria is down 20% from its May high and approaching its 2020 lows. For the reasons I've shown you above, I believe that better times are ahead for Altria, and the recent drop could present an excellent opportunity for investors to get in.

At this price, Altria has the potential to deliver a nice upside return during the next couple years, as well as solid dividends to keep those compounding returns coming.

We're adding this baby to the Wealthpin portfolio.

> ***Please see the most recent monthly issue for current buy limit and price target.***