October 2022 Newsletter: Catch That Gift Horse

- Running Oak's Efficient Growth portfolio **outperformed** the S&P 500 Total Return Index by **1.93%** in the month of September, with a return of -7.28%, gross of fees, versus -9.21% for the S&P 500 Total Return Index and -9.23% for the S&P 500 Equal Weight.*
- The S&P 500 was **down almost 30% more** than Efficient Growth in September.*
- Efficient Growth has **outperformed** the S&P 500 Total Return Index by **5%** since December.*
- Efficient Growth has provided **26% more return** than the S&P 500 Equal Weight Index since inception, given the same level of downside risk, gross of fees (Ulcer Performance Index).*
- Efficient Growth has **outperformed** the S&P 500 Total Return index by **0.74%** since inception, annualized and gross of fees, despite arguably the worst environment in history for a strategy focused on discipline, valuations, and risk. How many strategies outperform when historically out of favor?

I refrained from sending a note last month, because, by the time I was ready to do so, the market was down big every day. Who wants a snarky email from a sarcastic know-it-all when the market is in free fall? Thus, I am writing this a little earlier in the month than usual.

Get Along Little Doggie

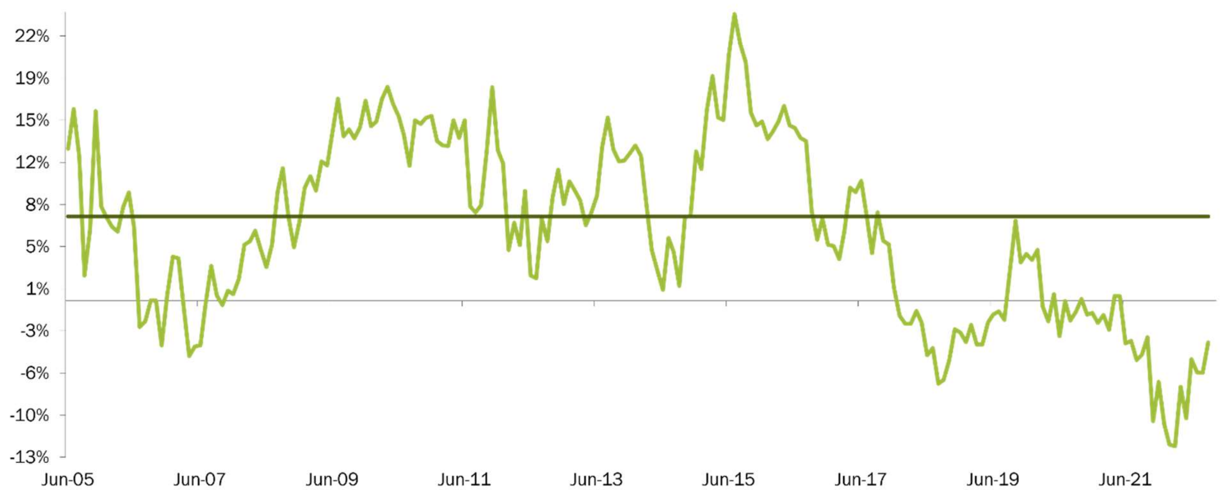
They say, "It's the best thing since sliced bread." I say, "That's a pretty low bar, given sliced bread is a major contributor to today's obesity epidemic in the developed world." They also say, "Don't look a gift horse in the mouth." I say it's better to look'em in the mouth than the other end.

10 months ago, when profitable, well-run companies (High Quality) were trading at the 2nd largest discount in 42 years; momentum and speculation were hotter for a 4-year run than any time in history; interest rates were close to 0, spurring irresponsible debt sales simply so companies could buy back stock to boost share price and CEO compensation **at the risk of shareholders**; and the relative performance of Efficient Growth was basically at an all-time low (while still managing to outperform, I might add), the gift horse was looking us right in the face. 10-months later, he's turned around and started to trot off. To our clients who hopped on for the ride and 5% in outperformance with far less downside risk, giddy up.* For all others, saddle up while you can; the gift horse is likely just getting going.

The High Quality universe is still trading at the 2nd largest discount in 43 years. Mid Cap stocks (currently 55% of our portfolio because of clear overvaluation in many Large and Mega Caps) is trading at the largest discount to Large Cap in over 2 decades. The debt for stock buyback binge is set to go from the best thing since sliced bread to full-on heart disease due to much higher interest rates and unsustainable, irresponsible debt on the part of many companies. Cap-weighted/passive portfolios are overweight the most egregiously overvalued of stocks while undervalued the cheapest - that ain't good. The gift horse that is Efficient Growth has a long, fruitful path ahead of it, as clearly illustrated by its over 30-year history of meaningful outperformance with lower risk.* Hop on while it is just starting to mosey. Statistics and history show that passive and Large Cap Growth-at-Any-Price portfolios are likely to be much more of a gift horse dunghill than a gift horse. Stocks don't generally go straight up, and those particular portfolios and stocks went straight up for roughly 14 years. All you have to do is look at any bear market to see what is in store for the hottest stocks and strategies during the prior run-up.

If words don't move you, here's a simple chart, showing Efficient Growth's rolling 3-year relative performance versus the S&P 500. Investing with Running Oak is a bet that the line goes up. Investing in passive/Vanguard/Large Cap Growth is a bet the line goes down. While the past may not necessarily be indicative of future results, I know what my bet would be.

Cumulative 3-Year Rolling Relative Performance vs S&P 500 (Apr. 2003 – Sep. 2022)*



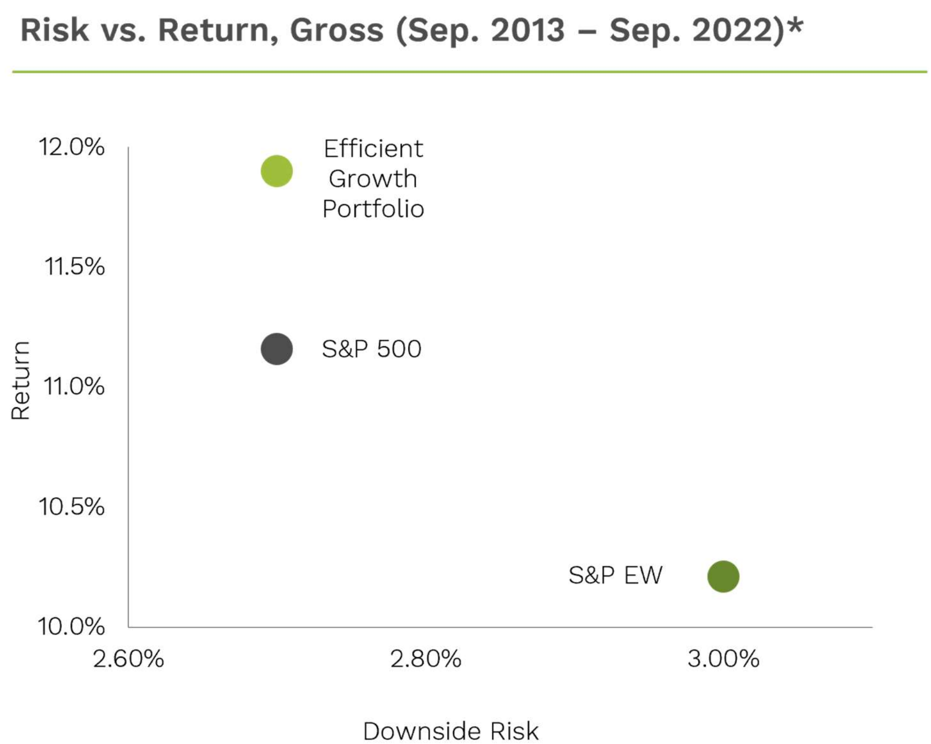
Why is the pretty green line above move likely to go up than down? It's a bet on profitable companies no longer trading at a historic discount to unprofitable companies; investors actually thinking about the price they pay for an asset (despite recent behavior, stocks are assets, not slot machines); more innovative and faster growing Mid Cap companies no longer trading at a massive discount to overvalued Large Cap companies, which they almost never do; and the historic decade long debt bender that companies have been on resulting in a hangover.

The Fed has been forced to reverse course on their wildly irresponsible behavior over the last 4 decades during which they prioritized stock returns and political machinations over economic stability. Unfortunately, one can get away with backwards priorities for only so long. There's no telling what the next 10 years will look like, but a parabolic run-up like the last 10 is unlikely. Risk once again matters; stocks can go down. Fortunately, this happens to be the ideal relative environment for Efficient Growth. If the market goes up, Efficient Growth has historically provided comparable upside to the S&P 500. If the market goes down, there are a number of ways in which we strive to protect our investors.

Running Oak actively mitigates downside risk for our clients in the following ways:

- **Earnings Consistency** – Holding P/E relatively constant, volatile earnings mean volatile stock prices
- **Undervaluation** – Investing in assets at a discount provides a degree of safety
- **Avoidance of Overvaluation** – Owning an asset at a dumb price is, well, dumb and begging for significant downside risk
- **Avoidance of Irresponsible Leverage** – Historically, few things can take a stock to $0 faster than too much debt
- **Equal-Weighting** – Diversification, diversification, diversification. Investing 25+% in a small number of highly correlated stocks, like the S&P 500, is irresponsible diversification.

Below is a quick look at how Efficient Growth has performed through arguably the worst environment in history for a strategy focused on discipline, valuations, and risk. If a strategy can outperform with less risk through a horrible environment, how is it likely to fare through an ideal environment?



If you appreciate math, common sense, and occasional sarcasm, we would love to speak with you. Please feel free to set up a time here: https://m.levitate.ai/25b96d-6d5n9i/30-minute-meeting

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**Past performance is no guarantee of future results. Performance expectations are no guarantee of future results; they reflect educated guesses that may or may not come to fruition.*

Performance of the Efficient Growth strategy has been tracked since 1989. Performance prior to September of 2013, while unaudited, was documented and generated on a real-time (not back-tested) basis. Such results are from accounts managed at other entities prior to the formation of Running Oak Capital. All indices are unmanaged and may not be invested into directly. Comparison described here are made relative to mutual funds included in the Morningstar Large Cap Blend universe, which were used for their availability and relative comprehensiveness of data. Other strategies managed in different vehicle structures may exist that are not represented here.

The S&P 500 Index is a capitalization weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

The opinions voiced in this material are for general information only and are not intended to provide specific advice or recommendations for any individual. To determine which investments and strategies may be appropriate for you, consult with us at Running Oak Capital or another trusted investment adviser.

Stock prices and index returns provided by Standard & Poor's.