Ride the Twists and Turns
By Joel Litman, chief investment strategist, Altimetry

Many folks don't understand the most efficient path between two points...
They believe it's always a straight line. But in a lot of cases, that's just not true.

Nature gives us countless examples...
Picture the amazing directional consistency and symphony of a field of sunflowers. Their ultimate goal is to capture as much sun as possible – a sun with predictable patterns.

The stalks of those sunflowers twist and turn and branch in so many ways. They're never just straight up and down. Those crooked paths reflect a plant's life of pursuing the most efficient path toward absorbing the most sunlight possible.

Lightning is another example. You might expect the electrical path from the sky to the ground to be a straight line. After all, that should be the most efficient path.
These bolts of electricity *do* take the path of least resistance. And yet, it's one that forks and branches and shifts any which way.

It's never – *never* – a straight bolt down.

The same thing is true in business and investing...
As I'll explain today, businesses and their valuations have significant pivot points. They fork one way or another throughout their life cycles.
And 2023 is already set to provide some incredible examples.
Like sunflowers and lightning, great businesses branch and pivot...

You've probably never heard of a little company called Suomen Gummitehdas Oy.

Founded in 1898, it started its life making rubber galoshes to compete against Russian imports. After several years of work, it moved its factory to a small town outside of Helsinki.
Over time, this little Finnish company realized how important its plastics could be for producing cellphones. And it used that to make a global name for itself.
The name of that small town is now known worldwide. The little rubber business became the global communications giant known as Nokia (NOK).

You've almost certainly heard of *that* company.

It's a similar story with a small San Francisco record store that started in the late 1960s. The shop owner noticed that jeans were extremely popular with kids. So he tried selling both records and jeans together. It was an odd pairing. The jeans didn't sell like he thought. So he opened a second location... *And jeans sales took off*.

The owner ran with that pivot. And over time, it became the company's claim to fame.
That one decision was central to the history of apparel behemoth Gap (GPS).
Gap has certainly sold far more jeans (and other clothes) than records to date.

And big points to you if you've heard of this one...

Oliver Chace and his many descendants were well-known industrialists of their time. The family built and ran textile mills in New England for more than 100 years. They started the Valley Falls Company in 1839. The Chaces acquired several companies over the century, eventually renaming the firm after one of its merged businesses – Berkshire Fine Spinning.

About 115 years after the company was first formed, Malcolm Chace Jr. merged it with Hathaway Manufacturing.

In 1965, Warren Buffett took control of Berkshire Hathaway (BRK-B), formerly known as Valley Falls. The rest is history. Some of the mills were converted to apartment buildings. The company as a whole became the investment behemoth we know today.

All of this is to say that no business (and no market) goes straight up. A lot of the biggest companies today have lived many past lives.
It's no surprise that valuations twist and turn – just like the businesses that underlie them...
At both a stock level and a macro level, important pivots can tell us much about volatility.
The market's weakness in 2022 has been the subject of much doom and gloom from investors and the mainstream media. However, let's put it into perspective...

The fact is that technology firms were due for some correction after running too far, too fast, for too long. Many Big Tech businesses hired too many people... lost sight of their main goals... and built bloated levels of overly bureaucratic middle management.

Tech needed a big pivot, and it got one. The recent rounds of tech layoffs show companies are right-sizing a lot of their poorer decisions.

With that said, many tech companies remain incredibly profitable.
And that's just tech. If we remove the six highest-valued companies from the S&P 500 Index – Apple (AAPL), Microsoft (MSFT), Alphabet (GOOGL), Amazon (AMZN), Berkshire Hathaway, and Tesla (TSLA) – the so-called "S&P 494" trades much cheaper.
Removing those six companies reduces the index's price-to-earnings (P/E) ratio from above 17 times to just 13 times. (The P/E ratio measures the value of a company's stock price against its earnings.)
That's a much more attractive price when you consider the market average is about 20 times.
This isn't a time to lose hope in the markets...

U.S. companies are still recording strong fundamental data.
As regular readers know, we believe right now is a time to be tactical. The market is pivoting.
We don't have interest-free debt anymore. The tech industry is going to look different from what we're used to. Global supply chains are reorganizing around the U.S. as the rest of the world reduces its dependence on China and Russia.

U.S. companies have been quietly and steadily building up their infrastructure. That will lead to a massive wave of reinvestment in U.S. manufacturing.
Our companies lead the way in innovation and commercialization of new technologies, goods, and services. And the power of U.S. energy on the global stage is now undeniable.
Keep in mind that we think 2023 could be a period of transition. It will be a difficult time for U.S. corporations and the stock market.

However, this is the kind of pivot that will strengthen the economy and the stock market for *decades* to come.

In the meantime, it's important to keep a cool head...
It might feel like we're going in the wrong direction right now. Don't panic. In a transitional period like this, you need to focus on the long term. Companies will adapt in due time.

The businesses that succeeded yesterday (like tech) probably won't be the first movers when the dust settles and a new bull market takes hold. Industrials – especially those with supply-chain exposure – are much more compelling today.

Be nimble, be watchful, and follow better data during important business and market pivots. If you can do that, you'll do well in U.S. equities in the years to come.

Wishing you love, joy, and peace,
Joel Litman