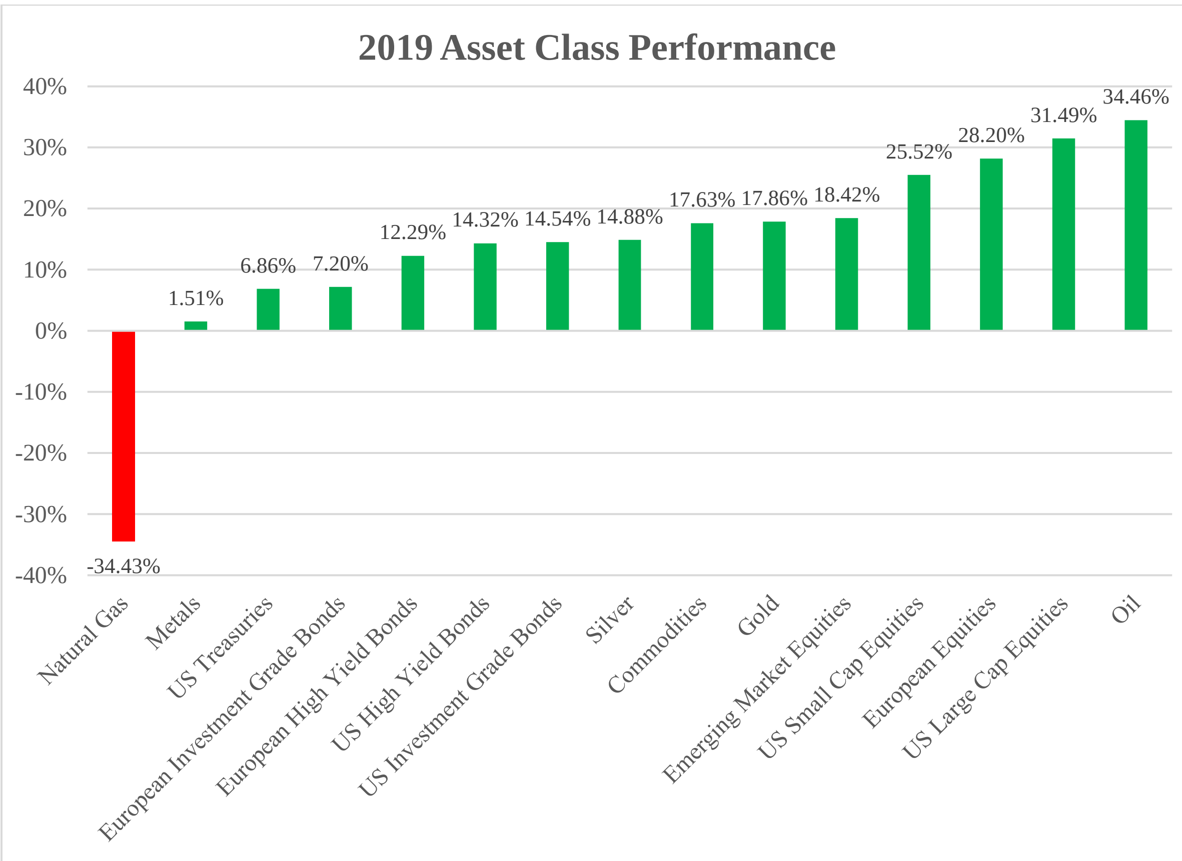
CAZ Investments
Quarterly Letter

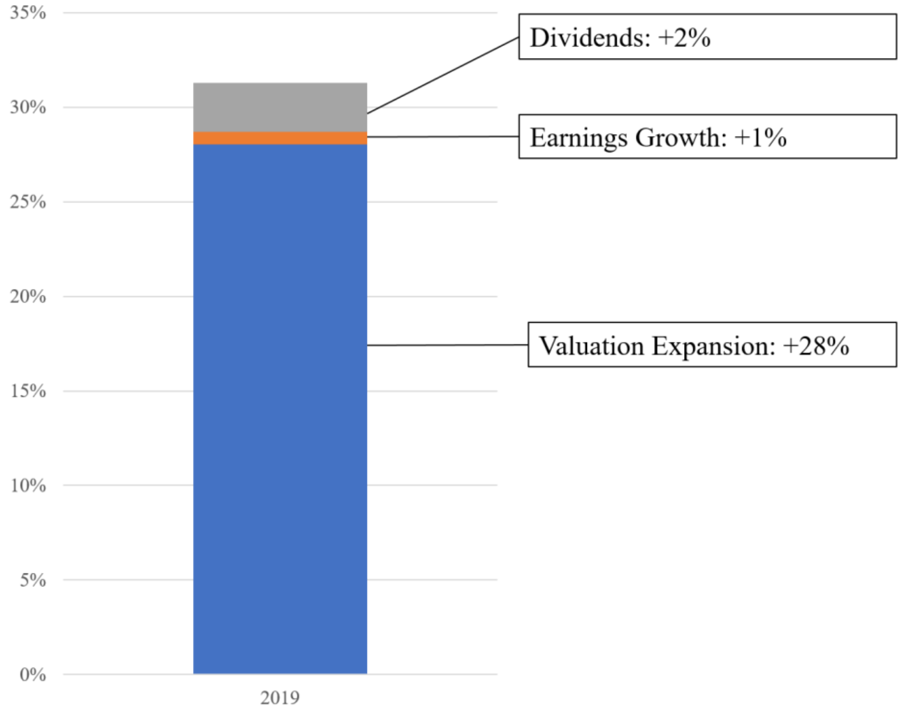
Up, Up and Away

To quote the famous cartoon character, Buzz Lightyear, "To infinity and beyond!" That is certainly what the markets felt like in the 4th quarter of 2019, capping off an outstanding year of performance for nearly every asset class. Risk on was the name of the game as markets began to celebrate the successful completion of the trade negotiations, an accommodating Federal Reserve, and an economy that appeared to be stabilizing.



Just after year-end, we held our Themes for 2020 event, with guest speakers Robert Smith (Vista Equity Partners), Purnima Puri (HPS Investment Partners) and Gabe Cahill (Neuberger Berman) and several of the charts used at that event are powerful enough to reproduce in this document. Below you will find several key points from our Themes recap, and then we will talk about our outlook for the remainder of 2020.

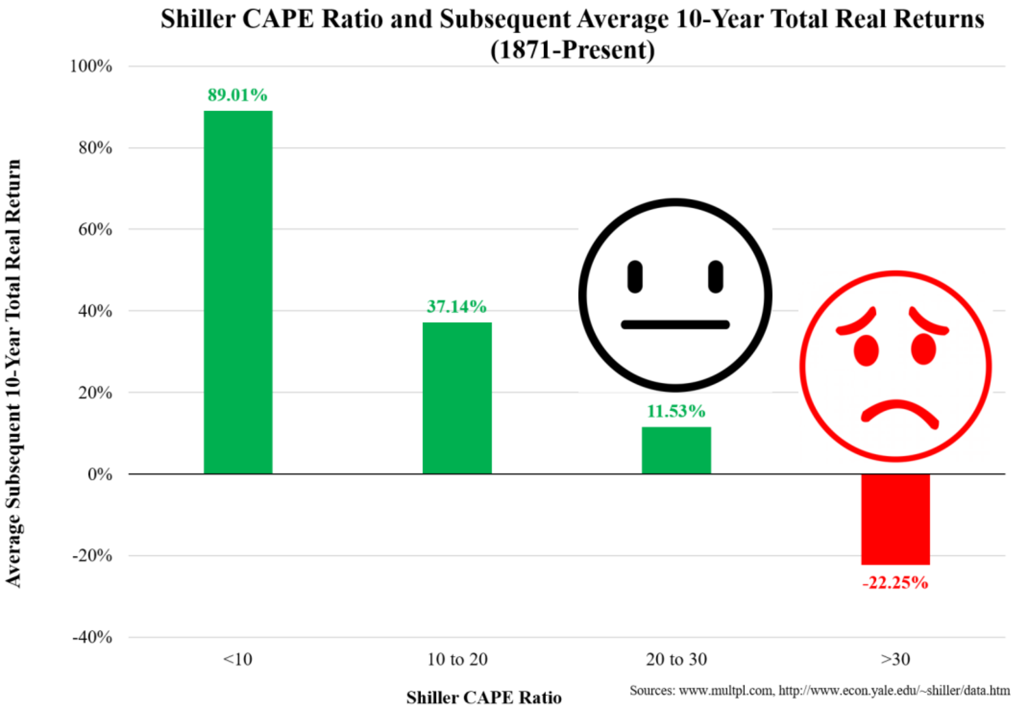
- Although it was an excellent year for equities, the S&P 500 return for 2019 was driven nearly entirely by valuation expansion rather than growth in earnings.



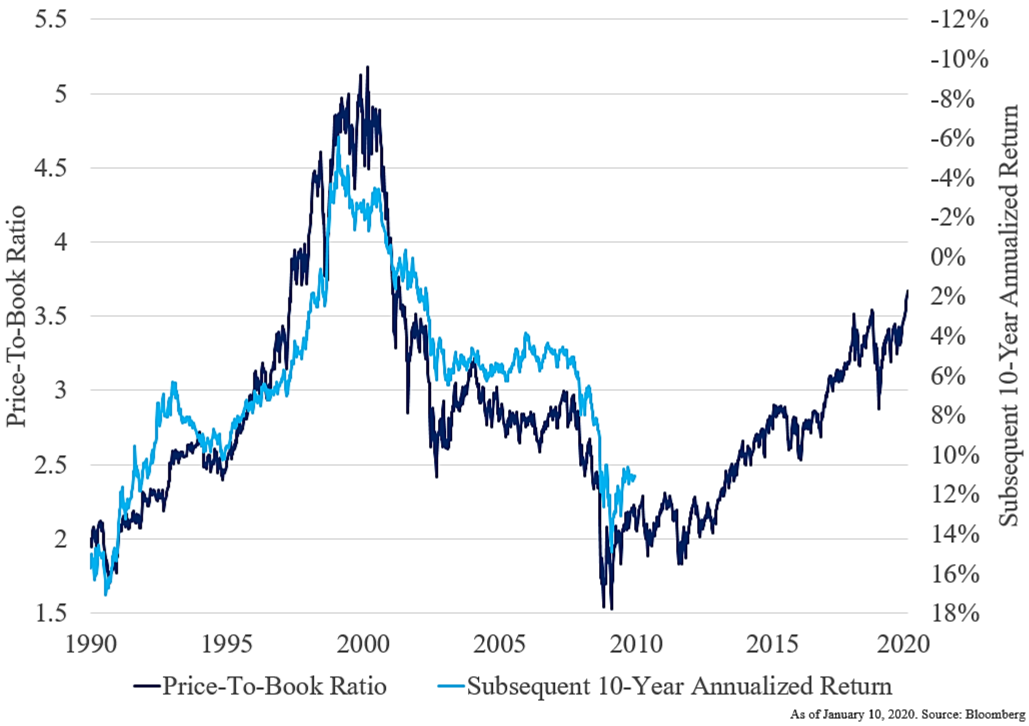
Source: Bloomberg

- As discussed at our previous Themes events, the Shiller CAPE Ratio is a valuable indicator of future S&P 500 real returns. As the chart below shows, the ratio has now risen to levels only exceeded by the Tech Bubble of the late 1990's. As a result of the valuation expansion that took place in 2019, the CAPE Ratio is now back above 30. A CAPE Ratio above 30 has historically led to strongly negative 10-year real returns, as shown in the second chart below.

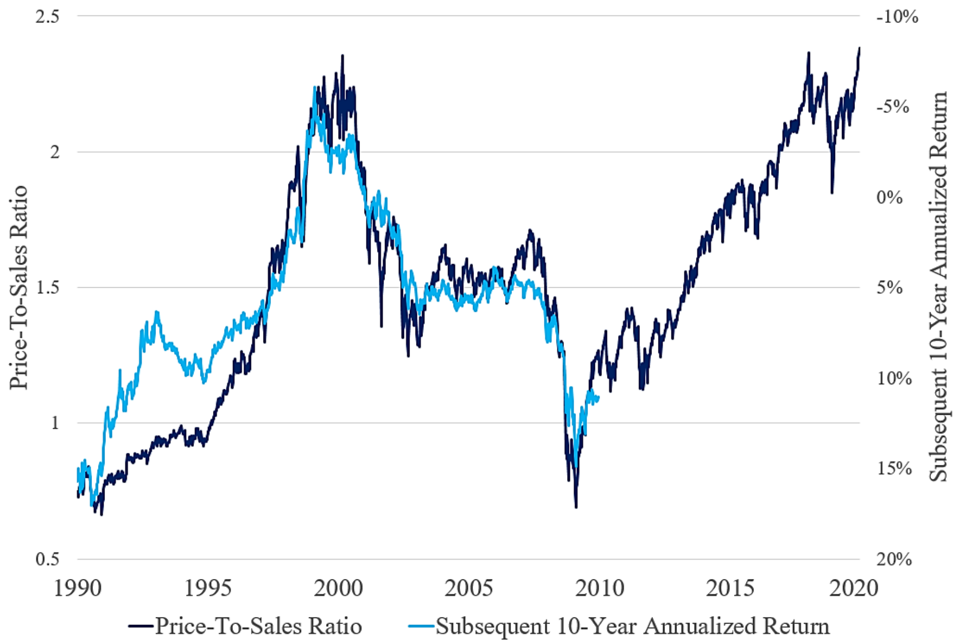
As of January 10, 2020. Source: www.mutlpl.com



- Further, the Price-To-Book Value Ratio has been remarkably predictive of subsequent 10-year annualized returns. With the ratio above 3.5, forward returns have historically been very low.



- Additionally, the Price-To-Sales Ratio has also been an accurate leading indicator of subsequent 10-year annualized returns. With the ratio above 2, forward returns have historically been significantly negative. We are now in uncharted territory, even surpassing the Tech bubble.



As of January 10, 2020. Source: Bloomberg

2020 has seen a continued march higher in the market despite the Coronavirus, concerns about worldwide economic growth, and relatively mediocre earnings announcements. Now, as we write this, markets are again at all-time highs. So, where does that leave us? It leaves with an outstanding "tape" where stocks seem to shake off any signs of negative news and charge higher, but very expensive valuations when compared to any historical standard. Indeed, as the price-to-sales chart above shows, according to that metric, we are now more expensive than any time in modern history.

We reiterate that expensive valuations don't mean that stocks must fall, however they do make it harder and harder to predict higher prices. And it means that downside risk is significantly higher than it has been, simply because there is farther to fall if valuations begin to revert to any rational mean. Therefore, we will maintain our rating on the **CAZ Scale of a 1**.

There are potentially serious storms that we see brewing on the horizon, including the economic impact of the virus and the increasing possibility of an openly Socialist candidate representing the Democratic party in the November election. How these matters settle out are challenging, at the least, to predict but it is safe to say that the mindset of investors could be influenced significantly by these factors, as well as several others. To reiterate what we stated last quarter, *the hardest part about valuation driven rallies is that they are typically based on psychology, and that can reverse on a dime. One wrong news headline, or tweet, can change the psychology of the markets which makes it very difficult to predict. That said, we are very aware of the adage "don't fight the tape," and the tape is actually acting quite well. Our caution for investors is to be sure that your allocation to stocks has not grown*

to a larger % of your target allocation than it should be. Sell when you can, into strength like this, not when you have to.

We are more than happy to have conversations with you about your asset allocation and be helpful any way we can. Further, we will continue to let you know what we are doing with our personal capital to generate consistent returns with very little correlation to the overall markets. There are several things that we have in final diligence and we will advise if those opportunities become a reality.

Please let us know if there is anything we can provide to make these letters more valuable. Please remember to access the private page on our website with the videos that contain individual vehicle updates. There is a significant amount of valuable information in those videos and they are worth the time to watch them. All our very best to a healthy and prosperous 2020!

All our very best!

The CAZ Investments Team