

MARKET INSIGHTS

SECOND QUARTER 2024

NAPLES GLOBAL ADVISORS

“Compound interest is the eighth wonder of the world. He who understands it, earns it ... he who doesn't ... pays it.” - Albert Einstein

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On April 8th, a large slice of the United States experienced a total solar eclipse (TSE). It was particularly special because it lasted twice as long as the 2017 TSE, and it was the longest TSE visible (with special eye protection) on land in over a decade. Admittedly, Naples Global Advisors (NGA) has no hardcore eclipse chasers that travelled to experience the totality in all its glory, but many of us did wander outside with our cool eclipse glasses to see what all the excitement was about. (Or perhaps some of us just needed a reprieve from the intensity of tax season).

The eclipse is used as a metaphor for many things, but it applies quite well to the cyclical nature of our business. For natural phenomena seekers, there is a ton of excitement leading up to the eclipse. The intensity peaks when the Moon passes between the Sun and Earth, completely blocking the face of the Sun. Then, in the blink of an eye, it is all over. Many observers are left to reflect on the “magic” that is our universe.

For NGA, activity and excitement build as the SWFL Season progresses then climaxes with April Tax Day. There is still work to be done post Tax Day, but there is also more time to think, to reflect.

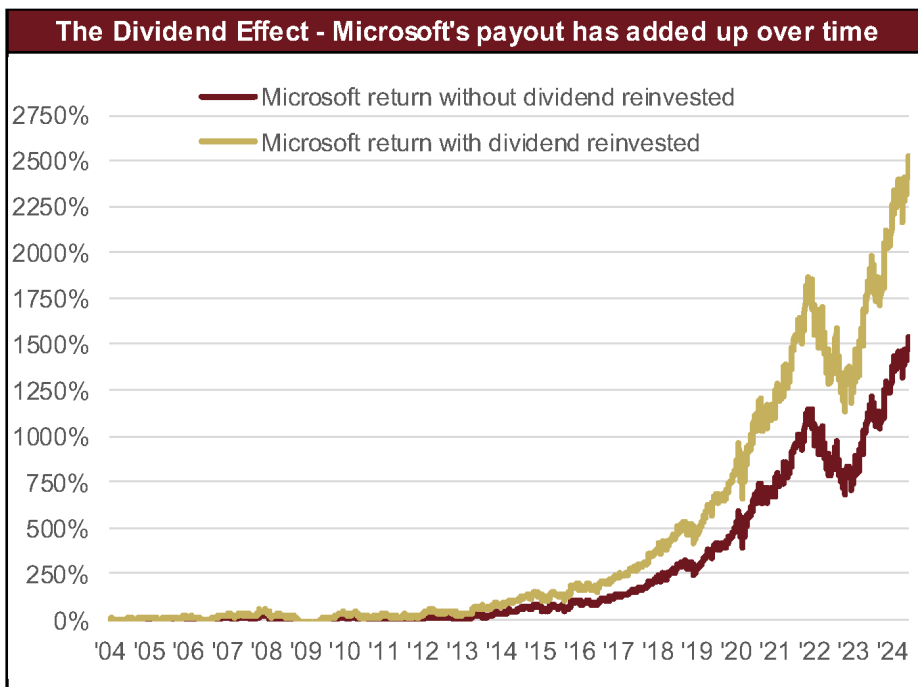


As we reflect on the investment markets, it felt like there was an underlying subtle change that may have been drowned out by the plethora of day-to-day headlines. Within the S&P 500, four companies initiated a dividend for the first time this year. That in and of itself is not newsworthy, but what caught our eye was in the details - all four were technology-related companies. Historically, tech companies have been more reluctant than others to share their earnings with shareholders. They favor their cash to be spent

on high return growth projects that should, in return, drive future earnings growth and thus the price of the stock. In fact, only ~55% of tech companies in the S&P 500 paid a dividend at the start of the year, which contrasts to an elevated ~85% for non-tech companies.

As dividend investors, we welcome with open arms this potential change in tech managements' attitudes towards dividends. Admittedly, the yields on these new dividend issuers are paltry, averaging just 0.6% (versus 3% on our average portfolio). Yet, we remain excited about the future opportunity set for dividends to be increased substantially as large tech companies potentially look to share more of their cash hoards with investors. Cash on the balance sheet at the ten largest tech companies totals an astronomical \$600 billion, backed by an equally impressive \$650 billion of annual operating earnings. SHARING more of these billions will go a long way for SHAREHOLDERS.

A trip down memory lane with Microsoft is a reminder of the importance of the level of the dividend (and resultant yield) AND the growth of that payout. Microsoft was one of the first real big tech companies to initiate a dividend all the way back in 2003. The yield was sub 1% then and remains sub 1% today. Nevertheless, the impact of that modest dividend has been astounding. The shares of Microsoft have appreciated over 1,500% in the last 20 years, but if one had reinvested the dividend, the total return jumps to roughly 2,500%!



Source: Wall Street Journal and Bloomberg

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It's curious that the world's most famous physicist is widely quoted in the personal finance and investment arena, but if you break it down into layman's terms, physics describes how the natural world behaves (by applying math). Einstein knew the mathematical law of compounding, simply applied it to the world of money, and was surely amazed.

To highlight this “magical” wonder, math professors usually pose a question to their students, “Would you rather take \$1 million today or a “magic” penny that doubles every day for 30 days?” It's

difficult to turn down the immediate \$1 million but if you did the math, it would show you that the “magic” penny will be worth more than \$5 million at the end of the 30 days. Many students are shocked, not too dissimilar to our reaction when we saw the 20-year total return statistics on Microsoft.

At the end of the day, this “eighth wonder of the world” continues to drive NGA's investment process and financial advice. It is why we focus on cash flows and the ability to reinvest them. We distinctly target dividend-paying stocks with our equity investments. We distinctly target coupon-paying bonds with our fixed income investments. Oh, and by the way, with bond yields in the 5% range and near 15-year highs, we are once again excited about the opportunity to compound some serious interest in the fixed income asset class again.

Stocks and bonds aren't the only investment where you can compound interest. We have had more discussions recently about increasing the amount of interest clients are earning from their cash. In our investment portfolios, we typically hold a marginal amount of cash, around 1-2% of client portfolios. Even so we are trying to maximize the interest earned by utilizing money market funds and/or short-term U.S. Treasury bills – both of which are currently paying around 5%.

Naturally, clients typically hold their large cash balances at their bank institutions for their living needs and rainy-day funds. We have heard many times from clients about their banks paying less than 1% interest on personal and corporate deposits. And so, we urge you to reflect on your cash balances. First, to make sure they are at efficient levels (not too little, but not too much) to meet your needs, but also to check that the interest being earned on those balances is maximized. The prevailing interest rate environment is not 1%; it is around 5%.

Underproductive cash is a drag on performance that doesn't show up on your statements. If you are uncertain whether you have an efficient level of cash or are earning appropriate interest, please call us. We want to ensure you are collecting your “magic” pennies!



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