BANYAN CAPITAL MANAGEMENT

Rooted in Thought

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How Little Changes

We usually ignore such nonsense, but, given the hoopla in financial press about the "Magnificent Seven" stocks (i.e., Microsoft, Apple, Amazon, Tesla, Meta, Alphabet, and Nvidia), we cannot help ourselves. Please allow us this indulgence. Recently, we read this about the Magnificent Seven:

> "[M]oney gravitates to what has performed best recently. For example, over the last three years, the earnings of the so-called Magnificent Seven . . . are up 157% as a group. . . . But those stocks are up 314% - which means that their P/E has doubled. . . . And for whatever it may be worth, the P/E of the Magnificent Seven is roughly 65 today . . . So are we dinosaurs [since we don't own them]? I don't think so. To the contrary, we've seen these periods before – and we'll see 'em again.[1]

Interestingly, this quote is not from a recently penned piece. It is from a 1999 periodical! (We are a bit behind on our reading so keep the book suggestions to a minimum.) We do not share this to suggest today is a repeat of 1999 – only time will tell. But it is striking how history repeats itself. In fact, many of the stats in the above quote align well with today's Magnificent Seven cohort.

To fully capture the post-COVID boom, we will use the five-year period through yearend 2023. Over that period, today's Magnificent Seven saw their earnings per share grow by 365% on average according to FactSet.[2] Yet, the stocks delivered an average total return of 508% over the period. Their valuation, or P/E multiple, has thus risen almost 40% to end 2023 at a very high 42.[3]

So, this begs the question, how did the Magnificent Seven of 1999 fare? Only Microsoft lived up to the hype, but even its owners nursed losses for 15 years after the bubble's peak. Intel and Cisco are up only slightly since then. IBM has less than doubled. Dell was taken private in 2013 at 25% of its bubble value. Lucent fell from $84 per share to 55¢. AOL is, to put it kindly, irrelevant.

A common epitaph in the graveyard of investors is, "This time is different," but sometimes it really is. Perhaps it will be different for today's Magnificent Seven. They are great businesses with bright prospects. Then again, most would have said the same of the Magnificent Seven of 1999, and we know how that turned out. Paying fancy prices for businesses widely loved is a hazardous habit.

The key to happiness, we are told, is low expectations. So, too, is it the key to ***building permanent wealth***. The trick is not to simply buy great businesses; many fortunes have been lost doing that. Rather, the trick is to buy great businesses priced for low expectations. Only then does the bridge between an obvious now and uncertain future have the margin of safety needed for safe passing.

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[1] Outstanding Investor Digest (Dec. 10, 1999), 25-26
[2] We input 1,000% earnings per share growth for Tesla since its earnings were negative five years ago.
[3] Trailing twelve months, FactSet.

Sincerely,

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