Investing Concepts

Valuations

There is nothing more impactful to an investor's future return than the price that is paid to acquire an asset. This is why understanding the relative valuation of assets within our global opportunity set is the central tenant of our **Investment Philosophy**. Below are two examples of the importance of valuations to investors.

Example #1: Buying a Rental Property

1. Similar Neighborhood
2. Same # of Units
3. Similar Structure

Investment Property #1

- Annual Rental Income = $100,000
- Sale Price: $1,000,000

Return on Investment (ROI)

10%

($100,000 / $1,000,000)

VS

Investment Property #1

- Annual Rental Income = $100,000
- Sale Price: $2,000,000

Return on Investment (ROI)

5%

($100,000 / $2,000,000)

The same principle has direct application to asset classes and guides our decision-making and tactical over/under-weight decisions within portfolios.

Example #2 – US Equities

	Average P/E (CAPE 10)	Average 10 Year Return	Minimum Return	Maximum Return
Quintile 1 (Least Expensive)	9.71x	15.29%	4.70%	21.43%
Quintile 2	13.04x	13.21%	1.54%	19.44%
Quintile 3	17.37x	10.00%	-0.37%	19.49%
Quintile 4	21.71x	6.94%	-4.15%	16.55%
Quintile 5 (Most Expensive)	30.91x	4.23%	-4.95%	9.07%

We've measured what happens from each of these valuation levels over the subsequent 10 years.

Notice that quintile 1, the cheapest price or valuation provides an average return of 15.29% /yr over the next 10 years. As we increase the price that we pay, the average return that you get as an investor declines to the point where in the most expensive market environments, quintile 5 your average return is 1/3 of what it was in the cheapest environment only about 4.5% per year.

Sources: S&P, iCM Capital Markets Research
The performance information does not reflect the deduction of advisory fees payable to iCM and any other expenses for services not covered by the advisory fee that an investor may incur, which will reduce a client's return. iCM charges one comprehensive fee for investment management services, which includes ETF due diligence and asset allocation decisions. Custody fees and trading expenses may add to overall expenses depending on the client custody arrangement. Data: Jan 1926 to December 2021.

The moral of the story - On a forward-looking basis, high valuations tend to create much lower returns when compared to lower valuations.

Integrated Capital Management
icm-invest.com
888.426.4689
info@icm-institutional.com