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# Monthly Monitor

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**August 2018**

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## **Are Financial Markets a case for Mulder and Scully?**

There are a lot of unusual things happening in financial markets today that make them look like a case from the “X files”. We’ve written extensively about the mis-valuation within bond markets. The fact that German 10-year bond yields continue to trade around 0.4% while inflation in Germany is near 2% implies investors are happy to lock in negative real returns. Our failure to understand this logic contributed to our decision to take our bond weightings to zero. The unexplained happenings in financial markets are not constrained to the bond market, the equity market is throwing up its own mysteries.

The goings on in the equity market have a strange eerie similarity with the dotcom bubble of 1999/2000. At the peak of the dotcom bubble, 29 members of the S&P 500 traded at over 10 times price to sales. Today, this figure stands at 39. Facebook stands out as one of the members of the so called FAANG stocks, whose valuation looks stretched on this measure. It’s on a price to sales multiple of 10.5 (this was 13 before the recent 20% share price fall). To understand how astronomical a valuation like this is, let’s turn to a quote from Scott McNealy who is the Founder of Sun Microsystems. He made this comment to Business Week in 2002 after the technology bubble burst.

*“But two years ago we were selling at 10 times revenues when we were at \$64. At 10 times revenues, to give you a 10-year payback, I have to pay you 100% of revenues for 10*

straight years in dividends. That assumes I can get that by my shareholders. That assumes I have zero cost of goods sold, which is very hard for a computer company. That assumes zero expenses, which is really hard with 39,000 employees. That assumes I pay no taxes, which is very hard. And that assumes you pay no taxes on your dividends, which is kind of illegal. And that assumes that with zero R&D for the next 10 years, I can maintain the current revenue run rate. Now, having done that, would any of you like to buy my stock at \$64? Do you realize how ridiculous those basic assumptions are? You don't need any transparency. You don't need any footnotes. What were you thinking?"

**Scott McNealy, Business Week, April 2002.**

This strange unexplained behaviour being exhibited by investors today is not constrained to large cap US equities. It's probably even more prevalent in the small cap space with 10% of stocks in the Russel 3000 index of small cap companies passing the magical threshold of being valued at over 10 times sales. It's not a pure US phenomenon either, or a pure technology phenomenon – expensive “hype stocks” are all around us. A great example from the small cap universe is Fevertree, the UK beverages company that makes mixer drinks. It seems to be the “in” thing to drink Fevertree tonic water, this hype has driven the stock to a price to sales multiple of over 20 times, or for those of us who still believe price to earnings is a more credible valuation measure – 74 times earnings.

Investors who have compared using price to sales as a valuation metric to spotting UFO's are starting to highlight a significant opportunity. They are asking the question, “what if there is a shift back into more “value” orientated equities? Alliance Bernstein highlight that value stocks are at relative valuations to growth stocks not seen since the TMT bubble of 1999. “The truth is out there”. In the long run, we believe valuation will re-exert itself in financial markets bringing misery to those who believe it's different this time and rewards to those who are prepared to stand against the crowd. With active shares (a measure of how different one is to the index) in excess of 90%, the Appian Equity Funds are standing well away from the crowd and are continuing to exhibit strong value characteristics.

### Appian Equity Funds Continue to Exhibit Strong Value Characteristics

|                             | <u>Appian Equity</u> | <u>MSCI World</u> | <u>S+P 500</u> | <u>Appian Small<br/>Cap Opportunities</u> | <u>MSCI World<br/>Small Cap</u> | <u>Russel 3000</u> |
|-----------------------------|----------------------|-------------------|----------------|---|---------------------------------|--------------------|
| <b>Price Earnings Ratio</b> | <b>13.7</b>          | <b>18.2</b>       | <b>20.1</b>    | <b>14.0</b>                               | <b>20</b>                       | <b>22.1</b>        |
| <b>Price to Sales</b>       | <b>1.1</b>           | <b>1.7</b>        | <b>2.1</b>     | <b>1.1</b>                                | <b>1.2</b>                      | <b>2.0</b>         |
| <b>Dividend Yield</b>       | <b>3.5</b>           | <b>2.3</b>        | <b>1.8</b>     | <b>2.8</b>                                | <b>1.8</b>                      | <b>1.8</b>         |

Source: Bloomberg 3/8/2018



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## Appian Unit Fund Prices

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1 August 2018

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|                                 |               |
|---------------------------------|---------------|
| Appian Value Fund               | <b>145.57</b> |
| Appian Equity Fund              | <b>195.51</b> |
| Appian SCOF                     | <b>198.80</b> |
| Appian Liquidity Fund           | <b>105.27</b> |
| Appian Ethical Value Fund       | <b>103.60</b> |
| Appian Burlington Property Fund | <b>110.25</b> |

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For more detailed information on each of our funds click [here](#)

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