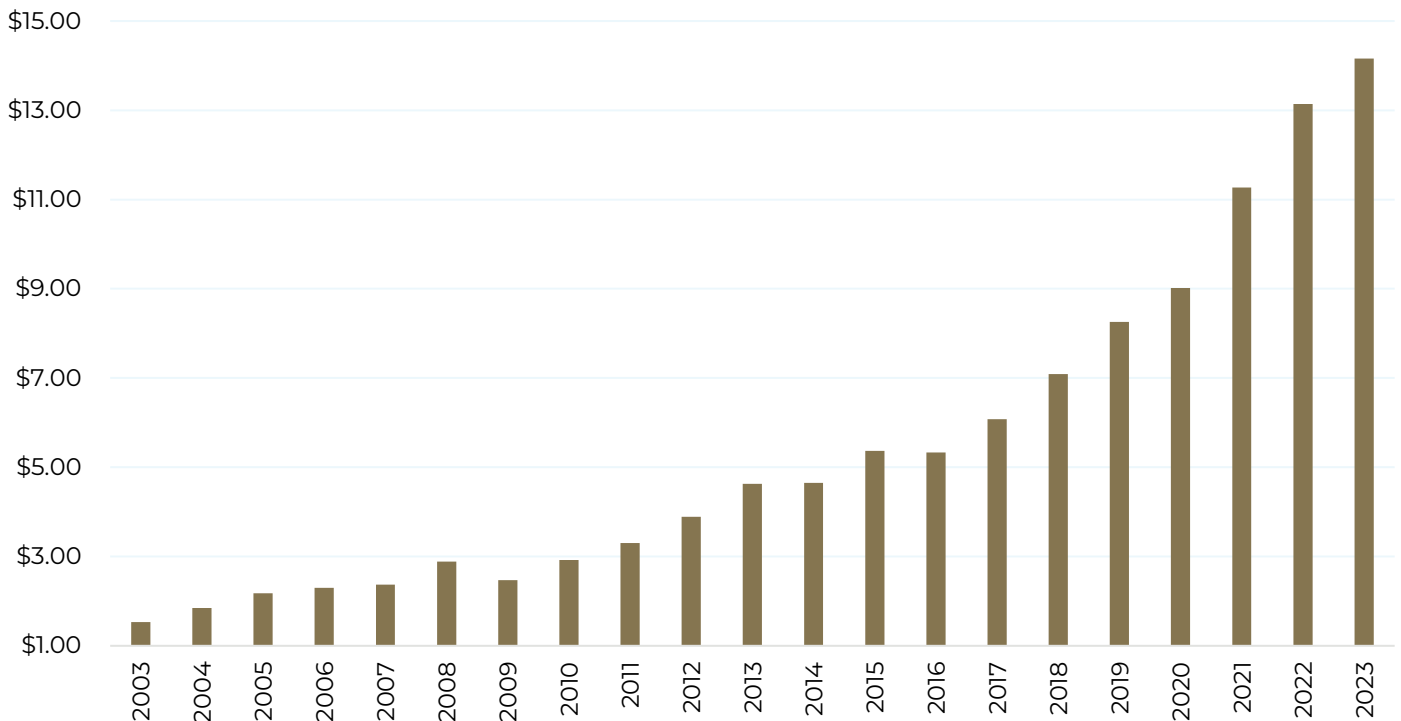


Time is on my side

Stock markets, so far in 2024, just like in all other years, have offered investors some wild moves up and down in individual stocks as a steady drumbeat of news on earnings, elections, trade wars and military conflicts create a frothy mix to digest. In the face of these price swings, investors are well served to remind themselves of the Rolling Stones' classic, "Time is on my side." Stock prices reflect the entirety of current and future profits, with the majority of the current stock price reflecting income forecast to materialize more than ten years from now. The split depends upon the level of earnings growth and discount rate, but to provide a sense of this, and assuming a discount rate of 8%, a company with 3% earnings growth has more than 60% of its value from earnings coming beyond the ten-year mark. For a company growing profits at 5% annually, these outer years account for approximately 75% of the stock's value, and for a business growing profits at 7% annually, the years beyond the current decade account for 90% of the stock value.

With so much value residing in these future earnings, realizing these profits requires investors to hang around for the long run, a difficult task for anyone paying too much attention to daily news flow, much of which pushes stock prices up and down with immediacy but ends up being less relevant over time. These price swings impact all stocks to varying degrees, and even the most stable, dependable companies are not immune. Consider US merchandise retail giant Costco, where annual earnings per share have risen at a near clockwork-like pace of 11% annual growth over the years, as shown in the graph below.

Costco annual US\$ earnings per share



Source: Guardian Capital based on data from the Bloomberg to fiscal year 2023.

If this pace of earnings growth seen over the past two decades is sustainable, this suggests that well over 95% of the current share price is represented by profits to be collected more than 10 years into the future, and Costco investors should, theoretically, be a group happy to sit tight while they wait to collect this income. However, the annual price variation for Costco shares over the most recent five years, from high to low price, is 24%, a striking disconnect from the monotonic rate of profit growth at the company. Despite owning a stock where profits far into the future represent over 95% of the value, investors still can't resist the temptation of buying in reaction to uplifting headlines and selling in the face of worrying economic updates, both of which can change weekly. When faced with the option of trading shares in step with daily events or holding tight to collect all of these future profits, investors would do better to tune out the news and tune into the Rolling Stones.

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PERSPECTIVES

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