1 Of These 4 Stocks Is My Next Retirement Portfolio Buy

Summary

- Recession risks are at a 10-year high, earnings growth expectations are falling fast, and the market is soaring on Fed rate cut euphoria.

- Yet I continue to steadily buy undervalued blue-chips each week, based on the latest macroeconomic data and my 186 company blue-chip watchlist.

- This week I'll invest $1,500 in one of four companies: Altria, Marathon Petroleum, Albemarle, or Energy Transfer LP. Each of these companies is between 17% and 47% undervalued.

- Their average yield is 5.4%, and analysts/management expects to deliver about 10% average long-term earnings/cash flow/dividend growth resulting in 15% non-valuation adjusted total returns.

- Adjusting for both valuation and margin of error, each of these stocks should deliver at least 14% CAGR total returns over the next five to 10 years.
"IT IS REMARKABLE HOW MUCH LONG-TERM ADVANTAGE PEOPLE LIKE US HAVE GOTTEN BY TRYING TO BE CONSISTENTLY NOT STUPID, INSTEAD OF TRYING TO BE VERY INTELLIGENT."

-CHARLIE MUNGER

(Source: imgflip)

Many readers have asked me why I'm still buying stocks for my retirement portfolio (where I keep 100% of my life savings) when the market is roaring higher, and recession risks are rising.

After all, since 1946, no recession has occurred without a significant decline in the market, an average 30% decline from all-time highs, over a roughly 12-month period.
Market timing, such as selling all your stocks before an expected correction/bear market sounds great in theory, but about 150 years of market history, from three countries, shows that steadily putting money to work in stocks is the better long-term strategy.
Figure 1. More often than not, it has paid to invest immediately

Systematic investment over a 12-month interval and a 60% stock/40% bond portfolio

<table>
<thead>
<tr>
<th></th>
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<tbody>
<tr>
<td>Immediate</td>
<td>68%</td>
<td>70%</td>
<td>68%</td>
</tr>
<tr>
<td>Systematic</td>
<td>32%</td>
<td>30%</td>
<td>32%</td>
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Immediate investment outperformed with greater frequency

<table>
<thead>
<tr>
<th></th>
<th>Immediate</th>
<th>Systematic</th>
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<tbody>
<tr>
<td>United States</td>
<td>68%</td>
<td>32%</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>70%</td>
<td>30%</td>
</tr>
<tr>
<td>Australia</td>
<td>68%</td>
<td>32%</td>
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</table>

Average magnitude of outperformance

<p>| | |</p>
<table>
<thead>
<tr>
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<tbody>
<tr>
<td>United States</td>
<td>2.39%</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>2.03%</td>
</tr>
<tr>
<td>Australia</td>
<td>1.45%</td>
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</table>

Asset allocation didn’t matter

<table>
<thead>
<tr>
<th>Allocation</th>
<th>Immediate</th>
<th>Systematic</th>
</tr>
</thead>
<tbody>
<tr>
<td>100% Equity</td>
<td>67%</td>
<td>33%</td>
</tr>
<tr>
<td>50% Equity/50% Fixed income</td>
<td>68%</td>
<td>32%</td>
</tr>
<tr>
<td>100% Fixed income</td>
<td>65%</td>
<td>35%</td>
</tr>
</tbody>
</table>

Source: Vanguard calculations, using benchmark data. See page 7 for a list of the benchmarks.

(Source: Vanguard)

In fact, here's what Jack Bogle, founder of Vanguard said about market timing:

Sure, it'd be great to get out of stocks at the high and jump back in at the low, but in 55 years in the business, I not only have never met anybody who knew how to do it, I've never met anybody who had met anybody who knew how to do it."
And as Peter Lynch, the 2nd best investor of all time (29% CAGR total returns from 1977 to 1990, despite sometimes owning up to 1000 companies) famously said:

Far more money has been lost by investors preparing for corrections, or trying to anticipate corrections, than has been lost in corrections themselves...The key to making money in stocks is to not get scared out of them."

This quote from Lynch, when combined with decades of market data from JPMorgan Asset Management, is a clear indication of the dangerous of market timing to your portfolio's long-term returns.

If Wall Street's biggest heavyweights, armed with a bevy of supercomputers and army of quants, can't time the market well, then it's no wonder the average retail investor has done so horribly trying to jump in and out of stocks. THIS is why I have zero plans to sell a single share of my blue-chip retirement portfolio, no matter how big recession/bear market risks get.

And speaking of recession risk, the probability of an economic downturn over the next 12 months is about 30% to 35% according to the Cleveland and New York Federal Reserves.
### Highlights

<table>
<thead>
<tr>
<th></th>
<th>May</th>
<th>April</th>
<th>March</th>
</tr>
</thead>
<tbody>
<tr>
<td>3-month Treasury bill rate (percent)</td>
<td>2.38</td>
<td>2.43</td>
<td>2.47</td>
</tr>
<tr>
<td>10-year Treasury bond rate (percent)</td>
<td>2.37</td>
<td>2.58</td>
<td>2.55</td>
</tr>
<tr>
<td>Yield curve slope (basis points)</td>
<td>-1</td>
<td>15</td>
<td>8</td>
</tr>
<tr>
<td>Prediction for GDP growth (percent)</td>
<td>2.3</td>
<td>2.3</td>
<td>2.1</td>
</tr>
<tr>
<td>Probability of recession in 1 year (percent)</td>
<td>34.8</td>
<td>31.0</td>
<td>32.7</td>
</tr>
</tbody>
</table>

(Source: Cleveland Federal Reserve)

**Probability of US Recession Predicted by Treasury Spread**

*Parameters estimated using data from January 1959 to December 2009, recession probabilities predicted using data through May 2019. The parameter estimates are $\alpha = -0.5333$, $\beta = 0.6330$.*

Updated 04-Jun-2019

I'm not going to stop buying undervalued blue-chips when recession is still a relatively lower probability event.
That's confirmed by the actual economic data, specifically the 19 leading economic indicators which have proven good predictors of the last four recessions. David Rice, aka "Economic PI" tracks these against their 30-year baseline to create the single best snapshot of the health of the economy.

The Mean of Coordinates or MOC (red dot) tells you where the economy is now, based on the most recent data. The green dot tells you where the MoC is likely to go, based on the most recent trends. In other words, as long as the green dot is not near that red box, the economic data is NOT pointing to recession.
(Source: David Rice)

And for the macroecon nerds out there, here's the actual statistics about how high each leading indicator is above its historical baseline. As long as the MoC and leading indicators are more than 20% above baseline then a recession is likely at least 12 months away (likely more like 18 to 24 months given current conditions).

That's not to say I'm completely ignoring the warning of the bond market, specifically the 10y-3m yield curve (best recession predictor in history according to Cleveland and San Francisco Fed studies).

But there are many theories, from people far smarter than me, that differ on how long or how severely the curve needs to be inverted before it means a recession is likely.

My 5 Yield Curve Confirmation Signals

- 10 consecutive days of inversion (Bianco Research model) - currently triggered
• 1 consecutive month of inversion (David Rice, aka Economic PI, who runs the BaR economic grid) - currently triggered
• 10 straight weeks of curve inverted at least 15 basis points (Blackstone model)
• 1 consecutive quarter of inversion (according to Campbell Harvey, a professor of finance at Duke University)
• 6 months of consecutive inversion (Morgan Stanley model)

Whenever a confirmation signal is triggered, I pair back my weekly stock buying ($10,000 per month, spread out in equal amounts each week) by 20%. Should all five trigger (no earlier than November 23rd), then I'll be putting all my savings into cash equivalents (the bond ETFs MINT and VGLT). When the bear market becomes official (or the signals turn off), I'll start immediately buying stocks on my normal $2,500 per week schedule.

However, as you can see, the yield curve has recovered in recent weeks from -28 basis points to -4 bp. This likely signals the bond market's confidence that Fed rate cuts (up to eight of them) will likely avert a trade war recession. Moody's Analytics estimates that each 25 bp rate cut boosts GDP growth (after 12 months) by 0.1% to 0.15%. This means that, as long as the Fed acts quickly enough, it could possibly boost GDP growth by 1%, basically neutralizing the negative effects of even a full-blown trade war.

Based on my recession capital allocation plan, I'm currently putting 60% of monthly savings into stocks, and that will go back to 100% the day the yield curve closes positive (resetting all recession confirmation clocks).

Remember that the future is unknowable and no less than Peter Lynch said: "in this business if you're good you're right six times out of ten."
And as Vanguard's 150 years of market data show, time in the market is far more important than timing the market. Or as Tom Phelps (author of "100 to 1 in the Stock Market") put it "Fortunes are made by buying right and holding on."

![Dividend Sensei](image)

Ranked #23 out of 6,800 Bloggers on TipRanks (#159 out of 12,008 overall experts)

### Dividend Sensei's Performance

<table>
<thead>
<tr>
<th>Success Rate</th>
<th>Average Return</th>
</tr>
</thead>
<tbody>
<tr>
<td>69%</td>
<td>+8.6%</td>
</tr>
</tbody>
</table>

319 out of 461 ratings were successful. Average return per rating per year.

(Source: TipRanks)

While 12-month forward returns are hardly definitive, thus far in three years of writing on Seeking Alpha, I've managed to surpass Lynch's 60% "good analyst" hurdle, and have outperformed 98.6% of all analysts tracked by TipRanks, 5,200 of which work on Wall Street.
So it seems logical to use my 5.5 years of experience as a professional analyst/investment writer to put my savings to work in quality, undervalued blue-chips, so I can profit from the secular growth trends of the world economy.

Now if you're buying the S&P 500 via low-cost index funds then it certainly might make sense to decrease how much of your monthly savings go into stocks vs. bonds/cash based on valuation.

After all, since 1994, 46% of market 5-year returns have been predicted by starting valuation (specifically the forward P/E ratio). But today the S&P 500, even at record highs, is at a forward P/E of 16.8 according to FactSet Research. That means stocks are 4% historically overvalued (vs. a 16.2 25-year average). That's hardly bubble territory.

And since I'm an active investor buying individual companies, even when the market does become incredibly overvalued (such as during January 2018, when the forward P/E hit 18.7) something great is always on sale. Back in January. REITs were in a two-year bear market so that was mostly what I was buying (I bought more at even better prices during the first correction of 2018).
Ultimately, my goal is to follow the wise words of Charlie Munger, one of the best value investors in history and Buffett's right hand for decades.

It is remarkable how much long-term advantage people like us have gotten by trying to be consistently not stupid, instead of trying to be very intelligent."

I consider using a probabilistic approach to capital allocation (specifically what I do with new money), based on the latest economic and bond market data, combined with a buy and hold approach to what I already own, a very "not stupid" Munger like strategy.

So that's why I'm still steadily buying stocks, and will continue to do so through at least late November (but possibly far longer). But what exactly am I planning to do with my savings?

1 Of These 4 Stocks Is My Next Retirement Portfolio Buy

<table>
<thead>
<tr>
<th>Company</th>
<th>Ticker</th>
<th>Yield</th>
<th>5-Year Dividend Growth Rate</th>
<th>Dividend Yield Theory Discount To Fair Value</th>
<th>Morningstar Discount To Fair Value</th>
<th>Price/Cash Flow</th>
<th>PE Ratio</th>
<th>PEG Ratio</th>
</tr>
</thead>
<tbody>
<tr>
<td>Altria</td>
<td>(MO)</td>
<td>6.7%</td>
<td>10%</td>
<td>39%</td>
<td>17%</td>
<td>11.0</td>
<td>11.6</td>
<td>2.3</td>
</tr>
<tr>
<td>Energy Transfer LP (Uses K-1 tax form)</td>
<td>(ET)</td>
<td>8.5%</td>
<td>13%</td>
<td>21%</td>
<td>34%</td>
<td>3.7</td>
<td>9.5</td>
<td>2.7</td>
</tr>
<tr>
<td>Marathon Petroleum</td>
<td>(MPC)</td>
<td>4.0%</td>
<td>19%</td>
<td>32%</td>
<td>41%</td>
<td>3.9</td>
<td>11</td>
<td>0.85</td>
</tr>
<tr>
<td>Albemarle</td>
<td>(ALB)</td>
<td>2.2%</td>
<td>6%</td>
<td>29%</td>
<td>47%</td>
<td>15.2</td>
<td>11.1</td>
<td>1</td>
</tr>
<tr>
<td><strong>Average</strong></td>
<td></td>
<td>5.4%</td>
<td>12.0%</td>
<td>30%</td>
<td>35%</td>
<td>8.5</td>
<td>10.8</td>
<td>1.7</td>
</tr>
</tbody>
</table>

(Sources: Simply Safe Dividends, Morningstar, Dividend Yield Theory)

While there are many ways to value a stock, Altria, Energy Transfer, Marathon Petroleum, and Albemarle, all appear to be highly undervalued. Their average P/E is 10.8, close to the S&P 500's March 9th, 2009 low of 10.3.

Their average price to cash flow is just 8.5, nearly half the 15.0 level Chuck Carnevale (SA's valuation guru and my fellow Dividend King) recommends.
Even their average PEG of 1.7 is far below the S&P 500's 2.8. Basically, any way you cut it, these four dividend blue-chips are trading at a discount to fair value. One that, when combined with their current yields and good long-term growth prospects, means each has a very good chance of achieving double-digit and market-beating returns in the coming five to 10 years.

<table>
<thead>
<tr>
<th>Company</th>
<th>Yield</th>
<th>Long-Term Expected Earnings/Cash Flow Growth (Analyst Consensus or Management Guidance)</th>
<th>Expected Total Return (No Valuation Change)</th>
<th>Valuation-Adjusted Total Return Potential (5 to 10-Year CAGR)</th>
<th>Margin Of Error Adjusted Total Return Potential</th>
</tr>
</thead>
<tbody>
<tr>
<td>Altria</td>
<td>6.7%</td>
<td>8.0%</td>
<td>14.7%</td>
<td>18.1% to 21.5%</td>
<td>14.8% to 25.8%</td>
</tr>
<tr>
<td>Energy Transfer LP</td>
<td>8.5%</td>
<td>6.0%</td>
<td>14.5%</td>
<td>17.9% to 21.3%</td>
<td>14.3% to 25.6%</td>
</tr>
<tr>
<td>Marathon Petroleum</td>
<td>4.0%</td>
<td>10.0%</td>
<td>14.0%</td>
<td>18.3% to 22.1%</td>
<td>14.6% to 26.5%</td>
</tr>
<tr>
<td>Albemarle</td>
<td>2.2%</td>
<td>13.7%</td>
<td>15.9%</td>
<td>20.2% to 25.9%</td>
<td>16.2% to 31.1%</td>
</tr>
<tr>
<td>Average</td>
<td>5.4%</td>
<td>9.4%</td>
<td>14.8%</td>
<td>18.8% to 23.0%</td>
<td>15.0% to 27.6%</td>
</tr>
</tbody>
</table>

(Sources: Simply Safe Dividends, Morningstar, Dividend Yield Theory, Gordon Dividend Growth Model, Moneychimp)

When deciding which of these to buy this week, I need to balance each one’s pros and cons.

**Altria**

**Pros:** Raises my portfolio's yield on cost (5.2%), opportunistic buy (MO crashed 4.5% on Friday due to yet another scary headline regarding Juul), stock is pricing in 2.1% long-term growth vs. 7% to 9% management guidance and Morningstar's conservative 5%. Dividend hike of about 5% likely coming in August which will raise YOC to 7% and provide a short-term catalyst for a nice pop.
Cons: Morningstar's downgrading of management quality to "poor" over the Juul investment is going a bit far, BUT there is no question the company overpaid for Juul (and Cronos as well). Only time will tell if those investments ever become accretive to adjusted EPS and FCF, though Juul continues to grow like a weed for now.

Energy Transfer

Pros: By far the highest yielder of the group (always nice to lock in tangible benefits like fat, safe yield). Energy in general and MLPs, in particular, are at their most attractive valuations in 15 years (or ever) and ET's ultra-low 3.7 times cash flow makes it the most "Shark Tank" like buy in this group.

Cons: My personal sector caps are 25% and holding caps are 5%. ET is 4.7% of my portfolio and I'm 24% in energy right now. While I have room for one more buy, should ET crash in the future (it trades closely with oil prices, despite 87% of its cash flow having no commodity sensitivity) I'd be locked out of buying more.

Marathon Petroleum

Pros: Fastest dividend growth guidance in the group (10+% over the long term) AND management has a good plan to achieve that, AND is executing better than expected on that plan. A new stock so would help me on my "drive to 35" meaning owning 35 companies by the end of the year.

Cons: Would cause me to cap out on energy (potential opportunity cost with ET or MPLX later) and rallied 10% last week. While it's still undeniably undervalued, I personally prefer to "catch a falling blue-chip with conviction" and Marathon isn't a falling knife anymore.

Albemarle

Pros: Fastest long-term growth potential of the group, courtesy of its wide moat (soon to be the largest and lowest cost Lithium producer in the world), excellent management, and a dividend champion to boot (will become a dividend aristocrat as soon as its market cap recovers). The most undervalued stock of the group, and the most undervalued blue-chip in America as far as I know.

Cons: Lowest yield of the group and business model is economically sensitive. IF we get a recession it could fall a lot lower.
Bottom Line: You Don't Have To Be A Genius To Earn Great Long-Term Returns... Just Disciplined, Patient And "Consistently Not Stupid"

By no means do I claim that my current capital allocation strategy is perfect, or necessarily right for everyone. While I'm 100% focused on undervalued blue-chips, with safe and growing dividends, that doesn't mean that my asset allocation (100% stocks) should be mirrored by anyone.

I merely offer this new series, to be released every three weeks, to offer interested readers, who share my long-term, blue-chip valuation focus, potentially good ideas to consider.

No matter which of these companies I buy next week, I'm confident they will do well over the coming five to 10 years. And if I'm wrong? Then that's where good risk management and diversification comes in.

Dividend Sensei Risk Management Rules Of Thumb

- ALWAYS maintain proper asset allocation (with periodic rebalancing) meaning owning enough cash/bonds to avoid having to sell stocks during inevitable market downturns.
- Own a diversified stock portfolio (ETFs or 20 to 30 stocks in most sectors works best for most people)
- Limit individual holdings to 5% to 10% of your stock portfolio (my personal long-term goal is 5%)
- Limit sector concentration to 15% to 25% (my personal long-term goal is 25%)

No matter how great an opportunity a stock seems, I'm never going to invest more than 5% of my capital into it. Over time I'll end up owning dozens (possibly hundreds) of great blue-chips, each bought opportunistically at a significant discount to fair value and high margin of safety.

Based on years of research, including studies spanning over 100 years of market history, I'm confident that, eventually, I'll achieve my goal of generous, safe and exponentially growing income ($15,000 per year in dividends and counting), as well as market-beating double-digit total returns.
**Disclosure:** I am/we are long ET, MO, ALB. I wrote this article myself, and it expresses my own opinions. I am not receiving compensation for it (other than from Seeking Alpha). I have no business relationship with any company whose stock is mentioned in this article.

Comments (174)

**Sugar Charlie**  

I consider Black Monday, October 1987, a great day which taught me an invaluable lesson. The DJIA fell 22.6%; I saw no fundamental reason for that; I held on; and equities recovered. That taught me NEVER to market time. I held on through the "dot-com" bubble burst (I held no dot com stocks); through "9/11" and the recessionary years which followed; and through 2008-09. I have prospered in consequence.

Of course, the correlative to such a strategy should be a well-diversified portfolio, holding stocks yielding good dividend income and stocks which will continue to earn and pay dividends through recessionary times. I keep cash and short term debt for liquidity, NOT for income, especially as, in taxable portfolios, fixed income assets will normally yield little or nothing after tax and inflation. So I keep all my risk in my equities.

24 Jun 2019, 03:25 PM

**Dividend Sensei, Contributor**  
Author's reply » SC, you sir have mastered the basics. Or as Stephen Colbert would say "you are an "it" getter".

24 Jun 2019, 03:50 PM

JOIN THE CONVERSATION