

PLENTY OF PRICE, NOT MUCH SALES

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In part 1 of this two-part blog series, *"The Bond Market's Sell-Off Is Taking Out the Stock Market's Leaders,"* I discussed the trouble currently confronting several mega-cap growth companies. Now let's look across the entire S&P 500.

Last year, I penned a piece called *"The Ghost of Sun Microsystems,"* digging into the history of one of the tech bubble's most legendary computer company's stocks.

The post-Dot-Com-crash reflection of Sun Micro's CEO, Scott McNealy, is legendary:

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 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?

I guess we could say that Sun Micro had plenty of price, but not much sales.

Today, there are 59 stocks in the S&P 500 that trade at 10 or more times revenue.

Figure 1: Members of the S&P 500 with Price/Sales Ratio > 10

Company	Price/Sales Ratio	Market Cap (\$ Bil.)	% S&P 500	Company	Price/Sales Ratio	Market Cap (\$ Bil.)	% S&P 500	Company	Price/Sales Ratio	Market Cap (\$ Bil.)	% S&P 500
1 Microsoft Corp	12.9	1,841.8	5.23%	21 Autodesk Inc	20.5	66.5	0.19%	41 ETSY Inc	34.3	26.0	0.08%
2 Tesla Inc	24.8	766.1	2.18%	22 Intercontinental Exchange Inc	10.3	63.3	0.18%	42 Copart Inc	12.6	27.9	0.08%
3 Visa Inc	20.5	443.5	1.26%	23 Equinix Inc	10.5	61.9	0.18%	43 Fortinet Inc	10.4	27.0	0.08%
4 NVIDIA Corp	33.9	369.1	1.05%	24 Analog Devices Inc	10.5	59.0	0.17%	44 Maxim Integrated Products Inc	11.7	25.6	0.07%
5 PayPal Holdings Inc	16.3	348.1	0.99%	25 Twitter Inc	15.4	57.1	0.16%	45 Avalonbay Communities Inc	10.9	25.0	0.07%
6 Mastercard Inc	22.1	335.1	0.95%	26 Edwards Lifesciences Corp	12.1	53.1	0.15%	46 Enphase Energy Inc	31.5	24.4	0.07%
7 Adobe Inc	18.6	235.2	0.67%	27 Monster Beverage Corp	11.6	48.7	0.14%	47 Alexandria Real Estate Equities Inc	12.3	23.2	0.07%
8 Salesforce.Com Inc	12.9	227.3	0.65%	28 Align Technology Inc	19.1	47.3	0.13%	48 Realty Income Corp	15.5	23.1	0.07%
9 Texas Instruments Inc	11.4	164.3	0.47%	29 IDEXX Laboratories Inc	17.1	46.2	0.13%	49 Versign Inc	18.0	22.7	0.06%
10 ServiceNow Inc	26.7	113.9	0.32%	30 Las Vegas Sands Corp	12.3	44.3	0.13%	50 West Pharmaceutical Services Inc	10.1	21.7	0.06%
11 Intuit Inc	14.2	109.3	0.31%	31 Synopsys Inc	11.8	43.4	0.12%	51 Marketaxess Holdings Inc	29.5	20.3	0.06%
12 Advanced Micro Devices Inc	11.6	108.2	0.31%	32 Public Storage	14.4	40.9	0.12%	52 Tyler Technologies Inc	16.9	18.9	0.05%
13 American Tower Corp	13.3	100.5	0.29%	33 Dexcom Inc	20.7	39.8	0.11%	53 Essex Property Trust Inc	11.6	17.4	0.05%
14 Intuitive Surgical Inc	21.8	91.8	0.26%	34 Cadence Design Systems Inc	16.9	39.5	0.11%	54 Monolithic Power Systems Inc	20.3	17.1	0.05%
15 S&P Global Inc	11.0	81.6	0.23%	35 MSC Inc	21.4	36.3	0.10%	55 Extra Space Storage Inc	11.8	15.5	0.04%
16 Zoetis Inc	12.7	80.3	0.23%	36 Brown-Forman Corp	10.5	35.4	0.10%	56 Duke Realty Corp	15.4	15.3	0.04%
17 Prologis Inc	17.9	78.3	0.22%	37 Xilinx Inc	10.8	34.2	0.10%	57 ABOMED Inc	17.0	14.3	0.04%
18 Illumina Inc	22.8	72.2	0.21%	38 ANSYS Inc	22.3	33.8	0.10%	58 IPG Photonics Corp	10.5	12.7	0.04%
19 Crown Castle International Corp	12.1	70.4	0.20%	39 Veeva Systems Inc	11.8	30.7	0.09%	59 UDR Inc	10.0	12.5	0.04%
20 CME Group Inc	13.6	68.6	0.19%	40 SBA Communications Corp	14.3	28.8	0.08%	Total		7,008.2	19.9%

Source: Thomson Reuters Refinitiv, as of 2/24/21.

Such [valuations](#) are likely a by-product of the "TINA" trade—own stocks because "There Is No Alternative" in a low-rate world. It worked famously when the bond market rallied for years on end.

What happens when the bond market goes the other direction?

Fixed income's red ink may just be getting started. Even after about a half year of yields rising, the 10-Year U.S. Treasury yield has not yet flirted with 2%; it remains 43 basis points lower than the average inflation rate of the last three years.

Figure 2: 10-Year Treasury Yield Minus 3-Year Average U.S. Consumer Price Inflation (CPI)



Source: Thomson Reuters Refinitiv, as of 2/22/21.

With Brent crude oil attacking \$65 and U.S. home prices up 11% over the last year, to name just two [inflation](#) indicators, it may be wise to recall that the [10-Year t-note](#) touched 3.24% as recently as November 2018.

Take it closer to home, to expectations for inflation in the next few years. The bond market anticipates annual price increases of 2.37% between now and 2026 (figure 3).

Figure 3: U.S. Five-Year [Breakeven Inflation Rate](#)



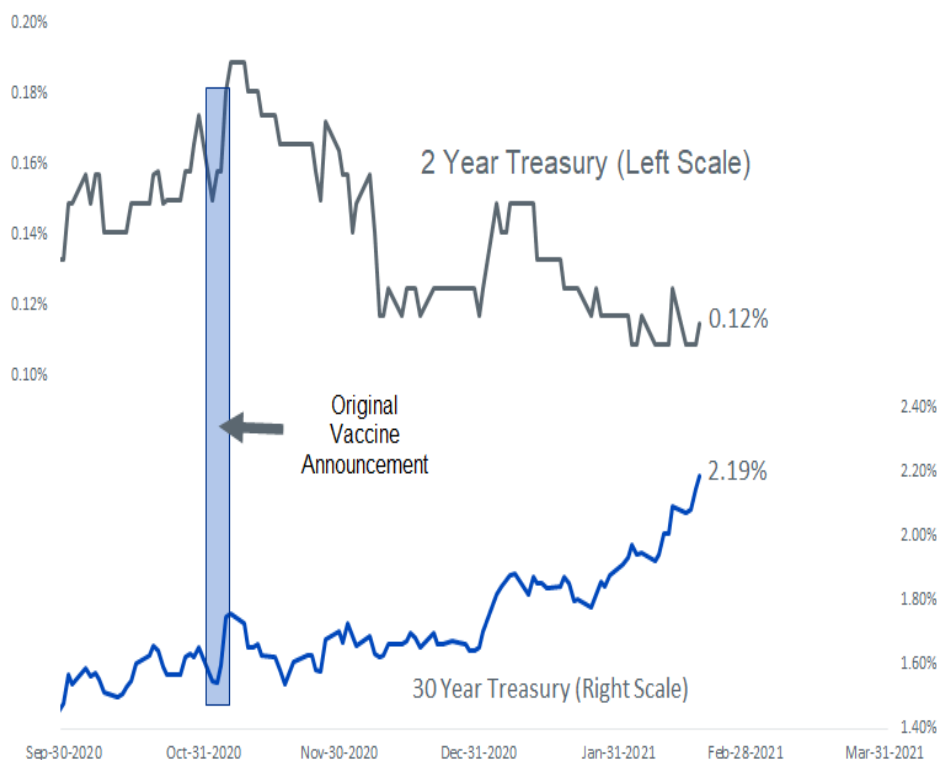
Source: Federal Reserve Bank of St. Louis, as of 2/22/20.

Meanwhile, in figure 4, the 30-Year Treasury bond appears to be doing one of two things:

- 1) Preparing for a repeat of the "Roaring '20s," or
- 2) Bracing for years of imbalanced budgets in Washington

In contrast, the 2-Year Treasury yield's slow drift lower could be a pointing to a "Snoring '20s."

Figure 4: Near-Term Yields Declining, Long-Term Yields Rising



Source: Thomson Reuters Refinitiv, as of 2/22/21.

Quizzically, the Street expects the [Federal Reserve \(Fed\)](#) to hold off on [rate hikes](#) until the cows come home, yet the consensus also expects the labor market to be on fire, with just 4.6% unemployment in 2022. It's hard to conceptualize how the Fed can continue to pin short rates at zero if jobs bounce back that strongly.

At the rate that commodities and house prices are surging, expectations for an accommodative Fed could get dashed. A newfound pivot to a rising rate regime—in both short and long rates—makes assets that promise distant cash flows look vulnerable, owing to the math behind present value calculations.

Stocks that trade for 10, 20, 30 times sales, many based on hopes and dreams of robust profits in 2025 or 2030 or beyond, may look appealing to some investors when Treasury rates are 0% or 1%—because future fortunes can be discounted at a tiny cost of capital.

But send interest rates up a point or two and the math changes.

If and when the five dozen or so companies in the S&P 500 with a price-to-sales ratio above 10 fall out of favor, it may be stocks with nearer-term cash flows that get the last laugh.

For standardized performance and the most recent month-end performance click [here](#) NOTE, this material is intended for electronic use only. Individuals who intend to print and physically deliver to an investor must print the monthly performance report to accompany this blog.

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DEFINITIONS

Valuation : Refers to metrics that relate financial statistics for equities to their price levels to determine if certain attributes, such as earnings or dividends, are cheap or expensive.

Inflation : Characterized by rising price levels.

10- Year Treasury : a debt obligation of the U.S. government with an original maturity of ten years.

Break-even inflation rate : For a given bond maturity, for example five years, the interest rate on the five-year nominal bond minus the interest rate on the five-year inflation adjusted bond; meant to approximate expected inflation over that time frame, in this case five years.

Federal Reserve : The Federal Reserve System is the central banking system of the United States.

Rate Hike : refers to an increase in the policy rate set by a central bank. In the U.S., this generally refers to the Federal Funds Target Rate.