MEDALLION WEALTH MANAGEMENT

March 2021 Market Commentary

Blinded By The Light

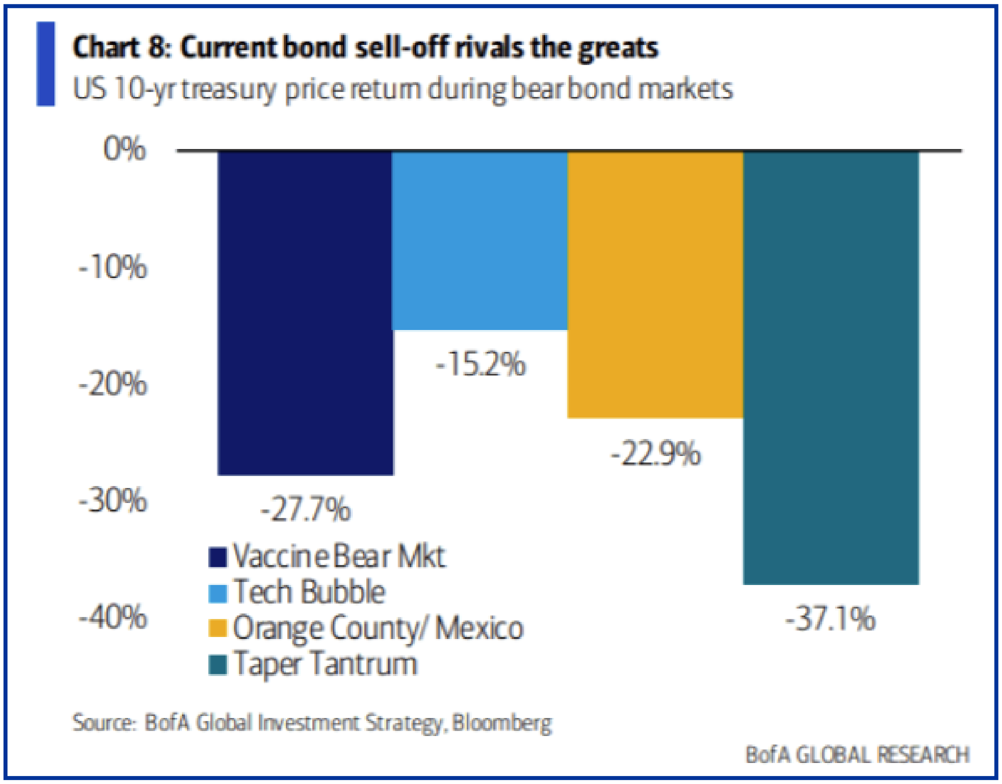
Yeah he was blinded by the light
Cut loose like a deuce, another runner in the night
Blinded by the light
He got down but he never got tight, but he's gonna make it tonight

https://www.youtube.com/watch?v=uozMTmEjxHc

One of my favorite Springsteen songs, **Blinded By The Light** was his first single, written in the summer of 1972. It was also his only #1 hit, when Manford Mann rerecorded it in 1977. It is a lyrical celebration of life, the strong gravitational pull of the sun, and our desire for the hot spot. ***"Some all-hot half-shot was headin' for the hot spot, snappin' his fingers, clappin' his hands."***

Believe it or not, what brought this song to mind this week was listening to Fed Chairman Jerome Powell's testimony to Congress. He really seems like a man who loves to look into the sights of the sun. He doesn't see any significant bubbles in financial markets, and doesn't see any inflationary pressures (other than transitory inflation due to expectations of a strong economy). He said, *"We've been living in a* *world for a quarter of a century where the pressures were disinflationary. Inflation dynamics do change over time, but they don't turn on a dime."*

The bond vigilantes took the Chairman's pronunciations of, low rates for a long time, as those of a man flying too close to the sun. The vigilantes sold long-term bonds in such a frenetic manner that the fixed income markets had one of their worst weeks in recent memory. As Bank of America highlights below.



There are several very powerful forces at work in the financial markets. The first is **Compound Interest**. Or as Albert Einstein reportedly said, *"Compound interest is the eighth wonder of the world. He who understands it, earns it. He who doesn't, pays it."* Another powerful force is **Duration**.

Duration is the concept of how long will it take for my original investment to be returned to me. It is most widely used in the bond market. A 30 day Treasury Bill has a very short duration since your money will be returned in 30 days. Cash is even shorter. A 30 year zero-coupon bond has a 30 year duration, since you receive no income for 30 years and have to wait till then for maturity.

This concept also applies to equities, with higher dividend yielding equities like Utilities or Consumer Staples having shorter durations and growth stocks like Biotech's and flying cars having longer durations.

The reason duration is such an important concept is that it helps explain how various securities will behave in an environment of rising or falling inflation, and rising or falling interest rates. In a period of rising inflation, each dollar received in the future is worth less than a dollar today, while in a disinflationary world a promised dollar in the future is worth more than a dollar today.

Here's an example of how duration worked in the last couple of weeks as interest rates rose:

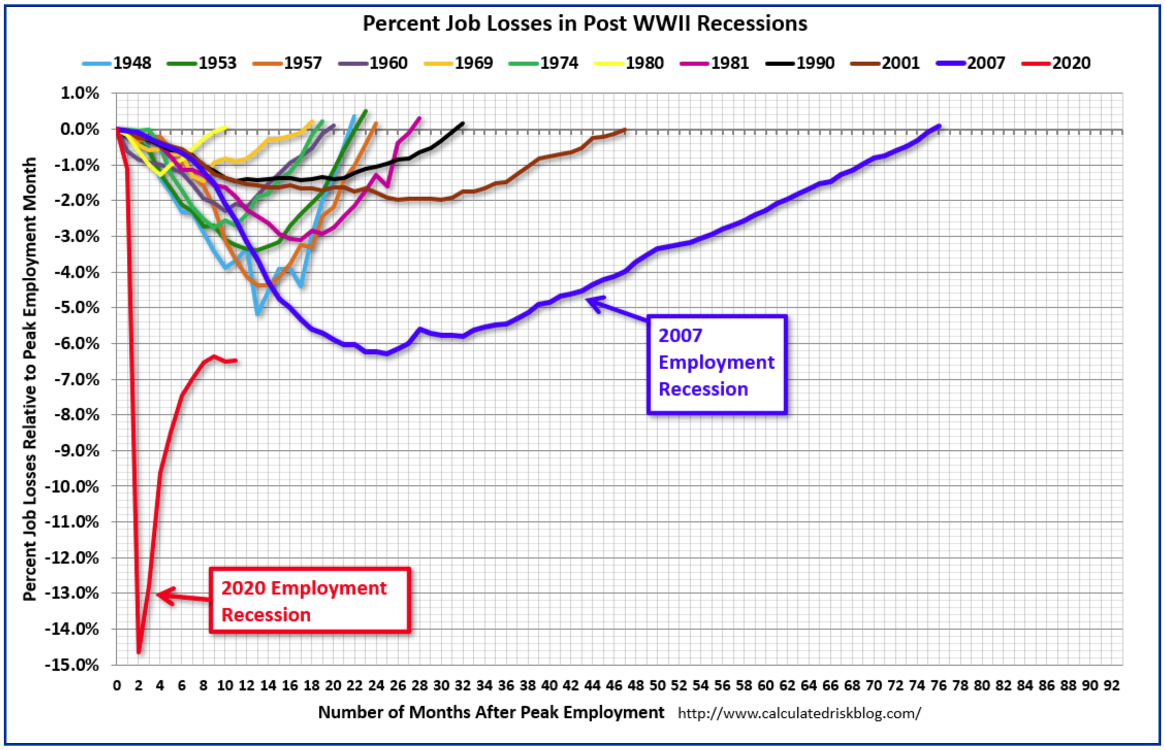
Bond ETF's	**% Below High (Total Return)**
High Yield (HYG)	-1.2%
Munis (MUB)	-2.2%
TIPS (TIP)	-3.0%
Total Bond Market (BND)	-3.7%
Investment Grade Corporate (LQD)	-5.4%
Emerging Mkt Bond (EMB)	-5.7%
7-10 Year Treasury (IEF)	-6.2%
20+ Year Treasury (TLT)	-18.7%
25+ Zero Coupon Treasury (ZROZ)	-27.5%

Stocks aren't immune to rising rates either, and we've seen a bit of a correction starting in the more speculative market segments. The NASDAQ 100 Index is off 6.5% from it's recent high, while the S&P 500 Index is off 3.0%. More speculative segments of the market have sold off even more.

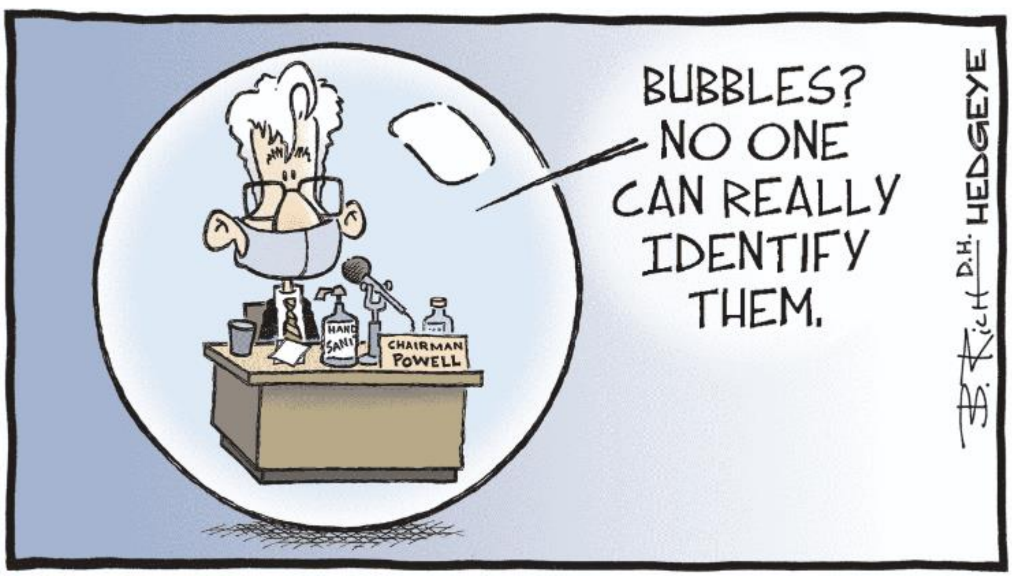
If the year were to end today, this would be the worst year for bonds in 44 years!

Barclays Aggregate, Total Return (1977 - 2021)					
Year	Return	Year	Return	Year	Return
1977	3.0%	1992	7.4%	2007	7.0%
1978	1.4%	1993	9.7%	2008	5.2%
1979	1.9%	1994	-2.9%	2009	5.9%
1980	2.7%	1995	18.5%	2010	6.5%
1981	6.2%	1996	3.6%	2011	7.8%
1982	32.6%	1997	9.7%	2012	4.2%
1983	8.4%	1998	8.7%	2013	-2.0%
1984	15.1%	1999	-0.8%	2014	6.0%
1985	22.1%	2000	11.6%	2015	0.6%
1986	15.3%	2001	8.4%	2016	2.7%
1987	2.8%	2002	10.3%	2017	3.5%
1988	7.9%	2003	4.1%	2018	0.0%
1989	14.5%	2004	4.3%	2019	8.7%
1990	9.0%	2005	2.4%	2020	7.5%
1991	16.0%	2006	4.3%	2021	-3.0%

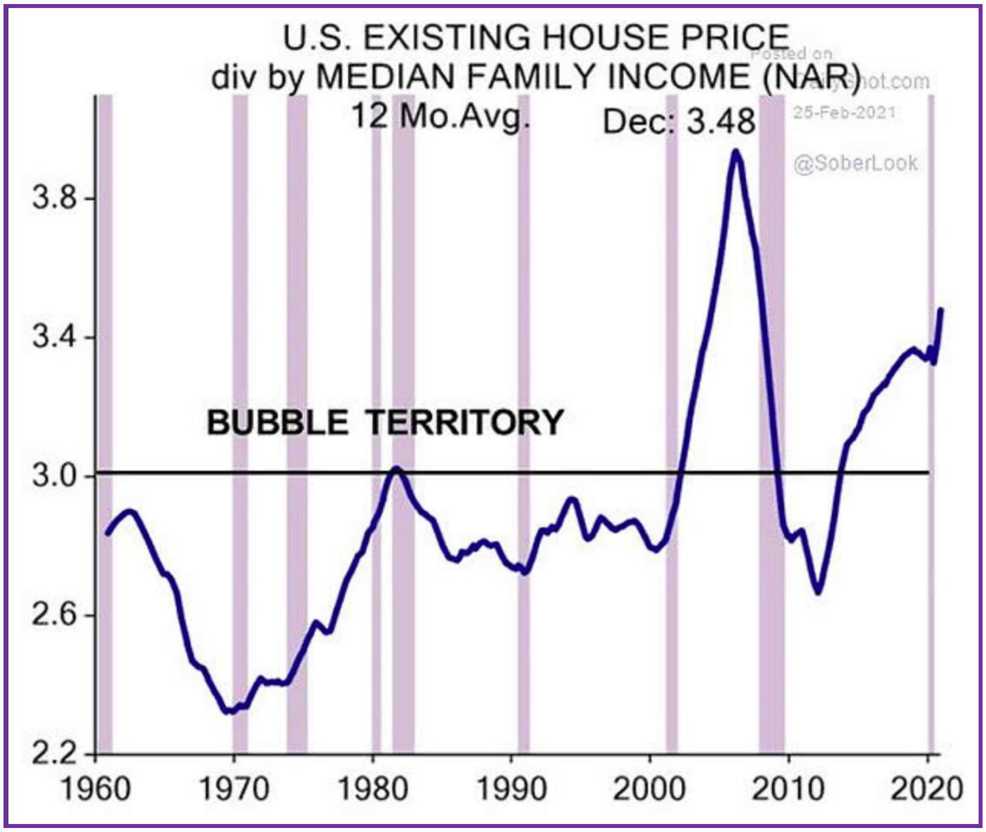
Of course Chairman Powell has his work cut out for him. The Fed is trying to stimulate job growth by keeping short-term rates at zero and buying Treasury securities hand-over-fist. This behavior encourages others to increase their risk taking, and hopefully will result in an economic boom and a return to full employment. As the graph below illustrates we have a ways to go till full employment returns.



The Fed is willing to tolerate inflation moving above its 2% target for a while as we wait for jobs to return. The theory is that the Fed will be able to quash inflation before it does serious harm to the system.



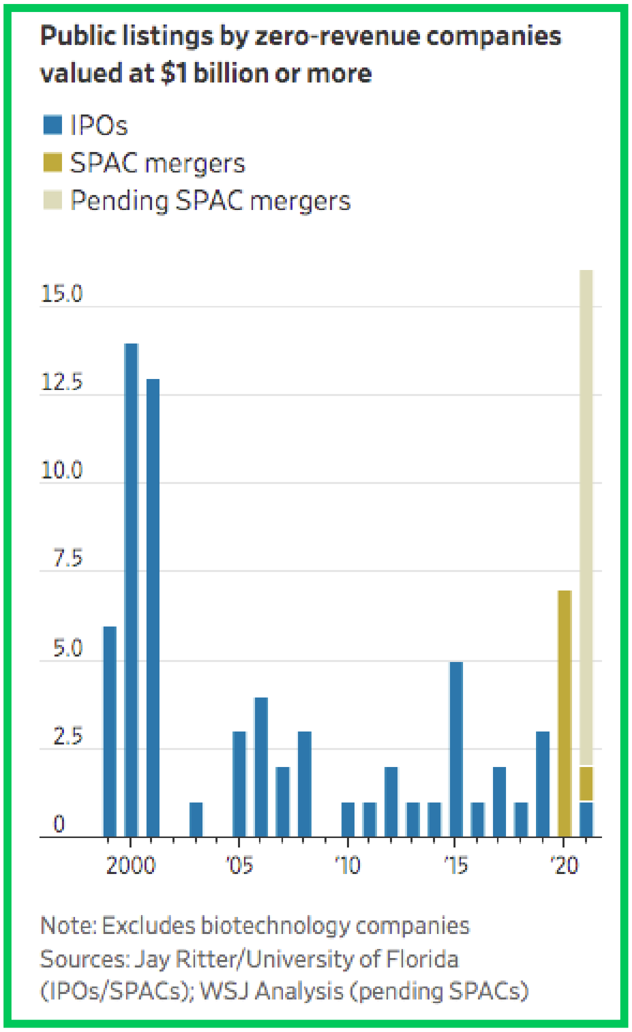
The problem with this theory is that it may result in bubbles in certain assets that can do real harm to the economy when popped. For most Americans their biggest asset is their home, and even though mortgage rates are near record lows we've seen a sharp acceleration in the cost of home ownership. The chart below shows that home prices as a percent of family income are starting to rival the levels we saw around 2006.



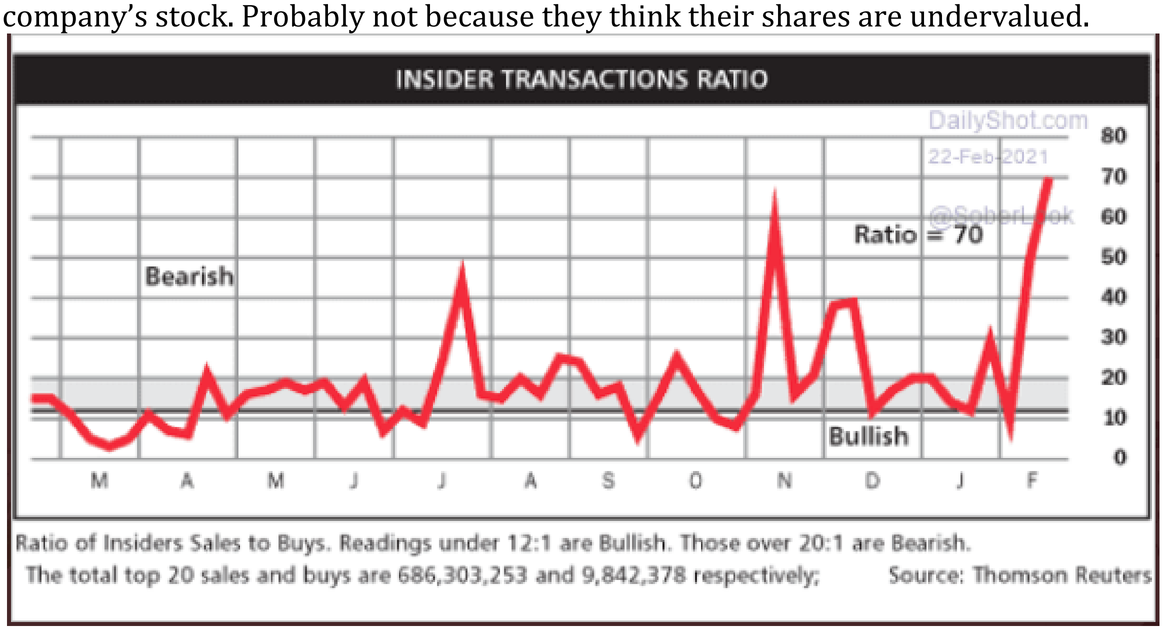
We've also started to see significant jumps in the prices of many commodities. Copper prices are up 88% over the last year, oil is back over $61 per barrel, and steel prices are up 30%. But probably the most shocking move has been a more than doubling of the price of lumber to over $1,000 per thousand board feet.

Even though the Fed says there are few signs of excess, or rampant speculation, or inflation, Mr. Market says otherwise. Last week the bond market reminded equity investors that it is not blind to these inflationary forces, and that duration is still a very powerful concept.

Another sign that we might be looking into the sun a bit too intensely is the willingness of Wall Street and corporate insiders to sell us stock. The first graphic below is eye-popping. The value of zero revenue companies (that's **ZERO** Sales!) valued at more than $1 billion going public has already blown through 2000's record and we're just through February.



And finally, not to be outdone, corporate insiders are selling a record amount of their company's stock. Probably not because they think their shares are undervalued.



What's a longer-term investor to do? It's certainly hard not to join the party, *cut loose like a deuce another runner in the night*. But the odds are not in your favor. Of course timing is always the great unknown, a lot of money can be made between now and the great unwind.

For now we are cautiously participating. In our fixed-income portfolios we have been focused on shorter duration securities and have even lowered are fixed-income exposure by buying some alternatives. One of the alternatives we have recently added is some commodity exposure.

On the equity front we have also lowered our exposure to the more aggressive growth stocks, and increased our exposure to value and those companies that may benefit from higher commodity prices.

"Mama always told me not to look into the sights of the sun
Whoa, but mama that's where the fun is"

Be careful out there,

Chris Wiles, CFA

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