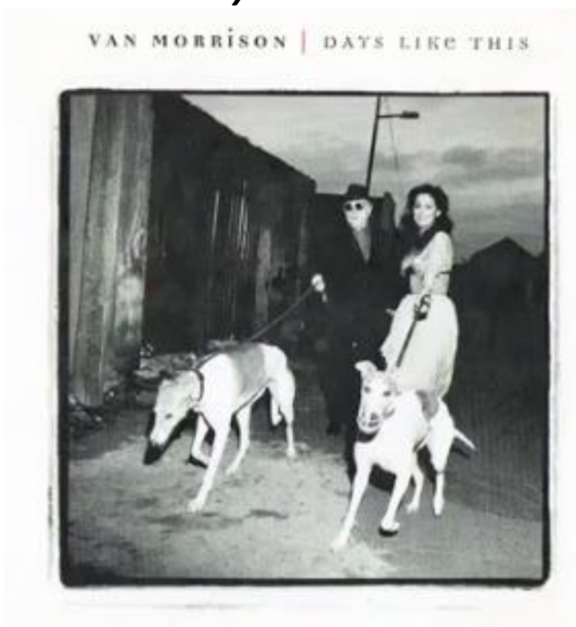
MEDALLION WEALTH MANAGEMENT

February 2022 Market Commentary

Days Like This



When you don't need to worry there'll be days like this
When no one's in a hurry there'll be days like this
When you don't get betrayed by that old Judas kiss
Oh my mama told me there'll be days like this

https://www.youtube.com/watch?v=3UUWkr4FUlo

Just a month ago I wrote "Everybody Had a Good Year" where I stated the fact that a booming stock market and a booming real estate market caused U.S. Household Net Worth to surge a record 17.7% in 2021. I also stated how weird it is for wealth to be surging while Consumer Confidence was plunging and that sometime in the future either sentiment would improve to reflect current valuations or valuations would decline to reflect sentiment.

As I feared and as January has proven, it was the market that corrected towards the declining sentiment.

You can see in the chart below that after a torrid 110% advance off of the March 2020 lows, the S&P 500 fell below its 200-day moving average for the first time in 19 months. It has since recovered some in early February, but we are experiencing some extreme volatility especially in individual stocks.

So what should we take from this current market action, will the bull resume its march higher or will the bear take us lower? History tells us that when we have a **Raging Bull** (characterized as more than a 30% advance in 18 months) followed by a stumble into a **Bear hibernating** just below the 200-day moving average, three possible scenarios have occurred.

1. The Bull shrugs it off and continues higher.
2. The Bull wins a long and turbulent battle.
3. The Bear slaughters the Bull.

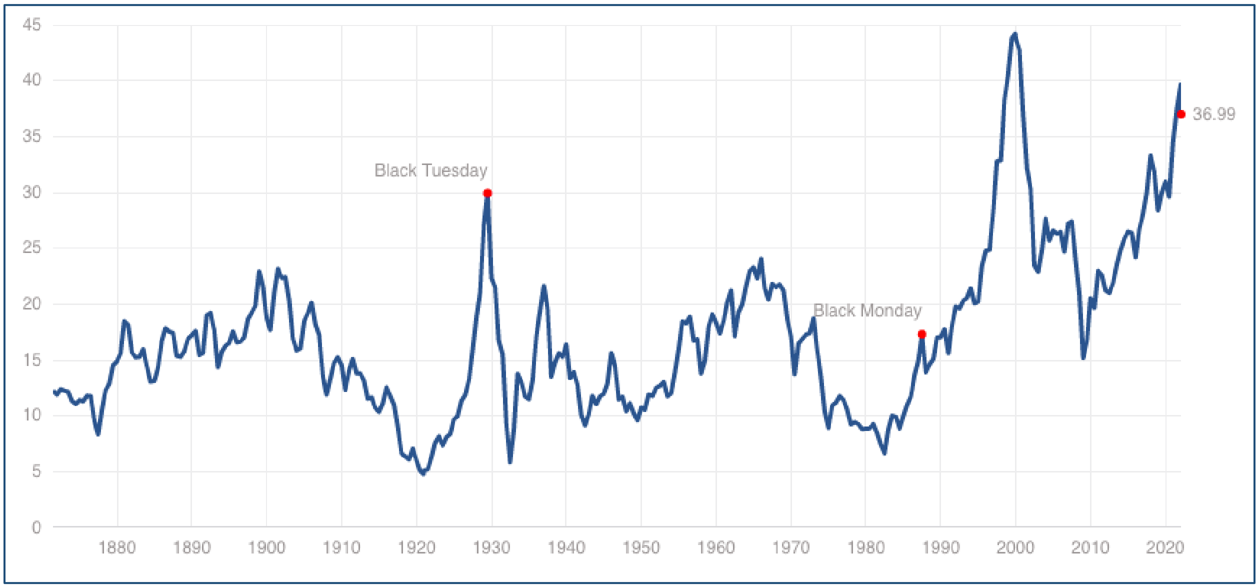
Every market environment has its own unique characteristics and I'm not going to go into each and every instance, but in the last 40 years we've really only had two instances where a raging bull stumbled into a hibernating bear and the bull got slaughtered, 1987 and 2001-2003.

Both of those bear markets were different, but they shared two important characteristics; 1) markets were trading at historically high valuations, which made them vulnerable to multiple contraction, and 2) interest rate policy was shifting from easy to tight igniting recession fears.

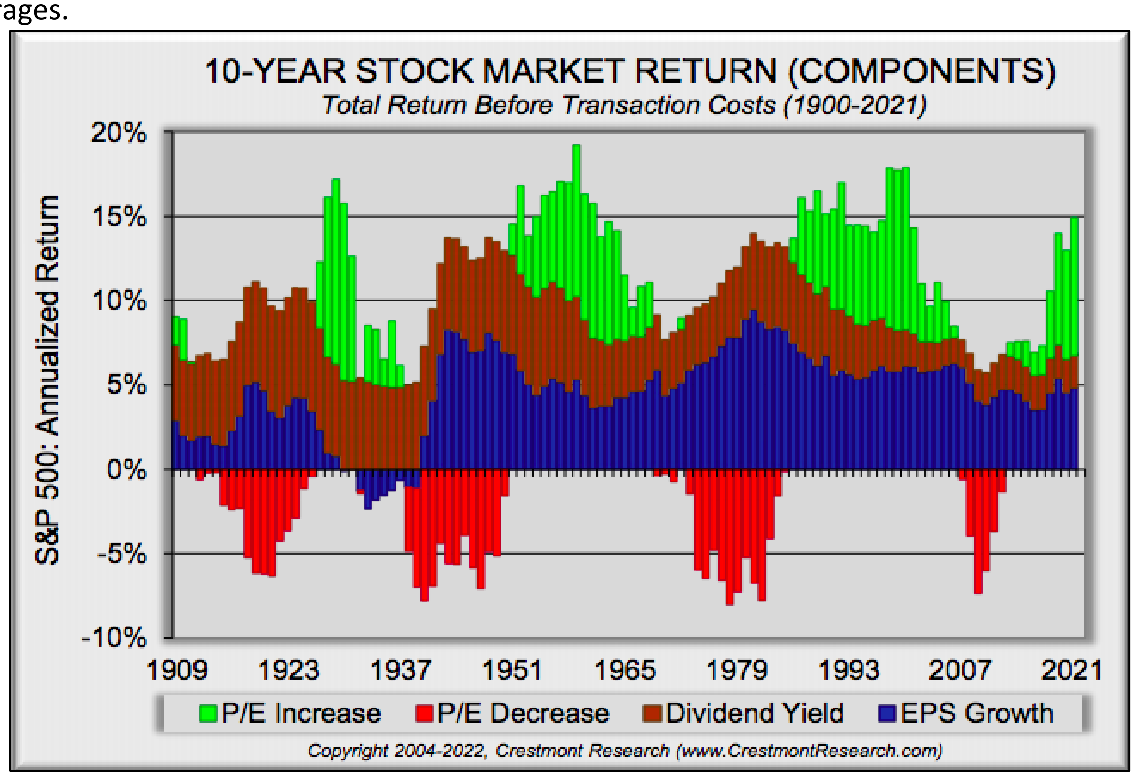
This is what we are faced with in 2022, a raging bull coming off of a record run and record high valuations, stumbling into a hibernating bear with the Fed tightening and a global pandemic causing havoc in supply chains resulting in accelerating inflation. Throw in a little geopolitical turmoil and we're setting up for an interesting year.

The chart below shows the markets valuation based on the Shiller PE. This Price to Earnings ratio is based on average inflation-adjusted earnings from the previous 10 years, known as the Cyclically Adjusted PE Ratio (CAPE Ratio), Shiller PE Ratio, or PE 10. \

10-Year Cyclically Adjusted PE Ratio



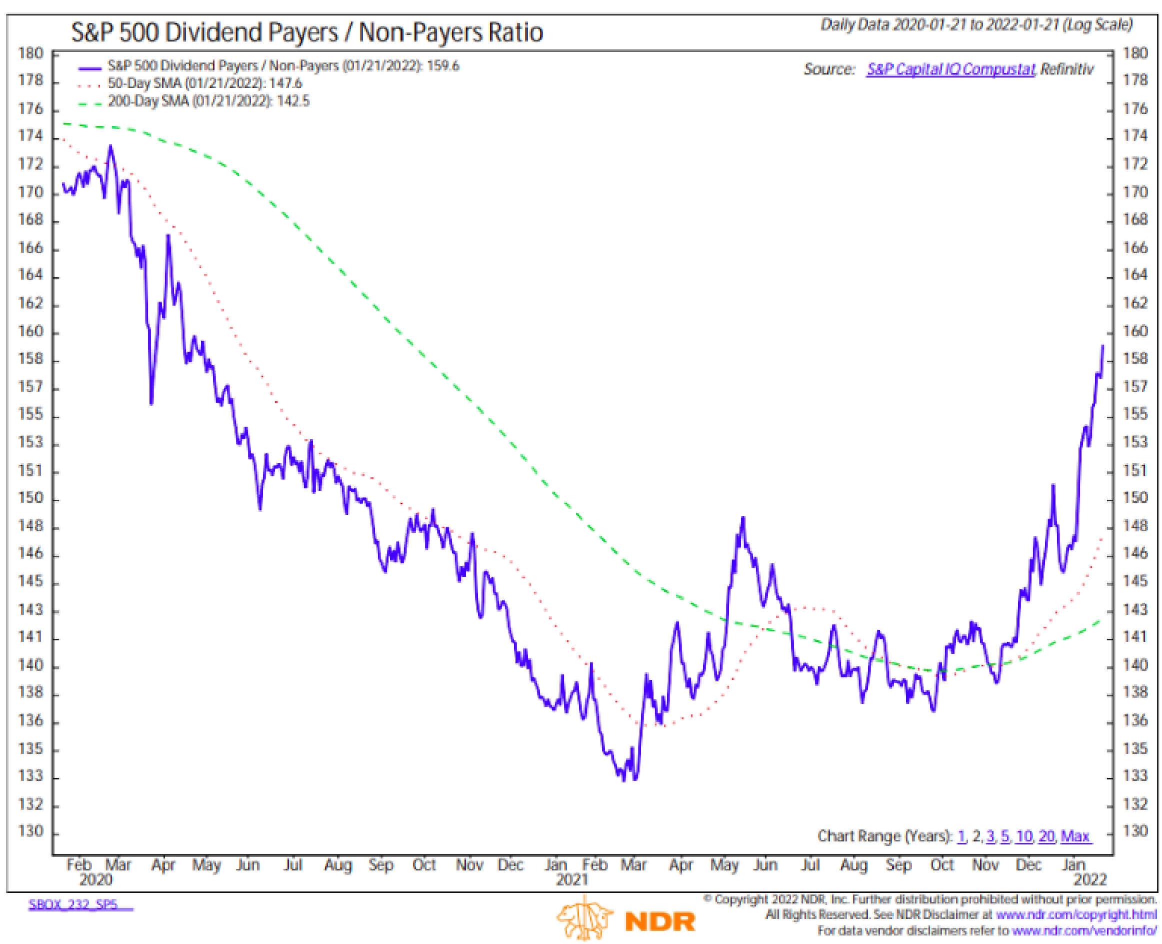
So, with inflation running in excess of 7% and the Fed talking about ending quantitative easing and raising rates in March, it is very difficult to see PE ratios expanding from these lofty levels. The following graphic is one of my favorites, it shows the breakdown of where the markets returns have come from. In a world where rates have declined to zero percent, expanding PE ratios were a large component of total returns. But if inflation and interest rates rise as they did in the 1970's and early 2000's, stock market returns will most likely fall below historical averages.



So how much damage has been done so far? That depends on where you're invested. As I write this on February 3rd the

- S&P 500 is only down -6.3%
- Small-Cap stocks are down -8.6%
- Developed Market Int'l Stocks are down -8.6%
- Tech heavy NASDAQ is down -12.1%
- Emerging Market stocks are down -17.2%
- Bitcoin is down -45.4%
- Hyper-Growth stocks are down -54.2%

On the flip side, energy stocks are only off about 1% from their very recent high while higher dividend paying stocks are down about 1.5%. Dividend paying stocks have been the place to be of late, as the chart below clearly shows.



I know **"Days Like This"** can be tough at times, but this is just the normal bull and bear tug-of-war. We are in an economy transitioning from ultra-easy monetary policy to something less easy. These periods generally are more volatile, but they are also cleansing. Many of the areas of the markets where capital was flowing regardless of fundamentals will see massive outflows, and those areas where fundamentals are real will be sought after for their stability. Fortunately these are the types of markets I love.

When you don't need an answer there'll be days like this
When you don't meet a chancer there'll be days like this
When all the parts of the puzzle start to look like they fit it
Then I must remember there'll be days like this

Be careful out there,

Chris Wiles, CFA

Where trust is Earned