Mid-June 2022 Market Commentary

Rebel Without a Clue

Into the great wide open
Under them skies of blue
Out in the great wide open
A rebel without a clue

Tom Petty And The Heartbreakers
https://www.youtube.com/watch?v=xqmFxqEGKH0

Last week the Fed had their two-day meeting and announced that they were raising the Fed Funds rate by 75 basis points to 1.50%-1.75% to combat inflation running over 8.5%. Later the Federal Open Market Committee (FOMC) had their presser where Fed Chair Powell fielded questions, but once again, not a single question about the Fed's role in creating the inflationary spiral that we are in. Lots of questions and blame regarding pandemics, war and supply chains, but no mention of years of 0% interest rates, $5 trillion in bond purchases, and $7 trillion in national debt.

We're just supposed to pretend that none of that happened, that we just woke up one day to runaway inflation, after more than a decade of excessively lose monetary and fiscal policy. We're supposed to smile and thank them for hiking rates and saving us all from a situation that they caused, while they blame everything but themselves.

Somewhere over the last couple of decades a school of thought has entered economics that believes that excessive amounts of liquidity and free money are not inflationary, it's called Modern Monetary Theory (MMT). Fed Chairman Greenspan played with it a bit during the Dot-Com bubble, then Chairman Bernanke implemented it in the depths of the Great Financial

Recession with our first cut to zero. Chair Yellen kept the pedal-to-the-metal and threw the experiment into high gear by continuing to keep rates pegged at zero, even while the economy expanded. Chair Powell attempted some normalization but quickly retreated when the pandemic hit.

It wasn't just rates being pegged at zero, they also decided to double down by vastly expanding the Fed's balance sheet through purchases of bonds and mortgages. While this was a sound tactic to help rescue financial markets that were frozen in 2008, its merits during an economic expansion are questionable at best. It was just another part of the MMT experiment.

US Federal Reserve – Total Assets			
Year End	Assets (in Billions)	$ Increase (in Billions)	% Change
2002	732		
2003	772	39	5.4%
2004	811	39	5.1%
2005	848	37	4.5%
2006	870	22	2.6%
2007	891	21	2.4%
2008	2,239	1,349	151.4%
2009	2,234	-5	-0.2%
2010	2,421	187	8.3%
2011	2,926	506	20.9%
2012	2,907	-19	-0.6%
2013	4,033	1,125	38.7%
2014	4,498	465	11.5%
2015	4,487	-11	-0.2%
2016	4,451	-35	-0.8%
2017	4,449	-3	-0.1%
2018	4,076	-373	-8.4%
2019	4,166	90	2.2%
2020	7,363	3,197	76.7%
2021	8,757	1,394	18.9%
2022 YTD	8,932	175	2.0%
	Period	$ Increase (in Billions)	% Change
	2002-22	8,200	1120%

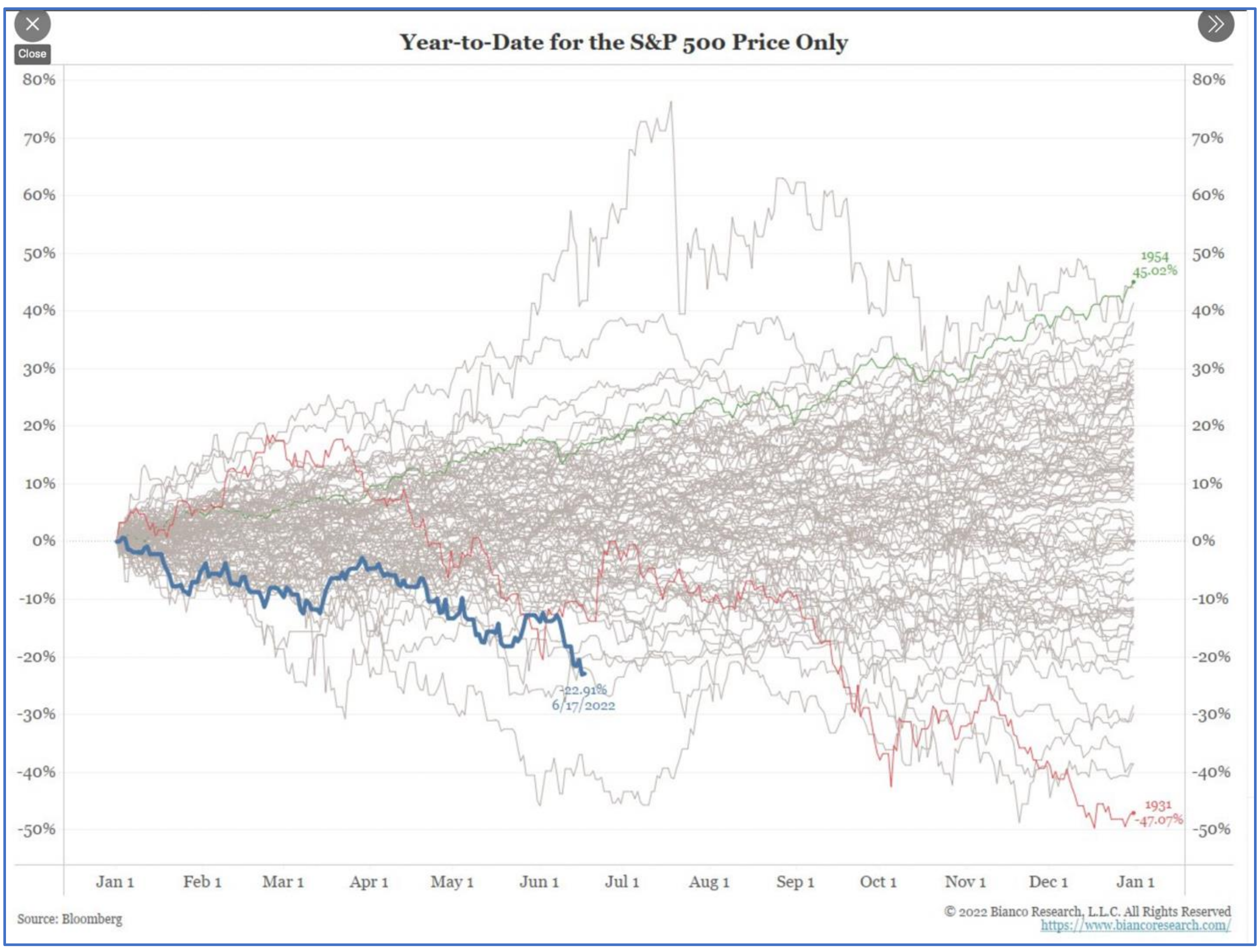
Even though inflation is running at a 40-year high, the Fed has actually increased their record high balance sheet by another 2% this year.

Question from the bald gentleman in the back.
Excuse me Chair Powell, while I admire your willingness to admit that you were wrong about "transitory" inflation, I was wondering if you are yet willing to admit that excessive amounts of liquidity and debt have contributed more towards our inflationary spiral than supply chains and Putin?
…crickets chirping…

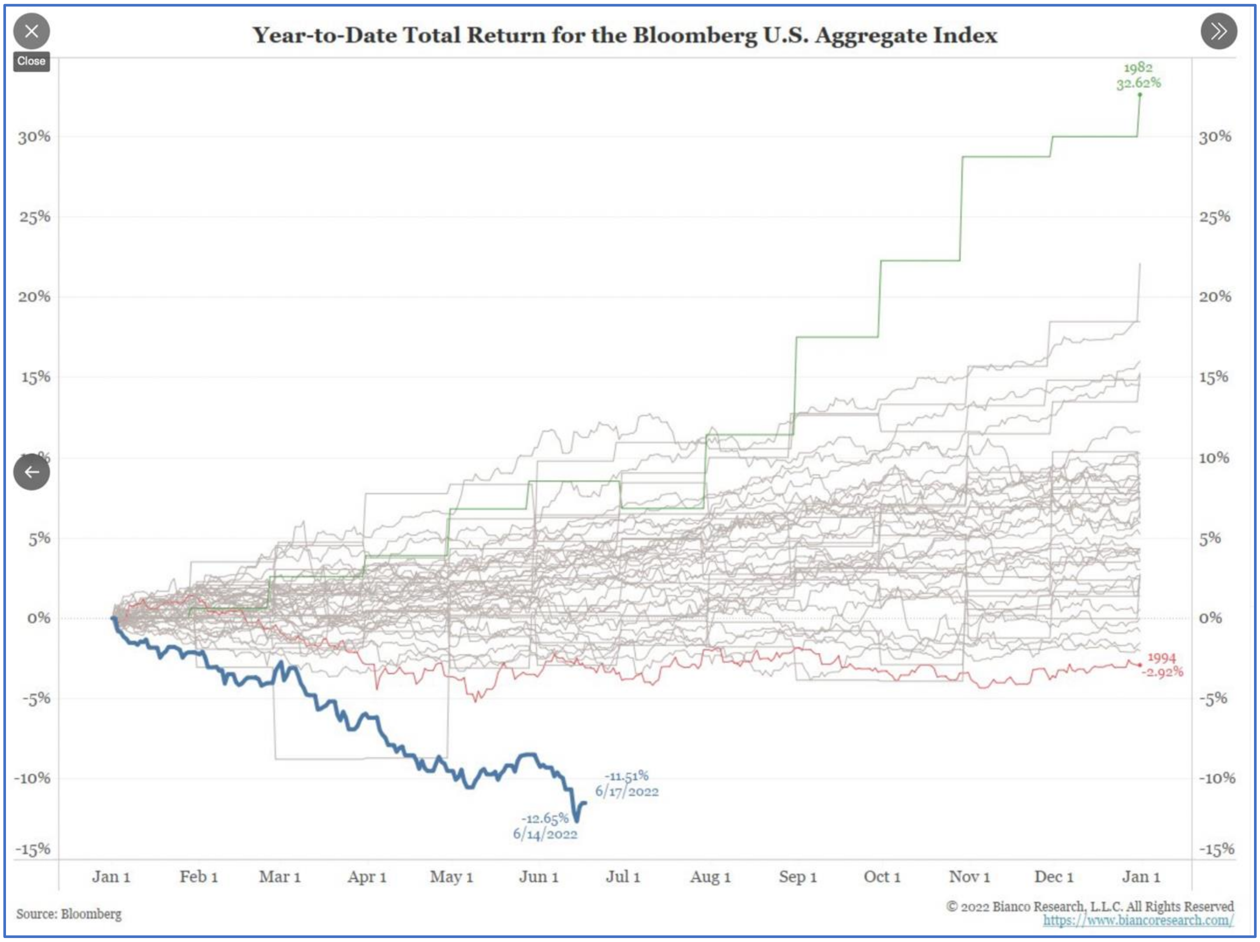
Sorry for the rant, every now and then I have to get that off my chest.

Ok, I realize that my primary job isn't criticizing the Fed but rather trying to navigate the playing field that they've created. That said, here is where we stand.

If it feels like these markets have gone nowhere but down, you're right. Ten of the last 11 weeks have been negative, this hasn't happened in 50 years. Also, other than 1932, during the Great Depression, this is the S&P 500's worst start to the year.



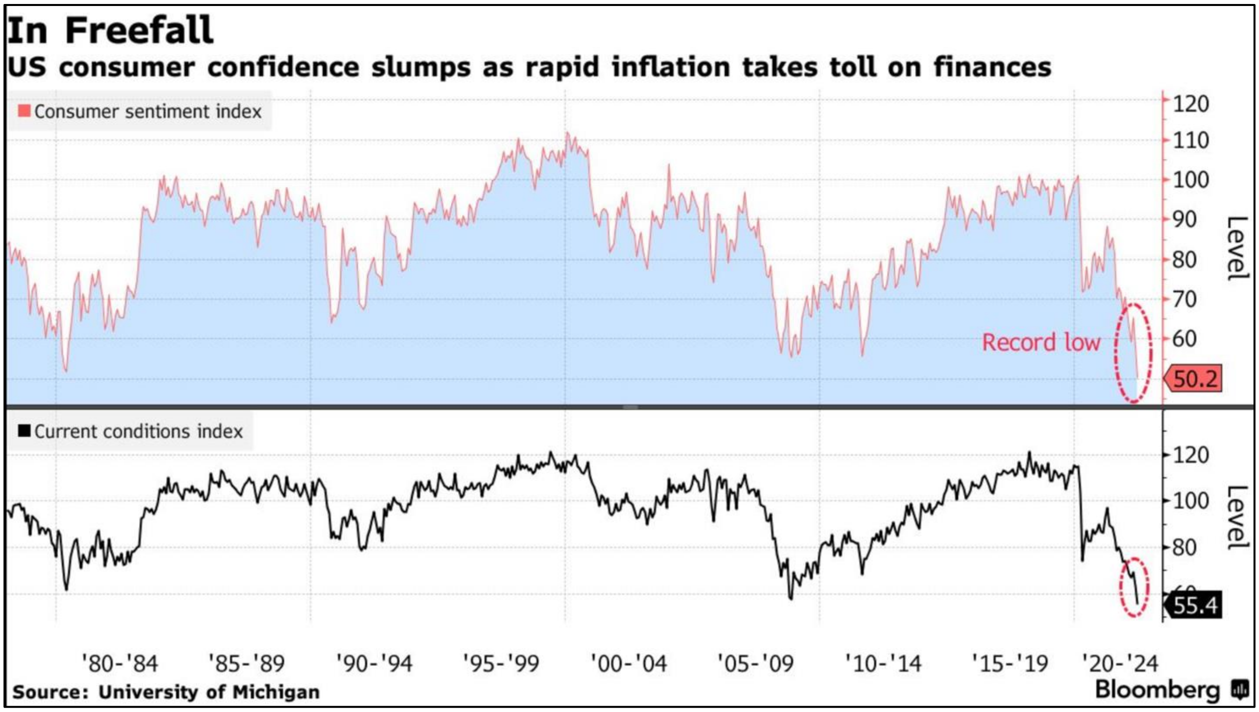
Usually when the equity markets are getting hit like this, investors can seek cover in the bond market. Unfortunately, when interest rates are near zero and headed up rapidly, bonds have offered no shelter.

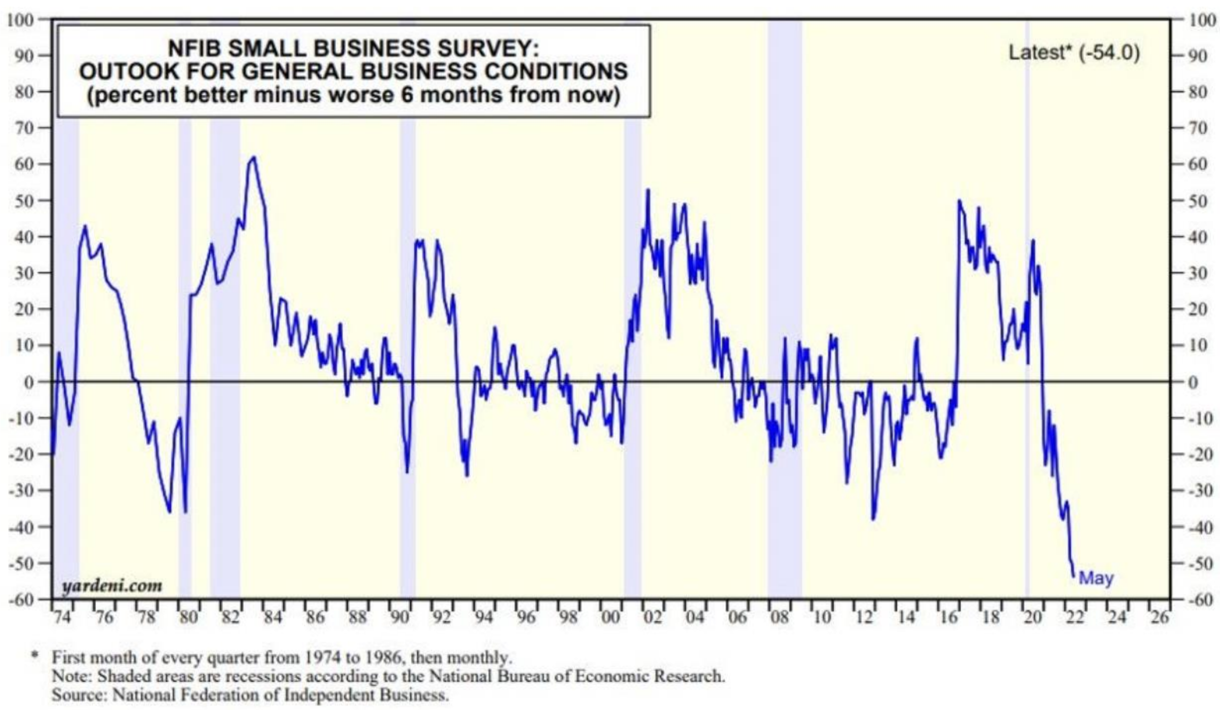


Inflation is depressing! It's been 40 years since we've had inflation at these levels and we've forgotten just how much it weighs on the psyche.

I'll throw in another Tom Petty bonus, ***Free Fallin'***.
https://www.youtube.com/watch?v=1lWJXDG2i0A

Both consumers and small business owners are more depressed than at any time since the last time inflation was at these levels.

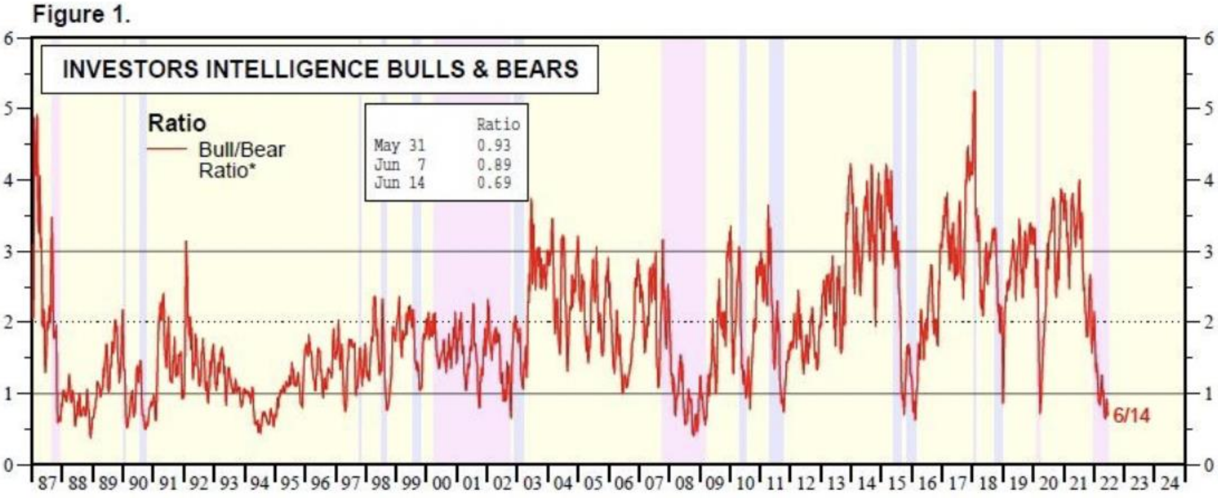




And investors are equally as pessimistic. Fun factoid, Thursday June 16 was the fifth time in seven trading days that more than 90% of the stocks in the S&P 500 declined. **Since 1928, that has never happened.** This is the most overwhelming display of selling in history.

Bulls & Bears

Figure 1.



Remember just two years ago, during that crazy liquidity fueled boom when the S&P 500 had annualized returns north of 18%, we had instance after instance of… "this has never happened before" on the upside. So please don't be surprised if we have instance after instance of "this has never happened before" on the downside. After nearly 40 years as a professional investor, I've never seen such a constellation of events where there is no historic analogue. Right now, I have more humility in terms of my views going forward than ever before. It's more important than ever to be open minded – the ending is not predictable.

Bear markets impact people differently, depending on what stage of their investing lifecycle they are in. For my daughters and other younger investors in their early savings years, bear markets are opportunities to put more money to work at lower prices, hopeful that in the long-run America will continue to be a great investment.

For us older investors in or near retirement age, it can be very painful. We look at our portfolios as a barometer of how comfortable we will be in our later years. Depending on the size of those portfolios, we may have to consider working longer or spending less, or both. We too are hopeful that investing in America will be fruitful, but our needs are a bit more immediate.

Now I can't possibly tell each and every one of you what to do with your portfolios for several reasons, first and foremost I don't know, and secondly each of you has different objectives and risk tolerances. What I can do is offer you a glimpse into what I am doing personally.

As a 62-year-old with a 20-30 year life expectancy, I need a balance of both current income and growth. While it is common to fixate on current income as we age, it is critical to remember, especially in an inflationary environment, that we also need that income to grow.

For several years now I've believed that our equity markets were trading at pretty high levels and therefore I've maintained a fairly high cash allocation of 15-20%. This hurt when stocks were screaming higher, but it's cushioned me some on the downside. I've also maintained about 15-20% in bonds. The remaining 60-70% has been in equity-income stocks, stocks that pay nice dividends and have the ability to continue to grow those dividends.

Lately I've been using some of my cash to nibble on some short-term bonds that have sold-off sharply, as well as nibble at some of my favorite stocks that are also down sharply. So far this has been a losing trade as we continue to set new lows. My current allocation is 65% equity-income stocks, 18% bonds, and 17% cash.

My goal is to gradually work cash down to around 10% while adding to both equities and bonds. I know I'm not going to pick the exact bottom in stocks and bonds, maybe it's already happened or maybe it's still years away, but I know we're closer to the bottom today than we were a year ago. I try not to fixate on what I've lost, instead I try and look at the opportunities this bear market is creating.

Again, this is just me, each of you is different and should discuss your particular hopes, fears, and asset allocation with your financial advisor.

This is not an easy time, especially emotionally. As Berkshire Hathaway's Charlie Munger so elegantly stated, ***"It's not supposed to be easy. Anyone who finds it easy is stupid."***

As always, be careful out there.

Chris Wiles, CFA

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