Starting Out Fresh!

January 2023 **Letter Number114**

One good thing about every New Year is that we all get a reset. The end of each year is a time for both celebration and reflection, and 2022 is no exception. We can take stock in what was good, while making a resolution or two for personal improvement, as well as to try to do more for the benefit of others. My resolution is to do more for you, wherever and whenever there are opportunities to do so.

A Brief review of 2022

A lot happened these past 12 months. The Federal Reserve (Fed) began to raise interest rates in earnest. A border war between Ukraine and Russia broke out. A 100-year storm devastated the state of Florida. The midterms dominated the news headlines for months. Twitter changed hands (and the new owner likes to Tweet)! The stock market may not have made the headlines like these other events, but it was nonetheless eventful. The great bull market took its last gasp, tapping out its all-time highs in the very first week of the year. What followed was a bear market, and it may not be over with yet. Take a look at the numbers *(data on December 2022, rounded to nearest whole percentage)*.

Dow Jones Industrial Average (Dow)	Down 8 %
S&P 500 Index	Down 20 %
NASDAQ 100	Down 34 %
Russell 2000 Index	Down 21 %
MSCI Emerging Markets	Down 21 %

One other index worth noting, the U.S. Aggregate Bond Index: Down11%. Frankly, it was disappointing for fixed income, likely tied to the Fed aggressively raising interest rates. A word of caution, the Chair of the Federal Reserve is on record that rates are not done going up. Consequently, there might be more downward pressure (over time) going forward. Somewhere ahead, the markets may force the Fed to reverse course on the rates, and that might make for an opportunity to go back on offense and be buyers.

Can't Say You Didn't See It Coming

Nearly every one of my letters in the back half of 2021 carried the warning that there was ample evidence of extreme bullishness in stocks, and that a hard rain may be coming. That warning may have fallen flat for some as market indexes (and stocks) kept hitting one new high after another. I warned that the first ones out would likely be the only ones out. My thoughts at the end of each letter included a "strategy" that leaned into very defensive posturing for several quarters, clearly being too early but not too late. My messages were consistent in that the signs of excess were everywhere, but to veterans of the markets we understand that there is no perfect market-timing mechanism. Consider this excerpt from Letter 101 *(December 2021 – the S&P 500 Index would top-tick one month later)*.

We are in the midst of a grand, potentially late-cycle bull market party with all of the signs of excess on full display. As all bull markets go, eventually the mood becomes giddy, the levels of risk-taking start to run amok, bravado results in more and more leverage (so as to amplify one's gains), and soon enough we are left with a full-on "carnival-like" atmosphere where everyone comes to believe they can get rich quick. It is the stuff bull markets are made of, here is some sage guidance that came from a famed investor nearly four decades ago;

"bear markets are born out of maximum optimism."

- Sir John Templeton -

Then, from my writings of January 2022 (Letter Number 102, mailed out six days before the all-time highs would be made on January 5, 2022):

in the year 2021 there were more than ample sightings of sheer madness as certain stocks were driven to nearly vertical movement on the charts, followed by equally extraordinary collapses. By the way, this is highly emblematic of very "late-stage" bull market activity. They are called "shooters," they go into a "blow-off" phase, and then they collapse. Good for those who got in low and sold off high! However, many participants likely came late, and then stayed too long.

At the March 2009 bear market lows (caused in part by the bursting of the housing bubble), the S&P 500 Index stood at 666. Twelve years later this most widely-followed index topped out at 4,809. As of this writing it is at 3,822, down just short of 1,000 points just this past year. It will be interesting to see how long it takes to get to that high again. The good news is that despite the awful losses in all the major averages, on a comparative basis many of us did quite well in 2022. Again, in nearly every letter in 2021, I suggested to those predisposed to capital preservation to keep equity exposures low, keep bond maturities short, hold some cash, and have some exposure to emerging markets and precious metals. Of those, it was the emerging market assets that fared poorly, but I still like the longer-term outlook for that segment.

So, What's Next?

The major stock averages hit their lows in early October and since that time there has been a bit of an upward bounce. Many view this as a "clearing trade," or in other words, it is a time where many of the algorithm-driven traders are reassessing their strategies, while the large institutional investors might be reallocating their portfolios to adjust for the many changes from interest rates to consumer spending patterns to the supply chain economics, and more.

Near the end of every year I review hundreds, and sometimes thousands, of stock charts in search of some interesting patterns. I'll find many that meet a rough image that I'm looking for, and then from those there is a much greater effort put forth to delve into the more fundamental data on those companies. The end goal is to identify a final three or four that look to be potentially highly attractive stocks. This year I went through all 2,000 of the Russell 2000 Index and I must say, it was an eye-opener. There appears to be way more carnage in these smaller capitalization stocks than what I witnessed when looking at the larger S&P 500 stocks. This suggests to me that at least on the appearances of their charts, many stocks look severely "oversold." I won't be surprised at all if some of these stocks stage an upward rebound in the first and/or second quarter of the new year. This doesn't mean all stocks will do well.

Bull markets first need to stop going up, and that is a tall task. Bear markets exist to deflate the massive over-valuations that got built up during the prior bull market cycle. However, the true challenge for the bear market is to keep as much capital in the market for as long as possible so as to inflict maximum pain. If the current bear market cycle continues to more fully express itself, it will try to suck more life out of the most rabid bullish traders, but that process can be slow and tedious. This is why there are often three or more "stages," or "legs" to almost all major market cycles. In my humble opinion, 2022 was merely the first major leg of what I believe will be a longer lasting, more devastating bear market cycle. We'll see as we get more evidence and with more time, but it rarely happens all at once. Further, even in bear markets there can be some significant (and potentially profitable) market rallies of substance.

Early 2023 Strategy

Looking at all those charts was effectively a search for some "fallen angels," investment-worthy companies that have fallen out of favor for one reason or another. Supported by research, valuation metrics, and perhaps some hopeful improvement in the charts, the intent of this search is to find interesting prospects. I cannot mention stocks by name in this letter, but I'm willing to make recommendations from my discovery process for each of you based upon our understanding of your long-term investment goals and tolerance toward risk. I am here to have that conversation.

For those seeking a strategy of growth but with an eye on your underlying capital base, this may be a time where a little more could be allocated to equities (with an eye towards value and dividends), while continuing to maintain some exposure to emerging markets and precious metals retaining some cash (but a little less), and maintaining an allocation to some shorter-term fixed-income (bonds, Treasuries, CDs). I want to emphasize that any significant negative surprise ahead with the economy (or perhaps a higher-than-expected rise with interest rates) would warrant that we revisit this allocation model. For those participating in our discretionary and fee-based "Solutions" accounts, reallocation is ongoing, and we likely already made some of these adjustments.

Last Word

Precious metals, both gold and silver, have been very soft throughout much of the past year, but there was a sudden hard rally that materialized in mid-November. I don't want to over promise and under deliver, but the current state of that market has many believing that the stage may be set for a more robust rally ahead. Should this materialize, it might be a surprise to many who trade in the futures markets, as it appears their favored position is to be bearish on this sector. A spirited rally might be just what the doctor ordered to push these futures traders to reassess their positioning. This has the potential to make 2023 a much more interesting year for this asset. Happy New Year everyone!!

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Past performance is not indicative of future results.

The Standard & Poor's 500 Index is a capitalization-weighted index that is generally considered representative of the U.S. large capitalization market.

The Dow Jones Industrial Average (DJIA) is an index that shows how 30 large, publicly owned companies based in the United States have traded during a standard trading session in the stock market.

The NASDAQ 100 is a modified capitalization-weighted index that is comprised of the largest non-financial companies listed on the National Association of Securities Dealers Automated Quotation System stock market. It includes both foreign and domestic companies, and does not include any financial or investment companies.

The Russell 2000 Index measures the performance of the 2,000 smallest companies in the broader Russell 3000 Index, which measures the performance of the 3,000 largest U.S. companies based on total market capitalization. The average market capitalization is approximately $490 million, and the median market capitalization is approximately $395 million.

The MSCI Emerging Markets Index captures large and mid cap representation across 26 emerging markets countries, covering approximately 85% of the free float-adjusted market capitalization in each country.

The Bloomberg U.S. Aggregate Bond Index is a broad-based flagship benchmark that measures the investment-grade, U.S. dollar-denominated, fixed-rate taxable bond market. The index includes Treasuries, government-related and corporate securities, MBS (agency fixed-rate and hybrid ARM pass-throughs), and ABS and CMBS (agency and nonagency).

The risk of loss in trading commodities and futures can be substantial. You should therefore carefully consider whether such trading is suitable for you in light of your financial condition. The high degree of leverage that is often obtainable in commodity trading can work against you as well as for you. The use of leverage can lead to large losses as well as gains.