Tranquility

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That's my view from our west-facing picture windows at this time of the year following a long day at the office. Our friends who visit from urban areas can't believe how lucky our family is to have such a beautiful and bountiful state of nature just outside our back door. Most of the time we agree with them, but out of full disclosure, this particular view happens to be from the longest daylight day of the year (June 20), which is only a few weeks out from when all of the barren trees of winter become a fresh green crop in late spring. Late in the day with the sun lower in the sky (but somewhat obscured by modest cloud cover) and with the calmest of water, it is the ultimate in tranquility.

Tranquility can be fleeting. Many years ago a tornado came upon us from the west, and after tearing out a large swath of trees a few miles before, it bounced along the terrain before crossing our lake. It then reasserted its full force right at the point of our property and continued eastward a mere 50 yards from our home. Miraculously our house survived without any damage (we were inside with our first child), but over fifty trees were effortlessly uprooted and, like a wide line of dominoes, they toppled one unto another along the way. This touchdown left a well-defined pathway of damage that ran for about 800 feet, then skipped off the ground and headed a few miles further east before blasting out another line of trees. The loss of so many trees on our property is a big part of the reason why the lake is now so visible to us (which certainly makes my wife, Julie, happy!). Prior to this event, our view was obstructed by full foliage, looking the same as what you see on the opposite side of the lake.

Just as tranquility can be fleeting, so can the state of the markets. If I could describe the current state of the markets in photographic terms, I would use the picture above as the de facto illustration. Calm and peaceful with lots of "green sprouts" and little conflict; two shades away from Nirvana.

Data Point: The past several weeks have been amongst the most tranquil I've seen in nearly three decades of following stocks. From May 17 through June 11 the Dow Jones Industrial Average moved less than 200 points from one close to another on 18 out of those 19 days, with more of them under 100. For an index that is at about 34,000 this constitutes a nearly negligible rate of change. I contacted a few people who have extensive market experience to get their opinion as to whether such a condition had occurred before and if so, what was it that followed? The question yielded a mostly, "Hmmm, interesting…"

Might this be a calm before a potential storm? Alternatively, have the markets become so subservient to the massive amounts of money printed up by our Federal Reserve that this might be the "new normal"? Of course, we will only get the answer with the benefit of hindsight, so perhaps the next several weeks could shape up to be an important piece of this puzzle and perhaps give a clue as to how the back half of this year might play out.

Tranquility can be fleeting? Here is an illustration.
Remember what happened just a little over one year ago? The daily action across the broad markets in late 2019 and early 2020 were somewhat similar to today in that we were grinding out steady new highs on the major averages and most stocks were very highly valued relative to historical metrics. I had put out several warnings in that time frame alerting followers that the conditions of the markets were quite ripe for

disruption. I described it as "a bubble looking for a pin." In early February (2020), we were getting early reports of a viral breakout in China, but no cases had been identified in the U.S. Nonetheless, that steady grinding upward action that had predominated the markets for months came to a sudden halt. As soon as reports surfaced that the virus had been identified as arriving in Washington State and then New York, the markets rapidly tanked. It took less than five weeks for the S&P 500 to give up over 35%, and many stocks in the more speculative sectors generally fared far worse. The pin had arrived in the form of a matter of health.

That was then. Today, though, one might argue that <u>conditions are even more out of balance </u>than they were pre-virus. The markets appear to have priced in a full recovery from the lockdowns (and then some), but we are far from a full recovery in the general economy. There continue to be enormous dislocations. There are disruptions to the supply chain, there are shortages of labor (even where generous wages are offered), there are products in short supply in many sectors, and then there is the imbalance of containers, trucks, and ships for intermodal transfers. In all, it is still quite messy. On top of that, there is more debt now than a year ago, there is more leverage (margin) in the markets, and it can be argued that there is less fear by investors, which many highly experienced market pundits claim can lead to less market stability should the unexpected occur. All in all, the appearance of "tranquility" that we are seeing could simply turn out to be a camouflage. If we use the stock market averages as the compass that gauges our recovery progress, I would submit that it is predicting a long period of uninterrupted prosperity. However, we've been on this trip before and the presumed destination proved to be out of reach. How should we prepare ourselves for the next leg of this market journey? I would say we should pack a safety parachute and have a ready exit plan. In my opinion, the bubble is back (with a vengeance) and is once again in search of the next pin.

Perhaps I can sum up my view of the current tranquility this way ….. it's a struggle (for me) to find good relative values and opportunities where the upside appeal far outweighs the apparent downside risks. Alternatively, I can easily find plenty of stocks (and other securities) that I would sell in a New York minute. For those who thrive on finding mispriced securities and taking advantage of them, one needs to turn over an awful lot of rocks in the current environment. There just isn't much out there that I can find that captures my interest in this particular environment.

However, do not despair! I have been in this game for a long time, and I believe that this too shall pass, and there will be fantastic opportunity somewhere ahead.

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The Energy Markets: More tranquility. Following a wild year for the hydrocarbon-related stocks in 2020 where the price of a barrel of oil plunged so low that it went negative at one point, this year is shaping up as just the opposite as the "per barrel" price of crude carves out new incremental highs at a steady clip. When this sector was in total disarray late last fall and the prices of most oil/hydrocarbon-based stocks had collapsed (and the dividend yields were at mouth-watering levels), we made a strong recommendation to commit to several stock positions. I did something unusual back then when I dedicated an entire letter to what I saw as a particularly rare opportunity in this sector *(see Letter 87, October 2020, "The Perfect Storm").* Many stocks in this sector appeared to be badly mispriced as the mass of investors became too fearful of what seemed then as vastly diminished potential. My logic? The world still relies heavily on hydrocarbon energy, and any move away from that will take years, potentially decades.

My current recommendation is to hold if you've locked in the high yields that were afforded from ultra-low prices, <u>although I am not as willing to be a buyer at current levels</u>. Oh, and by the way, what you just read above is a perfect illustration of what I mean when I say that "this too shall pass". Last fall was simply one of those moments with respect to the energy trade, and I expect there to be more across the broader markets somewhere ahead.

The Precious Metals Markets: To those of you who have been longtime readers of these letters, you know that this sector has been, and continues to be, nearest to my heart. I will be the first to admit that gold prices are much nearer to its all-time high prices than the median price of the past decade, and that an argument could be made that this asset class isn't much different than many others. However, that would be completely dismissive of two important features of gold. First, it has a very long history as an attractive asset in periods of inflation, and second, it is the only real form of money that cannot be created simply out of mid-air (like traditional currencies. Further, where the overall market for stocks has been working through a series of higher highs and higher lows for nearly a decade (with only the pandemic as a brief respite), gold (and silver) went through a bruising seven-year consolidation (a long trip to nowhere) and only recently broke out above that pattern (August 2019).

It is my belief (and that of many cohorts who I know to be savvy on the markets) that the Federal Reserve (Fed) has been painted into a corner with respect to policy alternatives for a very long time now. It is my belief (not Stifel's) that the Fed will not be able to raise interest rates by any meaningful amount without collateral consequences. The same opinion applies to reversing their massive asset-buying program that has been in place for seven of the past nine years (they are currently buying approximately $120 billion of securities monthly and holding them on their own balance sheet). It is my belief that somewhere ahead, this potentially "cornered" Fed will ultimately have to take some sort of actions to change the dynamic, and one potential result is that the U.S. Dollar could get pressured to the downside, if not well beforehand. I see gold (and silver) as a more stable alternative to that possibility. Of course, there is no certainty to this theory, but when it comes to making investments, you must have your long-term game plan in place and then have the discipline to make rapid adjustments if future events prove you wrong. I've seen nothing yet to convince me that we might be on the wrong trail. My strong recommendation is to have a position in the precious metals complex, owning some gold and silver bullion along with an assortment of high quality miners that have "proven and probable" unmined reserves. I am available to share the names of my favorites.

The broader market: Other sectors such as technology, communications, health care, and alternative energy (and all things "green" such as electric vehicles and batteries) appears to me to be under the influence of way too much hype, and as such, good values appear generally absent. In other words, prices today seem to have already discounted decades of future expected cash flows in these areas, so any "investment" at current levels look more like a speculative endeavor to me. If you have an appetite for volatility and can stay with positions that could very easily swing by more than 50% in a short time period, have at it and make your picks. Again, I would happily have a conversation with you and share Stifel research (if available), but I would likely hold my own opinions on the appearance of excessive valuations to myself.

Enjoy your Independence Day holiday, and don't miss out on all that summer has to offer. As always, we are ready to help with all of your long-term financial planning needs.

My website is "davidatstifel.com."

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Senior Vice President/Investments

Past performance is no guarantee of future results.
Indices are unmanaged and are not available for direct investment.
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 Standard & Poor's 500 Index is a capitalization-weighted index that is generally considered representative of the U.S. large capitalization market.