

# An Unstoppable Market?

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Does something have to give? We are living through a monetary experiment that is pitting unprecedented financial alchemy against massive herd behavior. On the one hand, we appear to have a Federal Reserve (Fed) that is willing to print (and employ) a seemingly infinite amount of money in order to “juice” the economy, while on the other hand, we have investors willing to accept such a move as “normal” operations and are immersed in the markets accordingly. In effect, the Fed authorizes the printing of trillions of U.S. Dollars and simultaneously makes purchases of trillions of dollars of various securities, holding them on their own balance sheet until maturity or until some unknown point in time in the future. The process of the Fed holding interest rates down to near zero percent while printing money and purchasing securities on the open market is a process commonly referred to as “Quantitative Easing” (QE), and the point in time in which they ultimately decide to start reversing these operations is commonly referred to as “tapering.”



My own bias, the best Hydrangeas in the North!

Various forms of Quantitative Easing have been around for over a decade (dating back to November 2008), but each subsequent version has been taken to a greater scale than each of those that came before, largely because with each effort a bigger bazooka was required in order to get the desired results in return (*Source: Yahoo News – A glossary of the Federal Reserve's full arsenal of 'bazookas'*). In the meantime, “tapering” has only been attempted once so far. Although it was first mentioned as far back as 2013 (and the market reaction to the mere words was swift), the only time the Fed actually acted upon its intent to reverse some of the QE was back in late 2017 but the results were disastrous; by late 2018 stocks began an aggressive sell-off, junk bond yields started to spike, and mortgage security prices became less stable. This “tantrum” brought the tapering to an abrupt end. It is believed by

many that we are fast approaching another point in time for a second attempt at

another actual tapering as several sitting members of the Federal Reserve Board have dropped hints in their recent regional presentations. The Chair of the Fed, Jerome Powell, has also been parsing selective language throughout the month of August whereupon his board may start to lean into some form of early tapering within a reasonable period of time in the not-so-distant future (which is all very ambiguous!), followed by the usual qualifier of, "...with the future incoming economic data ultimately guiding our decisions..." (or some variation of that).

One might never know that there is this actual contemplation of a potential change in the direction of monetary policy by simply observing the major stock averages. The Dow Jones Industrials, the S&P 500, and the NASDAQ 100 indexes have each traded to new all-time highs this past month, boosting the confidence factor of portfolio managers and financial analysts' outlooks even more. Tapering? No problem!! New highs are deemed as "super-bullish" and as such frequently spur on even more speculative activity. Never mind that two of the three indexes above (S&P 500 and NASDAQ 100) are largely and collectively being driven by a small handful of massive "mega-cap" stocks with high nine-figure billion dollar and trillion dollar valuations. That is another story for another letter. The



**In front of the Cleveland Federal Reserve**

important takeaway is that there remains the perception that the market is in a healthy bullish run, and this creates an environment where the average small investor feels they must participate in some manner. The "Fear of Missing Out" (FOMO) is a powerful magnet that continues to pull in more and more money into the market, but I believe this is how major bull market tops are usually formed. We are entering the two months of the year that have a reputation for excessive volatility, September and October. This may be one of the more interesting tests of the durability of this bull market because there are some very significant opposing forces at work. Supportive of further gains is the fact that the current bias and momentum are to the upside, the

trend of earnings has been generally positive, and the Fed continues to flood the system with significant amounts of previously-mentioned stimulus. On the other side are the bears, who are witnessing some of the most hyper-extended valuations in all of recorded market history (which many think are unsustainable), there are questions if too much of the expected future cash flows of companies has already been “priced in” to current share prices, and then there is the issue of seeing a few cracks develop here and there in the “uniformity” of market measures. Not to be left out, with much higher valuations come a much higher risk profile to stocks and the stock market indexes. To be sure, it is a tough call, but many investors seem to believe that we are much further into a mature phase of the long-running bull market than we are at the beginning of it.

In our letter of last month, we included several time-tested quotes from notable investors of the past century and this month, we wanted to finish that with some select observations taken from the book, *“The Intelligent Investor,”* written by Benjamin Graham in 1949. The book has come to be known as the definitive guide for “value investing,” and Graham is considered to be the Father of Value Investing. With that in mind, here is the first quote:

***“Speculative stock movements are carried too far in both directions, frequently in the general market, and at all times in at least some of the individual issues.” (pg. 31)***

This is a testament that momentum and the feverish yen to participate can push prices well beyond the ceiling range of acceptable valuations in bull markets just as much as fear, panic, and despair can crush prices far below known valuations in bear markets (and in individual stocks). The pendulum will often go too far in both directions, and every investor must be mentally prepared for such market behaviors during those extreme phases. In my opinion, we are far into one of those two events right now.

***“The intelligent investor is a realist who sells to optimists and buys from pessimists.”***  
(pg. xiii)

Value-driven investing is a discipline. It requires that one use time-tested guidelines that determine when to reallocate into or out of certain positions based upon both the recognition of the values of the underlying businesses that a stock price represents as well as the overall investor sentiment towards that same stock. Extreme bullishness in the market would have the intelligent investor selling his or

her shares to the wild-eyed speculators while at the other extreme (bearishness), that same intelligent investor would want to be a buyer of shares when others are in a deep state of panic, despair, and when the underlying valuations support such action.

***“The intelligent investor gets interested in big growth stocks not when they are at their most popular – but when something goes wrong.”*** (pg. 183)

It was mentioned above that two of the most popular indexes, the S&P 500 and the NASDAQ 100, are currently trading at higher and higher levels largely due to the hyper-extended prices of a small handful of the largest companies in the world. Actually, less than a dozen names, to be precise. We have seen throughout history that nearly every company experiences bouts of bad news, bad market conditions, or some other market-moving event that can crush the stock price either temporarily or permanently. It is at these moments when the bloom comes off the rose that the intelligent investor accumulates a significant position for the longterm. [As was pointed out in last month’s letter, we had a recent experience in the fall of 2020 when the hydrocarbon energy stocks collapsed and the biggest and best names within that group fell to their lowest valuations in decades.]

***“In an ideal world, the intelligent investor would hold stocks only when they are cheap and sell them when they become overpriced, then duck into the bunker of bonds and cash until stocks again become cheap enough to buy.”*** (pg. 179)

This snippet of sage advice might be useful to many, but the practicality of it in a world of near zero percent interest rates might give pause to most investors. Nonetheless, for those who are very long-term oriented and who have been deeply affected by significant losses in prior bear market episodes, these words are well understood and the ability to adhere to such a mission would be one of individual choice or preference. For some investors, another alternative to going into cash and bonds would be to actually take a short position in some of the most egregiously priced stocks, but this is a strategy that includes significant potential loss of capital if the underlying hyper-extended prices fail to retreat.

Finally:

***“It should be remembered that a decline of 50% fully offsets a preceding advance of 100%.”*** (pg. 192)

This is just simple math. It is always fun when your stocks and other investments are going up, particularly when they go up a lot in a relatively short period of time, but when one fails to limit one's losses, it often doesn't take much to get to a loss of half of the prior value of a position. There is an old Wall Street saying, *"They take an escalator up but an elevator down,"* meaning that they lose a lot faster than they make. The phrase above should be respected by every disciplined investor, and the need to occasionally "cut one's losses" should be a part of every investor's toolkit.

In the current environment, I continue to recommend that in this climate of hyper-extended valuations in so many of the most popular investment sectors, the intelligent investor rationale is to maintain an "underweight" in stocks and an "overweight" in alternative investments, including shorter-term maturity bonds (despite their ultra-low yields), cash (same story), and precious metals. On that last subject, we have continued to experience overall weakness in both gold and silver throughout the summer months, and even more weakness in the valuations of the underlying mining companies. However, as we continue to pull in more and more quarterly data from those mining companies, the direction appears to be bullish. Many companies are reporting exceptional cash flows (records for many), top-line revenue growth due to higher overall gold prices, and improving profitability. Unless there is a significant drop in the prices of the underlying metals, I fully expect these metrics to continue. However, the majority of names that I follow continue to trade at low relative valuations (historically low in several names), and therefore this sector is one I would recommend having more exposure to than some of the others. If the price of gold and silver improve into the end of this year or early next year, I believe there is the real potential of a upward movement in the prices of several mining stocks.

Although there has been little change in my recommended asset allocation models for quite some time now, I fully expect that to change soon. Life experience in the markets would suggest that relative calm is fleeting while volatility that creates opportunity comes often. Before I close this letter, I also want to share an observation with you that may have real-world consequences in the days, weeks, or months ahead. We have an administration (and several state government leaders) that leans heavily into policy mandates, and one of those mandates that is gaining momentum is the one where the unvaccinated must be masked in order to enter into

public areas. There are those who chose to be vaccinated, there are those who are undecided whether to vaccinate, and there are those who will not vaccinate. This is no longer an issue of availability, as the various vaccines have been readily available to anyone who wants them for months on end now. However, if our elected leaders start **mandating** that you must be vaccinated or else you will not be permitted to enter a restaurant, a store, a movie theater, an arena, a hair salon, or a gym, then you start cutting out 25%, 30%, 40% of consumers to those entities and no business can sustain that kind of a loss of their customer base. This potential over-reach can be debated, but its effects cannot be understated. I am carefully monitoring these potential actions, but it certainly appears (to me) that few are taking this under consideration as they continue to chase their glamour stocks higher and higher. Should mandates proliferate, I see no way that our economy benefits from that, and by association, the stock market.

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As we bring the third quarter to a close this month, it is time for many of you to take a look at your required distribution amounts from your qualified accounts (IRAs, 401ks, etc.). The penalty for failing to take the required amount is very steep. Senior Registered Client Service Associate Jeanne Jensen will start getting in contact with some of you. Let's all try to enjoy the waning days of summer and then get into our holiday season mode that follows!

David Holperin  
Senior Vice President/Investments

Indices are unmanaged and are not available for direct investment.

Past performance is no guarantee of future results. Index returns include the reinvestment of dividends but do not include adjustments for brokerage, custodian, and advisory fees.

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

Alternative investments involve a high degree of risk, often engage in leveraging and other speculative investment practices that may increase the risk of investment loss, can be highly illiquid, are not required to provide periodic pricing or valuation information to investors, may involve complex tax structures and delays in distributing tax information, are not subject to the same regulatory requirements as more traditional investments, and often charge high fees, which may erode performance. An investment is appropriate only for investors who have the capacity to absorb a loss of some or all of their investment.

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.