Are We There Yet?

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Here in the U.S., August 30 will mark the 25th anniversary year of the untimely and tragic passing of Princess Diana and her beau, Dodi Fayed. It was an unfortunate event that has had a massive amount of media coverage over the ensuing years, but it also remains one of the most memorable personal life events to my wife Julie and me. Princess Diana and Dodi were unbelted back-seat passengers in a vehicle driven by Henri Paul who, in an attempt to evade the paparazzi in the late hours of a night in Paris, went barreling into a moderately lit tunnel and lost control of his speeding vehicle, colliding into a concrete pylon. The princess passed at 1:23 a.m. on August 31, 1997 (Paris time).

At 7:27 p.m. here in Wisconsin (where it was the 30 of August), only a one-hour difference in real time as we are separated by the 7 hours of time-zone difference, my future wife-to-be and I were saying "I D0" to our minister's question of whether or not we will respect, love, and honor each other for all of the rest of our lives. We were at the climactic moment of our wedding that was taking place at my home, located on a private wooded lot and overlooking a relatively private lake. Prior to the wedding, a good friend of mine helped me construct a wooden platform that was built into the hillside as the place for us to say our wedding vows that night, and not too far away sat a cedar swing-bench so that Julie's elderly parents could have a front-row seat to the ceremony. Twenty-five years of Northwoods winters had definitely taken a toll on that wooden platform and bench, but here is what that site looks like:

As our lives together were at their infancy, Princess Diana's life came to a tragic end. Over the ensuing years my wife Julie and I would always know what year our anniversary was because the popular magazines (People!) and the media in general would always note the anniversary of the passing of the princess, and so there was always that constant annual reminder. Besides the 25 years of wind, water, and snow, this particular spot rests in such an area of our property that it doesn't get much foot traffic. It is higher up and somewhat out of sight from where we walk to get to our beach area, and in fact, ever since our kids have grown and moved on, Julie has rarely gone out to that hillside wedding location. However, there is one thing I can always count on …. she has <u>always</u> gone out to visit that spot on our anniversary date, the 30 of August, without fail. My 25th anniversary gift to my wife is a surprise this year, a refurbishing of that blessed spot in a place that is simply stunning at sunset. Now it looks like this:

Happy 25th Anniversary dear!

ARE WE THERE YET? Just like the movie of the same name, investors are finding themselves in a period of angst and are starting to get a little itchy for some more upside to their holdings. For years the major indexes for stocks here in the U.S. (and by definition, the largest companies that dominate those indexes) were notching one new high after another with only occasional, but brief, intermittent pullbacks. Not here in 2022 though. The year started with the major indexes topping out in the very first week of the year and then went on to make a historic decline that lasted well into the second quarter. As of this writing we are still significantly below those highs of the first week.

The economic climate has changed. Interest rates are on their way up. Economic growth is subdued. The supply chain is disrupted. There are worker shortages everywhere and the only remedy so far is that many industries and employers are having to pay more and more for any help they can find, which then feeds into a continuous inflation loop. Wage inflation is a significant component behind ongoing price increases across the global economy. As we continue forward, consumers are likely to pay more and get less. Eventually this can result in less discretionary spending (with the potential to decrease corporate profits for many industries) and a more concentrated spend for essentials, but with the potential for margin pressures there too.

Historically, stocks and bonds don't do as well during inflationary periods as they do in disinflation or stagflation environments. Inflationary environments might benefit hard assets more, such as real estate and certain commodities. That isn't necessarily what one wants to hear when their 401(k) and their pension assets are allocated to growth stocks and longer-term bonds. The bigger issue though, is that one must first recognize that the rules of the game may have changed, and those who do so early are more likely to adjust and reallocate in a way that might diminish the potential damage. Economies are always and ever cyclical, and therefore, so are the stock and bond markets. The extent and duration of these cycles are unpredictable, but they can be monitored and estimated, and that is about as good as it gets. More importantly though is the simple recognition that it is going to be different.

Every market finds leadership and develops a trend. I have always said that the stock market is one of the biggest puzzles known to mankind, and Mr. Market will do everything it can to fool the greatest number of participants for the maximum amount of time. The market leaders in one major cycle will eventually fade as new leadership develops for the next cycle, but the original leadership names don't disappear quietly into the night. They hang around and stubbornly refuse to go away. Lesser experienced investors will often cling onto the former leaders of a prior cycle partly out of hope and largely out of habit as they wish these stocks to return to their former glory. Many astute and experienced investors recognize that former leaders are just that, and the faster they dispense with them while looking for any hint at what might be the next leader of the pack are most likely the ones who can out-perform as the transition unfolds.

Are we there yet? I don't think so. However, Stifel's leading strategist, Barry Bannister, has laid out a series of technical charts and data that leads him to believe that the S&P 500 Index, currently at about 4,300 (up from a June low of 3,640) may still get to 4,400, a nice round number, in the current rally. By the way, although no one can predict the markets with any certainty, I believe the great Bull Market of 2011 through 2021 is over, and that we have now entered a Bear Market. Bear markets are commonly assumed to occur when there has been a loss of 20% or more off the highs and we have certainly achieved that in the first half of this year. The current rally, therefore, may turn out to be nothing more than a "contra-rally", or, a corrective upside rally imbedded within a longer-term, longer-cycle bear market. If that turns out to be the case, then that will be the answer to the question. Are we there yet? NO. If I've learned anything about bear markets, and I've lived through many of them, the final destination is a period of sheer selling panic.

Strategy: I have stated in letters 107 (May) and 108 (June) that the early selloff of 2022 reached a level of selling intensity that may need some upside correcting as there seemed to be somewhat of a mini-panic early in the new cycle (the bear cycle). Rarely do markets go straight up, and rarely do they go straight down. However, a reminder of an old Wall Street adage, "Stocks take the escalator up but the elevator down". The current "contra-rally" may run its course for a while longer, but my expectation is that somewhere ahead, and perhaps as early as this Fall, there could be another test to the downside as many large institutions do their year-end rebalancing (many of whom have a September 30 fiscal year-end). I am not predicting the future of the market, but rather, there needs to be some sense of the probabilities so as to try to allocate our assets based upon those expectations. Markets do not announce themselves; markets are not looking backwards. They are always forward-looking.

I do not expect a return to all-time highs, but that is always a possibility that must be weighed as a possibility, even if it's a minor one at the moment. Further, we are at an inflection point where the U.S. Dollar Index is waffling following a significant rally in the first half of this year. Will it continue, or will it fail? There is no answer to that; it could really go either way or do nothing. The upward trend has been interrupted.

This letter comes a little early this month. Enjoy your Labor Day holiday. Gosh, is it already that time of the year? Are we already there (yet)?

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to note that as interest rates rise, bond prices will fall. 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. Diversification and asset allocation do not ensure a profit or protect against loss. 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. Rebalancing may have tax consequences, which you should discuss with your tax advisor. When investing in bonds, it is important to note that as interest rates rise, bond prices will fall. High yield bonds have greater credit risk than higher quality bonds.