RAYMOND JAMES®

"While Rome Burns"

May 18, 2022

The following are the Exclusive and Sole Opinions of the Author.

Someone hand Nero his Fiddle.

You can feel it – the bear market panic is spreading. The current set of circumstances are horrifying. The economy has slowed to a crawl. Low, suboptimal growth has arrived year(s) early on the heels of foolish economic policies. The economy has stopped growing, hitting a wall of bad policy and uncertainty. Falling off the cliff is likely as the government policies continue to discourage investments in the future.

The world is aflame – there is a major ground war in Europe, one miscalculation away from turning into World War III. The Chinese are pursuing a massive arms buildup and expansion of forward facing, offensive military capacity at the same time their economy is failing. At home, the American people are fed up and ready for a major change in Washington. There are no outlying polls, it is matter of degrees of disapproval.

It is Magic when the market discounts the end of the world, sets aside the focus on current calamities and refocuses on a brighter future.

The current list of concerns is different and potentially more serious than we have recently experienced. There are common elements, but an uncommon alignment, an unpopular president, absurd economic policies, an out of touch Federal Reserve Board, and a vicious foreign adversary attacking allied, free nations.

The stock market crashed in late 2018 and again in early 2020. The needlessly harsh FED policy that led to the 2018-19 decline was insignificant compared to COVID in March 2020 when mortal fear stoked a market crash.

In each case the causative agency was known or became known quickly and the end of the world was once again postponed. The markets rallied as it became apparent that these problems could be contained and resolved.

It has taken a mere two years for the economy and world to descend into chaos. The accelerating stock market declines are part of a broad mark down of most assets needing a catalyst(s) to reverse these trends.

The midterms are now less than 6 months away. The incumbents always catch the blame in the midterms. Going all in with a pair of deuces does not help. The Republicans are holding the aces – voter preferences on the economy/inflation, crime, immigration, as well as an emotional component called voter enthusiasm, a euphemism for baser motivations on both sides in this contentious year.

The tendency is for voter attitudes that are firmly held at 6 months before the election to persist. Hungry babies because of a formula shortage seemingly due to government indifference or ineptitude will add to the deep-seated resentments. Never a sure thing, the market is already looking forward to a return to split governance.

We do not know how any of these real-world hard issues will play out. We never do. There are many concerns beyond the fear (or is it a rational expectation?) that **FED policy will result in a deep recession**. The European ground war could easily expand from a proxy conflict to a war with NATO. Chinese domestic "difficulties" might trigger an invasion of Taiwan. A more virulent Covid might appear. These are foundation stones of the wall of worry stoking emotional investing behavior and the bear market.

Are there unknown major vulnerabilities? The obvious "bad paper" of crypto currencies still seems relatively confined, student loan debt – is owned by the taxpayer. The Chinese economic bubble has been deflating instead of bursting. Not enough Russian debt to matter if it becomes worthless. Home equity is higher, car loans are deteriorating, but against higher values.

There's always a monster under the bed – but because it is an unknown, unknown you cannot sense it, by definition.

The equity and bond market are interrelated discounting machines – reducing future economic returns to net present value. Theoretically obvious, the actual multi-variate analysis must include subjective factors and many estimates of outcomes in the future. **In time of panic investors should be careful to appreciate the complexity of that mechanism and its validity, regardless of the lack of precision, or short-term disruptions.**

Subjective factors dominate investor psychology at important turnings points – fear and greed are the poles. Earnings, assets, dividends are all relegated to minor roles – because an "end of the world as we know it" mentality takes hold, an emotional impetus to investment decisions. Maybe not in 2019 – but certainly in 2001, 2008 and 2020.

Manic to depressive – the swing has once again been wrenching. Definitely on a major downswing, **many internal indicators are already at levels consistent with major market reversals**. Normally a process of rallies and selloffs as investments move from weak hands to strong hands – which can offer clues as to the timing of the reversal.

Valuations have rapidly improved in most sectors, with the exception of the top performing utilities and energy sectors. Both sectors are relatively minuscule portions of most portfolios. Underweight the top performing sectors is untenable in the manager's performance derby. It is not hard to imagine a doubling of exposure in generalist funds at the same time many of these companies are aggressively repurchasing shares.

Buy low and sell high suggests an ability to time markets that does not exist. Better understood as: Buy at high valuations, expect lower returns, buy at average valuations, expect average returns, buy at low valuations, expect higher returns. **Valuations are catching up to the low readings of the internal indicators near significant historical lows.**

A rules-based approach is useful in this rapidly changing environment. The checklist should focus on free cash flow and balance sheet sufficiency. Price Earnings ratios are an important valuation metric, but only one criterion for assessing valuation. Alternative measures, such as a dividend/free cash flow discount model, or in extreme cases a sum of the parts model may be more illuminating.

The economic environment will change repeatedly, companies who successfully negotiate the changes can prosper and emerge stronger. It will seem like an eternity until the outcome of the 2024 presidential election becomes obvious.

The markets have fallen sharply, valuations have improved. Investors should anticipate an end to the panic selling as the economic slowdown relieves inflationary pressure.


$COMPQ Nasdaq Composite INDX
18-May-2022 12:04pm
Open 11790.68 High 11826.22 Low 11576.55 Last 11581.40 Volume 1.8M Chg -403.13 (-3.36%)
©StockCharts.com
$COMPQ (Daily) 11581.40
MA(50) 13142.26
THAT MAGIC MOMENT when multi-year extremes are reached!
Investor motivation is going from fear and uncertainty to conviction and capitulation.
Low readings in are unusual and have proven to be good entry periods for increasing equity exposure.
Support
$NAA200R 13.58
PERCENT of shares trading above the 200 day moving average
Valuation at the time of investment is inversely proportional to return
Most of the time Nasdaq shares trade between 35% and 75% of the 200 day moving average
$$UMCSENT 59.10 (29 Apr)
University of Michigan Consumer Sentiment
!AAIIBULL:!AAIIBEAR 0.50
Individual Investors bul/bear sentiment
$NAHLW -2652.00 (13 May)
NASDAQ new high/low differential
2003 2004 2005 2006 2007 2008 2009 2010 2011 2012 2013 2014 2015 2016 2017 2018 2019 2020 2021 2022
25 May 9 16

RAYMOND JAMES®

The information contained in this report does not purport to be a complete description of the securities, markets, or developments referred to in this material. The information has been obtained from sources considered to be reliable, but we do not guarantee that the foregoing material is accurate or complete. Any opinions are those of David Lerner and not necessarily those of Raymond James. Expressions of opinion are as of this date and are subject to change without notice.

There is no guarantee that these statements, opinions or forecasts provided herein will prove to be correct. Investing involves risk and you may incur a profit or loss regardless of strategy selected. Holding investments for the long term does not insure a profitable outcome. Keep in mind that individuals cannot invest directly in any index, and index performance does not include transaction costs or other fees, which will affect actual investment performance. Individual investor's results will vary. Past performance does not guarantee future results. Future investment performance cannot be guaranteed, investment yields will fluctuate with market conditions.

9100 S. Dadeland Blvd • Suite 105 • Miami, FL 33156
O 305-670-8502 • T 800-709-1793 • F 866-208-0567
Raymond James & Associates, Inc., member New York Stock Exchange/SIPC