Website Commentary - September 2022

Clients and Friends,

Welcome to the Fall edition of my commentary on what is happening in the world and the driving effects on the various markets. My hope is that this will provide you with a bit of added information that will aid in discussions and decisions.

The past 4 months have been an up & down battle with the market as it tries to understand and digest Federal Reserve interest rate policy.

Arguably, the Fed has been late to the party, having kept interest rates at Zero percent for too long (in addition to its massive bond buying which continued through the end of March 2022). As of yesterday afternoon, the Fed borrowing rate was at 3.50%, making the prime bank lending rate 3% higher at6.5%.

Is this critical to the level of the market and does it impact Stock Market returns for the next several years?

Maybe not.

In looking at the most significant example of inflation and market returns, let's review 8 years that are deemed the most significant example of inflation in modern times, the years 1978-1985.

	Annual Inflation *(Note A)*	S&P 500 Return *(Note B)*	U.S. GDP Growth *(Note C)*
1978	7.60%	6.51%	5.54%
1979	11.3%	18.52%	3.17%
1980	13.5%	31.74%	-0.26%
1981	10.3%	-4.70%	2.54%
1982	6.1%	20.42%	-1.80%
1983	3.2%	22.34%	4.58%
1984	4.3%	6.15%	7.24%
1985	3.5%	31.24%	4.17%

Note A: Federal Reserve Bank of Minneapolis,(minneapolisfed.org), Monetary Policy – Consumer Price Index.

Note B: New York University, (https://pages.stern.nyu.edu/~adamodar/New_Home_Page/datafile/histretSP.html)

Note C: Macrotrends.net, United States GDP Growth Rate

Looking at the 4 years that represent the surge of inflation 1979 through 1982, the impact of the value of a dollar was -35.38%. The growth of the S&P market index for this time period was 79.18%, far exceeding inflation.

Why?

We have to look at what was taking place outside of the Consumer Price Index. We have to look further to policies that were put in place to drive the economy. The economy did not falter in significant numbers during the early 1980's. The most significant drop in GDP occurred in 1982, at a time when inflation was coming under control. At the end of this year, the Stock Market rose significantly in a process of looking forward to higher economic numbers that were being displayed quarter by quarter. Diving factors were policies put in place that rewarded the economy, rather than stifle the economy. The Reagan administration implemented the Investment Tax Credit, Research Credit, Jobs Credit. It incentivized energy production.

If this current period of inflation has any correlation to what took place 40 years ago, what should we look for?

FIRST and foremost, the Federal Reserve does not control the universe, and it will have limited effect on what takes place in the Stock Market. Its decision making and power creates short term disturbances.

We possibly would look for a change in the overall position of government that have placed more restrictive policies into the economy and have been looking towards higher taxation. The Mid-Term elections are 6 weeks away, and a change of control in Congress would be the most significant road block that we can look for.

The first step to limit inflation that should have been done would have been to ramp up energy/fuel production back to pre-COVID levels. The U.S. is still shy a couple million barrels/day of oil production from pre-COVID. We also have in approximately 5 million more individuals that are categorized as Not-In-Workforce compared to pre-COVID.

In general, the broad population doesn't understand this, or any of these underlying economic factors. COVID has translated to fear, and we could argue that fear has been purposefully orchestrated by these upper levels as a matter of control. Fear affects the Stock Market more than it should. Year over Year earnings for companies in the S&P500 was up 6% in the second quarter compared to the prior year. That is fundamental strength.

During this time, do not lose your sense of optimism. Stick to fundamentals and a theory of moving forward inch by inch, until the dust clears.

<u>Fundamental strategies for the market:</u>
The current level of the DOW at 30,100 and the S&P500 index at 3,750 is the first level of support that we are seeing. Companies that represent fundamental economic structure are those that

consistent and slightly growing levels of Sales Revenues and bottom line Earnings. Think of Apple, Home Depot, Waste Management, Pepsi, McDonalds, Walmart, etc.
The second level of support, if the Stock Market continues to drift will be DOW 28,800 and S&P500 3,575.
The Third Level of support in the Stock Market would be DOW at 27,000 and S&P500 at 3,350.

You may want to consider investing 1/3rd – 1/3rd – 1/3rd at each of these levels. If the DOW index and S&P500 Index do not drop to these levels, then a watchful eye on strength in quarterly GDP in combination with inflation subsiding will be the key.

As a final note, in the near future we will be starting up once again with our luncheons for clients & friends where we discuss economic factors.

Regards,

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