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Market Outlook:

Conditional pauses

Equity trading got off to a horrific start, then recovered nearly fully, last week as investors feared that the economic revival and upwards trajectory of business might be stalled out by a new surge in variant (Delta) Covid cases worldwide. Trading volatility…mostly selling…harkened back to the height of the pandemic last year during which all sectors were vulnerable to any reported slowdown in economic activity. Needless to say that confidence is a fragile thing right now. Particularly hard hit on Monday were the discretionary industries, those reliant upon heavy "traffic" such as travel, energy, and retail.

Adding to investor concerns was a surge in prices, the result of pent-up demand from months of dislocation, and a fear that any slowdown in business activity might mark the passing of the high water mark in the resurgence. This could also be the onset of *stagflation*, an insidious consequence of higher prices congruent with business calcification. In truth, all the talk about *inflation*, alone, maiming the recovery was supplanted by concerns that the real culprit might be *unrealistic growth expectations*.

The issue is now, as it has been for several months, is that until the Covid virus is eradicated or contained the likelihood of a robust rebound is nonexistent. Thus far, an inability to inoculate large percentages of the population, for their protection and that of others in their community, has been an intractable obstacle. Vaccine hesitancy is both political and personal. All told, these data make for a confusing picture about economic (and health) prospects. Thus, the violent sell-off early last week.

No doubt there were already questions about a continuation of the market's trajectory, with many predicting a correction within the long term bull (please refer to our July 1, 2021 Quarterly Commentary).

Which way is up…?

This begs the question, *"what constitutes a normal market?"* As quantitative analysts our theory presupposes that numerical statistics exist to guide in the creation of probability of performance and overall portfolio asset allocation. Mathematics endure, they are science. There is no probability greater than 100%, nor any less than "zero". Therefore, the range of outcomes for any measureable pattern falls into a bell shaped curve. Our array of macro guidelines consists of over 100 factors but might practically be pared down into four primary subsets: earnings, earnings acceleration, price performance, and our proprietary **ArlingtonEconometrics** stochastic rankings.

No doubt, as with many other analysts, our integers were already bursting at the seams, making a further high less likely. That doesn't mean that we are about to enter into a bear market or that the expansion is over. Rather, it is always productive to take a time out to reevaluate risk and rebalance portfolio allocation. When integers climb as high as they did in the first half of this year one can only be reminded that you can't fill a vessel "fuller than full".

Ascribing the stock markets, or any financial capital enterprise, as a *casino* is always problematic. Investments should not be thought of as a one-off exercise, but rather as a procedural method combining highly correlated data whereby risks are looked at in the long run…a macro overview…towards which consistency of return becomes the anticipated outcome. Chaos erupts when the markets are condensed into hourly games or speculative mania instead of a wider aperture of perception and a longer-term timeframe.

Despite the fact that some impulsive strategies might have yielded short-term success in the past, such behavior in a strict portfolio sense is often associated with steep risks and excessive losses. Investors eager for a big payday aren't aware of their hazardous behaviors, which only intensifies their addictive desire for more. The damage is already done when you initiate the game without a process, methodology, plan, or self-control.