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Elasticity

Interesting, how many diverse and dastardly headlines permeate the news and yet the markets, on balance, perform without apprehension. This type of naive *"what, me worry"* approach can be a boon to some but a concern to many others. Yes, the underlying fundamentals have been improving. So why then are more investors pulling out than posting in? By the way, our sentiment is always skewed towards "bullishness"…there is always something to invest in. But why are people finding reason to divest more often than seeking something in which to commit? Truly, confusion is the enemy of consistency.

On balance, the average investor has to be pleased with the performance of the markets during the last half-decade. Equity prices repeatedly hit record levels, not just weekly or monthly but daily. Is a linear trend to be believed or is it just an aberration from more traditional parabolic waves? Our assessment is that low interest rates, designed to spur economic activity following the last Great Recession, changed the equation for the markets. The Fed won by ceding control to corporations and consumers. Now, however, Central Banks are on a track of reclaiming their sovereignty over the economy. As CD's and Treasury Bills come back into fashion those fixed income investments run the risk of soaking up much of the speculative capital…and expectations…that went into stocks over the past two years. Stocks are expensive and gravity has a way of pulling an unabated linear trend back downwards. Besides, how much is enough? Can the elasticity in valuations perpetuate forever?

Markets

Some might argue that low interest rates are a stabilizing force in the economy; that growth is dependent upon low inflation, low borrowing costs, and aggressive capital expenditures. Others might posit (as do we) that lower rates contribute to a "cowboy economy" in which corporations use cash to repurchase their shares, individuals speculate more virulently, that more purchases are made "on credit", and that savings are kept artificially low because of a lack of alternatives to buying stocks. In that type of economy the employment figures and other financial data fail to capture the real schism between the wealthy and the poor, the educated and the uneducated, the hopeful and the hopeless. There is not only an undercurrent of fear and panic in the economy at these lofty levels, as evidenced by historically low confidence numbers, but also a diminution in the empathy factor that makes entrepreneurship and speculation estranged from an entire swath of the population. At the very least, these empathy gaps cause a rotation of money into unfortunate cycle choices and a shorter attention span. For example, how can the current housing boom be sustained while an alternate populace lives in destitution? How can oil and natural gas companies justify enormous profits when many can't afford to buy a car or the fuel that goes into it? Covid imposed the closure of many restaurants nationwide and yet too many of your neighbors go to bed hungry every night. Addressing social priorities that guide the allocation of private and public capital should be a fundamental requirement for the financial markets.

The war between Russia and Ukraine throws another ambiguity over the timing and scale of likely profits. That conflict has the potential to change continental identity and boundaries. Indeed, Europe is caught in its own dichotomy between rich and poor, powerful and powerless because of its long term refugee/immigration crises. The expatriate situations are a drain on Eastern Europe and their resources…as well as a test of their empathy towards political disquiet outside of their own particular borders.

Economic coordination is uniquely aligned to social justice. It is practically impossible to build a "Western" capital-style marketplace in any region that summarily dismisses an impoverished group seeking to gain access to the same dream. Resiliency and innovation are integral to building a society of shared purpose, shared values. But we must also recognize a generational sea change that is taking place. Market elasticity can only go so far if half the people cannot participate.

Markets and economies stagnate under the influence of infighting and strife. Cross border and intramural gunfire does not make for strong cultural development. As an unabashed capitalist, I would much rather have the kinks worked out and the mission well defined before I commit my money to the project.

The conflict in Ukraine might certainly place technical constraints upon the market in the near-term, also. Already down nearly 10 percent from its previous "all time" high, many analysts have concluded that a new bear phase has initiated. However, for that to be confirmed, my research would have to demonstrate several rounds of capitulation from the rally currently underway as stocks bounce up on "value" speculation, and I just don't think that negativity is warranted at this juncture. Here again, the elasticity of short term sine waves is constantly being tested by 24 hour news cycles. That is another reason why I am quick to admonish that the economy and the stock markets are not necessarily the same phenomenon nor that we are in "Bear" market circumstance. We'll just have to wait to see if earnings acceleration patterns are truly dominated by events in the Ukrainian theatre or rather by the fundamental underpinnings worked so hard to achieve in the global economy just prior.

Strategy

The pundits could be correct…there very well may be an economic reversal over the next few months. The benchmark averages, which traversed an unusual 20% gain in each of the last two years, is well above and beyond the kind of stochastic measurements that assure another year of such exorbitant expectations. We would not be surprised if the benchmarks ended the year flat to down, or certainly below performance in the high double digits. To be clear, we are not suggesting that the markets *will* reverse, only that it should not be unexpected if they do. Excitement can only come when/if the variables begin to disappear…Covid, war, economic instability, e.g. Low expectations, even lower profit performance, and higher interest rates are all factors which might quell enthusiasm for financial securities. Remember, elasticity stretches in both directions, up and down.

On a positive note, there is a new momentum in our analysis that is geared not so much towards those looking to "protect" what they have earned but towards those elements that bet on the future of planet Earth. The idea of "shorting" innovation and entrepreneurship is a backwards-looking strategy. Thus, a *daily portfolio performance appraisal* is anathema to building long term investment success. Interest rates, politics, even warfare do not *cause* the markets to lead or lag behind, or performance to suffer…it is the failure to plan, to pursue social justice and empathic responsibility aggressively. The investors who will be hurt the most during the next few months are those without discipline, who pursue elusive heights in the benchmarks, and who trade well beyond their means or tolerances for risk.

By comparison, there is nothing to fear about markets making new highs in generation-changing technologies. Every secular cycle contains highs and lows. But every seismic shift in industry, education, medicine, finance also comes with enormous potential to disrupt (positively) and to reconstruct a status quo in the image of that generation's greatest needs.

Conclusion

Our investment counsel for the coming quarter is simple: be invested, be cautiously optimistic, but be aware of the risks that are caused by insecurity and volatility. This will be one of the most challenging few months in the last several years. Invest your capital in long-term demographics and socially responsible themes…healthcare, agriculture, alternative/sustainable energy resources, education, technology, water, ecology, and infrastructure. Our weightings in equities are significantly lower this quarter because the funny thing about elasticity is to remember which hand to let go of first, lest the snap comes back and hits you too squarely in the face.

As bond yields rise, we would anticipate some diminution in equity participation, performance projections, and overall GDP output. As the historically "normal" relationship between interest rates and stock prices coalesces we should also be thinking about normalizing asset allocation quotients, particularly for high net worth and risk averse clients. Given the times, our goal is not to "give back" too many of the extraordinary gains we have won during the past few years. But such is the nature of investing that fluctuations will occur, especially with uniquely unpredictable current events.

Overall, however, we are laying out a blueprint to capitalize upon alternative scenarios in secular ideas that we deem have the potential to generate significant capital appreciation for decades to come. In that endeavor, we have no lack of confidence.

Suggested balanced account asset allocation, Q2, 2022
Equity: 32%
Fixed Income: 38%
Cash: 30%

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