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No shortcuts

Dismayed by last year's inconsistent market performance, as well as painful disruptions during the Covid pandemic, investors braced themselves against a wall of worry during the latter stages of 2022. Still shaken to this day, their confidence in institutions conjures up a more cosmic issue for the coming year: *is there ever going to be a satisfactory conclusion to these waves of crises?*

It is in moments of deepest despair that maximum opportunity is found. In fact, one's worst fears almost never occur. With few exceptions, the kind of bad news we are experiencing today is nothing that many of us haven't lived through before. To be sure, that is little solace to the aggrieved, but continually looking backwards, towards the last fight, is counterproductive to solving what lies ahead.

From an investment perspective, there are some who believe that buying on dips….massive dips…. definitionally produces high rates of return. But there is more to this story than simply finding good bargains or licking one's (portfolio) wounds. We have to drill down, beyond the noise, and realize that there is a sea change underway in the way things are evaluated and how the needs and opportunities of our time must be addressed.

Markets

The severe crisis of confidence which envelops the markets is borne from a post-pandemic surge in demand and a failure of producers and their supply chains to keep up. The victims are both large and small. The tremor reverberates all the way from corporate and governmental hierarchies to small business on Main Street. It has eviscerated wealth in ways not seen in decades.

Additionally, sudden "value" buying surges ruptured the traditional cohesion between fundamentals and technical charting patterns, thus exacerbating concerns about inflation, corporate earnings, and currency exchange. No doubt, it will take time to unwind the swirl of negativity.

Speaking of inflation, there are far too many forecasts about the direction and duration of interest rate policies. By trying to avert inflation, policymakers instead brought about the supply chain issues. They encouraged large amounts of cash to be built up during "easing" periods, now literally closing the spigot after the damage has been done. These attempts to reengineer demand and supply only added fuel to the fire. Note: there is plenty of money on most balance sheets ….particularly those which fund mergers, acquisitions, and share repurchases. *The real problem with fiscal and monetary policies is how to allocate for the impartial distribution of monies to avert a breakdown in our infrastructure, avoid another medical pandemic, educate the young, provide food and shelter to the indigent, develop alternative sources of energy, protect our planet from climate erosion, and tone down the unnecessarily harsh political discourse.* A sense of community, of common values, is not just a necessary doctrine of building social cohesion…it is a fundamental tenet that leads to financial outcomes we all desire.

When government is seen as the impediment to a solution the public loses an intrinsic altruistic trust. What happens then is "every man for himself" capitalism.

As a result of these frictions, our models are indicating distinctly negative earnings trends as well as heightened probabilities of market volatility. This coming year will not be without stumbles. If interest rates continue to rise, both stock and bond prices will stagnate, if not retreat even further. However, if policies abate, the stage might be set for longer term base-building and higher than expected rates of return.

Right now, though, costs are making it harder to drive an automobile, put food on the table, pay a mortgage, receive medical care, or to consider discretionary purchases. Rising prices put an anchor on industrial capacity, GDP, and sales of common goods in spite of recent indications that short term numbers are improving. History has shown us that recovery from rising prices and core inflation is a lengthy process, measured in years, not days or months. You, too, are most likely experiencing this pain in your own household. Perhaps there is a reticence that factors into your asset allocation decisions, as well.

As noted above, this situation is not unprecedented. As with other eras of speculation and contraction, the profit calculus remains the same: outperform your competitors by building a "better mousetrap" and consumers will flock to your door.

Strategy

As we embark upon a new calendar year it is the long-term scenario which supports our secular (generational) framework. Whereas sentiment and raw emotion might sometimes be more convenient to rally, for us it is always the statistical evidence that offers confirmation for our allocation decisions. It is, as mentioned, highly problematic trying to find earnings acceleration patterns right now, but it is not impossible.

Every cycle phase calculation has its inflection moments which offer "ideal" entry or exit pivot points, in fact, our recent list of purchase candidates includes several categories that we believe will profit in the near and long term, such as *biotechnology, ecology, energy, and industrials.* Having a "macro" perspective is helpful because it enables us to sift through the exogenous noise of political invective and cable news current- events to find authentic quantitative cycles of capital gains. Tangible data should also help to dispel the gloominess that many feel about portfolio performance...or lack thereof...and to focus upon what can be quantified.

Prudent portfolio methodology acknowledges that cyclicality is a part of the process. It is, in fact, the "denominator" to all calculable equations. New cycles and heightened volatility barrage our mathematical data constantly, but their influence over time can be minimized by widening one's aperture of perception. Therefore we believe that we are most likely *closer to the end of the dislocation in stocks and bonds* than we are to the misery we could only have imagined at the crisis' inception nearly three years ago. Strategically, however, we would caution that buying laggards on the way down is not consistent with our method of generating positive alpha. Rather, we are looking for leadership, where it exists, and to ride the crest of price momentum as it slowly builds.

The great divergence between the wealthy and the have-nots, winners and losers, continues to expand. Assuming no changes in monetary policy for the first quarter, inflation sensitive stocks (commodities, utilities, REITS) should flourish. These sectors are not *surrogates* for how the overall economy is faring, but rather *prototypes* of a continuing problem. We prefer companies that will "mainstream" solutions in energy, life sciences, agriculture, education, and technology. Thus, the challenge for all investors is to identify one's own timeline of perception and to adhere/adapt to it in the real world.

We attribute the current decline in valuation of financial assets to a hawkish monetary policy rather than a substantial change in fundamentals. The discounting in assets, in our judgement, doesn't directly reflect a lack of demand for goods and services, but more so the bottlenecks we cited earlier in this piece related to overstressed distribution channels. Too much demand in the system, too soon, led to a profound disconnect in the rhythm of economic patterns, a surge in inflationary pressures, and a stagnation in valuations that will take time to recover. Maintaining sufficient cash reserves right now is an effective tool to mitigate against the possibility of further asset price erosion. Please note below that our cash allocations are modestly expanding and most definitely more defensive as this new year gets underway. There is nothing wrong with prudence and patience before seeing evidence of trends bottoming.

The global marketplace is under tremendous strain. Terrorism, war, monetary policies, and psychological reticence have essentially cashed-in all chips on the table, leaving very little compromise or wiggle room. The lesson should have been learned from the last Great Recession (2008) that opening up the cash spigot (monetary easing) without reservation and for too long creates a J-shaped linear economic eruption with potentially dire after effects.

Conclusion

We would be exaggerating if we predicted a robust, double-digit return for financial assets for this year. The cost of inflation, price creep, and negative psychology is exacting a huge toll on personal finances. Most feel as if the markets are controlling their destiny rather than the other way around. As we've written during the balance of 2022, monetarists set the stage for imperfect lending practices that are now coming home to roost. Confusion about market direction makes one prone to flawed investment decisions that favor the short term over more appropriate long term strategies.

It would be simple if we could re-set the clock and go back before the war in Ukraine, Covid, inflation concerns, and portfolio volatility. But for now the most effective salve to our financial wounds lies in the future. Money always seeks an equilibrium. Although we are currently out of sync we will reverse course....it always happens. If history teaches us anything it is that an inexhaustible fountain of bad news, concerning just about anything, will always proliferate but can be safeguarded by intent, perspective, and a relentless search for purpose.

Suggested balanced account asset allocation, Q1, 2023

Equity:	**42%**
Fixed Income:	**41%**
Cash:	**17%**

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