Scotty C. George
Chief Investment Strategist

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The Other Side of the Coin

It is always during periods of maximum uncertainty and stress that investors lose their perspective about creating opportunity from the financial markets. Now, however, should not be that time. Rather, history has us poised at a remarkable inflection.

The global economy, although disjointed, is emerging from one of the most horrific health crises of modern time. Downside risk intensified during the pandemic; it is abating now. If the last three years taught us anything it is that cyclic phases are real and that the depths of the pain of a recession are not equally spread. Apparently, there are wellsprings of inexhaustible capital concerning just about any problem if the willpower is there to support it. No doubt, confidence is always a fragile element of the equation, but the more intense focus should always be on the future, not the past.

By fixating upon the hardships just endured, it is easy to become traumatized and inert as a result. No doubt, the disease was real and many of us lost a friend or a business because of it. Pain is slow to recede. It will probably last for a while. But from out of those disruptions emerges extraordinary exceptions that will influence our fiscal and emotional recovery.

In every crisis there is a moment of deleveraging, when we feel as though the pain will never end. But the sun comes up the next day, the skies literally and figuratively brighten. Markets awaken to the fact that this critical moment is our best chance to turn things…all things…around. It was not just our portfolios that needed loving care, but our entire value system. Fretting about the enormity of our problems is not the same as sitting down and mapping out a strategy for the future.

Markets

Not unlike other market reversals in recent memory (2008, 2002, 1986) the opportunities this time were hidden from plain sight but stunning nonetheless. New advances in pharmaceutical research led to the creation of a vaccine in record time. Restructured workplaces enabled commerce and communication to continue. The financial markets reengineered their technologies to allow a smooth transition of capital in the wake of panic selling and buying.

The similarities to the past don't end there. Global technology initiatives permitted the flow of goods and services despite supply chain issues and delivery backups. Was everything done perfectly? Of course not. Nor was it "equitable and fair" in every instance. But aggressive responses amplified the intent to move ahead of the stagnation and instructed us in how to move boldly when fear gripped the system.

To its credit, Wall Street and the global banking system were leaders in bringing stability to a fractured world.

After the initial panic and decline, there were more mini-crises to deal with. Our worst fears about education gaps, government accountability, spiritual listlessness, and crime in our streets happened. No one individual or institution had all the answers to quell those concerns. But commerce and industry had a mission: to maintain profitability and capital flow for its stakeholders and customers. The depth of the medical and financial disaster beckoned them to respond aggressively. They succeeded.

The pandemic wrought so many permanent changes and outcomes to our social construct. Perhaps so, but it also brought a stunning response: record employment across all demographics; global commercial supply chain integration; financial markets having one of their best rebounds in history. The economic maladies we are witnessing today, despite their inequities, are far less severe than they were preceding the pandemic. Markets are trying very hard to recover a sense of perspective and purpose.

We would argue that we are better prepared to deal with the next crisis because of the lessons learned during this one. What makes catastrophes so devastating is the failure to plan for them before they occur. Discipline….in life and in investing…is about problem solving and knowing how to attack the next step.

Investors who bought financial assets when they were cheapest reasoned that although global financial conditions were awful at the time, opportunity was present. In this case, reasonable fundamentals were "artificially" contravened by the Covid pandemic, yet never wounded. The headlines might have been dire, but this crisis…like others before….offered the chance for redemption and recovery. The sickness was curable; so, too, the economy.

Although the empirical data provides little conclusive proof that the recovery is ubiquitous, it is not hard to recognize fundamental shifts which might hasten particular sector expansion. To wit: inflation is receding, not expanding; consumer savings rates are expanding with the increase in short term fixed income banking products; earnings are proliferating in the industrial and consumer stocks; employment (which is as close a "leading" indicator as one might want) is stable; and tangible assets are still increasing in value without busting the budget of most purchasers.

Our work indicates that most data sets are improving, but undeniably different. Inflation is not the scourge once thought; bonds and stocks are not the enemy of wealth building; the pandemic is receding; and, as noted, commerce is not collapsing. And yet, it is still hard to erase the thought that just below the surface the potential for another crisis is looming. Despite all the breakthroughs, policies, and incentives of the last three years, consumers psyches are still raw and fatigued.

There is no blueprint to which we can refer that definitively gets us out of our morass. As noted, discipline and grit are only part of the solution. Trying to divine the Bulls from the Bears has become so insignificant in the grand scheme of things related to life and death issues. But we should also remind ourselves of the micro details in order to assuage our fears about the macro. Let's not forget that the last year and one half has been a banner period in the financial bourses. The market collapse that was widely speculated never materialized.

Given the tremendous panic instinct to sell, it is remarkable that common sense won. We would not be surprised to see that confidence continue.

Conclusion

Although it is becoming increasingly harder to tell the winners from the losers just by anecdotal evidence, every market offers clues about specific sector leadership. These clues help you to sift through the "noise" of politics and economic assumption to find real, quantifiable pattens of opportunity irrespective of geography, capitalization, or currency. These data also help dispel the notion that gloom supersedes hope when trying to climb out of an emotional hole.

Therefore, contrary to media hype, we believe we are more so building a base in the market than we are setting the stage for another capitulation downwards. Our relative strength indicators in the agriculture, financial, industrial, and consumer sectors strengthen our resolve that profits, and social good, can be mined in the next few months. Many observers are underestimating how successful the Fed and other global central banks have been at manipulating a "soft landing". They miss the fact that lower inflation (not the absence of inflation) really does increase spending and give consumers stronger buying power. This is the hidden gem in the midst of all the market's worries.

With the global economy gasping for air (liquidity) and inflation being held at bay, we can see both the bond *and* stock markets closer to an enduring rally than we've been in years. In particular, we favor a narrative that focuses upon tangible assets as the (literal) building blocks for the economy: steel, paper, wood, iron, and chemicals. We also maintain our bias towards "socially responsible" themes such as food, water, housing, security, and healthcare. But, overall, we stress that the bigger picture supports a cyclically positive…not catastrophic…summary.

Suggested Balanced Account Asset Allocation, Q3, 2023

Equities:	**55%**
Fixed Income:	**38%**
Cash:	**7%**

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