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# Market Commentary

*Fall, 2020*

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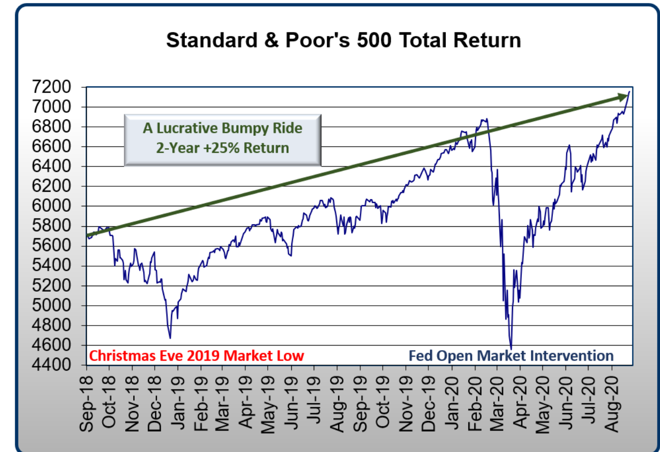


## *Money Bombs*

Dear Client:

The Great American Stock Market Rebound has come on the heels of the Great Economic Pause. (Beware, Moderates: Today, everything is either great or ghastly.) From their intra-year lows, stocks have appreciated +50% in four months—the equivalent of 5-years' worth of average returns delivered at 15 times the pace. The recovery puts equity prices at about the level they were during the nostalgic pre-crisis days.

It can be hard to fathom how the added weight of a pandemic—which shuttered 29% of business activity—places us on a footing equal (at least in Wall Street's view) to that which we enjoyed half a year ago.

Among some, the belief is that investors must have entered the realm of the absurd, bidding up prices well beyond reason. So, their thinking goes, we should expect another crash when sobriety returns to reveal that the economic crater is, indeed, deep and wide.

Maybe.

Undeniably, Covid-19 has been a Chicxulubian meteor (*a.k.a.*, the dinosaur killer) that continues to extinguish ill-adapted businesses, large and small, world over. And the effects of its impact seem destined to be long-lived. The greater indebtedness of consumers, businesses, and governments will not vanish as quickly as the pandemic might, if we are so lucky.

Nevertheless, the high-flying financial markets are not disconnected from what is happening on the ground. There is another story to tell.

Told succinctly, in these modern times:

- Down markets mirror an unraveling economy;
- Crisis-induced up markets mirror unraveling monetary policy.

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### *Superheroes*

The economic character of late-2020 differs from January's in more ways than just halted commercial activity and its debris fields.

Last spring, during the midst of the financial markets' death spiral, with epic speed and strength the Federal Reserve intervened to halt the impending economic collapse.

On March 23, the Fed promised *unlimited*, *open-ended*, *large-scale, broad-ranging* asset purchases. Immortal words destined for the annals of market manipulation. For the exchanges, that was equivalent to students being told that school is a "failure-free" zone. Peril was taken off the table. Like a rollercoaster that only feigns catapulting its riders, investors were assured that they would not crash and burn if they stayed the course. The risk-on trade blinked back on because, suddenly, the risk was gone.

In addition to the Fed's promises of no harm, other "somethings" have reinvented our economy, making it look and feel a whole lot different from that of before:

- Interest rates have tumbled (yet further):
  *The 10-Year US Treasury note yield, at a mere 0.65%, is down -73% from December 31;*

- The money supply has ballooned:
  *+20% for the 7 months through July;*

- The national debt:
  *Now at $26.6 trillion: +15% through July;*

- US dollar devaluation:
  *-10% from its 2020 high;*

- Almost as suddenly, we have seen a reallocation of national spending patterns as priorities have changed. In the immediate, it was the odd predilection to husband household paper products. Now dollars are chasing suburban living quarters and out-of-doors recreational equipment.

2020 is no 1929. During the Great Depression, the money supply *contracted* by 1% per month. Contrast that with today's Federal Reserve which grew the monetary base by 6% over just three weeks from March 11. The April 3rd *Wall Street Journal*: "It's reasonable to assume that by spring 2021 the quantity of money will have increased by 15% and possibly by as much as 20%. …it could surpass peacetime records, *outpacing the previous peaks in the inflationary 1970s*."[1]

*Why wait for spring? We passed the +20% mark just weeks ago.*

### *…or Supervillains*

One can imagine, then, that investors have bid up stock prices because the prospects for the common alternatives—cash and bonds—have grown dismal, at best.

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To give "dismal" context: In 2007, moments before the Great Recession's onset, an investor could have earned a comfortable 5% yield with a 10-year US Treasury. To generate the same inflation-adjusted income on the same note today, he would need to invest nearly *10 times more*. $10 million is the new $1 million. Bond investors have been treated badly for their thrift. For many, stocks win by comparison alone.

So, as warmly as we equity investors might revere our central bank superheroes, don't be surprised if our bond-investing neighbors hold the bankers in lower esteem. After all, fixed-income investors have been funding our national bailouts for years with ultra-cheap money with no let-up in sight.

### *"Don't Fight the Fed"*

Someone once said it.

Economic predictions are for soothsayers and television commentators. Fortunately, as we saw in March, the central bank is becoming increasingly demonstrative in telegraphing its plans. No guessing is required.

Another memorable date: August 27. Federal Reserve Chairman Powell announced that, henceforth, the Fed will target an *average* inflation rate of 2% rather than 2% itself. That is a seemingly innocuous change until we explain its application to a judge: 100 mph is not *actually* speeding if my *average* trip speed was just 65.

The message is that the Fed will let the economy run hot as we try to power out of a deep hole.

But Mr. Powell's statement begs a highly consequential question. After inflation exceeds the former 2% limit, why would the Fed ever wrench it below that level to generate a 2% average? To make bondholders whole and at the expense of workers? Probably not. Suffice it to say that the Fed's new ride feigns nothing. For bond investors, the rollercoaster is now short on seatbelts.

If we intentionally were to create an environment for inflation to take root, we would probably inflate the money supply; swell government spending and transfer payments far beyond tax receipts; devalue the dollar against foreign currencies; crash production capacity while adding the stress of vastly altered consumer spending; and have a complicit Fed promising not to intervene.

In other words, we would do all those very things that are now already on the stage.

Maybe that explains why equity prices have bolted upwards. In addition to the anemic returns to be had elsewhere, the rising prices might simply reflect a growing probability of a faster eroding dollar.

Stocks, historically, have been a good hedge against inflation; bonds a notoriously bad one. And like insurance, inflation protection in the form of equity ownership is best acquired before the fire starts.

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### *Dante's Parade*

The nation has hosted a series of crises this century. The ill-fated theaters:

- 2000: Dot-Com Bubble Burst
- 2001: 9/11
- 2008-09: Great Recession
- 2020: Covid-19 Pandemic

Each was precipitated by unique circumstances; each required a different national response. But common to each counteroffensive has been a loosening monetary policy. As its universal antidote, the government has dropped growing sums of money on the problems.

What will come next is unknowable. Maybe inflation, maybe not. Some fear a "blue wave" election. Others fear continuation of the status quo.

Whatever its shape, in time, there is sure to be another anxious market. Our current pandemic crisis is hardly behind us. When that troubling day arrives, successful investing again will be about avoiding irreparable harm.

The strategy to do so would seem to be unchanged (have you heard me say?): the ownership of a *broadly-diversified* portfolio of *directly-owned*, *high-quality common stocks* of *prospering companies* held in a *separately-managed* account.

Then, fuse that sound investment strategy to our clients' resolute personalities capable of seeing their portfolios through tragic episodes.

The result is a wealth management solution that I am confident will help us navigate the remainder of the pandemic, civil unrest, and the election—and then thrive in the better times that we optimists know lie ahead.

* * * * *

I wish you a healthy and stress-free fall season—and counsel against rollercoasters (my current fixation on them due to the kids having dragged me to Disney).

Kindest regards,

Russell B. Dow
*President & Senior Portfolio Manager*
*Member: Maine State Bar Association*

This paper represents the general economic overviews of Russell Dow, Dow Wealth Management, LLC, and does not constitute investment advice, nor should it be considered predictive of any future market performance. Any securities mentioned are for illustrative purposes only and are not recommendations to buy, sell, or hold such issues.

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Chart Page 1: S&P 500 Total Return Index

[1] *The Wall Street Journal*: **"**Get Ready for the Return of Inflation**"**

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