July 1, 2022

Greetings,

I understand that even though we all have a long-term approach to our investments, it is still quite frustrating to see our assets drop like this even over a relatively short period of time. I get it. We own all the same assets, so I have plenty of skin in the game. We are in this together and we will get through this together, just as we have done before during difficult times like this.

I will avoid the marketing 101 that I have read from the mutual fund companies as I still have some of my assets with these organizations. This will be nothing but the straight shooter that I am and maybe more blunt than usual. The "markets" this past quarter have been brutal. The first quarter of the year was bad but little more than a normal correction. This normal correction transformed into a wholesale selloff of virtually the entire market, other than the energy sector. The recent six months has been the worst start to a year for the S&P 500 since 1970. We have all been around the block a few times. I believe that we are on the same page here in that between not just the economy but with all the turmoil that has happened with this country over the years, we have all been through much worse than this. Remember 09/11?? How about the gas lines of the late 1970's?? Warren Buffet (yes, he is still alive as is his 96-year-old partner Charlie Munger) has said over the years that fear and greed move the markets in the short term. At this point in time, fear has taken over and the markets are at extreme negativity. The recent Michigan consumer confidence survey which is a key economic indicator (going back to 1952) is now at an all-time low. Historically, such negative sentiment is bullish (positive) for the stock market. That is, if you have a time frame longer than 3-6 months.

It is imperative to understand why things happen with the markets both on the upside as well as the downside. If you are simply a "bottom line" person as many are, then you are doomed to make some terrible decisions. As an example, on the upside, during the technology bubble of the late 1990's, if you didn't understand the risks of the downside in the speculation of buying companies with no earnings and in many cases no revenues, then you were essentially wiped out when the bubble burst. The best-case scenario was owing companies with fast growing earnings at nosebleed valuations.

Inflation is not that much worse now than it was just three months ago. It was a big problem then and it is still now. Inflation was a concern six months ago when most market participants were giddy. The big difference between now and six months ago is then, the market was complacent as far as the Feds expectations with future interest rate increases. Virtually all in the market knew the FED would soon begin raising rates but many were caught off guard with the velocity of their rate increases. I personally was not shocked at the Fed's aggressiveness. If anything, I welcomed the fact that after falling behind the curve and waiting too long, the FED finally woke up and became aggressive with its rate increases. What did surprise me was the markets reaction to the Feds moves.

Too many people want simple answers to complicated questions. I am unable to provide a simple answer to what has caused the worst start to the broad market in 52 years. This despite a decent economy. A big problem is the hedge funds. They control a lot of money and even more of the day-to-day trading volume. Most of them are leveraged (borrowed money, called margin) to goose their returns. In strong markets, this strategy helps them, and they are paid 20% of their profits (plus a 2% fee) so they are incentivized to take more risk. In a market that we have now, the leverage in the system has a devastating effect as the hedge funds are forced to sell stocks which they prefer not to sell but must because of the dreaded margin calls. What makes it bad for us is that the hedge funds are forced to sell high quality names that we also own. They are being sold only because they are so liquid. The high-flying stocks with nosebleed valuations that have hurt the hedge funds could have possibly been sold (since as a public company there is always a buyer) but since these companies are not liquid with high trading volumes as ours are, these highflyers were not sold. As their trading volumes were not high, if the hedge funds tried to sell them, the sheer volume of the sale would cause these companies prices to plummet even more than they already did. It is probable that some hedge funds had no choice but to dump some of these formerly highflyers even at depressed prices. As an expert I know in my profession said to me years ago "there are too many people managing a lot of money who have no idea what they are doing". I agree as many of these people who are running the hedge funds are under the age of 40. As this is the first time in 14 years that interest rates have risen, many of these hedge fund managers have never experienced this and have no idea how to react.

Another reason the market has dropped so much so quickly is quite frankly, many people have come into the market over the last several years who have no experience with it and probably should never have entered in it. At least not on their own. I refer to these people as the "Robinhood" crowd. Many of these people (I refuse to call them investors, sorry because they are not) instead of purchasing companies for cash as we do, purchased companies on margin, went into cryptocurrency (Bitcoin is down 70% from its high) as well as the options market. Robinhood is the name of a discount broker that started up 4-5 years ago and began the trend of "free" trading. As nothing in life is "free", there are now rumors that Robinhood could be sold to a larger company. The average account balance is just $ 5,000 so it appeals to the under 35 crowd that likes to trade frequently on their phones. I am all in favor of new people of all ages coming into the market. Heck, I started when I was just 23. I was in the market during the famous crash of 1987 at the age of 25. I don't condone new people coming in at any age who want instant gratification and are ready to run for the hills at the first sign of trouble. That is what is happening now. While it would be nice to just be in the markets when things are going well and in cash during down markets, that is simply not a realistic expectation.

What has caused much of the downturn in the markets is the popularity of passive investing, index funds and ETF's. Jim Cramer of CNBC has said on occasion over the years that if you don't want to hire an advisor, rather than pick your own stocks, go with index funds. In some ways, I do agree. In theory, it is not a bad idea. The problem is during down markets, individual investors, sometimes called "the retail" crowd simply don't have the discipline to stick to their plan when things get challenging as they are now. Jim Cramer said recently on CNBC that people aren't looking to sell Apple and Microsoft, they are selling "the market", the index funds and the index funds must sell Apple and Microsoft just to meet the redemptions. I am not looking to pick on the under 40 crowd in any way. I am just pointing out that we haven't had a market like this since the financial crises and that was 14 years ago, so many of these new entrants into the market weren't even out of college yet when this last happened. While it is all well and good to "do it yourself" to save on advising fees, one important thing that I and most other investment advisors do is prevent our clients from making mistakes that could hurt them. An example is having our clients avoiding selling during tough times when if anything, an intelligent investor should be buying stocks when they are on sale. The Vanguard group (the largest owner of index funds) did a study showing that over a nearly 50-year period, 76% of its customers in their index funds underperformed the broad market demonstrating that even by doing it yourself the odds are 3-1 against that you will even equal the markets return.

The persistent chatter each and every hour, are the recession fears. It should be noted that recessions are notoriously difficult to predict. Predicting a recession is about as easy to do as timing the markets. Timing the market is an exercise in futility. If a recession does occur, it will be the most predicted one in history. As 70% of the economy is consumer spending, if a recession does occur it will be more because people are talked into it than any other reason. As much of the economy is based on consumer confidence, it makes sense that if people (many of whom are not educated nor informed) constantly hear day after day about how a recession is "inevitable" it is only human nature that people will eventually pull back on their spending. I will also point out that the last three recessions of the past 22 years were not predicted.

I enjoyed watching Ken Langone on CNBC yesterday morning. I consider him a voice of reason and quite intelligent. He also talks in layman's terms. He is one of the founders of Home Depot. Mr. Langone said, "intellectually and emotionally we are already in a recession". In some ways, this makes sense. Technically, the definition of a "recession" are two consecutive quarters of negative GDP. GDP is the gross domestic product. If you ask a handful of people that you know what GDP is, the chances are they will have no idea and if they do, they won't care. FYI- Gross domestic product are the sum of all goods and services sold and produced in the country. When economists talk about the health of the economy, generally they refer to the economy as GDP. What people care about are if they are working and if so, how much their wages are growing (if at all), how much they are paying to put food on the table and to fill up their cars. By the way, the price of groceries is increasing faster than food in restaurants. Housing costs are out of control. Rents follow housing costs and from what I hear, rents are also on the rise big time. If you or someone you know are ready to go on vacation soon, be prepared for some sticker shock as far as hotel rates and airfares. Now that COVID isn't as much of a big deal, people are looking to travel at all costs.

I am far from a wild-eyed optimist. One reason I am not in the camp of the doomsayers/chicken little's is because I give little credibility to so called "experts" who are historically wrong. I watch the labor market. The unemployment rate is still 3.6% and showing few if any cracks. Companies are still hiring. Historically, layoffs occur prior to recessions. For every person looking for a job, there are two openings. Yesterday I had lunch with someone who I like to refer to as my "star client". I asked him how business was and he said, "it couldn't be better". My brother-in-law owns a nice sized company and when I chat about his business, he says "my biggest problem is I can't get enough product to sell". I would say that is a nice problem to have. A friend of mine who owns a building supply company with 40 employees is working 55 hours a week (he is 67) and is making more money than he ever did. I hope that I don't have to apologize for not being the profiteer of doom which is now in vogue but what I see are not signs of an imminent recession. Are there signs that the economy is slowing? Yes, without a doubt. Steve Leasman of CNBC said on CNBC this morning "that there is a huge difference between an economic slowdown and a recession and what we have now is an economic slowdown". What I have found over the past 28 years as an investment advisor is that when things are difficult, the vast majority of people, especially in the financial media, feel that the future will be just as bad if not worse than the present. Over the past 28 years these people have been consistently wrong as evidenced by the years soon after 09/11, the financial crises and just two years ago when the economy shut down because of COVID. I say to myself now, "why can't things improve as opposed to getting worse"? Over the next 6-12 months I can think of many more reasons why the rate of inflation will dissipate as opposed to stay as it is or go higher. One of the biggest causes of inflation is that the supply chain is so clogged up. With China now opening as a result of reduced COVID restrictions, that will help alleviate supply chain problems thus reducing the rate of inflation. The war in Ukraine has caused inflation to be higher than it would have been had there been no war. Yes, inflation was a problem before the war, but it has now become worse. The war will not last forever. What happens if it ends either later in the year or early next year?? Do we agree that will be a good thing? I am not attempting to state that a recession won't happen. Just pointing out some reasons why it is far from a certainty. If a recession does occur, it should be a mild one and over quickly.

If you have any questions or anything that you would like to discuss, please contact me. I am here for you and happy to help in any way that I can.