Stirling Bridge
Wealth Partners, LLC

MARKET COMMENTARY – June 1, 2022

Raiding the Piggy Bank.

Suspension systems in cars are wonderful. They take the stresses of the pounding road and transfer them away from the car's body, thereby making the drive a pleasant experience. The same can be said of savings in the midst of an economic jolt. Both cases, however, have a limited useful life. Shock absorbers eventually fail and must be replaced. Savings, if tapped continually, must eventually run out.

Personal savings skyrocketed since March 2020. Much of the planet experienced limited mobility and was therefore prohibited from spending income or savings. Adding to the cash hoard were government payments in myriad forms. According to folks who keep track of such things, $2.5 trillion in extra cash piled up in bank accounts.

And it is this excess cash that many market bulls point to today for their optimism. They say the extra savings will allow the economy to remain in growth mode in the face of higher costs and higher rates. Stated otherwise, consumers will spend down their hoards rather than tighten their belts. And, by the time the funds are exhausted, voila, the Fed will have gotten inflation under control.

In the very short run, this seems to be happening. Aggregate retail sales have continued their monthly climb even as the savings rate has now returned to the pre-pandemic level while on a definite downward trend.

Aside from the logistical component of today's inflation and the Fed's limited ability to fight it, we have two questions regarding the shock absorbing power of savings. First, how bare will folks allow their piggy banks to become before they tighten the purse strings? Second, what about the full range of savings rates? How might the shape of the distribution of savings rates affect our near-term economic future?

In answer to our first question, we admit that the personal savings rate has been lower than it is today. For a period of about five years leading up to the debt-fueled Great Recession the aggregate savings rate was consistently lower. This fact might indicate consumers will spend into savings still more. However, the current direction for interest rates is up. Barring a quick reversal to Fed policy it is difficult to believe consumers will intentionally drive savings lower and risk borrowing at higher costs.

The second question is a little more complicated than the first. To be sure, there are always those in the economy who save very little (or spend more than they earn). Our question centers on whether the number of folks doing so is large and whether they are just being rounded out of the aggregate results by a smaller number of huge savers. We tend to think that today's economic landscape with low labor force participation and much of the service sector decimated lends itself to greater savings disparity.

Stated another way, we think the lower tiers of earners are already making required trade-offs in spending in order to stay afloat. We expect that ripple to spread, impacting corporate earnings growth rates, and eventually crimping spending budgets at companies both large and small.

We now turn our attention to components. Specifically, the constituents that make up stock indexes, their performance, and what they are telling us.

According to our friends at JP Morgan and depending on the moment, the S&P 500 is down about 20% from its high. However, the average stock in the S&P 500 is down 26%. Other indices tell a similar tale. The Russell 2000 is down about 30% from the high, but the average stock in the R2K is down closer to 47%.

Readers who understandably never dig into the details of index construction can be forgiven if they shout, "How can this be?"

The short answer is because the biggest companies receive the biggest weighting in indexes. By itself Apple is worth about 6% of the S&P 500. And since Apple hasn't fallen as much as others, the index itself has been stronger than otherwise.

But why have Apple and other big companies not fallen as much? The surface level answer is multi-faceted and makes intuitive sense. They are big. They have access to cheap financing. They have resources and marketing stretching the world over and so are set up to weather storms. Whereas small companies are more vulnerable to idiosyncratic events.

However, believe it or not the deeper level answer as to why the disparity in returns exists this go-'round goes back to the first discussion on shock absorbers, i.e., cash.

The biggest corporations have piles of cash today. Whether from sales of product or from issuing ultra-cheap debt during the pandemic, they collectively sit upon $2 trillion of cash. And the biggest of the big companies have been using said cash to buy back their own shares in the open market during the downdraft. According to JPM, stock buybacks account for a large portion of the big cap out-performance so far this year.

And our question here is the same as before. In the face of rising rates and perhaps slowing sales growth, how long will business leaders draw down their cash balances? When will they cease to raid their piggy banks?

We think the limit is fast approaching. And unless we get real data that shows inflation is fully in reverse, we expect yet one more pillar of market support to evaporate.

To summarize, we believe that some of the shock absorbers for our retail sales and stock prices are beginning to deplete. Even though the indices aren't flashing recession, the average component of the indexes is flashing recession. Read our previous missives to see what we've done to prepare for a recession and what we won't do when faced with one.

Rest assured, with tweaks already in place, we remain invested and look forward to better returns to come.

Stirling Bridge Wealth Partners, LLC is fortunate to count many of you as clients. In the good times and bad, we remain committed to providing customized investment solutions and robust financial planning wrapped in a package of exceptional service. We thank each of you for your dedication to us and for your trust.

Sincerely
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