Is This Really Happening Again? 02.20.2024

When I found out I was going to have another daughter relatively late in life, my brain went through a "is this really happening again" miasma for weeks if not months. I had "plans" for my life that had to be shelved and remade. Which brings to mind the philosopher Mike Tysen, who said (I think), "everyone has a plan until they get punched in the face." Well, the "punch in the face" turned out to be a loving kiss on the cheek as Madelyn has become a total joy in my life. As a proud papa, I have to let you know that she just finished her last play at her school. The play was "Newsies Jr." and here's a clip of her singing a duet with her taller friend: https://drive.google.com/file/d/17yBLP-yfRfuEWlhY8WHYpOh25ldyEg4b/view?usp=sharing. Just beautiful. 😌

That phrase "is this really happening again" is also one bouncing around my brain when I look at the stock markets of the past few months, especially the tech indexes, which have skyrocketed (although as I type on Feb 20th, they've come down a bit in the last couple of trading sessions). I've been waiting to send a note the last month or so to see if we were going to reach the magic 5000 figure on the S&P 500 price index and we breached it on Feb 9th. While I "predicted" getting to 5000 in a note in Nov 2021 (www.tacticaladvisoryservices.com/market-updates), I didn't predict the circuitous route we have taken to get here. The last 3 months, in particular, have been astounding.

24 years ago, is a long time in the stock market world. Long enough to forget what happened back then. In the late 90s there was a huge surge in the stock markets in 1999/early 2000, particularly the tech area (aka the "dot.com" boom). Everyone was projecting 15% annual returns into infinity. Of course, we know how that ended with the NASDAQ tech index eventually dropping by about 80% and the S&P 500

declining about 47%.* Could that happen again? Well, stocks are surging to heights unimaginable just a few months ago. The recent 3 month surge was in the 99th percentile of all market history.^ In other words, "it's déjà vu all over again." This is the same type of market action that characterized the late 90's. With a huge market loss in 2022, now it's become a frenzy to get "easy" market gains. Of course, the old adage goes, "the market can remain irrational, longer than you can remain solvent." So, stepping in front of the train may be a bad idea.

*Source: Yahoo finance; ^ https://www.zerohedge.com/markets/goldman-risk-pain-trades-rises-we-head-next-weeks-barrage

2023 was a good year for most investors. We were up nicely in our managed accounts at Nationwide and at AXOS (using Q3 Asset Management) and up considerably more in our "structured investment" accounts^ about which I want to mention a word. Over the past couple of years, I have moved millions of dollars of client funds (and my own) to these "structured investments." These types of investments can have no market risk or offer up to 20% downside protection from stock market price index losses each year*. While the accounts with no market risk have more limited upside potential, both options link gains directly to the major stock market price indexes. The protections allow investors to be more aggressive while still maintaining a "moderate" or "conservative" risk profile. Because the indexes were up hugely in 2023, these types of accounts were also up significantly. These types of investments have been available for many years. However, they have, in my opinion, become attractive the past couple of years due to much higher interest rates, which allow for much higher upside potential than previously. The "buffers" protected client funds in 2022 when stock indexes dropped 20% and the accounts gained with the stock indexes in 2023. It could hardly have been better. If we get the stock markets over the next few years that I believe we are going to get, for those for whom they are suitable, I believe structured investments will be an indispensable part of one's portfolio. If we haven't discussed these, it is worth your time to find out about them. Please call Deena to set a time to talk or reply with an email.

^https://tacticaladvisoryservices.com/structured-outcomes; https://tacticaladvisoryservices.com/buffered-securities),

*Buffered accounts may provide up to 20% protection from price index declines while also allowing for 100% participation in the index chosen. Please refer to a product prospectus for specific information on costs, crediting methods, current rates, limitations, and buffer protections.

Now for a bit of market commentary.

The bullishness in the stock markets often leads to more stock market gains over the following 6 and 12 month periods^. However, the recent surge in the markets has not come without its cautions. One of my data feeds, Sentiment Trader, recently updated their "risk-off" model and it is now at 40% (complete risk-off is at 60%). If you look at the graph, you'll see the last time this model reached the 60% level was just before the peak in early 2022. Much of this increased risk is due to the lack of participation among large segments of the stock market. In other words, most of the gains in the indexes have been driven by a literal handful of companies, which may sometimes signal danger. While the S&P is near a 3-year high, fewer than 40% of its stocks are above their 10-day avg, fewer than 60% above their 50-day, and fewer than 70% above their 200-day. Since 1928, that's only happened once before: August 8, 1929.^^

For the past 5 years or so, large tech stocks have prospered while many other segments of the market have done little or nothing (this had made it very challenging to invest because of the necessity for diversification, which has led to reduced returns). We all have "recency bias," meaning everyone wants to invest where the most recent gains have been made and we tend to think that's where all the gains have always been made. However, it's important to remember, there are cycles for all asset classes. For the 10-year period from 2001 – 2010, large cap stocks made nothing (0%) while emerging markets were up over 400%, international up over 130%, mid-caps up over 60%, and small caps up over 75%.*

^Source; https://users.sentimentrader.com/users/sentimentedge/a-bevy-of-breadth-bursts; ^^Sentiment Trader 02.06.2024; *Source: Yahoo Finance

One interesting reason^ given for the recent surge in stocks is the banking "crisis." In the last month, New York Commerce Bank, a top 40 size bank, came out with an earnings report that was quite dour.* Reserves they set aside for bad loans increased considerably and their financial position was markedly worse then expected. The old phrase, "there's never just one cockroach," I believe, is quite apropos among the banking industry, especially the smaller and regional banks. In March of last year, the

Federal Reserve, in order to "save" the world again, set up a loan program for banks to trade devalued collateral (i.e. bonds that had gone down in value) for full value loans so the banks could meet their accounting requirements. That program is supposed to end in March 2024. A recent study* by academics at Stanford, USC, Northwestern, and Columbia made the following points:

1) The estimated unrealized/unrecorded losses on bank balance sheets were $2 Trillion as of about a year ago.
2) There are ~ 4,100 banks in the US. The study concluded that 2,315 of those banks (or 56.5% of all US Banks) have assets worth less than their liabilities. In other words, they are technically bankrupt. Of course, the problem for banks trying to "survive" is they don't lend much, meaning small business continues to struggle. Which, in theory, is a bad sign for the markets because small business buys from big business.

So, why would a banking crises potentially cause a stock market surge? Perhaps investors believe the Fed is going to capitulate again and lower rates and flood the markets with money to allow the banks that are in bad shape to survive and this flood of money would eventually make its way into the stock market. For my own thinking, this may well be the case but, the longer view is not good. In my opinion, more devalued dollars propping up failed institutions will eventually cause a larger crisis down the road.

^https://www.zerohedge.com/markets/hartnett-regional-bank-crisis-stoking-ai-bubble-because-powell-has-become-paper-tiger
* https://finance.yahoo.com/news/york-community-bancorp-nycb-reports-131005555.html
*Source: David Stockman newsletter 07.13.2023

As to what we are doing now for managed accounts at Nationwide – My "feeling" along w/ some other technical data, has caused us to become cautious the past few days and have reduced stock allocations and put more into the money market. I think we'll probably stay that way for the next few weeks.

Thank you for allowing us to be of service. Please let us know if you have need anything.

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