11.07.2022 - Piercings

My 10 (soon to be 11) year old daughter, Madelyn, asked the other day if she could get a 2nd piercing in her ear. As an "old" guy who wears no jewelry other than a wedding ring (and I don't like wearing that either), the idea of "needing" two earrings on the same ear is a foreign concept. Why would one want to pierce one's ear in the first place? And to get a 2nd one? What is the world coming to? Don't misunderstand, I know it's not a big deal, but it is a sign that my "baby" is growing up. As the Tao te Ching says:

> "If you realize all things change
> There is nothing you will hold on to."

And that's the thought that has prompted this note. As those who read these updates know, it has always been confined to discussions and explanations of current markets (that will be in the next note) hopefully written in an entertaining way. I have never discussed specific ideas regarding into what to invest or how to allocate one's funds. I am breaking that rule to a small degree with this note (see below) because our world has changed so radically from where we were just 8-12 months ago and I think it's important to get this information out now. I'm not just referring to the stock/bond/(traded) real estate market declines over the past year. I'm referring to a wholesale change in the way the world works.

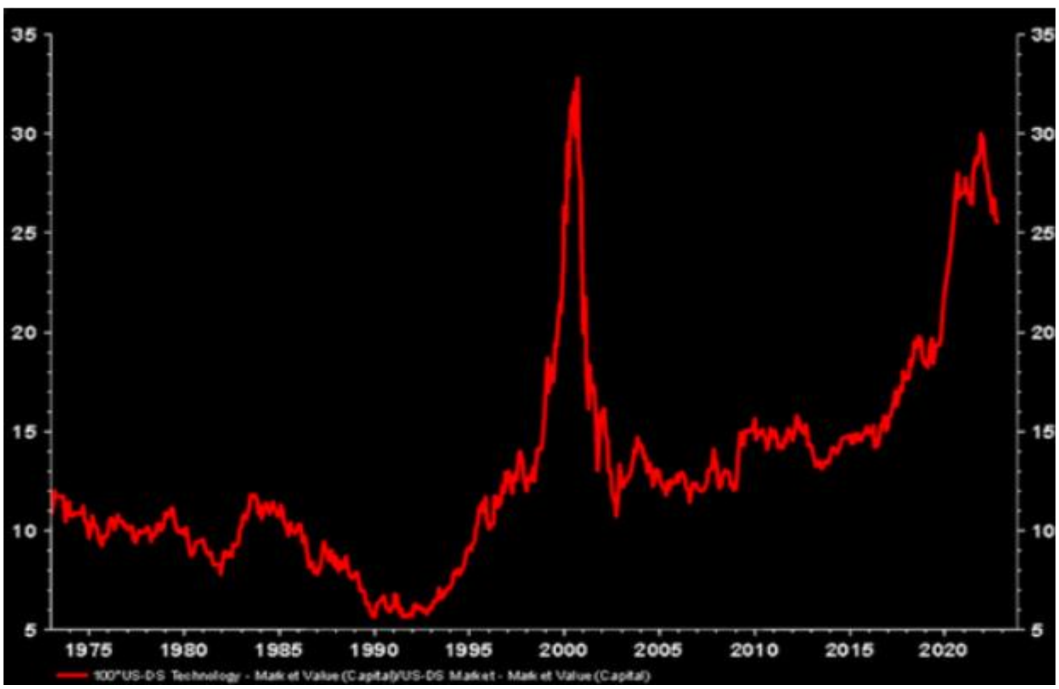
Here are some of the big "changes" that are affecting and will affect stock/bond/real estate/commodities markets over the next year and decade:

1) Worst inflation in the last 40 years due to the massive easy money policies of the world's central banks over the past decade
2) Unprecedented increases in government debt across the world that have left governments powerless to combat future recessions without aggravating the inflation problems
3) Interest rate hikes to combat inflation (which, ironically, also hurt the ability of companies to invest in new production to alleviate shortages)
4) Energy prices most likely staying high (for a period of time) due to numerous factors
5) Reconfiguring of supply chains that began in the 1970's.
6) Poor demographics in the developed (western) world and in China
7) More governments engaging in "top down" industrial policy which inherently leads to inefficiencies and misallocated capital

As a famous economist once said, "when the facts change, I change." That is the theme of what I believe has been playing out in today's investing landscape. Fixed interest rates have skyrocketed the last 6 months.*^. The former world beaters, Microsoft, Meta (Facebook), Google, Netflix, Nvidia, Amazon and Apple are down substantially from their peaks; between **-24%** and **-76%**.^ Some may say this is a new buying opportunity. I would ask, "are you sure?" Maybe the era of high valuations for growth companies has come to an end (at least for now) and the market will start to value companies the "old-fashioned" way, by a reasonable price to earnings ratio or a reasonable price to sales ratio. Instead of 30 or 40 or 50 to 1, maybe, with interest rates on short and long govt bonds over 4%*, quality corporate bonds around 5.9%*, and junk bonds over 9%*, the ratios have to come down to 9 or 12 or 15 to 1. If so, that means there is a whole world of hurt still to come for many "growth" companies still sporting relatively high valuations. When the stock market peaked in March of 2000, it took 13 years for the major indexes to move beyond the 2000 level.^ Microsoft took 16 years to move beyond year 2000 prices.^ So, your favorite stock, that you love to death, may be dead money for a long time. Here are a couple of pictures illustrating where we've been and where we may need to go.

The first graph shows the long-term cumulative return of growth stocks minus value stocks. You can see the massive run-up on the right side of the graph (dwarfing the run-up into the year 2000) that is now coming down just as quickly, possibly implying more pain ahead for growth. The second graph shows "price to earnings" valuations of tech stocks remain treacherously high, similar to the dotcom bust of 2000 when the Nasdaq declined over 80% (source: Yahoo Finance)

(source: Kailash)



(Source: Albert Edwards)

^* http://www.worldgovernmentbonds.com/country/united-states/
^Source: Yahoo Finance
*wsj.com/market-data/bonds/benchmarks

If what I'm writing comes to pass, then, in my opinion, investors will need to embrace a new "paradigm." What does that mean or look like? To me, it looks like this:

1) Allocating funds into fixed rate accounts that now pay 5% or more for 5 years. A couple of years ago I made the statement "if I could get 5% "guaranteed,"* people would line up out the door waiting to write checks." Well, that day is here. Quality companies are now offering fixed rates at those levels. I believe putting a portion of one's funds into those types of accounts is now a prudent thing to do.

2) Using "buffered" securities for a significant part of your stock market exposure. If we do get "up and down" stock markets, "buy and hold" is going to be a long waiting game without much result. Instead, I believe there may be a better way to "play" the stock markets. A number of companies have, over the past few years, introduced "buffered" securities. These types of stock market index-linked investments provide as much as 20%/ account year protection from downside losses while allowing for 100% participation in the indexes if they do go up (some crediting strategies limit the maximum gains possible).^ The table shows a hypothetical example of one such "buffered" investment. As you can see in the example, the total return of the stock market is about even for the 6 years while the buffered security is nicely positive. I do need to reiterate, this is a hypothetical example for illustration purposes only. Using buffered securities does not guarantee a profit. It can help to mitigate losses in down markets. The returns in the example below have been calculated in a simplistic way to help in understanding how this type of investment works. They are close to what they would be but not exactly.

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Total Return
Stock Market Index	-10%	**+24%**	**+10%**	-25%	**+15%**	-6%	-0.47%
Buffered Account with 20% buffer protection and 21% max gain/year^ (internal cost of 0.95%)	-0.95%	**+20.05%**	**+9.05%**	-5.95%	**+14.05%**	-0.95%	**37.76%**

Buffered securities, I believe, are an excellent strategy for long up and down cycles of the stock markets. For more details, go to my webpage (https://tacticaladvisoryservices.com/buffered-securities) and watch the two short (2 minutes) videos. Then you can click on the link to create your own illustrations if desired and to see current crediting rates.

It's important to note a few details in this hypothetical example referenced above. Please refer to a product prospectus for specific information on costs, crediting methods and buffer protections.

1) Your entire deposit is credited with any gains.
2) There is no "management" fee or daily managing for the fixed accounts or buffered securities.
3) I help with allocating into the various crediting strategies of the buffered securities on a year to year basis.
4) There is a 0.95% yearly internal charge for the buffered securities.
5) Both the fixed rate and buffered accounts have penalties for early withdrawal for a period of time (you don't get something for nothing). Most offer partial withdrawals of 10%/year or some variation with full withdrawals available in the event of death, nursing home stays or terminal illness (see the disclosures for specifics). Because of the penalties for early withdrawal, they may not be suitable for you and certainly not for all of your investing funds. Both require us to discuss your situation to determine whether they are a good fit for you.

*Guaranteed by the claims paying ability of the issuing company

^Crediting rates may change year to year. 2 and 6 year crediting options are available that provide longer certainty of rates with higher or no caps on gains but less protection year to year.

Robert Rhea, in his 1932 book "The Dow Theory," wrote the following:

> ***"There are three principal phases of a bear market: the first represents the abandonment of the hopes upon which stocks were purchased at inflated prices; the second reflects selling due to decreased business and earnings, and the third is caused by distress selling of sound securities, regardless of their value, by those who must find a cash market for at least a portion of their assets."***

At this point, I believe we have completed phase 1 of this bear market and are into phase 2. Of course, all the bad news in the world doesn't mean the stock markets can't go up for a period of time. We may have another large rally at some point. The big concern is will that rally hold or will it eventually fail as happened in 2008 after initially bottoming in early 2003 from the crash of 2000.

I could be wrong about all of this and I certainly don't know the exact timing of how things will come to pass (although I think there's a decent chance for a major bottom in Spring of 2023). If I am wrong, these ideas will cause no harm as we will, most likely, be happy to earn 4.5% - 5% on a portion of our account while the buffered accounts allow for the opportunity to participate directly in the gains of the various stock market indexes (some strategies do have maximum gains). On the other hand, If I'm right, we will be well ahead of the rest of the investing world.

I realize much of this sounds like "doom and gloom." I assure you, there are much worse prognostications offered by some of the world's most renowned money managers who are predicting we will all be shooting squirrels for food*. I don't think we'll go that far. I just want to try and prepare you for the worst if it comes to pass.
*https://www.ft.com/content/f3bb0f96-1816-4481-8318-4f7583326a4a

As always, thank you for allowing us to be of service. Please call if you want to discuss these ideas further.

Enjoy,

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