
Wealth Management Monthly | McClure Investment Management

# the big picture

## "Its difficult to make predictions, especially about the future." -Yogi Berra

The quote above recently popped up in an article I was reading and seems to sum up the state of investing today. I've never seen a market where the economic data and the financial market's reaction to it have been so contradictory. Let's see if we can shed some light on some of what's going on.

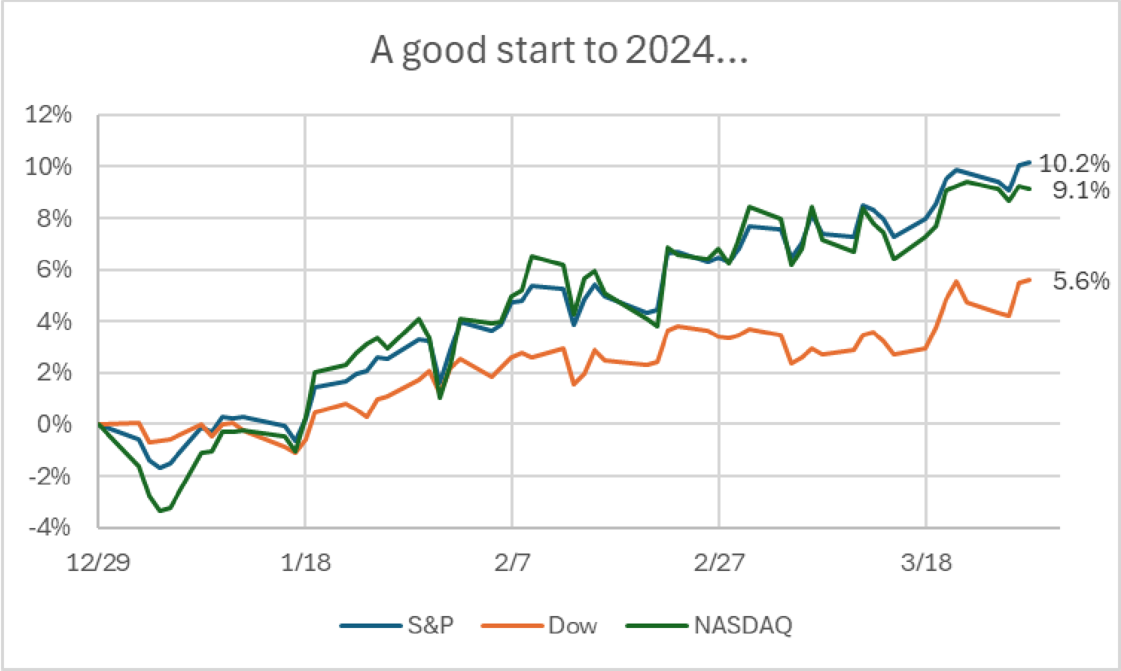
And please note, this is not a recommendation to buy or sell any security. Nor is it a recommendation to eat kerosene-soaked hamburgers while playing the accordion. My views may change at any time.

And a warm welcome to our new readers.

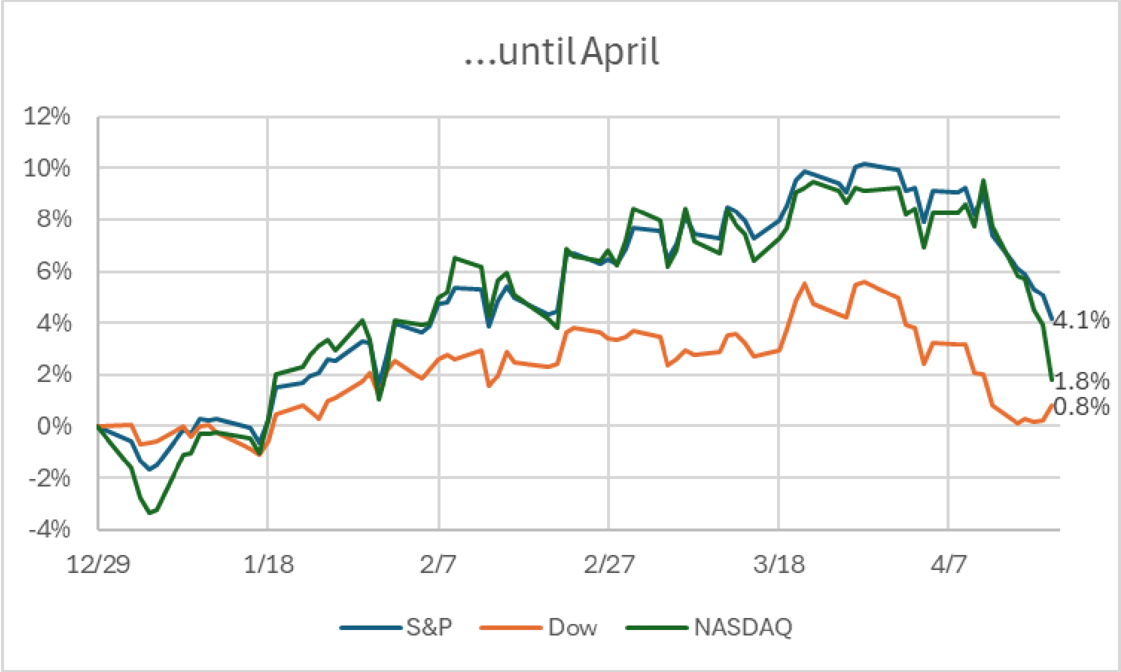
Onward...

**Stocks**

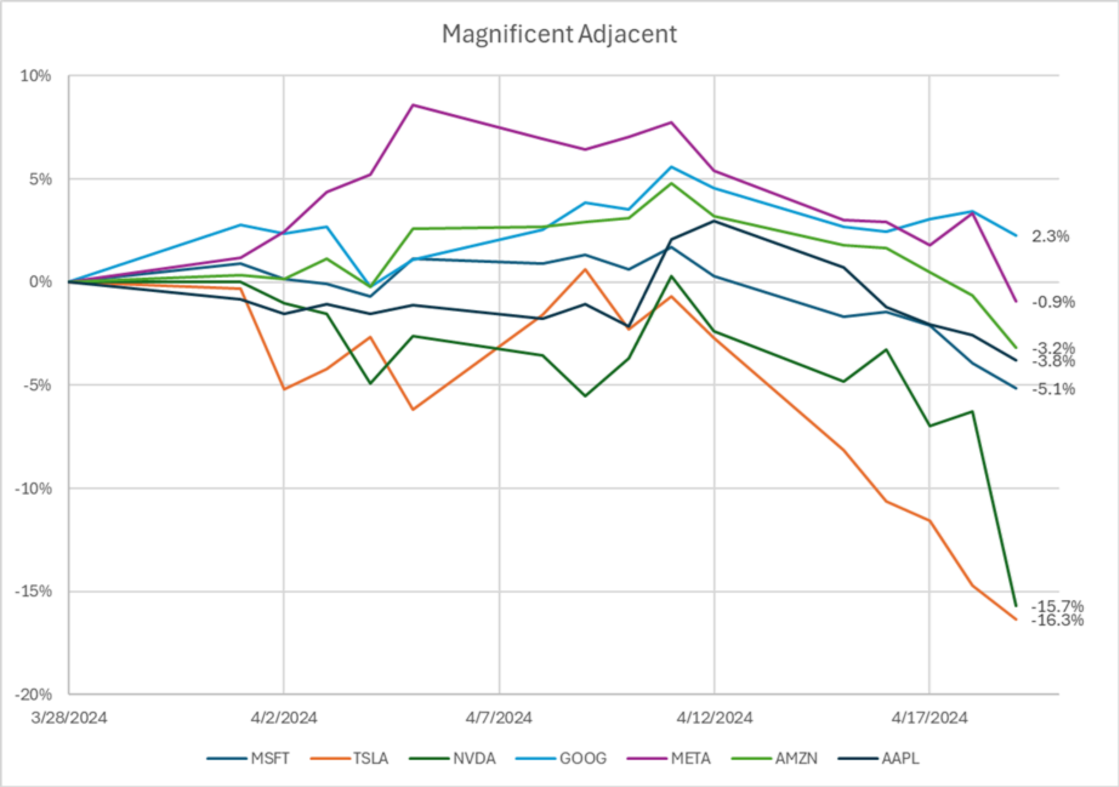
The first quarter of 2024 started out reasonably strong with gains in all three major market indices:



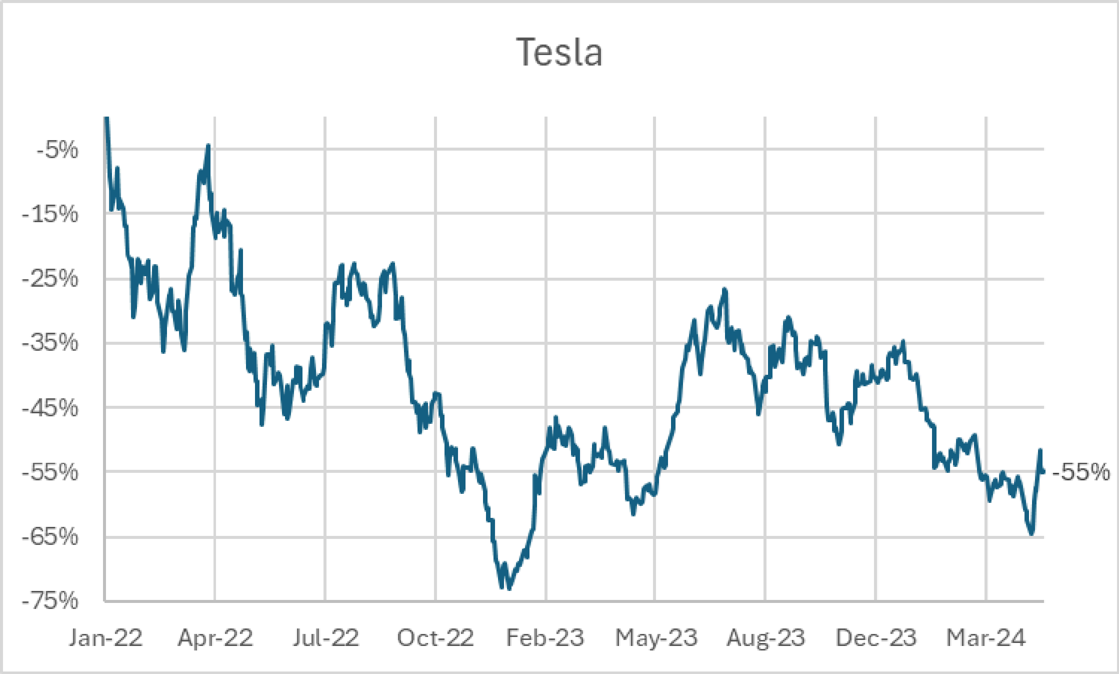

But once April showed up, things got a little messy:




A good portion of April’s pullback can be traced back to the formerly “Magnificent Seven”:

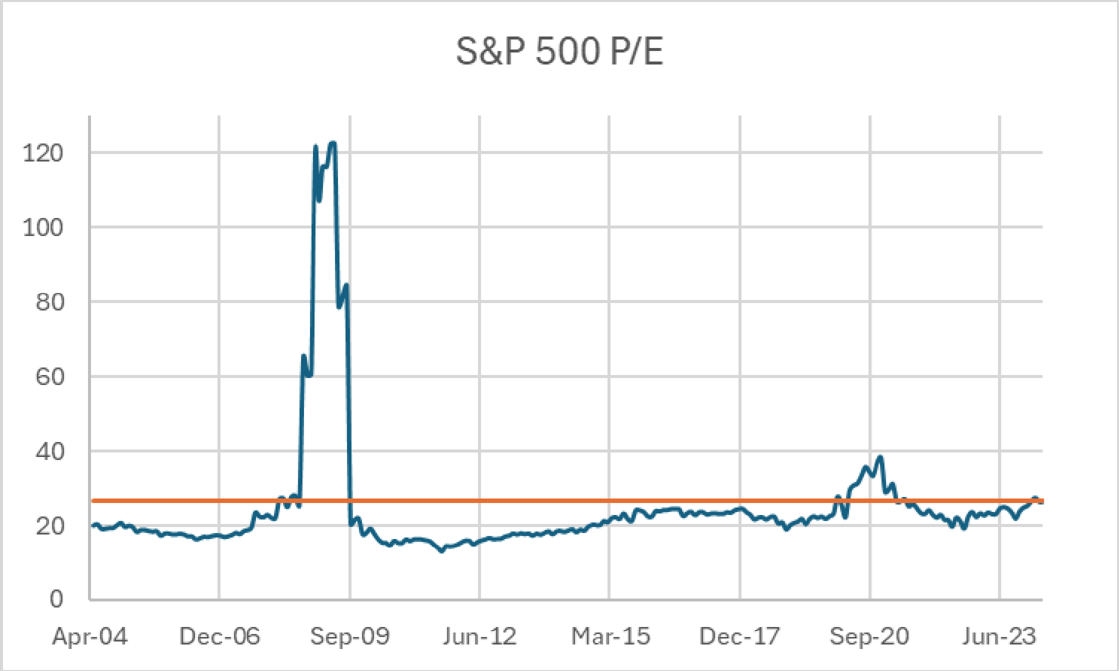



For the biggest loser here, Tesla, the poor 2024 performance is just a continuation of a pretty awful two-year trend:




Some of Tesla's woes come from supply delays. But quite a bit is being said about unforced errors by CEO, Elon Musk, who has managed to alienate many potential buyers. The Wall Street Journal and Washington Post, two publications that don't see eye to eye on much of anything seem to agree on this. Both articles are worth a read.

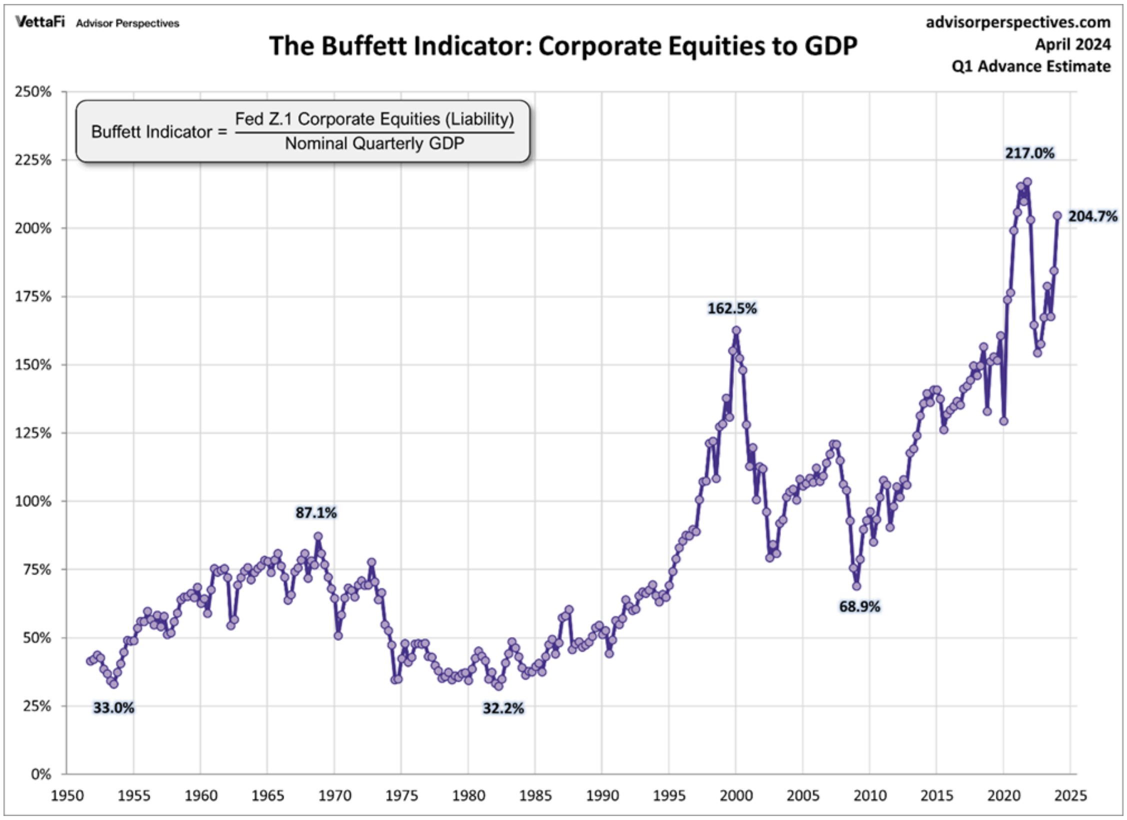
But for now, let's look at the broader market. The current Price to Earnings ratio (P/E) for the S&P 500 is about 26.




Not that 26 is the highest P/E ever. Over the last 10 years the market has traded at or above this level around 13% of the time. The two moves above the 26 P/E in the graph above correspond to (1) the global financial crisis from mid-2008 to mid-2009 where the “E” in “P/E” plummeted to almost nothing thereby sending the P/E through the roof, and (2) during the Covid 19 pandemic where the companies like DocuSign (-83% from its pandemic high), Zoom (-89%) and Peloton (-97%) were leading prices higher.

This is not to say a huge pullback is imminent, but it seems *extremely* unlikely we’ll see a sustained rally from these levels.

Warren Buffett’s favorite measure of market valuation comparing Gross Domestic Product (GDP) to the total value of corporate equities is likewise sending a strong signal that stocks look pretty expensive at current levels:




In the coming days we'll be trimming back a number of positions and adding a little to better positioned (priced) stocks and increasing our Fixed Income exposure. Speaking of which…

## Bonds

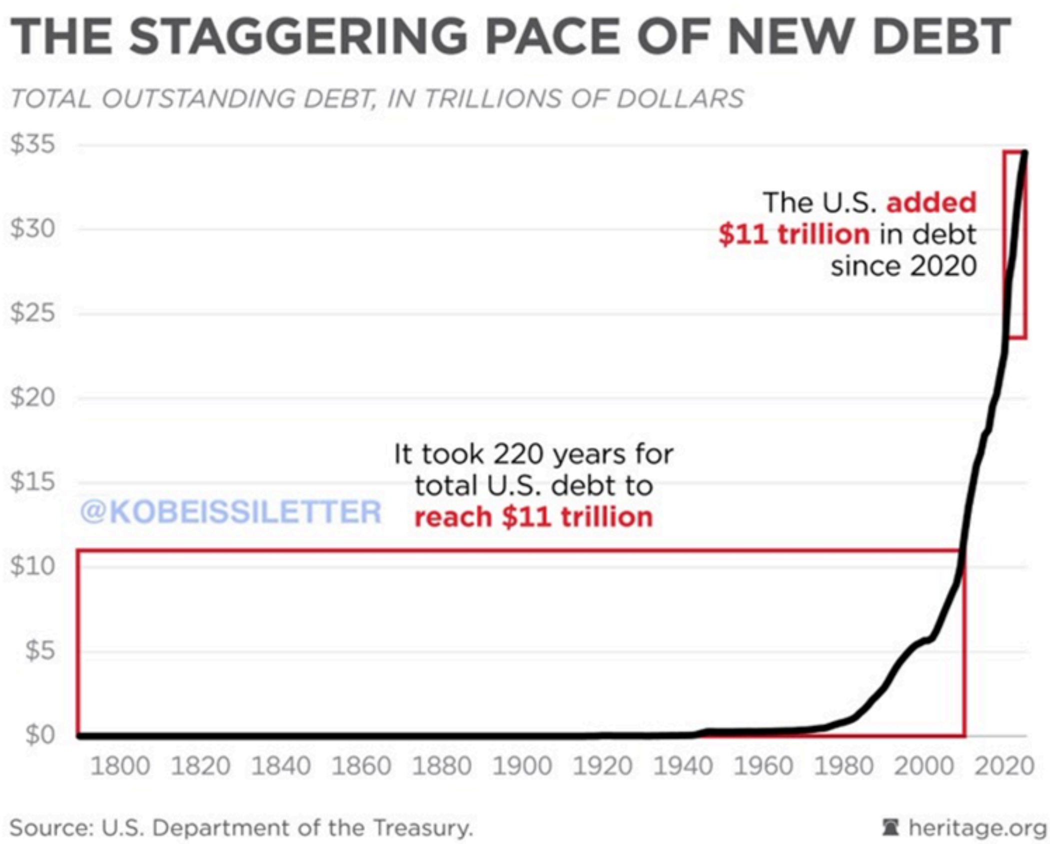
After years of holding cash instead of near zero rate bonds, we've been buying T-Bills and rolling them over as they've matured for the last couple years. With short term yields now around 5.3%, this has been a genius move. (Hold for applause.)

So, what's next in fixed income? The options, simply stated, are:

- Keep buying short term T-Bills and rolling them over, with the assumption that rates will continue to rise, or
- Extend maturities and buy longer term treasury and corporate bonds, assuming the Fed will step in and lower rates, thereby making our bonds rise in price.

There are more than a few really smart people – people smarter than me, if you can believe that – who recommend extending maturities assuming the Fed will come to the rescue and lower rates. I am not currently one of them as supply and demand don't look at all favorable for lower (long-term) bond rates and higher bond prices.

First, the US is issuing gigantic amounts of debt right now:

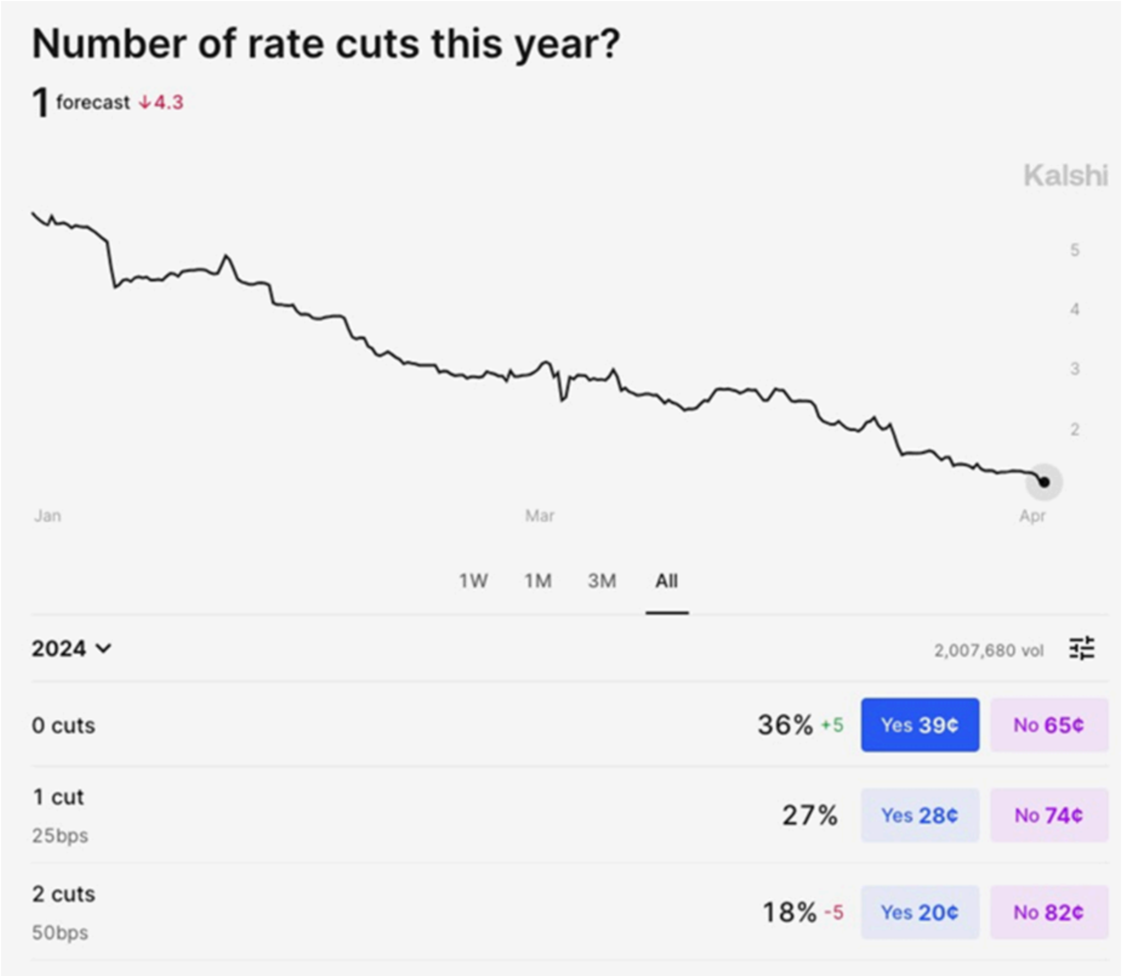



(And if you have the stomach for it, take a look at the US Debt Clock by clicking here.)

So, bonds are coming due that were issued at 0.5% interest and will be reissued at a nifty new rate of around 5%. That's enough of an increase to make interest on the national debt a bigger budget item than defense spending or Social Security and just slightly smaller than Medicaid.

So, we've got a bigger supply of debt than we've ever had, by a wide margin, and that debt is carrying much higher rates. The second reason to stay in short-term bonds rather than going long comes from the demand side of the equation. Many of the big buyers of US debt have gone or are going away, including Social Security, Japan, the US government's QE programs, etc.

When we add growing supply with decreasing demand, my Econ 1A tells me that prices are going to drop. And in the world of fixed income that means yields are going up. If we have an intervention by the Fed we could see yields drop. At the beginning of the year the consensus was the Fed would cut rates six times (see below.) But they haven't cut rates yet and the current consensus is for closer to 1 rate cut, not six.

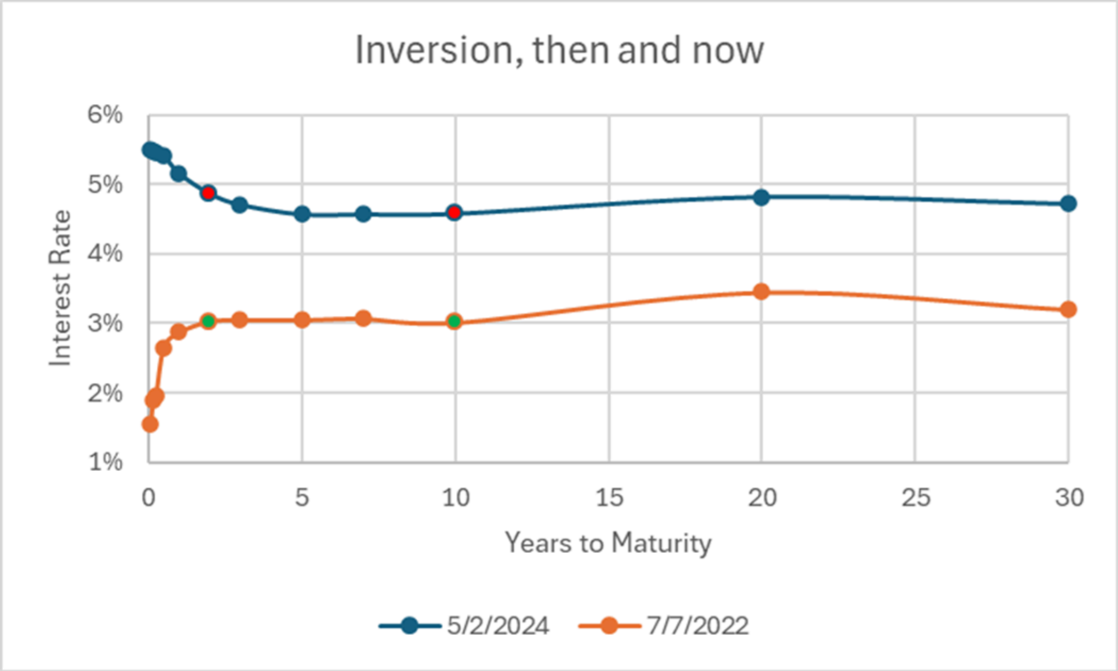



## More Fixed Income

I'll keep this short as I've mentioned it before. We have an inverted yield curve and it has been that way since July of 2022. That's a really long time. Inverted yield curves, where the 2-year treasury pays more than the 10-year treasury, typically presage a coming recession.

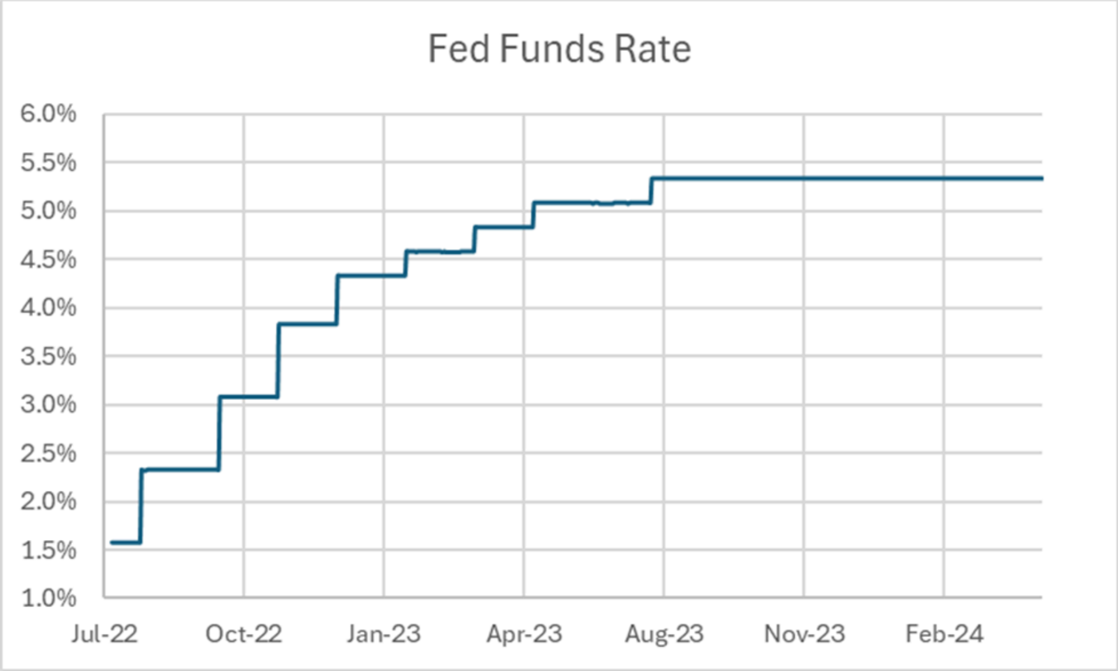
In a normal upward sloping yield curve, longer maturities will come with higher yields. And in the graph below, the orange yield curve – from July 2022- is *almost* normal. However, at that point in time the 2-year and 10-year maturities, represented by the green dots on the orange yield curve, became inverted with the 2-year treasure yielding just a tiny fraction more than the 10-year. It's probably too small a difference to see here but trust me, it's there.

Fast forwarding to today, represented by the dark blue yield curve, *every* maturity shorter than the 10-year yields more than the 10-year. This inversion is waving a giant red flag that something is amiss and has been doing so for a solid 21 months.




Another thing that should be pretty clear is that the Fed wields enormous influence over short term treasury rates as they've moved in lock step as the fed Funds Rate has marched upward from 1.5 to 5.375% (see below.)

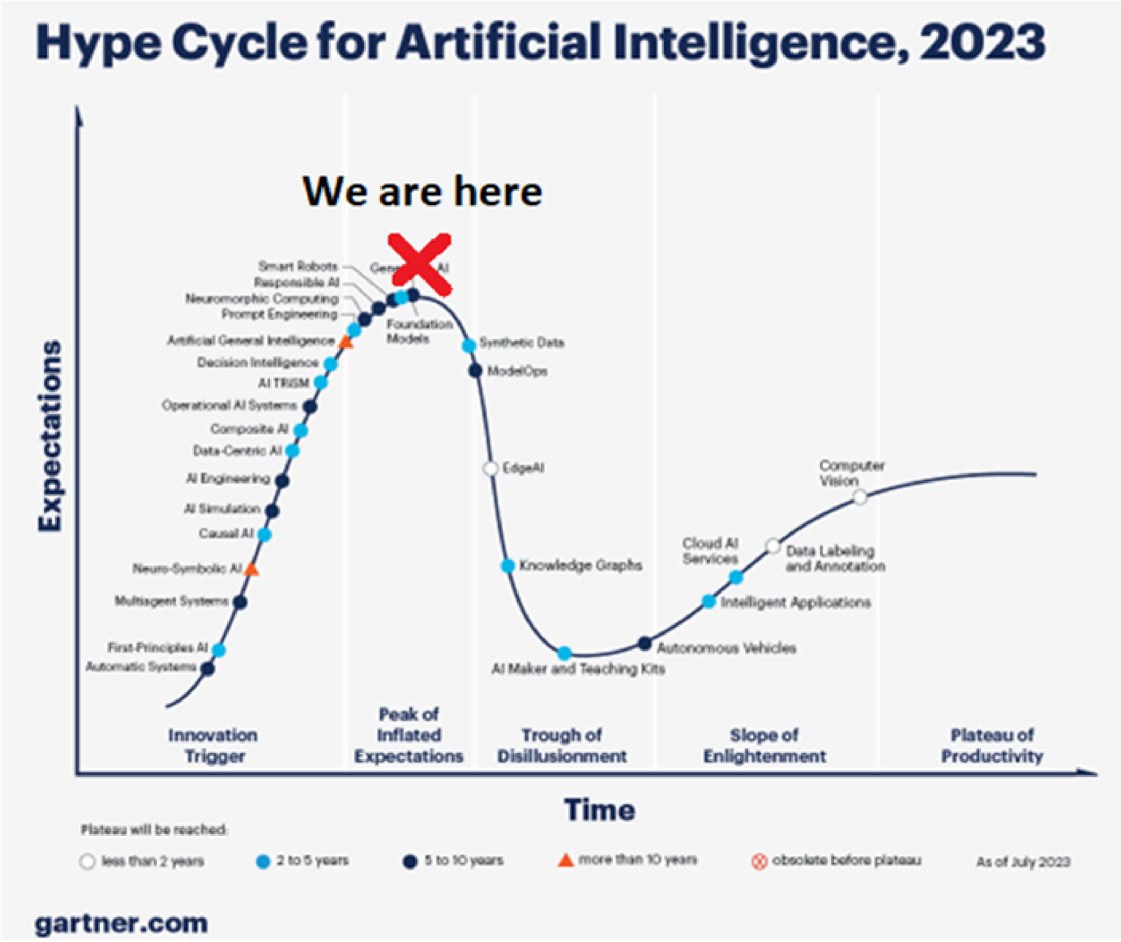
On the other hand, longer term rates are set by supply and demand marketplace. Equilibrium will come back when either the Fed cuts short term rates – which is what they do in a recession – or longer-term rates rise. While neither a recession of much higher long-term bond yields are necessarily good, we will continue to take advantage of the relatively high rates of return in shorter dated treasuries.




And last and certainly least, let's take a quick look at AI.

Gary Smith at Pomona College has written quite a bit - and very well - on the topic. Here, here, and here are some of my favorite of his articles. They're definitely worth your time.

Regarding the valuation cycle we're seeing in AI related stocks, please see the chart below that I stole from David Lewis who stole it from The Gartner Group.




Note that this cycle is exactly the cycle as the cycles we saw in Biotech in the '90s, the Internet in the 2000s, etc. Before each collapse there was rampant speculation and talk of "this time is different," while after the collapse there were often tremendous values to be found. As they say, history doesn't necessarily repeat itself, but it at least rhymes.

As always, please contact me with any thoughts, questions, bad jokes, etc.

Best regards,

Bob McClure