Marketline September 2021

Stocks:

As noted last month in this space, September can be a volatile month, and as if to prove the point, stocks headed down. The Dow sank 4.3%, the S&P was off 4.8% and the Nasdaq performed the worst at -5.3%. Factors mentioned in our last issue – the debt limit, budget negotiations, Delta variant, and upcoming earnings – are weighing on investors' minds. We can add to the growing roster of worries higher interest rates, the increasingly fraught relationship the US has with China, and China's own internal real estate issues – a reminder of the US's Lehman Brothers bankruptcy. As we mentioned to a client just today, markets detest uncertainty, and we've been served a full plate of that recently.

We have pared larger stock positions in some portfolios and jettisoned most shares of Disney, which no matter how you slice it, has grown very expensive. These actions continue sales that we initiated in late August, wherever we needed to rebalance or pad cash positions. Consequently, although we always wish we had more cash in a correcting market, we feel prepared as we move into earnings season.

Those of you who know me well know I am loathe to make predictions, but I believe September earnings announcements will disappoint. We have already seen a few stinkers – FedEx and Bed Bath & Beyond, both of which sank like stones after reporting. Demand is not the problem – instead, inflation is eating up margins, labor is hard to come by, and supply chains are a wreck. When you can't push product out the door, you can't turn demand into sales.

Foreign stocks actually logged better results than their domestic brethren, which hasn't happened since May. In Canada, where a snap election was held, the market was off 2.5%; Mexico sank 3.6%. But over in Europe, where economic improvement has been creeping along, September's returns were just about flat – which of course is better than a decline! This upcoming month will be a whole new ball of wax for Europe, though, as energy prices have sideswiped economies there. With low storage volumes of natural gas and no wind recently in several locales, coal and gas prices have been bid to ridiculous levels as countries try to buy whatever supplies are available ahead of winter. These price surges are reminiscent of the oil crisis of the 1970s in the US, when we experienced an embargo by OPEC. Some companies have moved to reduced operating hours to control energy use, tangling supply chains even more.

We believe the uncertainty saturating the markets will offer opportunities to add to positions in companies we like at lower prices, because – this too shall pass, as it always does.

Bonds:

Interest rates rose across the curve last month. Even the one year was up a basis point (0.01% - ok, nothing to write home about). The long bond rose from around 1.94% to end the month at 2.04%. As we compose this letter, the long bond is trading at 2.08%. The ten year has increased from 1.32% all the way to 1.53% today. Note that all these yields are well below the current rate of inflation, a situation that is not that unusual in interest rate history. Investors tend to think that bond yields "need" to be high enough to compensate for inflation, and maybe in a perfect world that should be so, but in reality, it is not.

These upward moves have provoked the usual hew and cry – investors expecting that *this time, inflation really will wreck the bond market* - despite perfectly good evidence showing that when rates were significantly higher February through May, the next direction was down. The market's schizophrenia around the inflation problem is readily apparent.

As stated last month, we're fans of the 'low interest rates for a long time' thesis. We're also starting to buy into the idea that recessions are becoming politically unfeasible. This could mean endless 'QE' in the form of bond buying by the Fed and low short term interest rates, interrupted by occasional attempts to 'taper'. We have in front of us the reaction to Fed Chairman Powell's latest words about tapering – namely a roughly 5% correction in stocks and a rise in interest rates. At some point, Powell will have to answer politicians who ask why higher rates are really necessary, when plenty of people are still not working. He will not have the opportunity to ask why large fiscal expenditures are necessary while inflation is running hot.

Note! Please review your Medicare benefits this month, especially your drug program. Enrollment starts mid October, and you may be able to make changes to reduce those expenses. Give us a call if you have any questions.

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