Marketline January 2022

Stocks:

Last month we wrote: "A correction would not be a surprise." Sure enough, stocks faded to start the year, with declines of 3.3% in the Dow, over 5% in the S&P 500, and a beefy 9% in the tech heavy Nasdaq. That's been the story of the last few months – tech returns have struggled to maintain momentum in the face of higher inflation and rising rates. This month was a doozy, though, marking the second worst start to a year in history for the Nasdaq, after 2008. Overseas stocks performed relatively well, with Canadian issues flat, Mexico's Bolsa in line with our Dow at -3.6%, and Europe rising 1.1%. Many advisors are calling for better performance from overseas stocks this year after a decade of lagging their US brethren. If that pans out it will likely be because the US market indices are saturated with technology companies, whereas Europe's are not. If tech corrects, it will be a worse drag on the US. But that doesn't mean that US industrials or US consumer stocks won't perform at least as well as their overseas brethren; it's all in how the indices are constructed.

Lately we have read a number of pieces pointing out that stocks actually perform fairly well when interest rates enter an uptrend. The problem is, the quoted returns generally are in the single digit range and are followed by horrific double-digit bear markets. So yes, the overall market might make progress while rates are rising, because there are plenty of companies able to raise prices to maintain profit margins. But the Fed tends to overstay in hawkish territory, dishing out too many hikes and causing the economy to collapse. Perhaps we'll avoid that this time around. An outcome more like 2000-2002, which hammered tech stocks but let value stocks perform well, wouldn't be too objectionable.

Most portfolios are overweighted in stocks, given the long, robust bull market. We were already correcting that imbalance at the end of 2021, but even after the negative action in January, we are able to trim larger portfolio holdings and sell some names outright, booking long term profits. Most recently, we've reinvested in bonds, which have also corrected. The result can be higher cash flow and less risk.

It's a bit too early for a full bore stock shopping trip – we need to see more of a correction. Even so, we're always looking for likely prospects. (For those interested, we use a variety of screening tools to find cheap stocks, but we also like the simplest of products – the daily 'decliners' list in the *Wall Street Journal*.) Last month we mentioned Cognizant, which we bought to replace Infosys. Currently on our watch list are a couple of restaurant stocks and Franklin Resources, an investment manager.

Bonds:

Yields rose again last month - but the yield curve also flattened yet again. This means the long end of the yield curve is not moving up in yield as much as the short end. This flattening is typical for this phase of the economic/interest rate cycle. We are approaching the actual date of a Fed hike, expected in March. With strong payroll numbers the other day, and even stronger inflation numbers, a hike is a given. The market has thoroughly discounted a 0.25% hike; if it's 0.50%, that may constitute a negative surprise. Meanwhile, overseas inflation is heating up too, so many jurisdictions will see higher interest rates.

Much of portfolio management is waiting. We are waiting for a shift in markets. Shifts – such as what is upon us now - are the moments that allow us to make changes that can benefit portfolios longer term. Although higher rates will cause existing bond portfolios to decline in value, excess cash can finally be deployed in new bonds at higher rates, and as noted above, we can also reallocate from stocks to bonds to lock in higher cash flows.

As far as where we are finding value, municipals are newly interesting since yields have retaken the 3% level in some instances. We have purchased the occasional federal agency bond – a market that hasn't been on our radar for at least two years. Corporate issues have been a bit slow to react to the rise in rates, but they'll get there. When their rates rise, we'll likely turn to higher quality corporates than we've been purchasing over the last several years. Last on the scale would be lower quality issues, which have held up extremely well so far. These quasi-equity securities need to see a greater sell off to pique our interest.

Marketline Monthly is produced by ***Cascade Investment Advisors, Inc****. We specialize in value investing for individuals. We apply our approach across markets, looking for low-priced securities that offer above-average potential. We use imagination and hard work to bring performance and personal service to our clients. Phone 503.703.3622 (Michelle); our website is www.cascadeinvestors.com. A full list of securities we invest in is available on request; mention of specific securities is not investment advice; such investments may or may not be profitable. Index returns quoted are price only.*