CORE Comments
ON PLANNING AND INVESTING FOR THE TWENTY-FIRST CENTURY

July 12, 2024

More Progress

Despite political uncertainties, especially after President Biden's alarming performance in the debate, despite weakening economic indicators, the stock market continues to rise. The stocks that have led the advance since last October, the large technology companies, continue to appreciate. Indeed, these stocks, including Microsoft, Apple, Nvidia, Amazon and Alphabet (Google's parent company) have been responsible for a significant portion of the total gain by all stocks. This concentration of gains among just a handful of the biggest names often suggests underlying weakness, weakness that presages a bear market in stocks.

A number of major central banks have begun to ease monetary policy, while the Federal Reserve has maintained its restrictive policy. Yesterday's very favorable inflation report will probably induce the Fed to begin its own monetary easing, likely beginning in September.

What will be the outcome this time? Of course, one cannot know, but I can suggest some possibilities. As I have written before, the business cycle has not been repealed. After the business expansion that followed on the Covid economic collapse will come a recession. When will this recession begin? The brief but very sharp Covid recession engendered enormous fiscal action during the last year of the Trump administration and the first of Biden's. Several trillion dollars of fiscal stimulus was enacted in those two years; executive actions by both administrations provided further relief and the Federal Reserve undertook monetary easing policies, all in an attempt—successful, as it turned out—to mitigate the painful effects of lockdowns and fear that Covid engendered.

The various legislative enactments and executive actions put substantial sums of money into the pockets of many Americans. The effect of federal largesse was a long run of spending by Americans, characterized after the fact as 'revenge spending.' After a couple of years, this spending emptied wallets, but that did not cause spending to slow significantly. In order to continue spending, many turned to their credit cards. However, by now, the emptied wallets have been joined by credit card limits and increasing levels of defaults in payments for credit card debts, car loans and the like. Just ask Walmart, Target and similar sellers of goods how things now stand with spending by their customers. It is weak.

By contrast to this argument about straitened consumers, consider the funds pouring into capital markets, especially the US stock market. Although Americans without high incomes are cutting their spending, wealthy Americans and many, many foreign investors are avid participants in this ongoing bull market. So far, we have not seen the limit to this inflowing capital to America's stock markets. Liquidity is more than robust.

By

Jack Mayberry

If one measures the effects of this gusher of liquidity, one sees that it has increased valuations of our stock market to remarkable and, probably, dangerous levels. By most measures, US stocks are priced more highly than all but the priciest ten percent of the time. This does not augur to well; such elevated valuation levels correct themselves and revert to well below the mean level of valuations. But when?

As is often the case, there are good arguments to be made for stocks continuing to rise or beginning to fall. I plan to stick with Nvidia, the company in by far the strongest position in the Artificial Intelligence arena. I also expect to continue to hold our positions in Japanese and in Indian stocks. The returns for our Japanese position are stellar; it certainly may not continue to appreciate at the same rate, but there is very little reason to sell it. In a different way, Indian stocks have been very strong and have very good long-term prospects.

At the same time, we hold defensive positions, including a good deal of money market funds and a hedging position in stocks. The money market fund provides us with ready capital for further investments, when and as…. The hedging position is in a fund that is short the Russell 2000 index, the primary measure of US small company stocks. Despite the gains this year in the S&P 500, the index measuring the major US companies, our short position in small company stocks has earned us a modest positive returns. Small companies are primarily domestic-oriented, by contrast to the aforementioned tech monsters, which generate enormous sales and profits outside America. As such, the small domestic companies are more immediately and adversely affected by the quite restrictive monetary policy of the Federal Reserve. And, when and as things get worse with the big companies, our hedging position will generate good returns.

For a few years, Core has held investments in gold—not physical gold, but in funds whose prices correlate precisely with the price of gold bullion. Core has also invested in Indian stock markets, as noted above. These are connected. I have written recently about the buying of gold by foreign central banks. A number of countries became concerned when they realized that sanctions on Russia after its invasion of Ukraine resulted in the freezing of hundreds of billions of dollars of Russia's investments in US and European securities. This stimulated central banks to buy more gold, not a readily sanctionable investment. In addition to central banks, many individuals, particularly in India, are avid buyers of gold. Their buying continues apace.

Yesterday's inflation report was very favorable and will likely incline the Federal Reserve to begin its monetary easing. The expectation after the report is that the Fed will begin to cut interest rates at its September meeting. The market response was to raise the price of long-term Treasury bonds, in which Core's portfolios hold a meaningful position. As the Fed begins its monetary easing, following other major central banks, long-term Treasuries will provide muscular returns.

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