

CORE Comments

ON PLANNING AND INVESTING FOR THE TWENTY-FIRST CENTURY

October 8, 2022

An Inexorable March Downwards

This remarkable—remarkably awful—year continues. The confluence of events--Russia's invasion of Ukraine, the continuing struggle with the Covid plague that kills many every day, world-wide inflation partly caused by plague-related matters, the profound threat to America's longstanding democracy by Trump and his mendacious minions, the horrible Supreme Court opinions already rendered and still to come from the empowered radical 'conservative' Justices—all these and more have rendered this a terrible period. In the context of these matters, to note that it has been an awful year in financial markets seems almost trivial. But I am charged with responsibility to safeguard your capital; to discuss it is my duty. First, the year so far. Then, what lies ahead.

At the end of the first nine months of 2022, the US stock market, as measured by the S&P 500, had fallen by 24 percent. If you measure by the Nasdaq 100, with its very big weightings in Apple, Microsoft, Google (Alphabet, as it now calls itself), Amazon, Tesla and the like, the decline was 30 percent. The broad index of all tradable US bonds (called the Barclays Aggregate, symbol AGG) had fallen by 14 percent. Thus, a conventionally balanced portfolio, holding 60 percent stocks (as measured by the S&P) and 40 percent bonds (as measured by the AGG) has declined by an awful 20 percent as of the September's end. Core's clients' accounts, while certainly unhappy, have lost far less than the typical balanced portfolio. This combination of big and simultaneous declines in stocks and in bonds is unprecedented. Indeed, for bonds alone, by some measures, the year so far has been the worst bear market since the mid nineteenth century. As I have written previously, one owns bonds as a counterweight to the variability of stocks; bonds typically rise in price when stocks go down. Until this year.

Without discussing the reasons for all this, let me move to my expectations of how things look in the year ahead. The Fed promises (threatens may be the better word) to keep raising rates until persuaded that inflation is certainly declining to its target rate of two percent. There is lots of evidence (with which I will not bore you) that inflation is already declining, but there is also evidence that it continues to rise. Fed Chairman Jerome Powell wishes to be compared favorably to Paul Volcker, the Fed chair who slew inflation in the early 1980s. Mr. Volcker's actions caused two recessions in those early 1980s. With those two recessions, he did manage to bring inflation down. Despite the human sufferings that recessions caused in job losses and the like, despite the asset price sufferings thereby caused (including a nearly 30% decline in stock prices), Mr. Volcker is widely praised for his work.

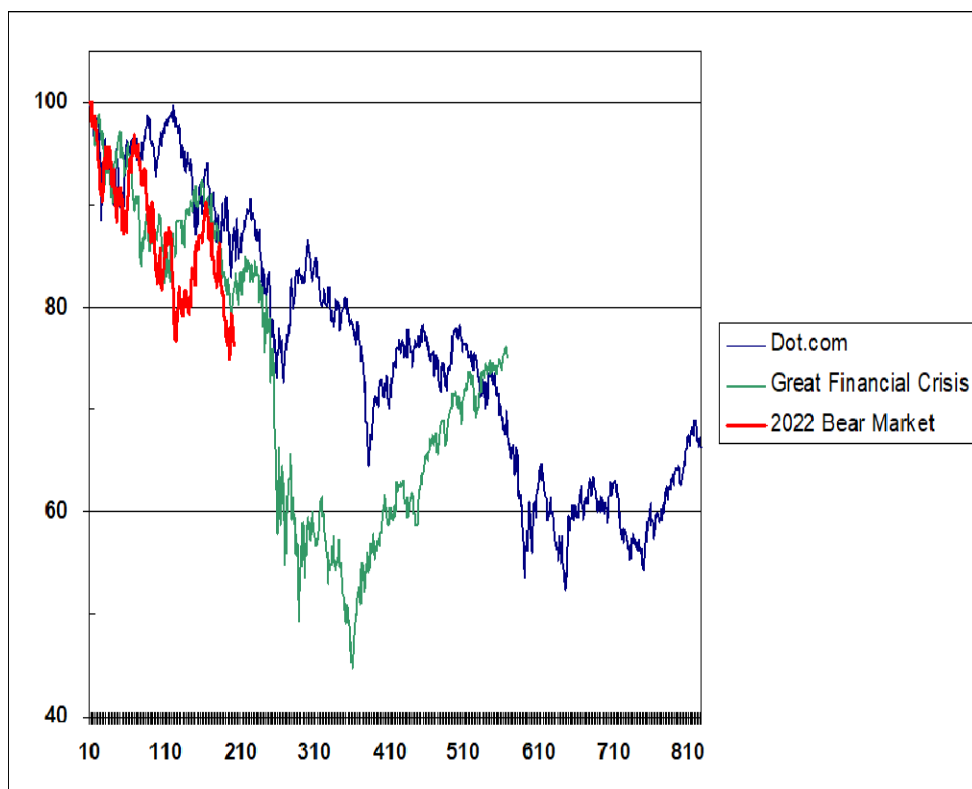
By

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The results that the Fed will bring about include a significant recession (one that

We recently changed our post office box in Sausalito to PO Box 866.

We have updated the chart below that shows the two major bear markets of this century and the current one, all rebased to 100 at the previous S&P high price. The x axis shows the trading days from the stock markets peak. Our 2022 bear market has moved lower since our last letter. It appears that stocks will go lower for a longer period of time.



may well have already begun), a large further drop in stock prices, and, because of the steep rise already in mortgage rates, a decline in home prices, probably bigger than experienced in the Great Financial Crisis of 2007 to 2009. Another result will be a very substantial rise in the prices of bonds, especially long-term Treasury bonds. As mentioned, this has been a terrible year for bond prices, but the year ahead will very likely be quite a good year.

The recession that the Fed is bringing about—Mr. Powell and other Fed governors refer to the inevitable ‘pain’ that their monetary tightening will cause—will crush demand, as is the explicit goal. That crushing of demand for goods and services will also reduce demand for borrowing. Reduced demand for credit causes bond yields to fall—one pays less for things not in demand—and for bond prices to rise. The terrible year for bonds so far will change. The twelve months ahead of us will bring economic pain but rewards for the holders of bonds, especially long-term Treasury bonds. But the recession will bring stock prices a good deal lower than they already have fallen. Only after the Fed stops raising rates and brings them down again will the stock market bottom.

Core’s investment approach.

The portfolios Core manages have suffered significant declines this year. I failed to appreciate soon enough what would be the effect of the Fed’s aggressive rhetoric and the persistence of its large rate increases. However, we have a large position now in your portfolios that benefits directly from stock price declines. We may continue to build this position, which increases in value as stocks fall further. In addition, as things roll forward, we will add to holdings in long-term, high-grade US bonds and reap benefits from the recession.

Nothing in this year has been easy. There is no reason to expect things become easier in the coming

months. However, history does provide a road map to what lies ahead when the Fed is so aggressive in its monetary tightening. I intend to use the guidance that history provides. There will be happier reading for you when you examine your investment portfolios.

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