StraightTalk
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Which Would You Rather?

The recent heat waves make me think of summers growing up, playing outside in my Fan District neighborhood until the streetlights came on and signaled it was time to go home. There were many games of stickball, two-hand touch football, and basketball - all set up and refereed by us, not by organized youth travel sports leagues. Often, as we walked to the playground or nearby school field, we would play the game, "Which Would You Rather?" Sometimes the game was which would you rather be, as in cowboy or Indian, astronaut or professional surfer - while other times the game was which would you rather have happen, as in death by shark attack or lightning strike. Well, that game of choice is where we find ourselves in the current economic situation. Put simply, which would you rather have, persistent, sustained inflation, or a Fed caused recession?

Before answering that question, it is important to review two important backward-looking facts, the first of which is outstanding corporate decision making, and the second of which is the opposite when it comes to our government. It would seem almost incontrovertible that, regardless of party, our government institutions have let us down, here and around the world. The ill-fated decision to close our economy (for "two weeks to slow the spread" which became at least ten times that long) wreaked unprecedented havoc on supply chains and labor markets – so much that, two years on, they are still not fully repaired. The good news is that they both are improving at a steady pace, and we can all now hope that "normalcy" may be just around the corner.

As an adjunct to the government edict that we all had to stay home, which by definition meant staying away from our places of employment, $5 trillion dollars were printed and handed out in various programs, with varying degrees of success. Anyone who has taken an Economics 101 class can tell you that doing so will cause, in short order, inflation. Of course, in the "which would you rather have" game - the question between creating inflation in the near future, or having a global depression in the current year – inflation wins, so in that context, printing the money was the right course of action. Predictably, most governments in the world hewed to the same script, and this is now a worldwide issue, albeit with some regional economic differences.

What is remarkable about that period is how quickly, efficiently, and successfully most corporations adapted and adjusted. Many companies in the U.S. had to contend with, not only running a business without employees at work, but also the very real possibility of no customers either. Faced with the potential loss of precious capital, creativity reigned, and e-commerce and remote work decisions were made, with capital deployed accordingly. Undoubtedly, the payroll loans from the federal government helped - and many companies not only averted disaster, they succeeded during unprecedented economic difficulty. One simple statistic from First Trust sums up this success quite succinctly. According to their research, for the two year period of March 31, 2020 to March 31, 2022 "The S&P 500 companies spent $1.5 trillion on stock buybacks, and another $1 trillion paying out dividends, *yet they hold the same amount of cash today as they did on March 31, 2020."* Read that sentence again – $2.5 trillion dollars spent, and they still have the same cash levels as before Covid. Indeed, in a world that looks more and more irrational with each passing day, owning the great corporations of America and the world seems to be the most rational thing one can do.

The reason for this recitation of the recent past is to simply point out that business activity was healthy before the pandemic, during the pandemic, and now, post-pandemic. However, government policy could well put the brakes on that activity, and the expectation of this has led to a meaningful decline in the prices of our great companies. You may have heard that the first six months of this year are the worst for markets since 1970, which although factually true, does not fully compare the two economic environments. There are similarities, of course, in that oil and gas prices are high, inflation is running hot, and Russia is relevant on the world stage. However, there are some key differences - namely, we have the capacity today to solve our domestic petroleum needs, rather than

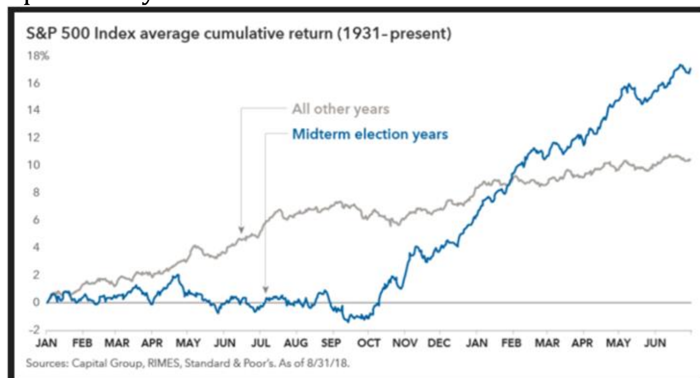
depending on imports, unemployment is quite low, not high, and much of the current rate of inflation will abate as supply chains work back to full strength, rather than remaining stubbornly structurally high.

However, the level of near-term uncertainty brought to you by your news source of choice seems almost astronomical, with both of the two feared outcomes being bad. Moreover, it appears that the choice between those outcomes is binary – either inflation continues to burn at unacceptably high levels, destroying the purchasing power of trillions of dollars in retirement savings – or, the Federal Reserve, now admitting their mistake, belatedly scrambles to smother the inflationary fire, thus plunging our economy into a recession.

Given that unsavory choice, both stock and bond markets have reacted in a predictable fashion, leading to heartburn each time you have opened your statement this year. This can create a lack of faith in the market's historic ability to repair and recover to new highs, which is what has occurred in every previous decline in history. Of course, what has happened in the past is no guarantee of what will transpire in the future, but it is a useful guide. *The trick is to stop thinking about your portfolio in terms of the stocks you own, and instead remember that they are companies.* Spend just a few moments thinking about the great companies you are currently a customer of - from your electric power and cable TV providers, to the stores you shop in, to the food, clothing and gas you purchase. Ask yourself if you fear any of them going out of business this coming year – or more importantly, if you fear ALL of them going out of business over that period of time.

In order to help you escape the negative news flow for just a short while, attached to this newsletter is a list of the companies that make up the Standard & Poor's 500 Index. I am not attaching them as an endorsement, or any sort of investment recommendation - but rather as an exercise to drown out the noise. Simply stated, your portfolio managers own many of these on your behalf, and the following exercise may be helpful to you. Look down this list of companies, and see how many names you recognize. As you do so, remember that these companies are among the largest, most strongly financed, best managed, and most innovative companies in the world today. Further, many of these companies have iconic brands that you and your family use every day. My simple exercise is to ask you to put a check mark next to each of the names you recognize, and ask yourself if you are planning to stop patronizing these companies. When you realize that you are not, and suspect that most other people won't either – you'll arrive at the conclusion that today's prices are not forever, and this too shall pass. As legendary investor Peter Lynch said, "The real key to making money in stocks is not to get scared out of them."

So as we turn our collective attention towards the final two quarters of the year, it is important to remember that markets are always forward looking, and most of the current news cycle is already priced into the market. It is also important to recognize that, in real time, market bottoms are a process, and that they are only a point on the chart in hindsight. It is quite possible that the late July rally means that the market has bottomed, but it is equally likely that we will see a retest of the June lows, and could go even lower this fall. The reason for this is historical, in that the second year of any Presidential term is different from the other three. These mid-term election years have a distinct trading pattern when averaged over time – and that average has translated to a market that goes nowhere for ten months, and then rallies sharply upward at year-end.



The chart above shows almost a century of these occurrences – with high and low inflation, and under Democrat and Republican presidents, in good economies and bad. We will have answers to the current big four unknowns this fall: the cadence of Fed policy, the rate of inflation, the balance of power in Congress, and the health of corporate earnings. With the market priced for the worst, any improvement for any of these could result in a surprisingly sharp rally.

At the end of the day, inflation is always an economic cancer, and it must be destroyed, even if that means causing a recession to do so. However, any recession that may come is likely just a pause for an economy positioned to continue growing in the future...

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