StraightTalk

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Is The Glass Half Empty, Or Half Full?

The question for long-term investors is never "what is today's news?" Instead, it is (or should be) "what will the news be a decade from now?" This longer-term focus requires two things that are hard to come by today. The first is the realization that bad news is immediate, easy to spot, and reported frequently, while good news often takes time to develop, is slow to be perceived, and is often ignored in today's sound-bite media environment. The second and more fundamental requirement is optimism – the belief that over time, things get better – which has been borne out by the history of humanity. Therefore, it all boils down to this fundamental investment question, "Do you see the glass as half empty, or half full?"

A quick sampling of news headlines would tilt most casual observers into the half empty camp - things like inflation, fears of a recession, supply chain snarls, incoherent government policy, the seemingly never ending Covid spikes, and now the rise of a new virus dubbed, of all things, Monkeypox. However, if one chooses to look for them, there are infinitely more positive news items, albeit less sensational than the aforementioned list. That list contains things like increasing technological productivity in the workforce, improvements in automation and artificial intelligence to make life easier, the rise of electric and self-driving vehicles, and globally, things like decreasing ozone depletion, declining child mortality, cratering poverty, rising literacy, and expanding access to all of mankind's accumulated knowledge on the internet.

More relevant to the investor, the half empty camp may choose to cite a recent decline in job openings, slowing payroll growth in May, coupled with slightly lower auto sales in the same month, oil prices near all-time highs, and gas at the pump at all-time highs. These all are statistics from *now* (actually last month) which are dutifully reported by the financial news machine, however, an investor prefers to look for statistics that indicate what may lie ahead. So, the glass half full view might include items like inventories at historic lows, rising productivity, an improving trade deficit, expanding manufacturing, a shrinking Federal Reserve balance sheet, and a surge of insider buying. This last one is important, because the people who make decisions in corporations generally have a feel for how the next 12-18 months looks for their businesses, and what they do with their own shares of stock is an excellent leading indicator. According to The Washington Service, which tracks such activity, over 1,100 corporate insiders bought shares in their companies in May, with the number of buyers exceeding sellers for the first time since March of 2020. I'm betting you did not see that data point on your financial news feed anywhere.

As I have written about for years, the average decline in any year since 1980 has been about 14%, according to Standard & Poor's research. On the morning that I am typing this, the S&P 500 is down 14.08% - *a completely average event.* However, it goes without saying that the last two years have been anything but average! We experienced the first global pandemic in our lifetimes, saw the resultant decision to close our national economy (in my belief, the largest policy mistake since Herbert Hoover was President,) which then required the ensuing printing of trillions of dollars to fill the economic hole, and we developed and distributed a novel vaccine.

The sum of all of that activity? We made it through without a depression, or even a recession, the market is still up 20% since January of 2020, and earnings are up even more; 34% higher as of today.* Before we collectively feel defeatist for not seeing the positives, and instead focusing on the negative – I suggest that it has always been this way. In fact, the British historian Thomas Babington Macaulay wrote back in 1830, "On what principle is it, that we see nothing but improvement behind us, yet we are to expect nothing but deterioration before us?"

Perhaps we all like to be miserable, or at least uncomfortable when digesting "news." Perhaps there is a national fear of "losing all of our money" or maybe it has just become habit to seize on the political, economic, or social change we don't like as an argument for…. *it's never been this bad.*

However, I think the best is yet to come. The profound improvements in life over the next decade from technology gains, the eradication of many of today's diseases due to biotech and life science discoveries, and the relentless march of freedom around the world, even as a few bad actors head in the other direction – these long-dated, consistent improvements will alter life as we know it for the better.

Returning to the markets, if you pause to think about for a moment – it is only logical that we might have some price giveback based on the outsized gains after the onset of Covid. Using the most widely tracked index in our country (if not the world,) the market doubled off of the coronavirus lows. On March 20, 2020, the S&P 500 closed at 2,304, and it finished last year at 4,706.* It is not often that the market doubles in less than two years, and a reasonable person might expect a bit of cooling off after such a move. Of course, a routine, garden variety, ordinary, historically average pullback is never described as such by the pundits. All of the doomsday fear peddlers crawl out from under their rocks for TV and print interviews about how "this time is different" and we should all prepare to live in a hardened bunker with canned goods and a weapon. Or worse – they start hawking gold or bitcoin as the answer to the temporary price declines of the great companies that have thus far always proved just that - temporary. History clearly shows there are no market declines from which there has not been a full recovery.

Indeed, a glass half full investor might look at the fact that the prices of those companies are now below where they were for the back half of last year, and more importantly, are down when earnings are not. In any other area of our economy when prices are lower than last year, this is described as either a bargain or a sale. Only in the stock market is it portrayed as an imminent disaster that could ruin your financial future.

As I have mentioned in recent conversations, my expectation is that we may well have a recession, but I do not expect one this year. The economy is still moving forward at a brisk pace, consumers are still spending in an effort to catch up on what was paused during Covid, and help wanted signs appear in business windows across America. This is not typical of an economy peaking and beginning to cool off.

That said, the dual combination of a business cycle that will ultimately need a breather, coupled with the increased financial friction of higher interest rates could tip us into a mild recession late next year, or in early 2024. It is far from a foregone conclusion, but it certainly remains a possibility. If one were to occur, it would clear out those businesses not positioned well in our economy, and will allow any nervous investors to capitulate and cash out. That kind of selling and the price decline it would create should set the stage for what I believe to be the third leg of this secular bull market that began in 2012, which will carry us to new highs by the back half of the 2020s before ending.

As for the near term and the summer news cycle, I would not expect much to occur during the "dog days of summer." As is so often the case, life tends to slow down in the summer months, as trading volume typically declines, and clients, traders, advisors, and investment managers take vacations and stop focusing on markets for a short while. This summer has the additional dynamic of three large economic news questions hovering over the market, which I do not expect answers to until after the summer has concluded. Those three questions are:

1. Has inflation peaked?
2. What did the Fed do in their June, July and September meetings?
3. Will we avoid a recession in 2022?

Knowing the answers to these questions this fall should offer some clarity, and allow markets to break out of the summer trading range. Until then, get to a pool, beach, or lake, and enjoy dining out – but whatever you do, stay away from financial news and predictions that this time is different. It isn't…..this too shall pass.

**Market data from Standard & Poor's Research*

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