



## Nowhere to Hide

*-J. Kevin Meaders, J.D.\*, CFP®, ChFC, CLU*

**May, 2022** — If you've been reading my letters over the last year, then you know we have been expecting a major market correction. Last June I wrote:

Granted, the NASDAQ is heavily tech laden, and the pandemic has certainly sent some companies in the tech sector to meteoric highs. In just over a decade the index has soared from 1900 to just under 15,000! It looks like the dot.com boom on steroids. And you know what that means, right? Exactly. It means the subsequent crash will be just as dramatic.

The more I look at that chart the more I am convinced we are in for something disastrous in the NASDAQ, just as in 2000. A 50% drop? Probably. And it will drag the Dow and the S&P down along with it—retail investors don't differentiate much when they're dumping equities in a panic.

Less than a year hence, that prediction is shaping up right on track. No one can say they didn't expect it, or weren't at least warned.

2022 has been a tough one for investors no matter where they tried to take refuge. So far this year, the Dow Jones Industrials has lost almost 10%, the S&P 500 almost 13%, and the NASDAQ upwards of 20%.

Worst of all, the historically safer positions like high quality corporate bonds and government bonds have all suffered relatively large losses this year. The Barclay's Bond Aggregate, which no one can beat consistently over time, has lost an astounding 9.4%.

And for that money languishing in cash, inflation has eroded about 5% to 8% so far this year.

To make matters worse, Congress continues to push for more spending. Can't they see that this is exactly what they should NOT do?

As we have been expecting for some time now, the market is starting to show cracks, and we predict that it will get worse. For stocks, at least.

We've seen this cycle play out many times before and here is how it goes (in case you forgot):

You can just jump in anywhere in the cycle so let's start with near zero rates and a ridiculously overpriced stock market puffed up by \$7 trillion of new money.

Inflation starts to show itself and finally reaches a level that makes front page news. This puts pressure on the Fed to raise rates. And they do, starting with .25% and then increasing the rate every other month. (Obviously, this is where we are now in the cycle).

Today, as expected, the Fed raised the benchmark rate by 50 basis points, or 1/2 of 1%. As of right now, the Federal Funds rate is at .75%. I think we will see 2.5% before the end of the year.

In the interim, bond prices drop because investors are looking to buy newer, higher yielding bonds that will soon be issued as the higher rates take effect. This is exactly why the most conservative portfolios, which are highly invested in bonds, have taken a beating this year. It doesn't matter the quality of the bond; all bonds are guilty. But don't worry; it won't last.

The chart below represents US AAA-rated corporate debt: the best of the best of the corporate world. As you may know, AAA is the highest credit rating possible.



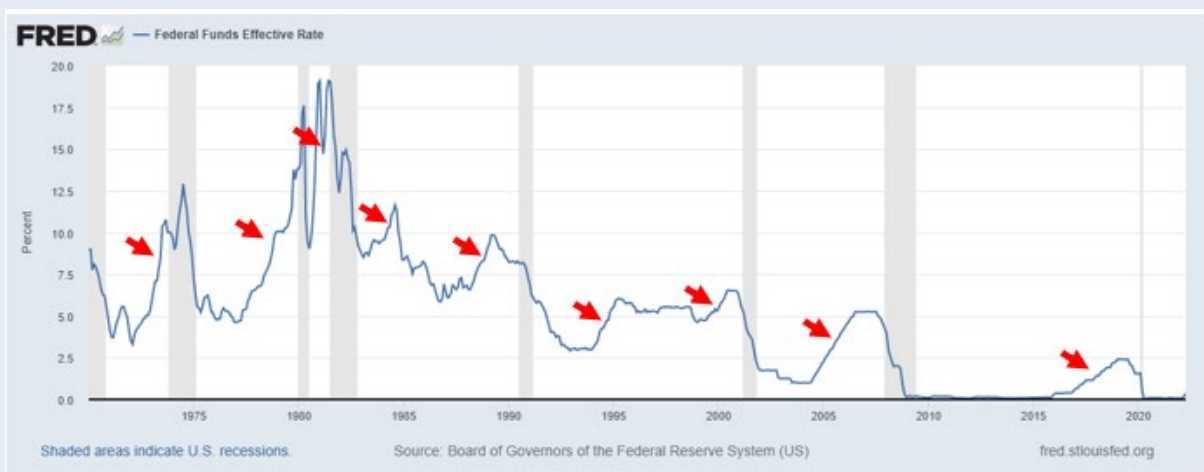
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Returning to the cycle, the Fed continues to raise rates until eventually stocks reach a breaking point and collapse. We have seen the NASDAQ pull back by 20% off its highs, but the other shoe hasn't fallen yet. When it does, the Fed will reverse course and drop rates again. This will be a boon for bonds, and they will rally at least as much as they have dropped. Oftentimes much more.

Finally, with zero rates again and more stimulus, stocks will be attractive again and start a new boom. And then inflation picks up, and the whole cycle starts anew.

One reason that any point in the cycle is not so easily recognizable is that the cycle can be so long—perhaps ten years or more. Where we are in the cycle today though is pretty darn recognizable. We are at full interest rate lift-off, marked in red arrows in the chart below which represents the magical base interest rate, since 1970.



Note that the grey lines indicate recessions, which of course occur after a severe stock market correction. This looks to be what we are headed for again—as I know you are sick of hearing.

Even though this is one of the worst macroeconomic environments we have seen in 40 years, we at least have some idea of how it plays out. Our holdings of gold, silver, oil, and aerospace and defense have had a countering effect on dropping stocks and bonds, and since our bonds are short term, they have also been less affected.

Now the question becomes "what interest rate will be needed to really crash the market?" Go back to the chart again and look at all the peaks in the rate. This was the rate needed to crash the market, and why the rates reverse so sharply. Oops! Note how that rate is lower and lower since 1982. I would be surprised if we saw 4% again.

Remember, we are still looking for a 50% overall drop in the NASDAQ and 30% or more in the other indices, just as in 2000. And don't forget the Buffet Indicator. We are watching all of these things on a daily basis and feel pretty good about our positioning. Everything seems to be going exactly as we expected—save the Ukrainian crisis of course.

One of the most important factors in a market downturn is quality—quality of stocks and quality of bonds. Often, investments that are highly leveraged or of poor or questionable quality do not survive a major correction. Remember Enron, Bear Sterns, Lehman Brothers, E.F. Hutton? Rest assured, we built your portfolio(s) with exactly this in mind.

If you are the least bit concerned, I sincerely ask you to contact me. One of the most important services we can provide is to simply be here for you when times get tough. Please know that our whole team is standing by to help in any way we can—me most of all.

As always, we appreciate your loyalty and friendship.

My very best,

J. Kevin Meaders, J.D. CFP, ChFC, CLU

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*The **Bloomberg Barclays US Aggregate Bond** Index, which was originally called the Lehman Aggregate Bond Index, is a broad based flagship benchmark that measures the investment grade, US dollar-dominated, fixed-rate taxable bond market. The index includes Treasuries, government-related and corporate debt securities, MBS (agency fixed-rate and hybrid ARM pass-throughs), ABS and CMBS (agency and non-agency) debt securities that are rated at least Baa3 by Moody's and BBB-by S&P. Taxable municipals, including Build America bonds and a small amount of foreign bonds traded in U.S. markets are also included. Eligible bonds must have at least one year until final maturity. But in practice the index holdings has a fluctuating average life of around 8.25 years. This total return index, created in 1986 with history backfilled to January 1, 1976, is unhedged and rebalances monthly.*