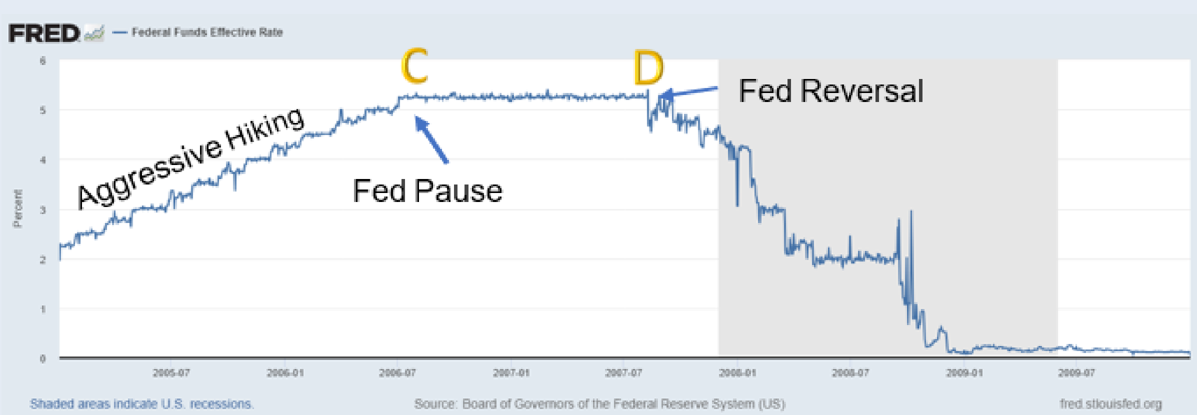
The Tail of the Dragon

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

December, 2023 — Last week the Fed announced it will hold rates steady again, much as we expected. Inflation has slowed, true, but it is still more expensive to live in America today than it has ever been. The recent $16 McDonald's value meal photo made headlines worldwide, and has reminded folks that inflation is not "transitory" after all. It's here to stay.

The recent rally in the stock market this year has been impressive and generally follows this trend at the tail end of a cycle—when interest rates are near their peaks, and everyone is hopeful the worst is over. I want to revisit the lead up to the 2008 crash. Here again, is the NASDAQ from 2005 through 2009, and the Fed Funds Rate during the same period.



If you take a look at “A” on the top chart, the NASDAQ was a little over 2000 and just one year later, “B”, the NASDAQ had melted up to over 2800 before it finally melted down to just over 1200—quite a ride.

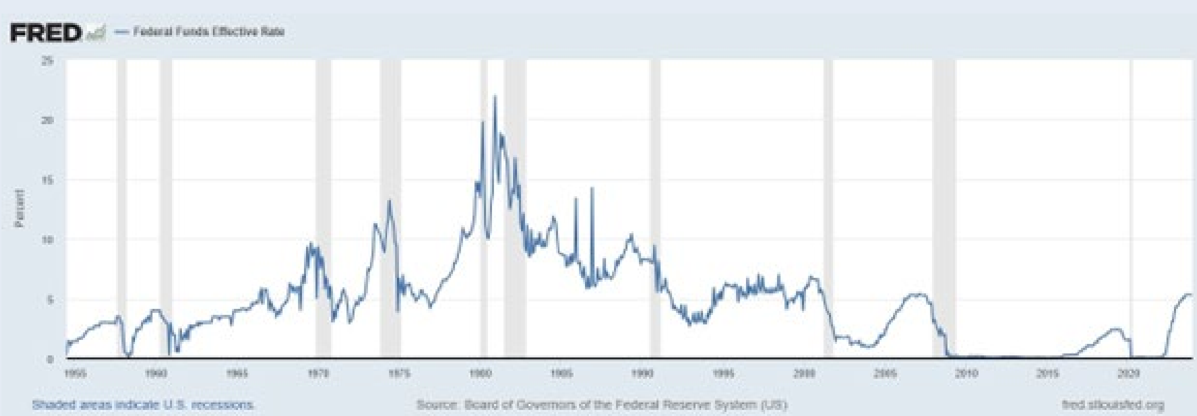
NASDAQ – last 2 years

The chart above shows the NASDAQ for the last two years, beginning at 15,000 and currently around 13,200. Investors in the NASDAQ in the last two years have had a wild ride, and are still down about 12% for that period.

The tail end of the bull market is often like a whipsaw effect. Professional investors look around and wonder why? “Who in the world would invest at these levels?” Remember Greenspan’s famous “irrational exuberance” comment? We are there again.

Also, a great deal of market growth has been due to the media hyping the Fed’s idea of a “soft landing.” Since World War II, the Fed has managed to arguably pull off a soft landing only once!

I know there are many TV pundits now trying to redefine what “soft landing” and “hard landing” mean and the relative degrees of “softness” and “hardness.” This reminds me of freshman intro to philosophy. Forget all their hype: look with your own eyes and think with your own brain.



If you look at the Fed Funds chart above, you can see how many times they raised the rate and then quickly and sharply reversed it. Stop and think: "why would they do that?" Because they overshot it and crashed the market. Those are NOT soft landings—no matter how you try to redefine it.

Also, you've got to remember the source of all this "soft-landing" hyperbole. Who is behind it, and what could possibly be their motivations?

Again, think for yourself. Is it in the interest of ANY of the big wall street firms for you to sell? What about mutual fund companies? What about the media who takes in billions of marketing dollars from these firms? If you were to sell out of stocks and go to 5.35% two-month T-bills, for instance, you might not be tuning in to the market report as much.

In fact, in some circles, we are already hearing about interest rate drops. That's right, they're already talking about lowering rates. Well, if you look at history, they are probably correct—except not because the market had a soft landing, because like every other time since World War II (expect one), it was a hard landing.

Thankfully, at least one of my readers has taken heed:

> "Warren Buffett's firm Berkshire Hathaway sold $28.7 billion of stock in the first three quarters of 2023 in a move that some economists have interpreted as ringing alarm bells for the American economy.
>
> According to the company's earnings, the Nebraska-based firm of the legendary investor and billionaire, known as the Oracle of Omaha, sold a net $10.4 billion of stock in the first quarter of the year. In the second quarter, it sold close to $13 billion of shares and bought less than $5 billion. In the third quarter, it sold about $5.3 billion worth of stocks."

The article continues:

> "As Buffett is considered one of the greatest investors of all time, as well as one of America's richest men, his moves are closely observed and analyzed.
>
> For Steve H. Hanke, a professor of applied economics at Johns Hopkins University who served on President Ronald Reagan's Council of Economic Advisers, Buffett's and Berkshire Hathaway's "recent lightening up on stocks and accumulation of a pile of cash—$157 billion—is consistent with the fact that stocks are relatively pricey right now."
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> But it's also, crucially, a sign "that a recession is right around the corner," Hanke told *Newsweek*.
>
> "The money supply of the United States, broadly measured [M2], started contracting in July 2022, and has been falling like a stone," Hanke said. "Since last year, the U.S. money supply has contracted by 3.3 percent."

> According to Hanke, there have been only four periods in U.S. history—in 1920-21, 1929-33, 1937-38 and 1948-49—in which the money supply has had significant contractions."[1]

I don't know Professor Hanke, but I know Professor von Mises, and this is exactly in line with what the Austrian School of Economics has been saying from the start: Monetary expansion creates a boom – monetary contraction creates a bust. Higher interest rates create monetary contraction.

Our "landing"—whether soft or hard—is yet to come. Apparently, age has not dimmed Mr. Buffet's insight. After all, I first learned about the Fed-created boom/bust cycle from him!

What no one knows, including the illustrious Oracle of Omaha, is exactly when the bust will occur. Going back to our charts on the first page again, take a look at the second one—specifically from point "C" to point "D". From the time the Fed stopped raising rates in July 2006 to the time they started lowering them in July 2007, a full year passed, and the NASDAQ reached a new all-time high, point "B".

Likewise, the Dow Jones Industrials just hit an all-time high, finally breaking its last record set back in January 2022. Dow investors are thus just now getting back to where they were two years ago, and NASDAQ investors are still down about 12% since then. Nonetheless, those indices have no doubt melted up recently, much like they did in the months preceding the crash of 2008.

Our strategy has not changed—we were just a little earlier than Buffet, but luckily missed out on much of the turmoil of 2022. But now we believe we are nearing the peak of interest rates and the time may be nigh for a shift to longer term treasuries.

Indeed, where appropriate, we have just moved a portion to 10-year treasuries. Our yield is a little less, but longer-term treasuries usually rally significantly when rates begin dropping. The yield curve is still inverted but is slowly flattening. And the cycle continues…

We are pleased to invite you to a Live and In-Person Lunch n' Learn on the State of the Market on **Thursday, January 18 at 11 am** in our first-floor classroom, adjacent to the water fountain. If you have never come before, I especially urge you to join us. We will cover these issues and more, share some lunch from Apple Spice, and join Jennifer Scholten and Penni Evans for some BINGO with some delicious and glittering prizes.

I hope to see you there!

From all of us at Magellan Planning Group, Magellan Tax, and Magellan Legal, we wish you and yours a very safe, healthy, and happy holiday season!

My very best,

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

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[1] https://www.msn.com/en-us/money/markets/warren-buffet-selling-287-billion-in-stock-rings-alarm-bells-over-economy/ar-AA1lkOIv