Magellan Planning Group, Inc.

Waiting is the Hardest Part

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

September, 2023 - Today it seems as though there are two types of investors: those who are imminently waiting for a market correction, and those who just don't have a clue. It is easy to see why those who are not students of history can be easily misled by mainstream media. After all, do you really expect Wall Street to tell everyone to sell? That has never happened; and it never will.

In my opinion, this is why the Austrian School of Economics is not promoted in college, or anywhere else for that matter. This is an individualist school that requires critical thinking in the face of established dogma. The Austrians apply observation to theory. For me, there is no doubt the Austrians have it right.

It is not that this school of economics has anything to do with the country of Austria per se, but the theory developed there as a result of the monetary conflagration of the Weimar Republic set up by the Treaty of Versailles after the onslaught of the Great War.

Anyone managing their own money—and especially those managing others—should be intimately familiar with the monetary theory of the trade cycle (MTTC) as developed by Ludwig von Mises, one of the leading scholars of the Austrian School of Economics. Why? Because it, and only it, "fits" perfectly the observations in real space and time. In his magnum opus, *Human Action*, Mises wrote:

> The wavelike movement affecting the economic system, the recurrence of periods of boom which are followed by periods of depression, is the unavoidable outcome of the attempts, repeated again and again, to lower the gross market rate of interest by means of credit expansion. There is no means of avoiding the final collapse of a boom brought about by credit expansion. The alternative is only whether the crisis should come sooner as the result of a voluntary abandonment of further credit expansion, or later as a final and total catastrophe of the currency system involved.

Does this not fit the historical facts perfectly?

One can easily see this boom/bust cycle by looking at one simple chart. Not a chart of the stock market; but a chart of the Federal Funds Rate, which is the base rate for all other interest rates. Lower rates cause monetary expansion; higher rates cause monetary contraction. Enough contraction causes a market correction. Even more causes a recession.

Fed Funds Rate Since 1955

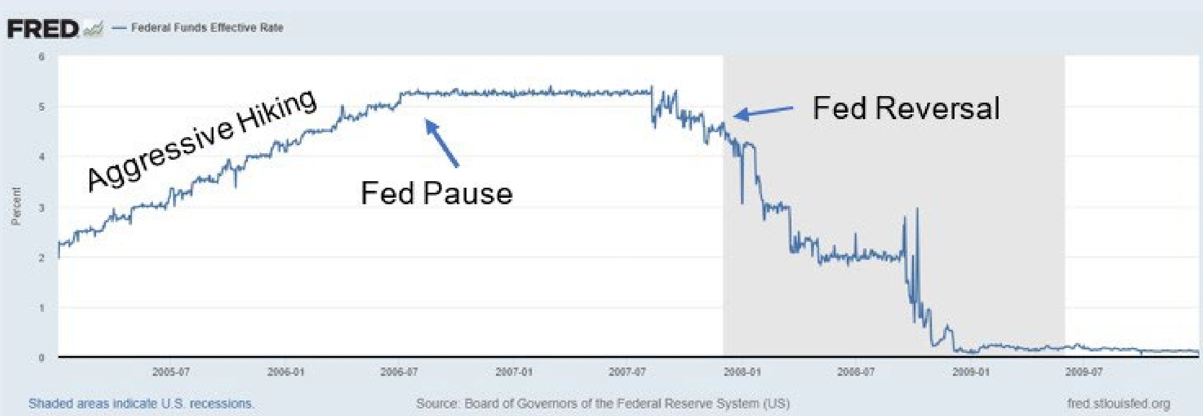
The chart above shows the Fed Funds Rate since 1955. Notice the grey lines running vertically. Those lines indicate a recession. In some cases, such as in 1987, there was not an official recession, but there was certainly a market correction.

In most cases, however, you can clearly see a rate hike, a sharp rate reversal then followed by a grey line (recession). In almost every instance, a hike in interest rates is followed by a significant stock correction—whether it is labeled a recession or not. This is the main takeaway here.

Let’s focus in on the NASDAQ from 2005-2009. We all remember what happened in 2008 and the terrible recession that followed.

During 2005 and up until July of 2006, the Fed was aggressively hiking rates from its lows after the dot.com market crash of 2000, the previous super-cycle.

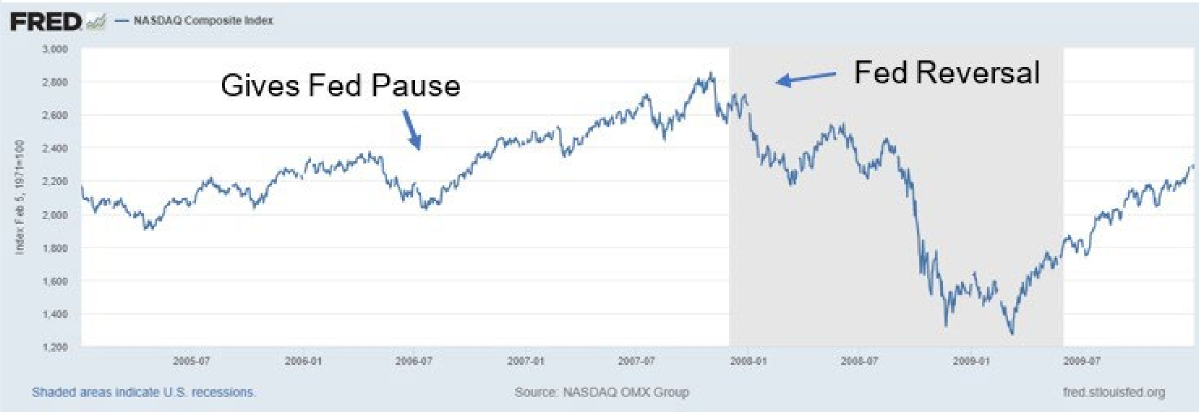
Fed Funds Rate 2005-2009



Suddenly, in July of 2006, the Fed abruptly halted rate hikes. They paused for more than a year before they reversed their rates. Why?

Well, take a look at the NASDAQ during that some period. In July of 2006 you can see there was a relatively significant pullback. This frightened the Fed and gave them cause to pause.

NASDAQ 2005-2009

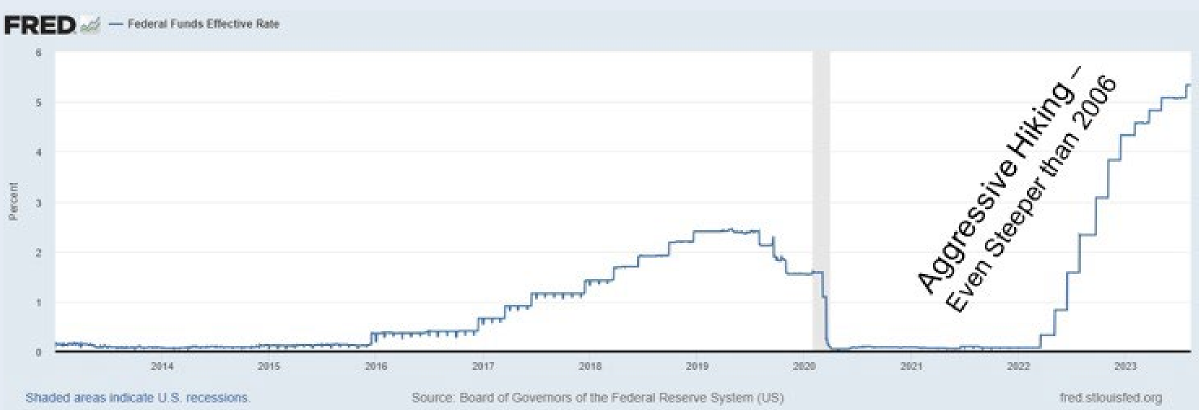


But even though they paused, the damage had already been done. By the end of 2007, stocks started dropping sharply, and the Fed reversed their position—as they always do.

Now let's take a look at where we are today. As in 2006 and 2007, the Fed has been aggressively hiking rates. This has been to fight the inflation that was caused by all the helicopter money during and after the pandemic.

This time, however, the Fed rate hikes have been even steeper and sharper than they were back then.

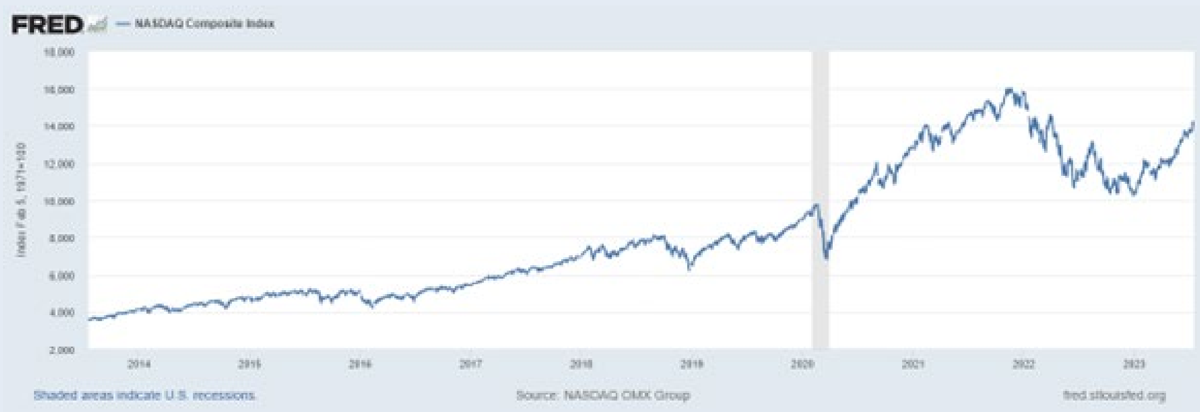
Fed Funds Rate Last 10 Years



Even though the Fed has started to curb their rate hikes for now, inflation remains pretty sticky. The absurdity of spending almost another trillion dollars in made up money (Inflation Reduction Act and CHIPS Act) to help the economy will do nothing but make inflation worse. We will never see prices go back down, only up. Not because things are more expensive (which is what it looks like to the average person) but because our dollars are worth less.

Finally, if we look at the NASDAQ for the last 10 years, you can see that it's been full tilt since the pandemic recession of 2019, but then last year it took a significant downturn. Though obviously 2023 thus far the market has regained some of those losses.

NASDAQ Last 10 Years



Could the 2022 selloff be the precursor to another 2008-style crash? Could this be the same indicator we saw in July of 2006? Then, the Fed paused. Today, they have yet to pause. Talk on the street is that we are in for about four more quarter point hikes, to occur at every other Fed meeting.

But here's the thing. Even if the Fed pauses, it is our belief that the damage is already done. Just as in 2007, the pause didn't matter much. The market crashed anyway.

This is exactly where we believe we are today. Somewhere between July 2006 and the crash of 2008. Interest rates are higher today than they've been in 22 years. What could go wrong?

Anybody born before 1980 should remember two instances rather well. For now, it is just a waiting game. And I know that sometimes waiting can be the hardest part.

As always, there are no dumb questions. Please contact me with any cares or concerns.

Our very best,

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