Weekly Capital Market Comments

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NORTHEAST SEQUOIA
PRIVATE CLIENT GROUP

Time Is A Flat Circle

Following an attempt to console the second of my three children (soon it will be three-for-three) in coping with the cancellation of their Fall 2020 college soccer season, I found myself reading a sobering article written by Brandon Anderson, a writer for the Tarheel Blog entitled, "The dominoes for the 2020-21 NCAA plan have started to fall." The most formidable aspect of the article was not how the author methodically detailed the ultimate demise of college sports for the rest of 2020, but rather was the last sentence of the article, "**Time is indeed a very flat circle."** This of course brought me back to the first season of True Detective. And there, I need to thank my friend Tripp for first introducing me to that series; and if as coincidence would have it, Tripp graduated from UNC Chapel Hill! But back to the theme of this week's note. Any philosophy major will quickly draw a straight line to Nietzsche's doctrine of eternal recurrence, but in our opinion, it also describes what pundits and investors should ultimately expect of capital markets going forward, because memories are short, and investors rarely learn from their mistakes. As Matthew McConaughey's character, Rustin Cohle utters during an interview, ***"Everything we've ever done, or will do…we're gonna do over, and over and over again."***

The current '20 earnings multiple for the S&P 500 is a whopping 26.5x. Even the forward 12-month multiple is at an elevated 21.8x, which is over 2 standard deviations wide to the long-term average (dating back to 2001) of roughly 16x. Given this valuation backdrop, we need to cross our fingers and hope analysts are correct about a "V" recovery for both the economy and market. But even if we look at expected 2022 operating earnings of $175 per share, we observe only a 2% annual growth rate from the $165 per share in 2019. And using earnings of $175 two years out, the S&P is currently trading at 18.2x, which is still 2-turns wider than the long-term average. Further, while corporations continue to withdraw 2020 earnings guidance, or "kitchen sink" their 2Q20 earnings results, strategists and talking-heads will look past this, citing no inflation, a zero interest rate policy (ZIRP), and that ace-in-the-hole phrase, "the stock market is a discounting mechanism." Yeah, we've heard that before, and have even used it under certain conditions. But we don't think this is one of those times. On an extended holiday are the bond vigilantes, as fixed-income investors have no choice but to rummage for yield, as the Fed seems willing to backstop any credit, thus compressing investment-grade and high-yield credit spreads down close to their long-term averages of 36bps (or 0.36%) and 550bps (or 5.5%), which is 120bps and 450bps tighter to those observed at the height of the market draw-down in March 2020.

So it should be no surprise that investors continue to rationalize overvalued equities (mostly growth/FANG), and continue to bid up bonds with reckless abandon. And why? Because as the theme of today's note suggests, they are programed to act irrationally over, and over and over again, just as they did in past bubbles of '29, '87, '00 and '08. And mind you, all of this is happening despite a laundry list of negative geopolitical headlines, the deepest recession since the '29 Depression, and a Presidential Election that is only 115 days away.

But with the retirement of our clients at risk, or the education of their children at stake, we opt to be more conservative and pragmatic. We see no need to whole-sale allocate into equities in the near-term, unless a vaccination for COVID is discovered, re-openings reopen again, or the recession starts to run its course.

For equity investors with longer-term goals, we continue to suggest dollar-cost averaging into either well diversified portfolios, or highly specified equity portfolios that may barbell (good vector/bad vector) the ultimate trajectory and outcome of the COVID pandemic, or the duration of the recession. For investors and clients with a shorter time

horizon, or those moving into the distribution phase, we urge shorter-duration bond portfolios as well as credit worthy preferred equities. Municipal bond portfolios should also be short in duration when buying at current values, whereas cash value continues to afford many clients financial balance as well as a multipurpose financial planning tool.

We'd love to hear your thoughts.