This is Not the Crash You're Looking For

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

February 26, 2018 — If you've been following my letters in recent months, then you know we have been—and still are—expecting a market crash in the not-too-distant future. And unless you've been on a cruise in the south pacific, then you no doubt witnessed the 2,000-point "correction" the week of February 5th.

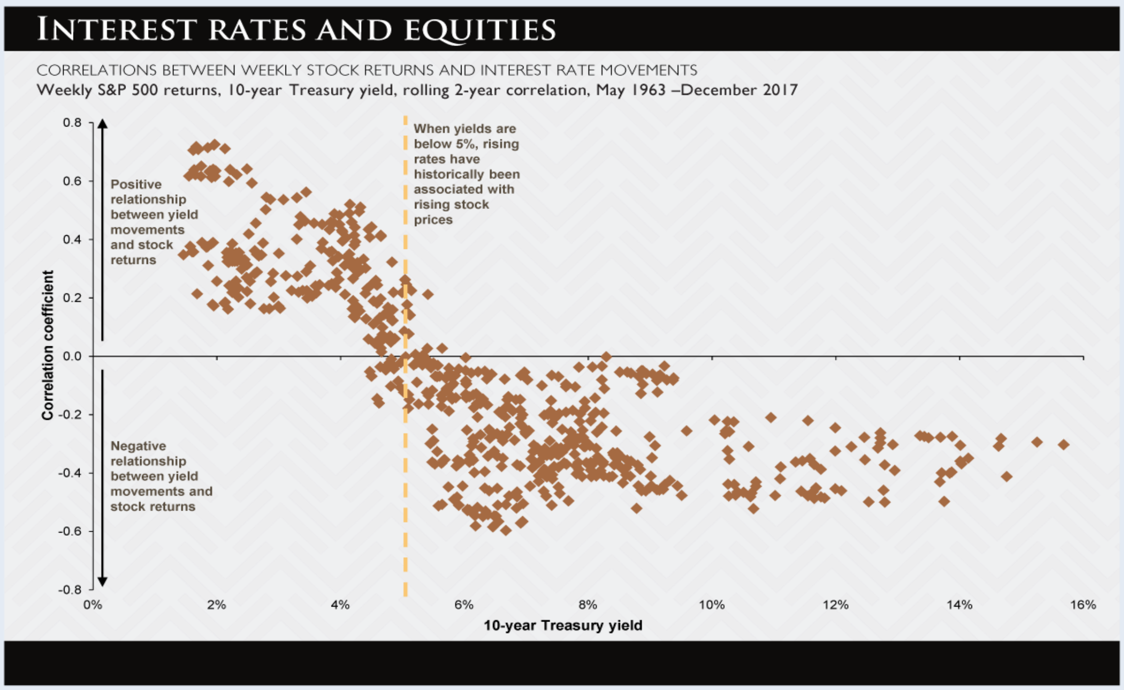
Quite frankly, the correction comes with some relief for me—I knew we were in for something. In fact, we used it as a buying opportunity for cash that we had on the sidelines for new clients. The chart below illustrates the Dow Jones Industrial Average for the last 12 months, as of February 22, 2018.

Note the mountainous growth followed by the steep crevasse to the upper right. It bottomed out a little under 24,000 and has already recovered 1000 points. This is a retrenchment, and retrenchments occur when too much ground is covered too fast.

One of the criticisms of aggressive military commanders is their tendency to push the battle lines forward beyond the lines of support, thus exposing their flanks to the enemy. To correct the issue, it is necessary to stop, sometimes reverse, and dig in, or entrench. Thus begins a period of retrenchment.

The markets are no different. Too much growth for too long makes investors uneasy. Look at that massive run up again, from 20,500 to over 26,500 in just ten months. Something had to give, and inflation fears sparked the selloff. Why? Because headline inflation means that the Fed will continue to raise interest rates, and often, if not always, this leads to a market crash. But as you know, this is exactly what we have been expecting for some time.

The Fed will continue to raise rates and unwind its balance sheet—essentially destroying money that it had previously created—until the market crashes. From the ether it was borne, back to the ether it returns. But the big crash is not yet imminent; this market retrenchment is not that crash we've been looking for, and we still point to late 2019 as the fateful period.



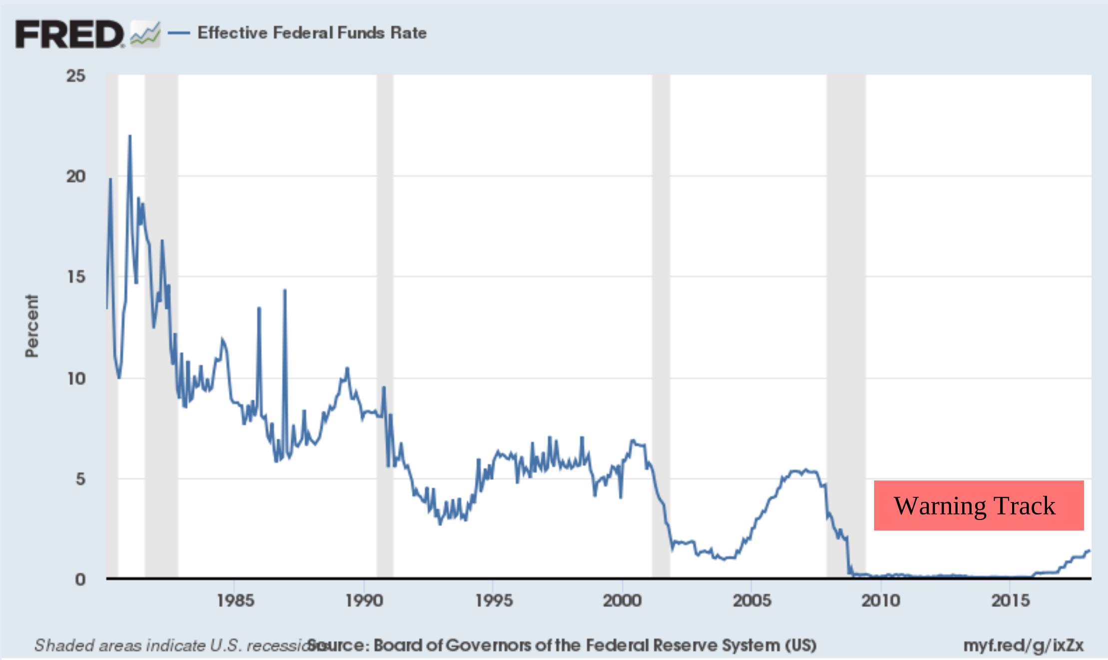
Rather than look to a specific date, however, we look at specific conditions, particularly the Fed Funds Rate and the ten-year treasury yield. The following chart tells a valuable story. It shows the relationship between the 10-year treasury yield and stock prices. Since May 1963, when yields are below 5%, stocks generally do well. Conversely, when yields are above 5%, stocks generally have negative returns.

We must also consider the fact that during the above stated period, interest rates experienced all time highs, especially during the Carter years after Nixon took us off the gold standard in 1971. I think it is logical to assume that our current economic conditions, i.e. historically low interest rates, could produce a negative result as low as 4%. You can see from the chart above that negative returns have *never* occurred at this rate—at least since 1963. Currently the 10-year treasury rate is just shy of 3%.[1]

[1] 2.87% as of February 21, 2018. Federal Reserve System.

Higher treasury yields would indicate a dropping price of the treasury itself. This is the result of two things: investors prefer to stay on the shorter end of bonds (like we do), and investors are moving assets out of dollars to take advantage of a more appealing international market. Both of these make perfect sense, and really speak more to a bullish, rather than bearish, global economy.

Treasury yields are mostly determined by the price of the underlying treasury, which is in turn determined by supply and demand. The Fed Funds Rate, however, is dictated by the Board of Governors of the Federal Reserve System. This is our key indicator since it directly affects monetary expansion and contraction—money creation, or money destruction.



We are now clearly on the path of money destruction. And we know what happens at the end of that path, right? Right.

Currently the Fed Funds Rate is a tad under 1.5%.[2] Our warning track is about 3%. Thus, for our clients' accounts that we are managing, we will take money off the riskier side of the table every time the Fed raises it from there on out—getting tighter and tighter until… the market crashes. Then we will simply reverse the positioning.

So far, so good. You may ask "Well, if we know a crash is coming, why not flee the market now?" Good question, but you'll be surprised how much growth will occur between now and then. A great deal of the market growth we've seen since the election has been in *anticipation* of a corporate tax deal. Now that it's actually been passed, we have just begun to see the benefits.

[2] 1.42% as of February 21, 2018. Federal Reserve System.

As this money repatriates back into America, shareholders of the largest value (dividend-paying) companies are in for a bonanza. You will see dividend increases, stock buybacks, and even special dividends as companies seek to allocate all this returning cash. Rest assured, the executives at all these companies will do whatever it takes to get big bonuses, and this can only occur when shareholders are fat and happy. You can always count on the executives doing what's in their best interests.

So here we go again. Another gangbuster year, albeit with sporadic volatility such as we have recently seen. Don't let the volatility get to you, but if it does, you may want to consider adjusting your risk tolerance before it gets worse, because it will.

We are sticking to our guns and riding through the volatility, looking forward to some nice growth in the value sector, all the while keeping our eye on the Federal Reserve. When we hit the warning track—it will be time to batten down.

If you are uncertain as to how best take advantage of the coming market growth and also position yourself for the coming crash, please reach out to us to see if we can help.

About J. Kevin Meaders

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Kevin Meaders graduated from Oglethorpe University in Atlanta with a double B.A. in Philosophy and Political Science, and then obtained a law degree from Georgia State University College of Law, focusing on estate planning and trust law. He has earned the designations of Certified Financial Planner (CFP®), Chartered Financial Consultant (ChFC) and Chartered Life Underwriter (CLU). He holds a General Securities Principal and Registered Representative registration and Investment Advisor Representative registration through Voya Financial Advisors (member SIPC).

About Magellan Planning Group

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- Estate planning with our in-house Attorney-at-Law to determine and prepare the documents needed to minimize family liability and maximize privacy. (www.magellanlegal.com)
- Tax planning through a relationship with our in-house CPA to manage tax obligations throughout the year and prepare a tax return that takes into account current tax laws. (www.magellantax.com)

Our relationship doesn't begin and end with the preparation of a plan and the appropriate documents. We establish close personal relationships with our clients and their families and maintain those relationships through regular 'check-ups', market commentaries and educational Lunch & Learns.

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