IN THE FINAL ANALYSIS – Episode 2

Hosted by Jim Yockey

Well, there's one thing for sure: we can absolutely say that the last few weeks have been really stimulating. Whether that's good or bad remains to be seen. But uncertainty, performance, and probability have been on everybody's lips. When it comes to uncertainty, you have war, inflation, interest rates, the economy, politics. Where would you like to start?

Okay, let's start with war. It is unconscionable how we have handled the Russian invasion of Ukraine. I think all of us can agree that that's the case. How that could have happened in the 21st century is just beyond mind-blowing. The real problem is we do not have a clear-cut solution except to hit the bully in the nose, figuratively speaking, of course. It appears we do not have the political will or the courage to do exactly that. Indeed, the uncertainty because of that is going to last for a while—months or even years. We've been here before. Interestingly, in the last couple of weeks, we have seen the intensity of the conflict be reduced in the headlines in the news media. Disappointing, but true.

One of the immediate byproducts of the war, of course, is inflation. Everyone's felt that in this country and around the world in terms of the increase in food cost and fuel. We tend to have those kinds of things occur periodically anyway, but this exacerbation because of the war is a critical change. Without getting too deep in the politics of the situation, in particular, the price of oil and gasoline, the fact is that there are immediate solutions that we could employ that are not necessarily politically comfortable for some.

You should be encouraged, however, because inflation's really not going to last very long. And part of it has caused supply chain issues and some of the other things. If you define inflation, it's the rising cost of everything or anything that you're interested in. A lot of that has to do with the money that's in the economy that is currently being spent.

I challenge you to go past a mall, particularly on the weekend, and not see that there are just no parking places for you because everybody's in there spending money. Well, that contributes to inflation. Also, when you don't pay your Visa bill at the end of the month, you're actually creating more money into the economy too, which also exacerbates the inflation issue. So we're all involved in creating inflation at this time.

So what about interest rates? The rising interest rates hit those people who are trying to buy new homes and things like that, of course. That's jumped more than a percent in the last few weeks, but also it hurts bondholders. Remember that when interest rates go up, if you own a bond, the market value of that bond goes down. So, you're going to have a choice. Do you hold until you can redeem your bond and get all of your principal back, or do you sell it at a loss? That's one of the difficulties about bonds. And quite frankly, since they haven't paid very much over the last 10 years, very few people find them comfortable to own in the first place. Indeed, that's kind of why we've all been investing in equities, essentially find stocks or the proxies for stocks like mutual funds have been the only game in town. Most likely what we're going to find is that the markets stay volatile, which is the way they've been all year. And we'll continue that to the end of the year.

In terms of inflation pushing us into a recession, I don't think so. There's been a lot of talk lately about the fact that short-term rates are higher than longer-term rates. And that's a good indication that we're going to have a recession. But no one talks about how long it could take after that crossover happens that we really do have two-quarters of negative GDP growth. So, inflation is probably off the table for a bit longer.

That basically brings us to performance. And yes, the market has been fussy most of this year, down around 4% or 5%, and NASDAQ's probably down a little bit more than that, maybe 9% or so, where the technologies got hit particularly. But should we be worried about that? The volatility is likely to continue, are we going to continue an upward trend in equities? Because equities begin to be less attractive when bonds are paying a reasonable interest rate, not just bonds, but savings accounts and things like that. What you think about when you consider owning bonds is that it's not related to the movement and the risk that you have in equity markets. So, theoretically, you have an approach to managing risk that is different than what you've been experiencing over the last few years.

It just may be a little too early to make that choice. Let's see what happens in the next year or two. It may be the case that equities are still the only game in town. So one consideration might be that you keep some cash handy for opportunities as they might reveal themselves over the course of the next year or so, but more than anything else, you need to pay attention to your asset allocation and make sure that you have sufficient management to help navigate you through these uncertain times.

In the final analysis, we [in the finance industry] don't do forecasting very well, never have. Assessing the probability from a mathematical point of view is convenient, but oftentimes the future holds a completely different path. So, no one—no matter who you listen to—they are not going to be able to predict exactly what will happen both in the war, in interest rates, in inflation, the economy, or anything else.

You have to pay attention on a daily basis. You have to compare the amount of risk that you can tolerate, *emotionally* tolerate, and compare that to the amount of risks that are obvious in the current economy. That means while you might be a long-term investor, you have to be adaptable. And that is the final analysis.

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