The Carl / Timpone Group
at
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The Serious Investor’s Guide

Market Trends and Interest Rates

Big Changes and Housing Affordability

Since our last newsletter back in September of last year, many things have changed. The U.S. Presidential election has come and gone, the trade war has mostly come and went, interest rates started coming down, and the stock market hit all-time highs many times this year. Residential real estate values are at all-time highs, while commercial real estate is in the tank. The housing affordability index is now at all-time lows because wages have not kept pace with the increasing cost of housing along with higher mortgage rates. In fact, most homeowners cannot move or upgrade due to the low mortgage rates they have locked into since the pandemic induced mortgage refinancing boom. If they have a 2.5 to 3% mortgage, they will now have to take on a 6 to 7% mortgage, and at much higher values if they buy a bigger home. For most existing homeowners, they could barely even afford buying their own homes at the estimated Zillow prices of today. This could slow the economy because real estate transactions triggers massive spending by the consumer.

Inflation and the Wealth Effect

Inflation may be slowing a bit, but prices are still up dramatically in the past 5 years, making it difficult to get by for most Americans. The disequilibrium of wealth between the haves and the have nots continues to widen. The top 10% of investors in the U.S. own 80% of U.S. stocks according to Moody’s. In addition, this same 10% account for almost 50% of all consumer spending. Although the stock market and home values are both at all or near all-time highs, any significant correction to the downside could likely hurt consumer spending due to the wealth effect. This wealth effect is far more important to the economy at this point than interest rates. So even as the economy slows or declines interest rate reductions will have to be quite substantial to have a positive effect.

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High Speculation Continues

Major speculation in the U.S. stock market is getting quite extreme with momentum investing in A.I., quantum computing stocks and many others trading at levels that make no sense whatsoever. Crypto is off the charts as well. This type of investing is never done at the bottom of a market, so investors need to be smart and careful to own companies that are undervalued and not chase the next hot thing. The vast amount of speculation on these stocks at extremely high valuations continues to allow us to take advantage of value-based opportunities that can become the growth stocks of the future. This is a lower risk way of building wealth and generating significant long-term returns.

The Debt Buildup and Onshoring

Meanwhile, U.S. Government debt levels have risen to very high levels, and although, if the economy slows and the Fed continues to reduce short term interest rates, it might not have the effect of lowering long-term rates and mortgage rates could continue to stay at higher rates inhibiting the economic recovery a bit. The good news is the recent tax incentives passed by Congress is helping with the onshoring of U.S. businesses from abroad. This increased capital spending should help the economy continue to grow in the years ahead and create many more jobs. There also has been a dramatic increase in mergers and acquisitions this year and this is expected to continue in the new year.

Geopolitical Risks and A.I.

The biggest risk we see in terms of the U.S. and world economy is geopolitical risks with China and Russia. China wants Taiwan and Russia wants Ukraine and to destroy the West. Another concern we have is the unrest regarding the growing high unemployment rates among the youth around the world. The other risk is what everyone seems to be ignoring right now and that is A.I. or artificial intelligence. There are certainly many enormous benefits of A.I. such as increased efficiencies and increased productivity going forward. However, that could come with a significant reduction in employment and increases in electricity demand. This may exacerbate the unemployment situation especially for our youth at least temporarily but may help keep inflation at bay. On the plus side over the longer term A.I. may help to create new jobs as has every major technological revolution has in our U.S. history. In addition, the enhanced profitability at many companies from employing A.I. could be quite beneficial as well.

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Long Term Value investing

There is no sugarcoating the current challenges; this is a very difficult environment to navigate if you do not have true long term investing experience. We have managed portfolios and guided clients over the past four decades and endured some difficult times. We know the pain that can be caused by mismanagement of our Country, and devastating events like the dotcom bubble bursting, the great recession, Russia's invasion of Ukraine, and the global pandemic to name a few. Our focus in managing portfolios is how to avoid risks to a great degree, and still have significant upside potential, and we prefer to be getting dividends or the promise of them in the future. We continue to be investing in the companies that make economic sense, that have strong balance sheets, good managements, good fundamentals, and that are priced at low valuations relative to their estimated private market values. By investing this way, as merger and acquisitions activity continue to increase, we could certainly benefit. We also believe in adequate diversification, but not over-diversification which we believe is more like hiding, not real investing.

The Bottom Line

The bottom line is that there are many challenges ahead and It is not going to be easy to make significant returns in the years ahead. Cerulli Associates anticipates $124 trillion of wealth transfers will be occurring through 2048 so we need to stay focused on your financial and estate plans for you and your families. As the current speculative environment gets deflated investors will likely be rotating into more conservative approaches. This should allow us to continue to benefit with above average long-term results. Although the economy and the general stock market may be in for some turbulence in the years ahead, we feel we are well positioned compared to most investors and the over-all investing environment. We encourage you to contact us if you have any questions or concerns or if you are facing any major life changing situations.

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