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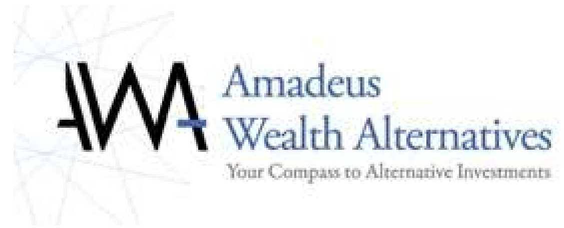

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In this week's recap: Stocks edge higher in short week.

Weekly Economic Update

Presented by Ed Papier, July 12, 2021

THE WEEK ON WALL STREET

Stocks managed small gains as investors wrestled with concerns over economic growth prospects and a rise in COVID-19 infections.

The Dow Jones Industrial Average picked up 0.24%, while the Standard & Poor's 500 gained 0.40%. The Nasdaq Composite index added 0.43%. The MSCI EAFE index, which tracks developed overseas stock markets, slipped 0.78%. [1,2,3]

A CHOPPY WEEK

In a truncated week of trading, stock market action was turbulent and indecisive. A mixed start saw cyclical stocks sell off amid concerns of slowing economic growth, while growth stocks advanced in response to falling yields.

After strengthening mid-week with the release of the FOMC meeting minutes, stocks skidded when reopening fears resurfaced Thursday on a new wave of global COVID-19 infections and Japan's emergency declaration that reintroduced lockdown protocols. This led to a broad-based sell-off, with financials, home builders, and technology hit hard. A drop in bond yields added to the deteriorating sentiment.

Bond yields rebounded on Friday, setting the stage for a strong comeback for stocks, with the three major indices closing at new all-time highs. [4]

ATTENTION TURNS TO BONDS

Since reaching a 2021 high of 1.74% in March, the 10-year Treasury yield has been in a slow, steady decline, closing at 1.37% on Friday. [5]

One explanation may be that reopening sentiment has turned more cautious as the Delta variant of COVID-19 spreads globally. Another view is that overseas investors are buying Treasuries, effectively lowering yields.

Perhaps it's abating inflation concerns, or simply excess liquidity finding its way into bonds. Whatever the message, the yield narrative has changed from just a few months ago when it was believed that the 10-year treasury was heading to two percent. [5]

THE WEEK AHEAD: KEY ECONOMIC DATA

Tuesday: Consumer Price Index (CPI).
Thursday: Jobless Claims. Industrial Production.
Friday: Retail Sales.

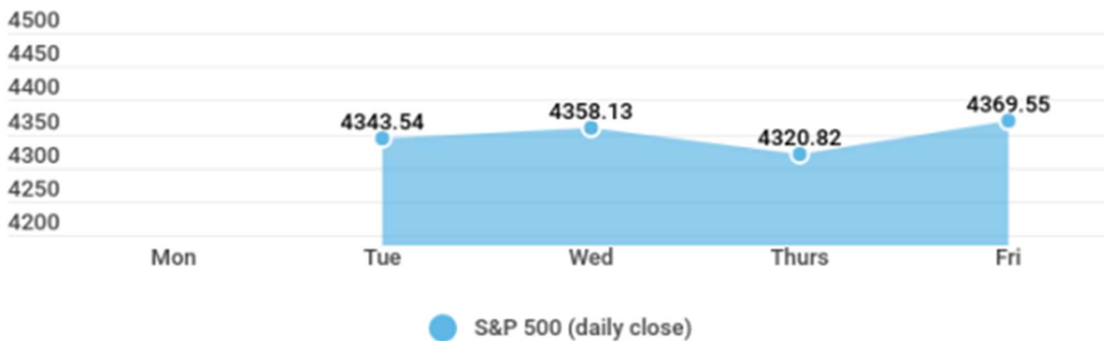
QUOTE OF THE WEEK

"The unhappiest people in this world

are those who care the most about what other people think."

C. JoyBell C.

Market Index	Close	Week	Y-T-D
DJIA	34,870.16	+0.24%	+13.93%
NASDAQ	14,701.92	+0.43%	+14.07%
MSCI-EAFE	2,297.41	-0.78%	+6.98%
S&P 500	4,369.55	+0.40%	+16.33%



	Treasury	Close	Week	Y-T-D
	10-Year Note	1.37%	-0.07%	+0.44%

Sources: The Wall Street Journal, July 9, 2021; Treasury.gov, July 9, 2021
Weekly performance for the Dow Jones Industrial Average, Standard & Poor's 500 Index, and NASDAQ Composite Index is measured from the close of trading on Friday, July 2, to Friday, July 9, close. Weekly performance for the MSCI-EAFE is measured from Friday, July 2, open to Thursday, July 8, close. Weekly and year-to-date 10-year Treasury note yield are expressed in basis points.

OF NOTE

In the 1980s, British Prime Minister Margaret Thatcher liked to say, "There Is No Alternative" to her market-driven economic reform ideas. She said it so often people began abbreviating it as "TINA."

More recently, TINA has been applied to investing. You must buy stocks because TINA. You can't make money any other way. Just close your eyes, buy and hold forever. Or at least through a full market cycle.

Regrettably, it isn't true. First of all, buying and holding stocks isn't guaranteed to work no matter how long you give it. There have been periods where stock market returns were less than zero for 20 years.

Starting in 1966, it took 16 years for the market to recover back to its original level and in inflation-adjusted terms it was 26 years. The first decade of this century was essentially flat.

However, there is nothing like a roaring bull market to make everybody forget the past. We all know it's different this time (note sarcasm). After all, the Fed has the wind at our back, and all we have to do is to unfurl the sails and move ever forward. Hence TINA.

Typically, potential investors are shown stock market returns over 60 to 80 years, which includes three or four full cycles, and then take those returns projected into the future. Save your money you are told, accumulate $1 million, and then you can take 5% a year for a 30-year retirement. Just keep your money invested and it will grow faster than your withdrawal rate, because the average return is over 7%.

Well, not so fast. It makes a great deal of difference *when* you start your retirement. If you start at a time of high valuations (like now) the chance your money will run out before 30 years is also quite high. In fact, if you start at the top 25% of valuation quartiles you would run out of money in an average of 21.8 years.

There was a survey done in 2000. The average investor expected to make 15% per year for the next 10 years. Oops. They got zero, especially after inflation. Portfolio strategists have long tried to deliver on that dream with ideas like the "60/40" stock/bond allocation. In theory, the bond part will gain value when the stocks are weak, thereby smoothing the overall return and reducing total portfolio volatility. A nice idea, and one that used to work fairly well. It hasn't done so recently because yields are so low, and the Fed's QE has distorted bond prices beyond economic fundamentals. We can't be confident they will zig or zag at the right times.

In fact, many of the street's market wizards have soured on 60/40:

- At a recent Milken Global Institute Conference, asset management experts suggested "The 60/40 portfolio is largely a relic of the past, with alternatives likely to become a bigger portion of investors' portfolios over the next decade".

- Jeremy Grantham's GMO suggested they are advising all out clients to invest as differently as they can from the conventional 60% stock/40% bond mix, just as they did in 1999. They forecast US Large Cap Equities will return -6.6% on average over the next 7 years.

- David Rosenberg, former chief economist at Merrill Lynch, has recently suggested "What makes the most sense in this era of financial engineering and central bank manipulation is to shift the portfolio to real or tangible assets that spin off a reliable cash flow stream".

- Morgan Stanley Wealth Management predicted 60/40 will return 2.8% over the next 10 years in Nov. 2019 when the market was lower than today.

- Research Affiliates forecasts -0.4% over ten years for a 60/40 portfolio.

- Bank of America reports "The End of 60/40" confirms that the historical role bonds have played as a hedge to equities is coming to an end, expecting a 0.2% average return for the S&P 500 over the next 10 years.

- Citibank Chief Economist: "There is a 100% historical probability of down markets in the next 12 months at current levels".

- John Hussman (Hussman Funds): "I continue to expect a loss in the S&P 500 on the order of 65-70% over the completion of the current market cycle"

This new (and artificial) reality is becoming more obvious, and it's a big problem. Trillions of dollars are invested in variations of the 60/40 idea. Almost every large pension plan and endowment keeps its money in some combination of stocks and bonds, but the bond part no longer behaves like it's supposed to. Bond portfolios average 3% if you're lucky. It's probably more like 2% and in a rising interest rate market could be a lot less. It's become dead weight, contributing little or nothing to overall returns and maybe even adding a new kind of risk.

Suppose for example, the Fed decides the economy is doing well enough to aggressively "taper" its various support programs. This could easily make stock prices fall (because liquidity will shrink) while long-term interest rates rise (because the economy is growing). That's the worst of both worlds for a stock/bond strategy.

So what can you do? Fortunately, there *are* alternatives to the kind of stock investing Wall Street usually peddles. And some of them are far more likely to help investors achieve their goals. Sadly, some of the best private investments aren't publicly available. Our government has decided they are too dangerous for small investors but "accredited investors" who meet certain income and net worth requirements can jump right in. Like TINA, that is also stupid. Wealth doesn't prove intelligence, nor does lack of it mean one needs protection. Nevertheless, it is the law for now, so we have to follow it. [6]

Amadeus advocates these alternatives, among others: Private debt, private equity and real estate on a primary and secondary basis, direct secondaries, promissory notes, equipment and aircraft leasing, direct and co-investments, venture investing, energy, options trading (to hedge long positions), multi-alternative, GP (General Partner) interests, litigation finance, energy, and other special situations.

Do your own search, but in today's environment, but consider avoiding advisors whose idea of portfolio construction is to buy and hold traditional stocks and/or ETFs in a TINA-like fashion. It may very well the wrong time to construct a traditional 60/40 portfolio.

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Please feel free to send us their contact information via phone or email. (Don't worry – we'll request their permission before adding them to our mailing list.)

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The forecasts or forward-looking statements are based on assumptions, may not materialize, and are subject to revision without notice.
The market indexes discussed are unmanaged, and generally, considered representative of their respective markets. Index performance is not indicative of the past performance of a particular investment. Indexes do not incur management fees, costs, and expenses. Individuals cannot directly invest in unmanaged indexes. Past performance does not guarantee future results.
The Dow Jones Industrial Average is an unmanaged index that is generally considered representative of large-capitalization companies on the U.S. stock market. Nasdaq Composite is an index of the common stocks and similar securities listed on the NASDAQ stock market and is considered a broad indicator of the performance of technology and growth companies. The MSCI EAFE Index was created by Morgan Stanley Capital International (MSCI) and serves as a benchmark of the performance of major international equity markets, as represented by 21 major MSCI indexes from Europe, Australia, and Southeast Asia. The S&P 500 Composite Index is an unmanaged group of securities that are considered to be representative of the stock market in general.
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CITATIONS:

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