Is this Just a Correction in a Bull Market?

As you all should know by now, we do not attempt to time markets because no one can reliably predict when markets turn. We only know after the fact. The following are two questions investors are thinking about.

1. Is the brief market swoon last week the sign of more trouble ahead?
2. Is the market rebound on Wednesday the 'all-clear' signal for the market?

We have no idea what the future holds for the direction of the equity or bond markets. Anything can happen, and many times it is the most unexpected that occurs. **The basic design of our portfolio models is balanced so that the goal is to benefit from long term increases in asset prices**, while using diversification to moderate the wide swings in any single market or economic environment.

While we manage money that way, it doesn't mean we don't pay attention to the old pros that after years of success, continue to share some of their collected wisdom. So, with the stock market potentially at a crossroads, we'd like to share some of the more interesting comments we heard this week from Ed Yardeni currently of Yardeni Research; Howard Marks, co-founder and co-chairman of Oaktree Capital Management, the largest investor in distressed securities; and Stanley Druckenmiller, chairman Duquesne Capital, a hedge fund he founded in 1981, which is now a family office. If they had an investor Hall of Fame, all three would be there.

Ed Yardeni remains constructive on the economy and the stock market. We would summarize his key points as follows:

- The **recent market correction is healthy** and gives earnings some time to catch up to prices. Yardeni was concerned that we were experiencing the early stages of a melt-up (see chart below) and taking this breather now can avoid a melt-down in the future.

- Yardeni believes **the economy is doing great** and could be up 25% to 30% (annualized) after a 33% annualized decline in the second quarter.

- He is of the opinion that **more fiscal stimulus is not necessary**, but believes that in the next month or so a Congressional deal will be struck for another $1 trillion in stimulus spending.

- The five stocks that account for about 25% of the S&P 500 and led on the way up also led on the way down, which is healthy. The stock market has hinted at a broadening away from technology for several months, **but [Yardeni is looking for a broadening of the stock market] to pick up steam**. He does not see a recession coming and expects that as tech goes through a correction, other sectors (industrials, financials, and energy) will pick up the slack and we will avoid another bear market.

- **Underlying market fundamentals are strong**: The economy continues to improve and a vaccine by year end should provide enough juice to keep the markets on the uptrend in 2021 with cyclical stocks becoming more attractive.

Howard Marks thinks the best opportunities now lie outside of the tech sector. His key points are:

- Short term rates are effectively at zero and that pushes asset valuations up (low discount rates imply higher valuations). This has pushed up the growth/tech sector. **While some argue valuations are high, Marks accepts that valuations may actually be fair because interest rates are so low, however, if valuations are fair with rates near zero, that implies that prospective returns are not attractive from here.** Just because something is fairly valued does not necessarily make it an attractive investment.

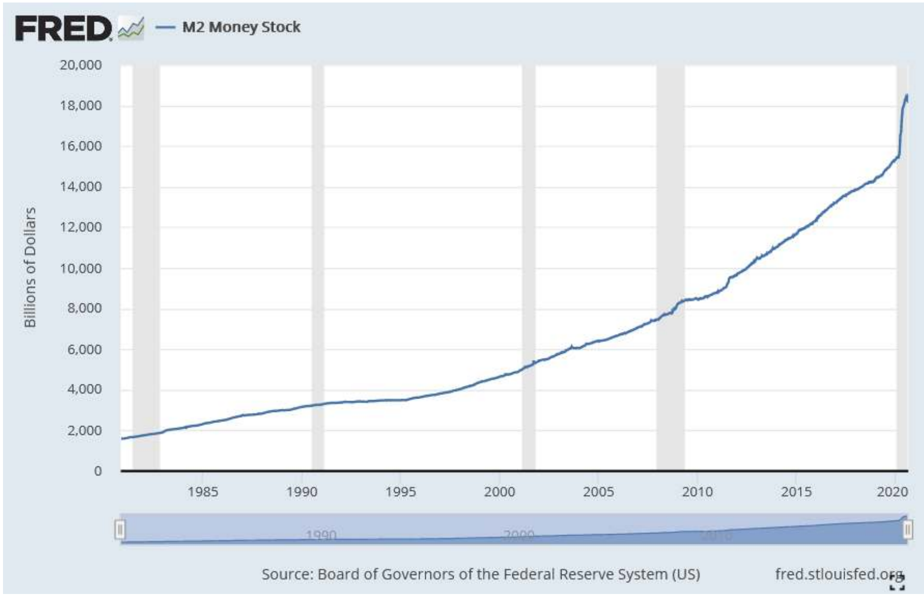
- **Marks believes that the [best opportunities are in things that are currently out of favor].** The market this year has created a real dichotomy between what is in favor (things that benefitted from COVID, like tech and delivery companies) and what has been out of favor, like real estate, entertainment and hospitality stocks. In his mind, when viewing these two groups, he is comparing stocks that are successful and expensive with stocks that look low priced but are in businesses that are currently challenged by the pandemic. **He believes the big money will be made by buying the stocks in the latter group that will not only survive, but thrive post COVID**.

- Marks does not hate tech stocks. In the long run he believes the tech stocks that are able to validate expectations will also make you a lot of money. In other words, whether buying the leaders or laggards, stock selection is critical to his investment equation.

Stan Druckenmiller's background as a macro investor/strategist comes though clearly in his **very different take on markets and the economy**. (Global macro investing is a strategy that is based on interpreting the investment implications of macroeconomic developments in the world.)

We outline his points as follows:

- The line between the **FED and the Treasury Dept**. is now blurred. Both are now acting together to address the economic consequences of the pandemic (i.e. printing money, see M2 Money Supply chart below), and that **has created a 'raging mania' in financial markets.** While Druckenmiller believes that Fed Chair Powell did a great job early in the pandemic, what the FED has done since then is excessive. He reminds us of how we thought former FED Chair Alan Greenspan was doing such a great job in 2005, but it ultimately led to the Great Financial Crisis of 2008-09.
- Druckenmiller believes that **the brief correction we've had recently does not provide any 'valuation support' for the market**, but that may not matter because of what the FED has done to support markets (again, money printing).
- He also expressed concern that the FED was apologetic at the recent Jackson Hole economic summit because inflation was only 1.6% over the last ten years and not the 2% targeted inflation rate. In his view, the FED implied that the unprecedented financial accommodation in monetary policy since 2009 was actually not enough. Druckenmiller believes that **recent FED actions to be more tolerant of inflation (inflation averaging, which we discussed in our August 29 weekly note) also come with substantial risks to economic stability.**
- As a result, he is now worried about Inflation for the first time in many years and is **concerned that inflation could hit 5% to 10% in 4 or 5 years**. We are printing money indiscriminately despite a $3.5 trillion (and growing) deficit while at the same time is lobbying Congress to 'do more spending'.
- Ironically, he believes that **these new FED policies have also raised the risk of deflation, stating that historically, deflation has always been preceded by the collapse of an asset bubble,** which he clearly believes we are in. He thinks the odds of the FED hitting their 2% sweet spot for inflation have gone 'way down' due to their actions.



The Myth of the K-Shaped Recovery

As a general rule, economics and politics don't mix well. What is politically expedient is rarely founded in sound economic theory. **There is a new theory being that is becoming more common in the media is that this will be a K-Shaped recovery**, which means that the recovery is split between industries and economic groups. If you are at the top, you are seeing your economics go up, and if you are at the middle or below, you are seeing the opposite. **The fact is that in each economic cycle, there are winners and there are those that struggle, both from a corporate and personal perspective. So, in that sense, every recovery is K-Shaped.**

We are a country of entrepreneurs. **We historically have embraced creative destruction, which has changed the way we live and do business.** Fifty years ago, Sears was the dominant retailer. Today Sears is bankrupt and Amazon is the dominant retailer. Robotics, automation, and artificial intelligence are all changing our world in ways that we could barely imagine 20 years ago. In the long run, it will force us to change the way we function; the way we live; the way we support ourselves. It is estimated that 1 in 8 Americans have worked in McDonald's at one point in their life. As we look into the future, we can envision a time when very few will work at McDonald's because of automation, and McDonald's labor force of the future will need to be technologically skilled to keep the restaurant operating. **The main issue in our view is that a K-shape recovery is not healthy as it continues to create a wider wealth gap, which historically is not good for our society.**

What We're Reading

9/11 Remembrance: The Man in the Red Bandana (14 min. video)

Senate defeat of 'skinny' coronavirus aid bill puts it on 'dead-end street'

Ford Deploys Robot Dog to Map its Facilities

GM, Nikola join forces to build electric trucks

How the Economic Machine Works, by Ray Dalio (30 min. video)

Biden proposes a tax penalty for offshoring

Container rate records are shattered as US imports surge

JPM Becomes First Wall Street Bank to Demand Traders Return to the Office

Farming Rises, Sports Tumbles in U.S. Industry Ratings

Anders Tegnell and the Swedish COVID experiment

The above headlines are from multiple sources, including, Reuters, The Wall Street Journal, The NY Times, Bloomberg, Barron's, and CNBC.

Markets This Week

It was another tough week for the stock market with Energy and technology leading the way down again. Oil prices have declined from roughly $3 to $38 over the last 2 weeks, and after an amazing run, tech stocks are taking a much-needed breather. On a positive note, Homebuilders bucked the trend, rising 2.4% as low rates has spurred home buying and re-financings. Long term Treasuries also had a good week, as did gold. Finally, we also note that interanion markets performed much better than the U.S., with developed markets up almost half a percent on the week.

US Equities	1 week	YTD	Fixed Income	1 week	YTD	Sector Breakdown	1 week	YTD
S&P 500 (SPY)	-2.50%	4.85%	20+ Yr. Treasuries (TLT)	1.05%	22.40%	Consumer Disc. (XLY)	-0.67%	17.39%
Dow (DIA)	-1.61%	-1.55%	Barclays US Aggregate (AGG)	0.22%	6.62%	Info. Technology (XLK)	-4.31%	24.29%
NASDAQ (QQQ)	-4.56%	27.79%	Intermediate Municipal (MUB)	0.10%	2.97%	Financials (XLF)	-2.29%	-18.53%
Russell 1000 Growth (IWF)	-3.37%	20.85%	US Corporate Bonds (LQD)	0.30%	7.38%	Health Care (XLV)	-1.05%	3.62%
Russell 1000 Value (IWD)	-1.49%	-11.00%	Barclays US High Yield (HYG)	-0.03%	-1.38%	Utilities (XLU)	-0.72%	-7.10%
Vanguard Mid-Cap (VO)	-2.05%	-1.67%				Industrials (XLI)	-0.25%	-3.53%
Vanguard Small-Cap (VB)	-2.36%	-7.68%				Energy (XLE)	-6.47%	-43.75%
International Equities	1 week	YTD	Commodities	1 week	YTD	Consumer Staples (XLP)	-1.29%	4.11%
MSCI EAFE (EFA)	0.47%	-5.32%	Commodities (PDBC)	-2.06%	-18.21%	Comm. Services (XLC)	-3.21%	12.04%
MSCI Emerging (EEM)	-0.92%	-1.52%	Gold (GLD)	0.42%	27.65%	REITS (VNQ)	-2.03%	-11.99%
						Homebuilders (XHB)	2.41%	16.22%

The table above is an analysis of the weekly and year to date returns of various markets/sectors that we follow (More RED = worse performing markets/sectors| More GREEN = best performing markets/sectors)

Investment Planning

[How You Can Win More by Losing Less]

The further you fall, the harder it is to climb back up. It's a universal truth that is painfully apparent in the investing world

Tax Planning

Nine Defenses Against the Biden Tax Increases

Here's what to do by year-end if a big tax law change looks imminent.

Estate Planning

Probate Explained: What Is Probate, and How Does It Work?

Probate is the legal process that takes place after someone dies in order to prove the deceased's last will and testament and carry out the deceased person's estate,

Retirement Planning

What to Do with Your Pension Fund when You Retire

Retiring with a pension is more complicated than simply claiming your payments.

Health

Health Tips for Going Back to School During the COVID-19 Pandemic

As schools around the country begin to welcome back students, parents and staff are eager to make sure they are following every preventive measure.