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Resolute Connections

In this month's newsletter you will find two articles concerning the current state of the stock market in the US and one about the somewhat positive developments in the European markets as Greece has exited the international bailout program. Bottom line today it appears the markets have awoken from a slumber and returned to the level of volatility that has been the norm in the past.

If that is a concern to you, or if you have any questions about anything we have covered in the articles, or a specific situation please feel free to give us a call, or visit our website, www.ResoluteFinancial.com.

Fire in a Crowded Theater

Yesterday's market declines—the Dow down 3.15%, the S&P 500 down 3.29% and tech stocks, as represented by the Nasdaq index, off 4.08%--were entirely within the normal range of mini corrections, which we've experienced numerous times since March 9, 2009. In fact such corrections of roughly 5% usually occur 2-3 times per year. But they represent an interesting test of character for the press and market pundits.

The most responsible voices in the press and elsewhere point out that market corrections are normal, and fear of market corrections works to the investor's advantage. Fear of incidental declines is exactly why investors demand a higher return from stocks than, say, for cash.

The responsible voices will point out that being able to control your fear is one of the best ways to generate higher returns in your portfolio. They will say—correctly—that there has yet emerged no way to know the future, and therefore we have no idea if this lurch in the market is temporary or the first sign of a significant downturn. Not knowing means that any action you take is likely to be wrong—especially since the markets have always recovered to set new highs after every downturn so far.

But these declines always bring out the opportunists who do everything they can to feed the fear. In order to get clicks, or draw attention to themselves, they will predict disaster, and claim to know what's going to happen tomorrow or in the next week or two. They'll make it sound as if this one-day reversal is a clear hint of doomsday—and of course the normal fear mechanisms in the human mind is programmed to pay attention to warnings like this.

Your best course, which your rational mind already knows, is to simply tune out the pundits who yell "fire" in a crowded theater. You know that they don't know the future any more than you do. Stocks just went on sale, albeit a little bit, and if you're in accumulation mode, you might hope they drop a little more, so you'll be able to buy cheaply and hold on for the recovery.

Your rational mind knows that panic seldom leads to a good outcome; please, if you can, give it your attention amid the screaming and shouting that is sure to show up in the news this week.

Beware the Bears

If you've been paying attention to the financial news lately, you're probably seeing a lot of ominous predictions—and they're usually backed up by some ominous headline. The most simplistic are saying that the bull market has now lasted ten years, so therefore it's about to come to an end—as if bull markets come with a time limit. Others, equally simplistic, are saying that the market has reached a new high, and,

well, don't markets fall from their all-time highs? This ignores the fact that more than 70% of the time, a new high is followed by another new high—and ultimately, so far in history, every new high has eventually been surpassed by the next one.

The more credible predictions are based on the fact that the U.S. debt is exploding, or that the U.S. is experiencing an expanding credit bubble in the government, corporate sector and also—perhaps for the first time—also the youngest workers with their crushing student loans. The Fed is committed to raising interest rates, which will make all that debt more meaningful somewhere down the road. And then we have the meltdown in Turkey, the potential consequences of trade wars on the global economy, and the flat yield curve that is in danger of inverting.

The most important thing to know about all this is that there is no economic consensus that the U.S. or the world economy are about to plunge into recession in the next six to 12 months. None of these simplistic arguments or ominous headlines, separately or together, add up to an imminent market meltdown or fire sale of the same stocks that you're holding in your portfolio. That, of course, doesn't mean that a meltdown couldn't happen tomorrow, but it could just as easily happen one, two or three years down the road. And it's helpful to remember that various pundits have been predicting a major pullback constantly over the past nine years of bull market returns. Anybody who was spooked by these pundits would have missed out on significant gains.

This is more of the same noise, albeit with somewhat scarier headlines in the background.

Interestingly, the indicator that is taken most seriously in economic circles is the inverted yield curve. This occurs when short-term bonds yield more income than longer term bonds. We aren't there yet, but the bond markets are certainly moving toward one of those rare times when two-year Treasuries are yielding more than 10-year bonds. Every recession since 1977 has been preceded by a yield curve inversion.

But is this cause, effect or coincidence? A recent article by Laurence Siegel, Director of Research at the CPA Institute Research Foundation, acknowledges that inverted yield curves have been a pretty good predictor in the past. But he says that in the

present marketplace, there is, as yet, no pressure coming from the things that a recession corrects: high inflation, high levels of debt, rich stock market valuations (though we may be moving in that direction), and tightness in the labor market.

A yield curve inversion affects the supply and demand for capital, which can have impacts on the economy which could cause a recession. It discourages banks from doing what they were made to do: borrowing short and lending long to viable businesses that are expanding. In the past, there may have been a more direct cause and effect than there is today. Today, banks can turn to hedge funds and a variety of other lenders who will allow them to borrow short at reasonable rates.

The bigger point is that recessions are inherently unpredictable. If we had a reliable way to predict them, we would already be in them, because companies, knowing the time and date of the recession, would pull back in anticipation of it, and simply bring it on more quickly. The same is true of major market pullbacks; if you, or I, or anyone else knew when it was going to happen, we would already be running for the exits, triggering the pullback prematurely.

Bottom line: we don't know when or where the pain will come; we only know THAT it will come. So it might be time to reassess your tolerance for sharp market movements in the downward direction and to adjust your portfolio if your risk appetite has changed in the past few years.

Crisis Continued

We should probably all be celebrating the news that, after eight years of headlines predicting the worst sort of gloom and doom, the nation of Greece has emerged from its bailout program. Over that time period, the country received 289 billion euros ($330 billion) from the International Monetary Fund, the European Union and the European Central Bank. Greece can now borrow at market rates again.

Which means the crisis is over, right? Actually, for the average citizen, the crisis is ongoing and getting worse. True, Greek unemployment has fallen from a catastrophic 28% at the peak to a hair-raising 19.5% today, but that may be because

400,000 Greeks have emigrated, perhaps never to return. True, the country has shown a small increase in GDP over the past 12 months. But the Greek economy is now 25% smaller than it was when the crisis began. Meanwhile, its aggregate debt burden (banks and government debt) has actually increased, and now stands at 322 billion euros ($366 billion)—or 181% of the country's total economic output. The best case forecasts have Greece's debt-to-GDP ratio falling to "just" 100% by 2060.

How is it possible that the bailouts provided so little cover to the beleaguered nation? The problem was that the bailouts were not really designed to help the Greek economy, but instead were made to make sure that the (primarily German) bank lenders would be paid back as close to "in full" as possible. More than 70% of the "rescue" loans actually went directly to the lenders in the form of principal repayment, interest payments and incentive payments to foreign bondholders. All of the loans came with strict conditions that the country raise taxes and cut spending, sending the Greek economy tumbling headlong into depression.

Maybe we should cheer the fact that the scary headlines and talk of a "Grexit" are finally over. But we should also realize what happens when a nation gets itself into debt too far over its head—and consider the cautionary tale of how the world treats a debtor nation that owes too much and saved too little.

Source:
Bob Veres Inside Edition Newsletter

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