



Timely Insights into Markets and the Economy

I nvestors Q uarterly

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Equities

- *In the world of finance there is something known as the “greater fool theory”.* Basically, it involves speculation that ignores intrinsic value and bids an asset higher and higher, counting on a greater fool to come along and buy your expensive asset at a higher price. Someone ends up holding the bag at the end of the day.
- *Since we are intrinsic investors (shameless plug), we only buy securities that our analysis tells us has a solid margin of safety.* Buying things that might or are expected to make you rich is playing with fire. These days, the current “Tulip Mania” seems to be crypto-currencies. Where is the intrinsic value? When clients ask me if they should buy Bitcoins or any of the other up and comers, I just say no.
- *Unfortunately, September lived up to its reputation for inflicting pain* and we still need to get through October before hopefully getting a tail-wind going into the end of the year. That may end up being wishful thinking when we consider the latest set of challenges equity investors are currently facing.
- *The ongoing debate over the debt ceiling sparked fear going into month’s end before the can-kickers in Washington did what they normally do and postponed the death-match until December.* Add to that fiscal and monetary concerns, ongoing supply-chain disruptions, slower economic growth and new concerns over inflation and investors end up with a pretty full plate of worries. Oh, and Covid...
- *Not all the news is bad however.* Despite showing the markets are fairly priced at current levels (see our [Relative Value](#) (click link to view) chart), stocks are at least not overvalued. As we look forward to 2022, the target should rise north of 37000 on the Dow. Another plus is that the Price/Earnings ratios are much less stretched than they were a year ago thanks to continued improvement on the earnings front. Naturally, all eyes turn to Q3 earnings at this time of year.

Fixed Income

- *Investors' attention has also returned to the bond market.* The Fed as usual has to perform a balancing act using monetary policy pitted against fiscal policy. Many believe the Fed has left the spigot on way too long. The flood of money represented by Quantitative Easing (QE) risks spilling over the top of the tub and completely wrecking our fiscal house!
- *On the other side of this balancing act is fiscal policy (think Congress and the White House).* Pressure is being applied from both ends of Pennsylvania Avenue for endless spending increases. I have shared this link in the past, but it is always worth taking a periodic glance at the National Debt Clock (click here to view [Debt Clock](#)).
- *The National Debt is closing in on \$29 Trillion and the folks in D.C. want to add another \$2-\$5 Trillion on top of that!* We are now facing a \$3 Trillion deficit for the year. Someone once said that spending doesn't matter as long as there is economic growth. I know I sound like a broken record on this, but growth and spending have to balance each other out. You can't afford a Mercedes on a sub-compact car budget. Okay, I am done with that (for now).
- *Which brings us back to bonds, rates and inflation.* If we can all agree that too much of anything can be toxic and if we are waiting for a return to something called normalcy, then it would make sense for the Fed to start retuning rates to historical averages.
- *I have pointed out repeatedly that the 10-year Treasury Note in the 2% range is nothing to lose sleep over.* The Fed is by nature a slow and deliberative body. Assuming he keeps his job, we hope that the current Fed Chair can take his balancing act from one end to the other without making some of the same mistakes back in the 1920s that ended so badly in October 1929!

Conclusions

- *I may be changing my mind about the transitory nature of inflation primarily due to the supply-chain disruptions.* It is also too soon to write the economy off due to the employment situation. The relief checks issued since 2020 expired in September; and so we will need to watch the jobs reports carefully. One positive – the number of job openings finally went down in the latest Job Openings and Labor Turnover Survey (JOLTS) report!
- *Volatility remains subdued, which provides a reason to be optimistic on equities.* We will also be watching third quarter earnings for guidance moving ahead. Inflation tends to hurt large caps, but over the past 20 years or so, inflation surprises to the upside have benefited the Russell 2000, where we still maintain a sizeable position.
- *Finally, I had intended to talk about tax hikes that are supposed to pay for everything to make those spending increases "free".* If you believe this nonsense than YOU may end up being left holding the bag! I am out of space here, but really, you almost have to pinch yourself when you hear this nonsense. More next time!

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