Friday Freak Show

Last Friday was an eye opener for the bulls and day traders. We've had several daily declines of almost 1000 Dow points since the start of 2022, but I don't believe that a decline of this magnitude has come upon us quite so abruptly this year. So, the dramatic effect has been considerable and it's easy to understand if someone feels an anxious reaction. But, absolutely the most important thing for investors to understand about this selloff, is that it's not really predicting anything. It is almost entirely a consequence of the overwhelming impact that computerized trading and day trading now have on daily stock market behavior.

Here are the salient points which one should take away from Friday's action:

Market behavior

- It is important to understand that this panic selloff was not driven by a dramatic or abrupt change in the economic outlook. It was triggered by some plain talk by Federal Reserve Chairman Jerome Powell about the need for the Fed to persist in its battle against inflation and its will to do so.
- Much of the decline occurred in one 30-minute period, more or less coincident with Powell's speech in Jackson Hole Wyoming. That makes it yet another example of the huge impact of extremely short-term trading that now dominates the equity markets. The biggest culprit is high speed computerized trading systems. But it also includes the day traders (fondly called Robinhoodlings in past commentaries). They do little or no in-depth research and trade minute-to-minute, often on their cell phones.

Economics

- Let's start with accepting the unavoidable reality that the U.S. economy is slowing. This is a forecast which we have made in the past. The massive cash infusions that the Federal government injected into our economy (mostly in 2020) to counter the negative effects of the Covid pandemic were exceptionally effective in preventing an economic collapse. They were of such a massive and sudden scale that we have never seen anything comparable since World War II. The infusions were clearly of sufficient scale to achieve their objective. The economy re-accelerated. Unfortunately, almost two years later, the beneficial effects are waning. And……the trillions of dollars of debt accumulated by the federal government, businesses and consumers over the last several decades—a pile that only got worse with the pandemic distributions—makes it almost impossible to initiate new stimulus. So, the U.S. economy will gradually continue to lose steam as the stimulative economic funds that came from those infusions are depleted.

- Nonetheless, in spite of the fact that I have been an observer of the U.S. economy for 50 years, I am still amazed at its remarkable creativity and resilience and its ability to find new sources of growth. These creative sources will be the key to mitigating the slowdown. At present our forecast is that our economy will slow gradually.

Investing Process

- We have been attempting to prep clients for over a year on the approach which we feel will be necessary to succeed in such a sloppy investment environment. Here are the several basic points:
    - ***The Fed's fight to slow inflation will persist for months.*** There are too many structural problems in the global economy (political conflicts, Ukraine war, global drought, Covid disruptions in China, etc.) to expect inflation to improve as fast as everyone hopes.
    - ***Interest rates will not go down. They are more likely to rise further and for longer than expected.***
    - ***The slowing economy and gradually higher interest rates will limit the ability of the broad equity markets to rise.*** We believe that investors may experience several years of flat to modestly negative returns.

Today's highly volatile momentum markets with their tendency toward shallow qualitative analysis have created side effects that can be exploited. The stocks of some companies that have recently disappointed can suffer precipitous declines. Among that group are plenty of candidates that deserve new consideration—even when the general market has little appeal. ***This market already has an excellent batch of investment candidates.***