July 2022

Banner WSJ headlines last Thursday, and Friday highlighted the state of the U.S. economy. From Thursday:

Fed Lifts Rates by 0.75 Point Again

Powell expects further increases even as some indicators show signs of softening

BY NICK TIMIRAOS

WASHINGTON—The Federal Reserve continued a sprint to reverse its easy-money policies by approving on Wednesday another unusually large 0.75-percentage-point interest-rate increase and signaling more tightening was likely this year to combat 40-year-high inflation.

Officials agreed unanimously to lift their benchmark federal-funds rate to a range between 2.25% and 2.5%. ...

The S& P 500 rose 2.6%, while the Nasdaq Composite had its biggest one-day percentage gain in more than two years, surging 4.1%. Yields on the benchmark 10-year Treasury note fell to 2.731%. ...

Mr. Powell said it was too soon to say whether the Fed would dial down the size of its rate increases to a half or even a quarter point at its next meeting, in September. But he said that at some point, it would be appropriate to slow the pace of rate increases to assess their cumulative impact on the economy.

“These rate hikes have been large, and they’ve come quickly,” Mr. Powell said, referring to the Fed’s four consecutive rate hikes since March. “And it’s likely that their full effect has not been felt by the economy, so there’s probably some significant additional tightening in the pipeline.”

The Fed chairman said the slowdown in economic growth in the second quarter had been notable, citing signs of cooling consumer spending, hiring and housing activity. “Are we seeing the slowdown in economic activity that we think we need?” Mr. Powell said. “There is some evidence we are, at this time.”

Mr. Powell suggested the central bank wasn’t likely to ease up on rate increases simply because growth slows. That is because with inflation running well above the Fed’s 2% target, it wants to see economic growth slow below its estimated long-term trend of around 1.8%. ...

Employers have been adding jobs at a brisk pace this year, and the unemployment rate has held at 3.6%, a historically very low level, between March and June. ...

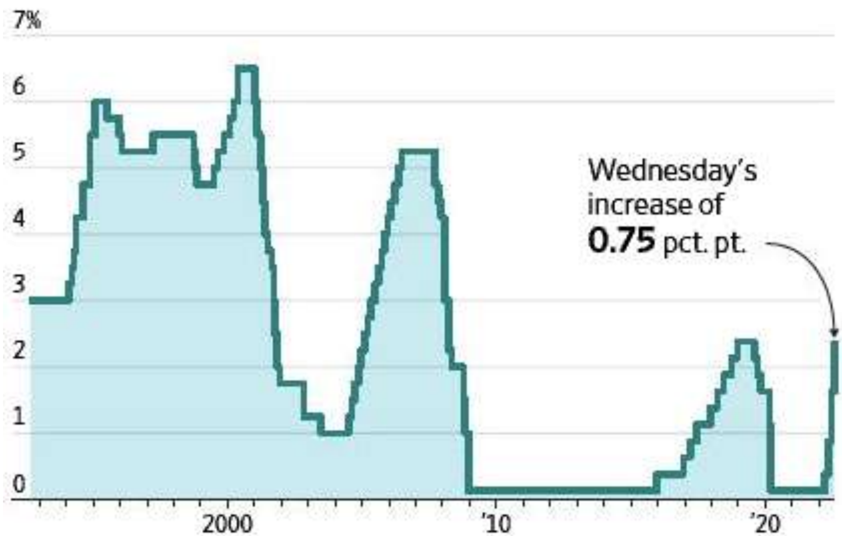
Mr. Powell cited brisk job growth in dismissing concerns that the economy is now in a recession. “I do not think the U.S. is currently in a recession,” he said. “There are just too many areas of the economy that are performing too well.”

Mr. Powell ... repeated his view Wednesday that he is more concerned about the risk of failing to stamp out high inflation than about the possibility of raising rates too high and pushing the economy into a recession. ...

“The whole point of 75-basis-point increases is to tighten financial conditions,” said William Ackman, founder and chief executive of Pershing Square Capital Management. “Each time Jay Powell has raised rates, ironically, he has eased financial conditions because of his unwillingness to acknowledge the Fed is prepared to take the country into a recession in order to eliminate the inflation scourge.”

Fed officials are raising rates at the most aggressive pace since the 1980s. Until last month, the central bank hadn't raised rates by 0.75 point since 1994.

With Wednesday's action, the central bank has raised rates since March as much as it did between 2015 and 2018 and returned the fed-funds rate to a level last seen three years ago, before a slowing economy led the Fed to cut rates slightly. Officials slashed them to near zero in March 2020, when the Covid-19 pandemic raced around the world.



Note: Chart shows midpoint of range since 2008.
Source: Federal Reserve

U.S. inflation has accelerated since March 2021. Demand surged after the economy's reopening and aggressive government stimulus, and Russia's invasion of Ukraine has further aggravated supply-chain disruptions and driven energy and commodity prices up this year.

How consumers and businesses respond to tighter money will help resolve one of the biggest questions facing the Fed and financial markets: how high officials will ultimately raise rates.

Another hot inflation reading earlier this month—the Labor Department reported its consumer-price index rose 9.1% in June from a year before— prompted investors to speculate that the Fed might increase the fed-funds rate by a full percentage point at this week's meeting. The Fed targets 2% inflation on average and uses a separate gauge, the personal-consumption expenditures price index.

Investors in interest-rate futures markets are betting that after raising the rate to around 3.5% at the end of 2022, the Fed will reverse course next year by lowering it.

Mr. Powell said Wednesday it was too soon to say how the rate path would evolve, but he pointed to projections officials submitted last month showing they expected to raise the fed-funds rate to around 3.5% this year and 4% next year. ...

In recent years, low inflation has given the Fed more flexibility to quickly cut rates in reaction to growth slowdowns, but officials don't have that luxury right now. They are worried about consumers and businesses anticipating inflation to stay high. ...

Since the Fed raised rates by 0.75 point last month, several other central banks have accelerated their own rate increases. Investors have responded in ways that reflect growing worries about recession. Oil and commodity prices have declined. So have market-based measures of future inflation and bond yields.

The fed-funds rate, an overnight rate on loans between banks, influences borrowing costs throughout the economy, including rates on mortgages, credit cards and business loans. The housing market, as one of the most interest-rate sensitive corners of the economy, has been the epicenter of the Fed's effort to stimulate growth last year and to slow it this year. Prices of homes have surged amid strong demand, but sales are slumping now as rates rise sharply.

From Friday:

GDP Drop Stokes Recession Fears

Economy contracted 0.9% in latest quarter, marking the second consecutive decline

BY HARRIET TORRY

The U.S. economy shrank for a second quarter in a row—a common definition of recession—as the housing market cooled under rising interest rates and high inflation took steam out of business and consumer spending.

Gross domestic product, a broad measure of the goods and services produced across the economy, fell at an inflation and seasonally adjusted annual rate of 0.9% in the second quarter, the Commerce Department said Thursday. That followed a 1.6% pace of contraction in the first three months of 2022.

The report indicated the economy met a commonly used definition of recession— two straight quarters of declining economic output.

The official arbiter of recessions in the U.S. is the National Bureau of Economic Research, which defines one as a significant decline in economic activity, spread across the economy for more than a few months. Its Business Cycle Dating Committee considers factors including employment, output and household income—and it usually doesn't make a recession determination until long after the fact.

Most economists surveyed this month by The Wall Street Journal expect the economy to grow in the third quarter and in 2022 as a whole, though lately they have lowered their estimates.

"We're seeing a sharp and necessary deceleration rather than a recession," said David Mericle, chief U.S. economist at Goldman Sachs, adding that slower growth is needed to rebalance the economy's supply and demand for goods and services, and cool wage growth and inflation. ...

Headed into midterm elections this fall, the latest figures have put the White House on the defensive about the state of the economy.

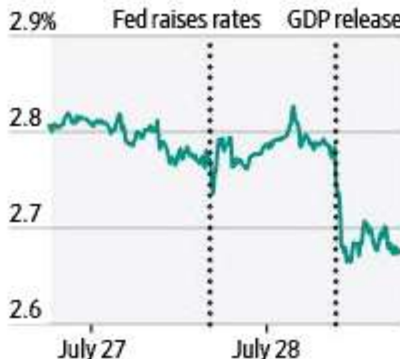
"It's no surprise that the economy is slowing down as the Federal Reserve acts to bring down inflation," President Biden said Thursday. "But even as we face historic global challenges, we are on the right path and we will come through this transition stronger and more secure."

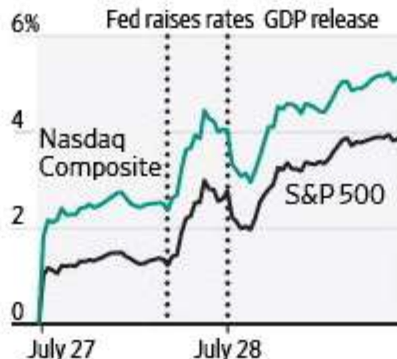
Republicans seized on the GDP figures, along with elevated inflation, to argue the administration is trying to redefine what a recession is and playing down signs of an economic slowdown. ...

Stocks climbed Thursday, despite the GDP data, extending a rally sparked Wednesday after Fed Chairman Jerome Powell hinted that the pace of interest-rate increases would eventually slow.

The new figures mark a sharp pullback from the final quarter of 2021, when GDP rose at a 6.9% annual rate. That capped a year in which the economy recovered strongly from the effects of the 2020 pandemic-driven recession and posted its best annual growth since 1984, stoked by low interest rates and roughly $6.4 trillion of government borrowing and spending since Covid-19 struck.

The GDP report underscored the challenges facing U.S. businesses, households and policy makers—including high inflation, weakening consumer sentiment and supply-chain volatility.





Inventories— specifically, the pace of restocking—accounted for much of the decline in the second quarter, subtracting 2.01 percentage points from GDP. A shift in consumer spending away from goods and back toward services, and rising prices cutting into people's buying power, left many companies with stockpiles of products they are now discounting to unload.

Consumer spending, which accounts for about two-thirds of total economic output, rose at a 1% annual rate in the second quarter, down from 1.8% in the first quarter. ...

The U.S. economic recovery is following an unusual trajectory, with weakening output but strong job gains. The unemployment rate, a key barometer of economic health, held steady at a low 3.6% for the past four months, and employers continued to hire at a strong pace.

The Labor Department said Thursday that new applications for unemployment benefits, a proxy for layoffs, held last week near the highest level of the year, a sign that the tight labor market is loosening. ...

Americans still have relatively healthy balance sheets. After the pandemic hit the U.S. economy in early 2020, increased household saving, government stimulus checks and enhanced unemployment benefits boosted household finances.

The resulting "excess savings"— the amount above what they would have had there been no pandemic— remains elevated. According to Moody's Analytics, excess savings totaled $2.5 trillion in May. ..

On 5/22 we shared "**Why we finally bought**":

"Our repeated warnings about inflation, and speculative excesses, has been accompanied by cash building in most of the accounts we manage. ... As stocks were capitulating on Wednesday, we added to domestic funds, resulting in all of our clients now being fully invested.

While pessimism has reached an extreme (see our SentimenTrader update), and we believe that stocks are near enough to a bottom ...."

From the front page of Saturday's WSJ:

Markets Post Best Month Since 2020

Hopes that a weaker economy will slow the Fed campaign to raise rates spurred gains

*By **Karen Langley, Joe Wallace** and **Rebecca Feng***

Major stock indexes rose Friday to end their best month since 2020, clawing back some of their losses from a dismal first half.

The S& P 500 gained 9.1% in July, while the Dow Jones Industrial Average rose 6.7%, the strongest monthly showing for each index since November 2020. The tech-heavy Nasdaq Composite climbed 12% for its best month since April 2020.

Investors have taken comfort in recent days from the idea that slowing economic growth might encourage the Fed to raise rates at a slower clip. They also have been encouraged by positive signals during earnings season, as expectations for quarterly profit growth rose over the past month. ...

Still, the major indexes are deep in negative territory for 2022, after the S& P 500 ended June with its worst first half since 1970. The benchmark is now down 13% for the year. ...

Data Friday showed robust growth in consumption and wages, potentially keeping pressure on the Federal Reserve to raise interest rates to bring inflation under control. Worker pay and benefits rose 1.3% in the second quarter—a near record pace—and consumer spending rose 1.1% in June, accelerating from May. ...

In the bond market, the yield on the benchmark 10-year U.S. Treasury note edged down to 2.642% ....

The yield on the two-year U.S. Treasury, meanwhile, settled Friday at 2.897%. That extends a span in which the shorter-term bond has traded at a higher yield than its longer-term counterpart, a situation known as an inverted yield curve that is seen as a warning of a potential recession. ...

Three from Morningstar:

5 Signs of Speculation

Crossing the line from investing to gambling.

John Rekenthaler
Jul 28, 2022

Bad Aromas

A reader forwarded me an article bearing the indelicate title of "On Bullshit in Investing." Its author was Benn Eifert, managing partner of a San Francisco-based hedge fund. Rarely do I agree with hedge-fund executives, especially those who run absolute return strategies, which I have deemed "an aspiration, not a realistic investment objective." However, that headline looked promising.

Happily, the book matched its cover. The article made excellent sense, albeit for the vainglorious reason that it overlaps so strongly with this column. Among the targets that Eifert and I have shared are Special Purpose Acquisition Companies, ARK Innovation ETF, Allianz Structured Alpha, and Infinity Q Diversified Alpha, the last of which, I mused, might the worst-ever public fund. (Bernie Madoff, of course, handily captured the private-fund honors.)

Eifert offers five red investment flags. I wholeheartedly agree with them all. However, there is room for additional discussion, as animal manure is such a fertile subject. In that spirit, here are my five signals for when an investment is really something else: a speculation in disguise.

Sign 1: No Track Record

As with backup quarterbacks, new investments benefit from high expectations. After all, they have not *yet* failed. If a new security's initial performance is strong, investors rapidly begin to believe that a better mousetrap has been invented at last. Rarely has it. Rather, the investment has not yet faced an environment that spotlights its disadvantages. When it does, their disappointed owners are often quick to sell. Many then buy another untested issue, repeating the cycle.

Fortunately, U.S. investors have to some extent learned from their mistakes. When I started at Morningstar, in the late 1980s, the largest mutual funds were brand new: government-bond funds that boosted their "income" (in truth, those distributions were short-term capital gains) by selling options. Once their shareholders realized what they owned, they fled, and those funds quickly vanished. Today's investors are harder to fool. To be sure, they can be tempted, as with SPACs, they tend to be more patient than their predecessors.

Sign 2: A Lack of Cash

Hope is a powerful lure. In addition to new offerings, securities that do not generate cash also invoke the backup-quarterback syndrome. They may not look like much today, but just consider their potential! The expectation consists either of future corporate profits, for emerging companies that are long on vision and short on revenues, or in the belief that the investor will eventually be able to sell the security at a higher price even if it never can distribute cash. (The obvious example is cryptocurrency.)

Cashless assets do sometimes blossom into terrific investments. We all have all heard the stories of those who became fabulously wealthy by holding the shares of profitless companies before those businesses become household names. (Usually, it happens for initial employees, but it can occur for outside shareholders as well.) That said, for every acclaimed winner there are dozens of forgotten losers. Buying tickets is a tough way to make a living, even with equities, which have high expected long-term returns. It is tougher still when attempted with securities that can never accrue profits, such as collectibles.

Sign 3: A Secret Sauce

This item, I confess, echoes one of Eifert's cautions, which counseled against "overly complex investments with nontransparent sources of return." Beware investments from people who would have you believe their strategy is too difficult for mere mortals to comprehend. Either they are being disingenuous, or their strategy really is indecipherable–to them as well as to outsiders. When disaster strikes, their shock will match those of their shareholders.

This occurred most (in)famously in 1998 with Long-Term Capital Management. According to a state treasurer who decided against committing money to the organization, Capital Management's principals suggested that he

was wise to refuse, since he did not appear to be smart enough to understand their investment process. As it turned out, neither were they. Shortly thereafter, the fund went bankrupt, being unable to service the debt it had assumed.

Sign 4: Ignoring History

Market historians have no monopoly on insight. While previous events offer a useful guide for what may come, they by no means necessitate the future. Consider, for example, inflation. For 40 years, long bonds repudiated the apparent lesson of the 1970s, by thriving and prospering. But this year those securities took a beating, confounding those who, swayed by recent history, had decided the experience of the 1970s was no longer valid.

However, as with owning lottery stocks, betting against the past defies the odds. Usually, the "New Normal" ends up looking much like the Old Normal. For example, when Bill Gross used that term to argue that 2010s would be a lost investment decade, featuring "inexplicably low total returns" for bond and stocks, the opposite occurred. It was a Golden Age for investing, as with the 1990s.

Avoid portfolio managers who claim to know how "this time will be different." It probably won't be. Even if it is, it may not match their expectations.

Sign 5: Special Membership

My fifth and final warning is against pledges of investment exclusivity. When portfolio managers offer everyday shareholders the opportunity to invest with the elite rather than with the usual huddled masses, the best response is to hold one's wallet. It's delightful to receive special treatment. Unfortunately, retail investors are *not* special; they don't bring enough money to the table to merit the extra attention. The only reason to make such an offer, then, is to hustle them.

Thus come the "liquid alternative" funds that charge 2% annually but do not post the gains of the top hedge funds. Or SPACs, which supposedly offer retail investors the chance to purchase initial public offerings at the ground floor but cut different and better deals for their larger shareholders. Or separately managed accounts, which for years-–although this shortcoming is improving, fortunately–sold the promise of customized portfolios without delivering that benefit.

Wrapping Up

Speculation can be lucrative. Securities that violate my precepts–or Eifert's–may become spectacularly successful, particularly when money is easy, as during the past several years, before the Federal Reserve raised interest rates. Also, sometimes people enjoy playing with their portfolio's house money, and there's nothing wrong with that. Therefore, I do not counsel strictly against buying assets that carry these warning signs. However, one should do so with clear eyes. Such trades are gambles, not investments.

Have Tactical Asset Allocation Funds Earned Their Keep?

At long last, the opportunity for tactical funds has knocked.

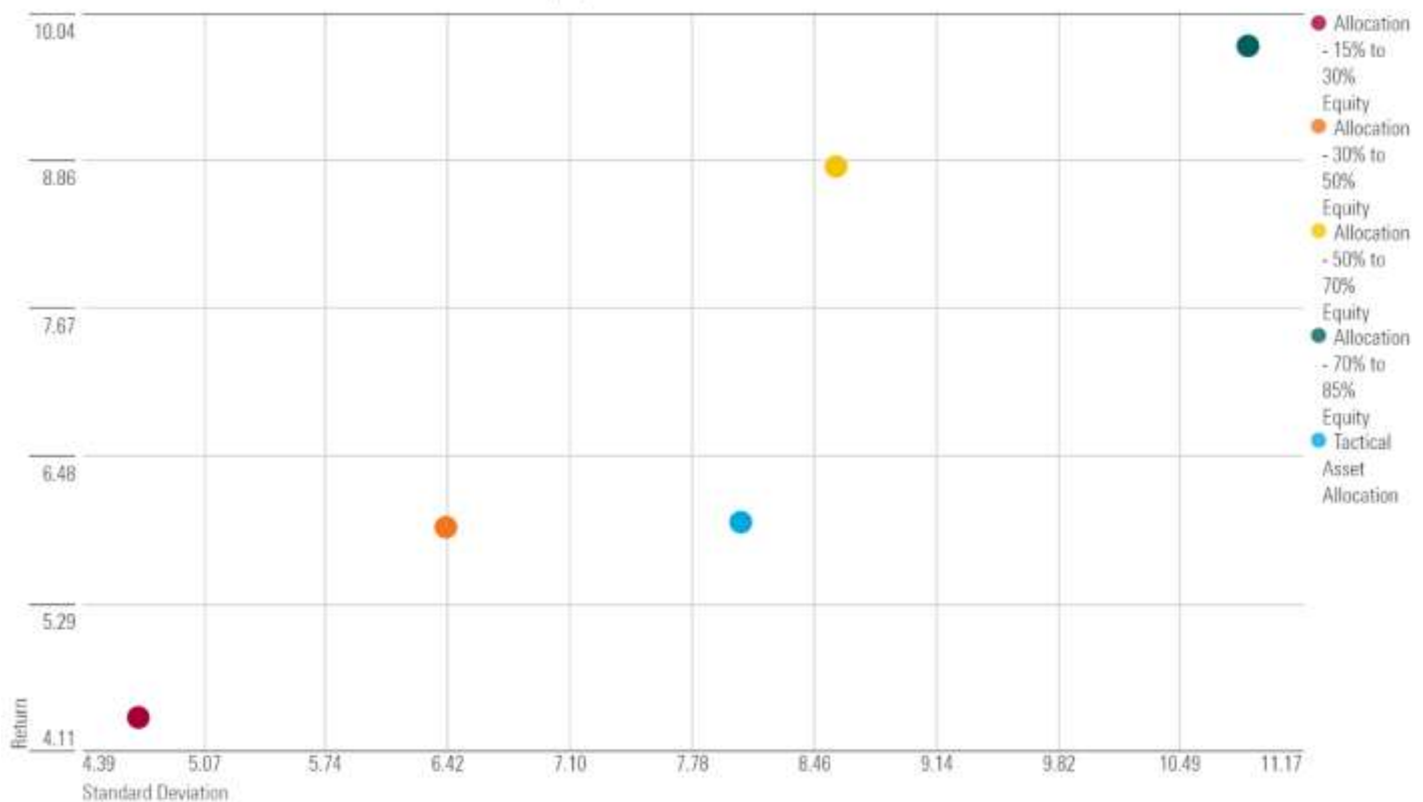
John Rekenthaler
Jul 25, 2022

The Perfect Storm

This year has provided the ideal climate for tactical-allocation funds. Unlike strategic-allocation funds, which hold their positions through thick and thin, tactical funds hope to dodge bear markets. They cannot anticipate losses that arrive abruptly, such as those that chaperoned the arrival of the novel coronavirus. But when investment woes are telegraphed, as with the losses caused by the Federal Reserve's interest-rate hikes, tactical funds should excel.

Tactical funds desperately need a victory. The decade that preceded this year's turmoil was unusually quiet, featuring steady stock- and bond-market gains, punctuated by brief downturns in late 2018 and early 2020. That's terrific for investors but unpleasant for tactical funds. Lacking opportunities to show their steps, while also burdened by their higher costs—like an extra pizza topping, tactical allocation does not come for free—the group badly trailed its rivals.

The proof lies below. The chart depicts the 10-year returns, through this past December, for several categories of allocation funds. The closer to the chart's northwest corner, the better the category's performance. Lamentably, the light blue dot that represents tactical funds lands somewhere near Mississippi.

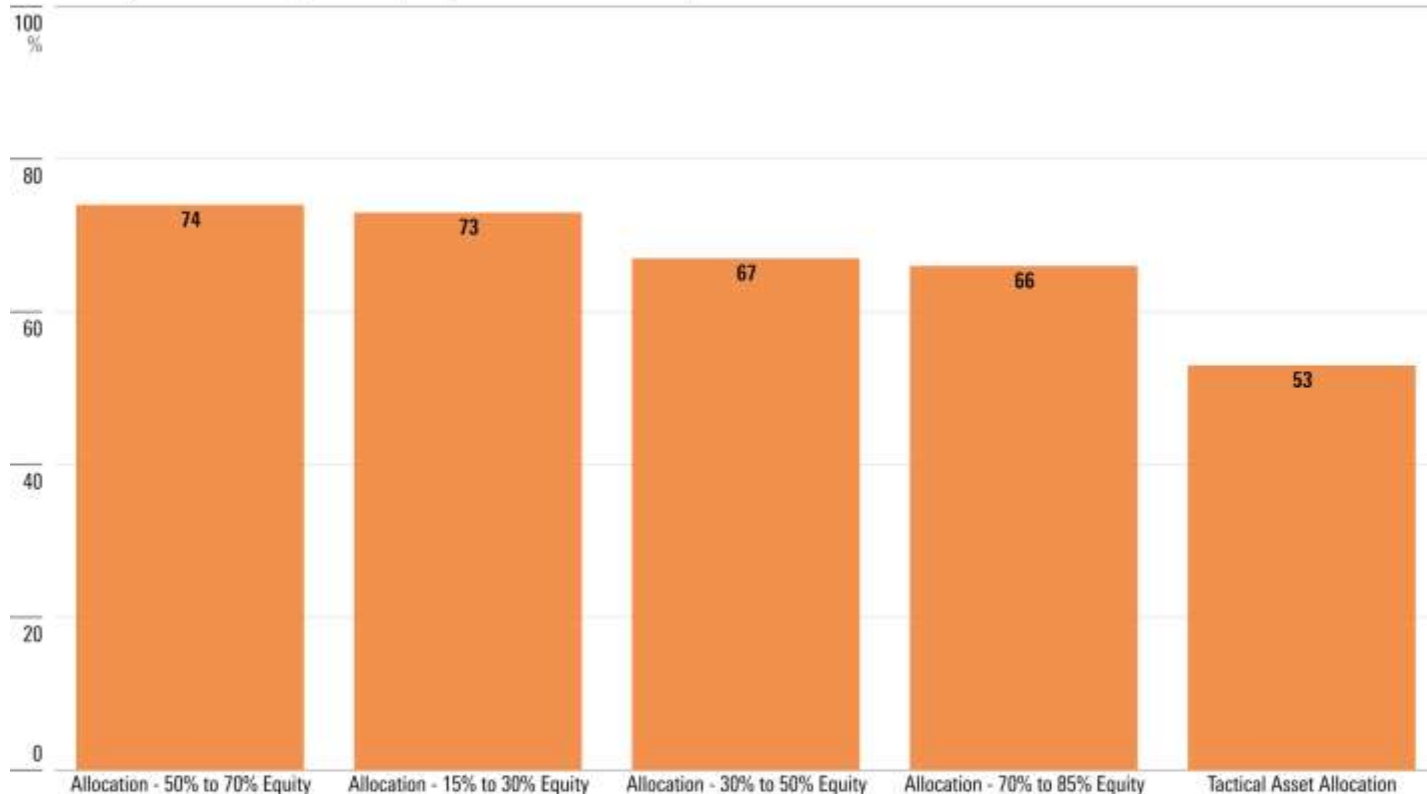


Considering Survivorship

As measured by volatility, the closest competitor to tactical funds was the allocation—50% to 70% equity Morningstar Category. Over the decade, such funds outgained their tactical rivals by 3 percentage points per year. After adjusting for tactical funds' lower volatility and steeper expenses, the deficit becomes 2 percentage

points. That amount represents the average annualized loss from tactical funds' trades. For tactical funds, less would very much have meant more!

In fairness, that margin could be affected by survivorship bias, because the calculation excludes funds that expired between 2012 and 2021. It may be that tactical funds existed throughout the decade, while their competitors came and went. If so, the study will have treated tactical funds inequitably, by counting all their outcomes while overlooking some of their competitors'. The next exhibit tests that hypothesis. Its shows the percentage of funds in each category that survived the 10-year period.

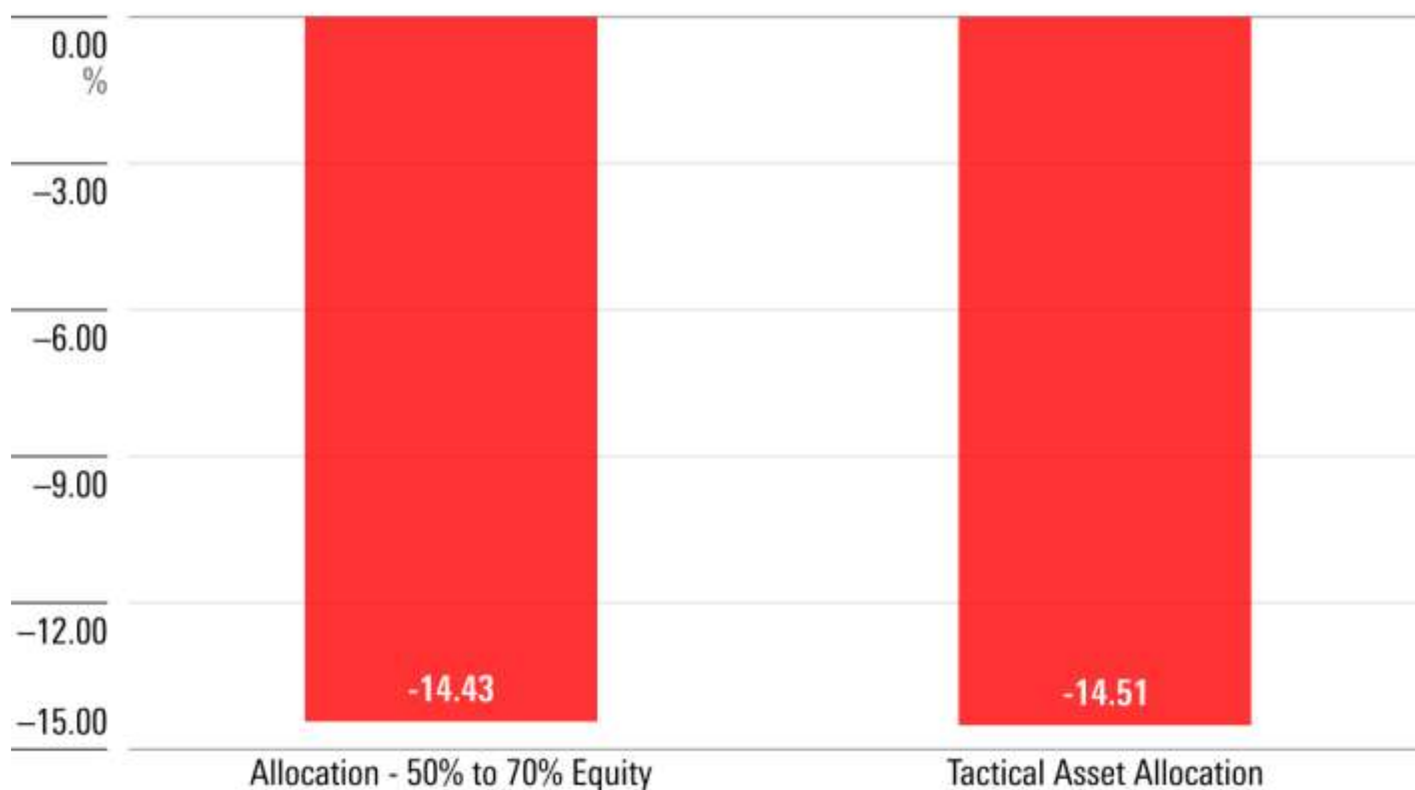


Oh, dear. Tactical funds were *more* likely to vanish than other allocation funds, not less. Given that most mutual funds are axed because of poor performance—companies routinely shutter 1-star offerings but rarely their 5-star siblings—the figures imply that tactical funds have fared even worse than the numbers suggest.

This Year's Model

They cannot possibly have recouped that entire shortfall in 2022, but perhaps they have made significant inroads. Below appears the average year-to-date total return for tactical-allocation funds, along with that of its nearest competitor, the allocation—50% to 70% equity category.

One need not read the fine print to understand the lesson: As the lengths of the two bars demonstrate, the two groups have behaved almost identically. Through June, tactical funds had lost 14.4%, with their strategic competitors a smidge behind, losing 14.5%. In that rate of closing speed, tactical funds will fully regain their lost territory in … [checks spreadsheet] the year 2145. Give or take.



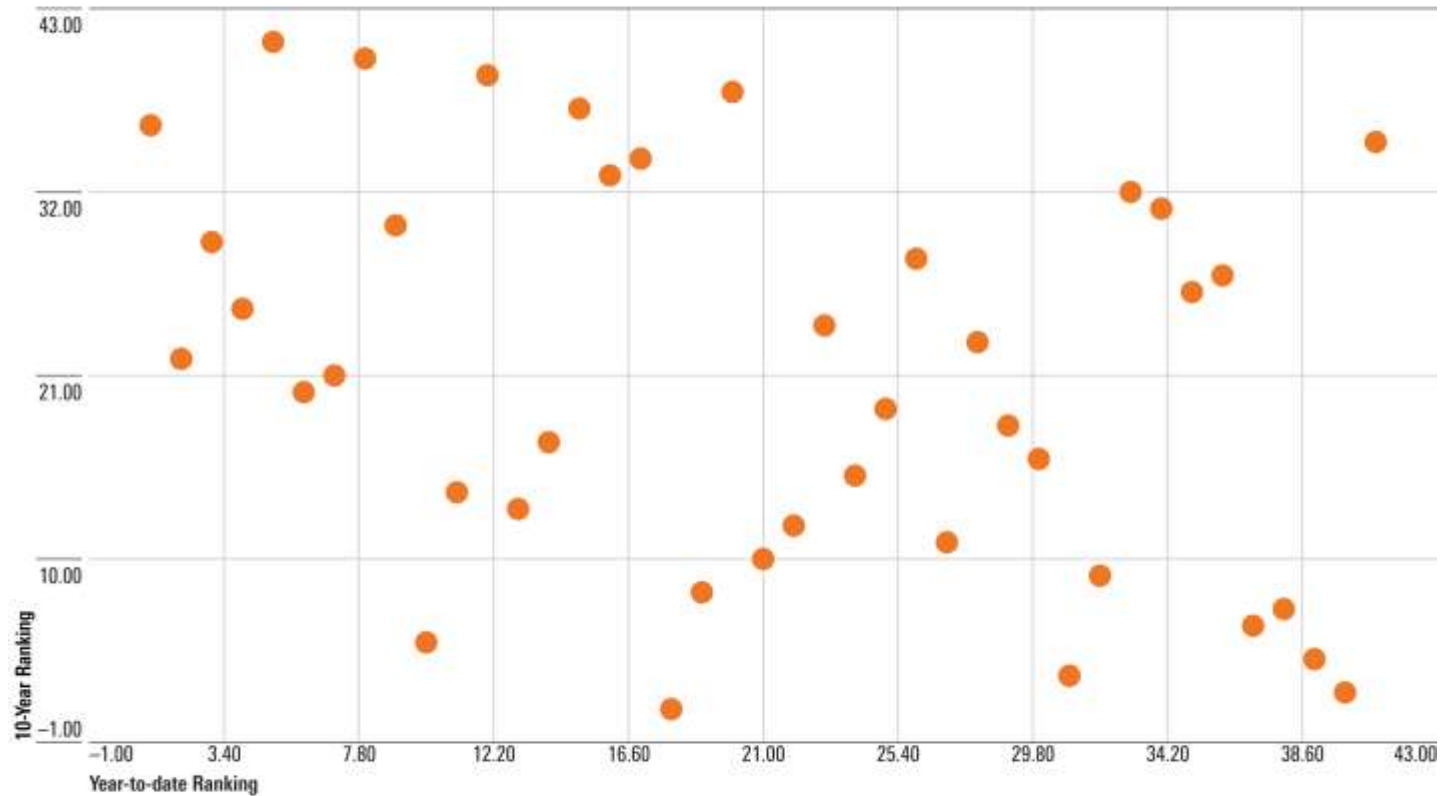
Does Performance Persist?

There is one last chance for redeeming tactical-allocation funds. As proponents of active management frequently state, shareholders own individual funds, not investment categories. For those who hold the best funds within a category, aggregate amounts are immaterial. After all, several tactical funds have notched outright profits this year, with several more landing only slightly in the red.

The question is whether shareholders can identify those funds before the fact. One simple but useful test is to see whether this year's results align with those of the preceding decade. Were 2022′s winners also successful from 2012 through 2021? If so, investors might have spotted them in advance. However, if their 10-year returns were not particularly strong, it's unlikely that many shareholders would have recognized the opportunity. For better or worse, most evaluations of active management include a healthy dollop of past performance.

I tested this proposition by comparing the total-return rankings for tactical-allocation funds over the 2012-21 period against the year-to-date rankings. To cite an example, Astor Sector Allocation Fund placed third among the 41 tactical-allocation candidates during the preceding decade. This year, it occupies 29th place. In that case, at least, past performance did not provide a useful indicator for future results. But it may be that with other funds the result was different.

It was not. This final exhibit plots the two series of rankings.



Total-Return Rankings for Tactical-Allocation Funds over the 2012-2021 Period With the Year-to-Date Rankings. - source: Morningstar Analysts

A pattern does exist. The dots faintly but perceptibly trend from the upper left to the bottom right. Unfortunately, that is the *wrong* effect. If the relative performances were persistent, with the stronger funds remaining superior, the dots would rise to the right. Instead, the opposite has occurred. In general, the tactical-allocation funds that had the highest 10-year returns entering 2022 have dropped the furthest. Meanwhile, the erstwhile laggards have led.

In summary, investors had little, if any, chance of selecting this year's tactical-fund winners. Perhaps they could have identified the most conservatively positioned funds, in the belief that the Fed's interest-rate increases would cause a bear market. But anybody who knew that much, in advance, should not be buying a tactical-allocation fund. They should be *managing* one.

Wrapping Up

Regular readers of this column will know that, in general, I prefer cheap and simple funds to their costlier and more ambitious rivals. History lies on the former's side. However, I will readily recognize exceptions to the rule, should they appear. (I will happily do so, as exceptions are interesting.) Recent events gave tactical-allocation funds that chance. Regrettably, they fumbled the ball. I see no reason to invest in such funds.

Are Long Bonds Still for Fools?

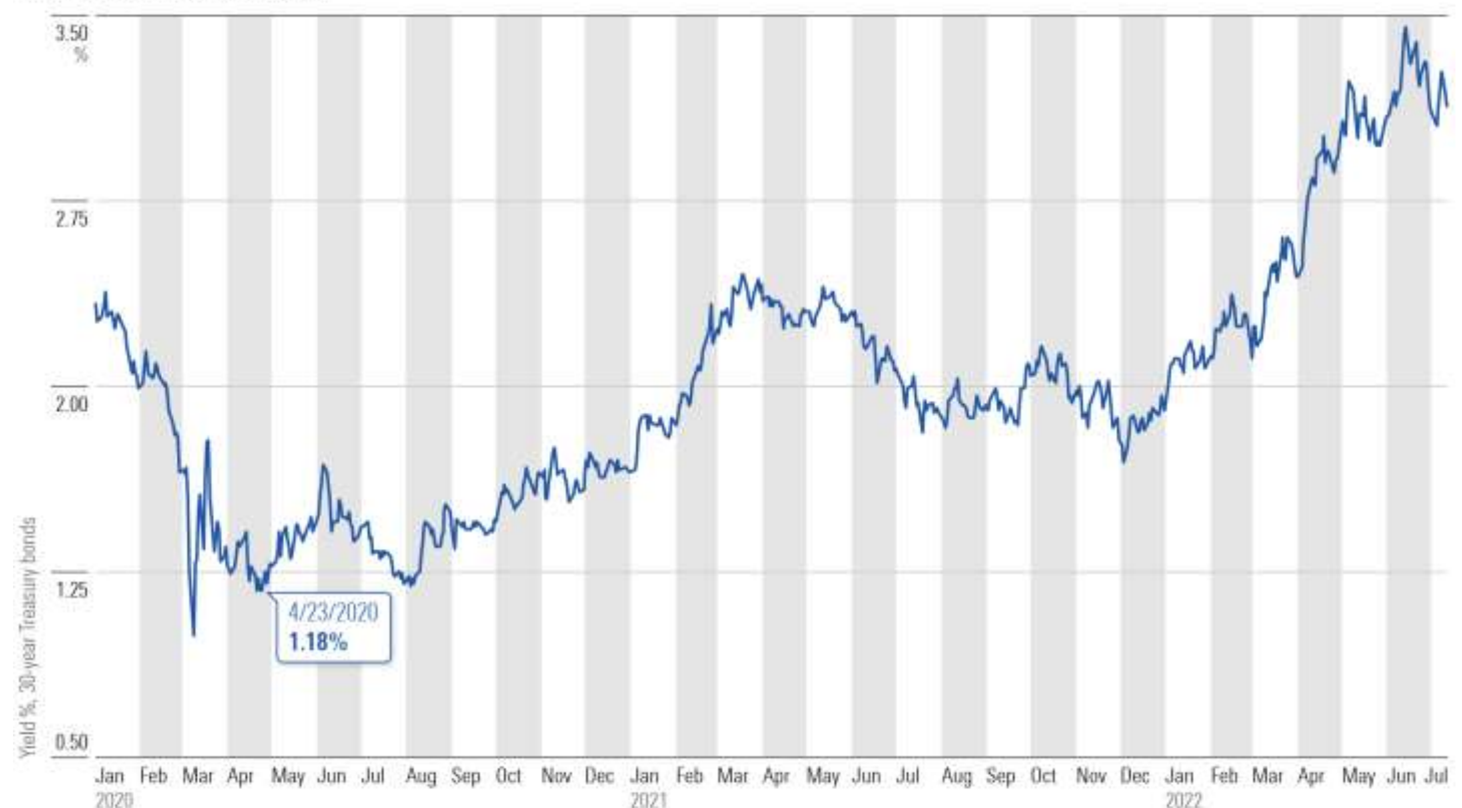
Re-evaluating the prospects for 30-Year Treasuries.

John Rekenthaler
Jul 18, 2022

The Bear's Market

The only thing daring about my column published on April 23, 2020, "Long Bonds Are for Fools," was its title. At that time, 30-year Treasury bonds were obviously and openly overpriced. However, as costly securities can always become more costly, the headline was nevertheless incautious. Long bonds could have extended their rally, making me look like one of those boastful sports personalities who "guarantee" outcomes that occur 50% of the time.

Not on that occasion. Even as the coronavirus news worsened, investors concluded that safety should not be *that* expensive. The very next day, long Treasury yields bottomed. (Now that I think of it, the sports announcer comparison was accurate: My occasional market-timing efforts are either spot-on or spectacularly wrong.) Treasury payouts are now almost 3 times their spring 2020 level.



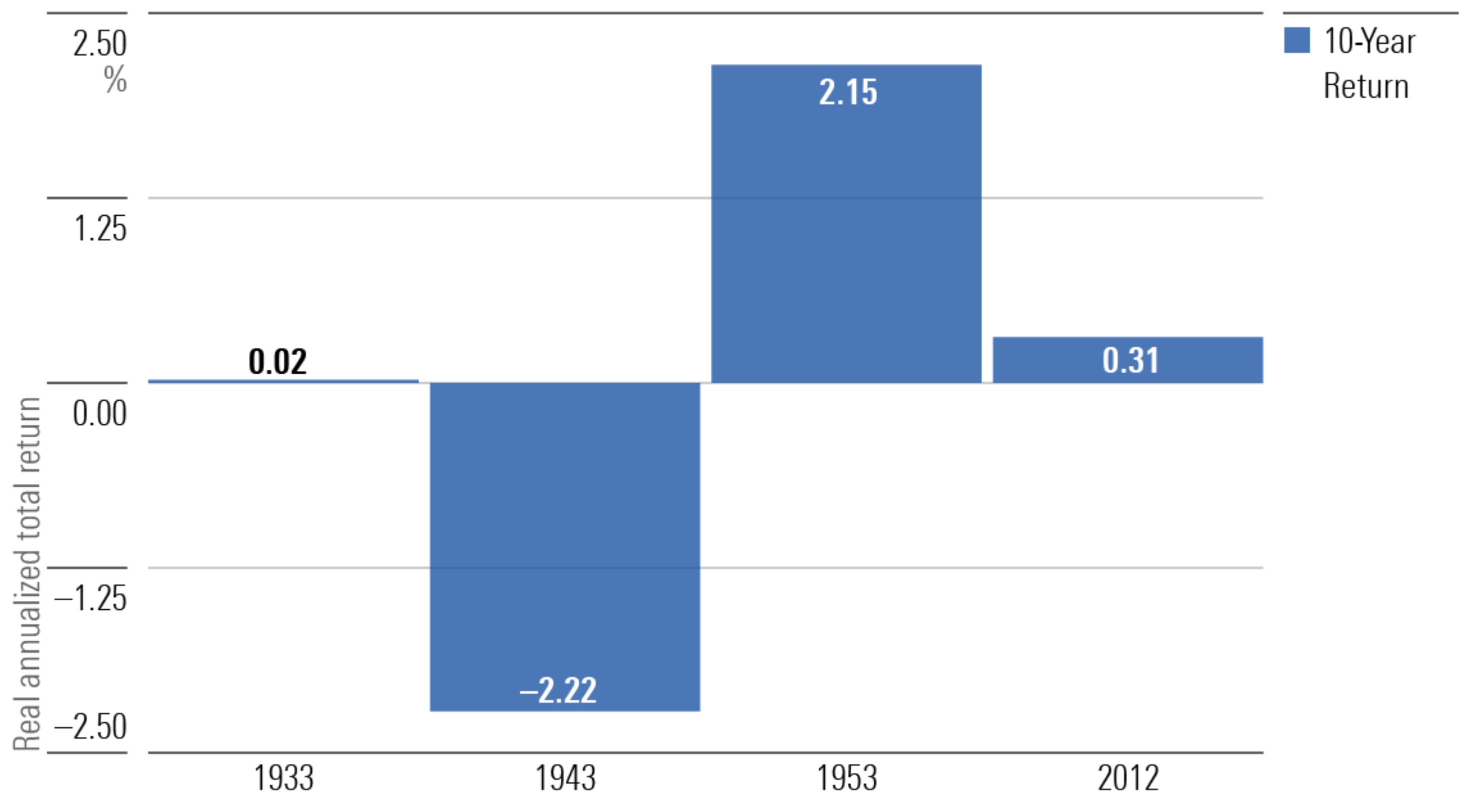
The performance of long Treasuries has consequently been wretched. From May 2020 through June 2022, the total return for the Bloomberg U.S. Treasury 30-Year Bond Index was negative 16.6%. (When yields are so low, bond returns are determined almost entirely by price change.) Since that date, long Treasuries have trailed every conceivable rival: stocks, cash, intermediate-term notes, commodities, and cryptocurrencies. Long bonds have been the bottom of the investment barrel.

Return to Normalcy

The good news: After their pain, 30-year Treasuries are back on familiar ground. In spring 2020, yields on long Treasury bonds neared 1%—a mark well above anything they had previously recorded, even during the Great Depression. That was uncharted territory. In contrast, their current 3.1% payout is thoroughly mainstream. To be sure, long Treasury yields are below their century-long average of 5%, but at least today's distribution lands within an established range.

The natural question becomes: How have long bonds fared in the past, when similarly priced? Answering that thoroughly would make for a protracted and exceedingly dull study. So, I cut to the chase, by considering only 10-year results, generated from fully independent time periods that began when the yield on long Treasury bonds resembled today's level. Those periods began in 1933, 1943, 1953, and 2012.

I then considered changes in consumer prices in order to calculate inflation-adjusted performance. Doing so better illustrates long bonds' benefits (or failings) than using nominal figures. With real returns, a positive annualized result indicates that long Treasuries grew their investors' wealth during the test period; a neutral return, that they retained their purchasing power but did not provide appreciation; and a negative return, that they lost real money, despite the alleged safety offered by their government guarantees and regular distribution.



A Cloudy Forecast

The lesson seems clear: Unless 3% Treasury yields presage an unexpected increase in inflation, as was the case in 1943, they will not necessarily hurt an investor's long-term returns. But neither do they help. There have only

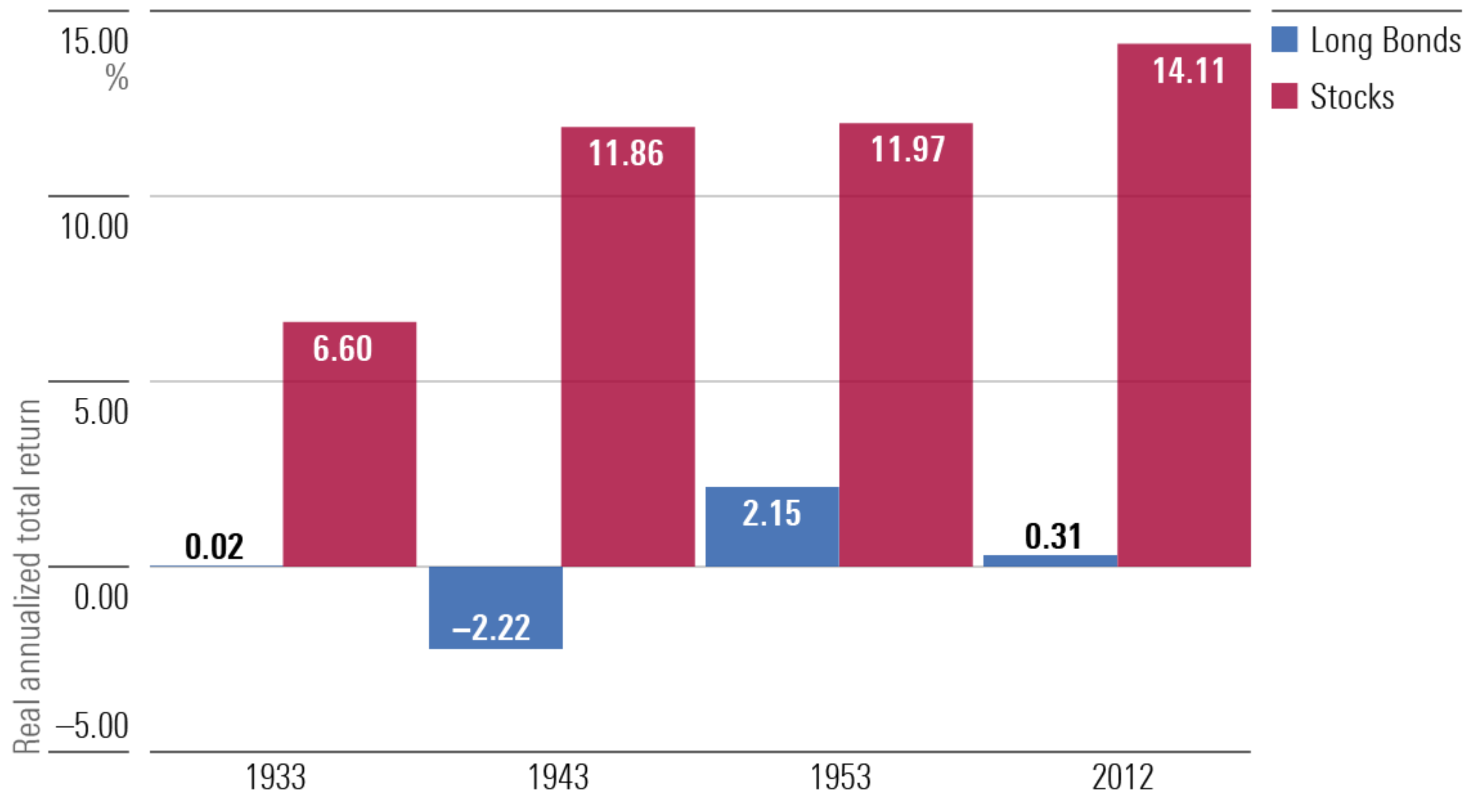
been two stretches in modern U.S. history where 3% yields were profitable. The first came during the Eisenhower administration, and the second in the 2010s.

That makes sense. A 3% yield can provide a positive real return over a full decade only if: 1) inflation stays consistently low or 2) Treasury payouts decline further, so that they end the decade much lower than where they commenced. As mentioned above, the first outcome has occurred only twice. The latter has never happened. Not once have Treasury yields finished a 10-year period significantly below where they started, when beginning at a 3% rate.

In short, while history does not suggest that 3% yields will sink Treasury-bond investors, neither is it complementary. Even if today's high inflation rates are temporary, as most economists claim (the public firmly disagrees), the outlook for long Treasury bonds is uninspiring. And, should inflation persist, thereby further surprising the already surprised economists, long bonds will continue to slump.

The Investment Competition

One must also consider the opportunity cost. Monies that are invested strategically into long bonds could instead be placed in equities. Doing so would increase the portfolio's volatility, but the compensation may well justify the risk. That certainly has been the case for the four 10-year periods evaluated above. While long Treasuries posted decidedly mixed results, equities were consistently spectacular.



In truth, "spectacular" understates the matter. Buying stocks during the Great Depression led to the weakest outcome, but even so, investors who took the chance pocketed a 90% cumulative gain after inflation. Profits

only increased from that point, culminating in a 274% real return for those who bought stocks in January 2012 and held for the next 10 years. (Golden investment eras are much easier to recognize in hindsight than when they occur.)

To be sure, equities and long Treasuries are different beasts. Although, as we have recently seen, rising interest rates can clobber long-bond prices, ultimately Treasury-bond owners can at least count upon receiving their original principal. Equity shareholders, of course, cannot. Thus, I make the comparison advisedly. Still, when Treasury yields have been at current levels, the differences in future performance have been stark. The margin of victory has been too large to ignore.

In short, I remain unenthusiastic about long Treasuries. No longer do I believe that they should attract only central banks that must stockpile reserves, or traders who plan to flip them to greater fools. When long bonds pay 3%, they can deliver an acceptable, if unexciting, return while protecting a portfolio's equities against inflation—although not stagflation. But the alternatives remain more attractive. Cash is the safer path for reducing a portfolio's risk, while equities are preferable for increasing its return. ...

Appendix - The indexes used for Exhibits 2 and 3 consist of: 1) Ibbotson Associates SBBI Long-Term U.S. Government Bond Index, 2) Ibbotson Associates SBBI U.S. Inflation Index, and 3) Ibbotson Associates SBBI Large-Company U.S. Stock Index.

Follow-ups

Two from Bespoke. On Jul 14:

Pure growth stocks have significantly underperformed since late 2021, coinciding with higher inflation and a hawkish Fed causing interest rates to rise dramatically. The wild multiples that the most uber-growth stocks traded at could not withstand the Fed's shift from its zero-interest rate policy and the surge in inflation. In retrospect, the meme-stock era marked the last straw for the bubbly conditions in the hyper-growth sector. Nothing has been more illustrative of the surge and subsequent collapse of the hyper growth trade than the ARK Innovation ETF (ARKK). From 2017 through 2019, ARKK handily outperformed the S&P 500, but once COVID arrived on US shores in Q1, the ETF experienced monumental outperformance. Over the last twelve months, though, ARKK has underperformed the S&P 500 by over 54 percentage points, erasing most of its historical outperformance versus the S&P 500.

On Jul 11:

The New York Fed runs a monthly survey of consumer expectations (SCE) which covers topics ranging from inflation, the labor market, and household finances, and while its history is limited (starts in 2013), it provides a great look at where US consumers see the state of the economy and financial markets. The latest update for the month of June was released earlier today and provided some really interesting insights regarding different trends, but one we wanted to focus on here is how Americans view the prospects for stock prices.

As the equity market has weakened this year amid higher inflation and the Fed's rate hike cycle, consumer sentiment towards the stock market has been declining, but the pace has really picked up in the last two months taking the total percentage of consumers expecting higher stock prices to its lowest level (33.8%) in the history of the survey. Put another way, just about two-thirds of US consumers expect stock prices to *remain flat or decline* over the next 12 months. Add this to the long litany of other sentiment surveys showing investors and consumers alike have little confidence in the stock market.