July 16, 2021

Dear Investor,

The economy has opened with a bang, companies are enjoying solid revenues boosted by people out and about resuming their previously normal activity and by the price hikes the companies are successfully pushing onto consumers.

For now, everyone who owns assets is feeling pretty good! People who own various commodities like lumber for example, feel good in particular:

We wrote about the commodity cycle in our letter last quarter, and the theory being pursued by many professional investors now. Is this the start of a long upward cycle in commodities? Perhaps. Lumber has pulled back lately, is it permanent? Or temporary? What does it mean for stocks? History shows that initially it is good as companies raise prices which are absorbed at first. Not long after that, however, consumers begin to purchase fewer units while simultaneously the costs for those companies are increasing. Stocks can be buoyant until we hit that point. Normally, a strong start such as this to the first half of a year sees continued strength, although many times it levels out. In 2013, we saw QE3 add $80 Billion/mo to the markets, and the S&P 500 rose upwards of 30% for the year. Right now, the Fed is adding $120B/mo to markets, a 50% increase, so perhaps the rise continues.

Q2 Earnings and Conference calls are about to start, so we will soon see what the odds are for further advances. We either rock on, or caution about inflation emerges. For more detail, along with a broader market review and outlook, please read on. And call us at (614) 734-WLTH (9584) if we can be of assistance helping you think through your positions!

Best Regards

Mike Sullivan, President, Certified Financial Planner Professional®

Perspective & Outlook:

The broken record theme continues … the $120 billion in newly minted money used by the Fed every month to buy mortgage bonds, U.S. Treasury bonds, and corporate bonds is keeping rates low and funding corporate stock buy-backs. The stock market continues to love it, and many investment account balances are rising, with no great worries about the new debt:

INDEX	TYPE	2021 Q2	YTD
Standard & Poor's 500	US Based Large Stocks (500)	**8.5%**	**14.4%**
Dow Jones Industrials	US Based Large Stocks (30)	**5.1%**	**12.7%**
Nasdaq Composite	US Based Large Stocks	**9.5%**	**12.5%**
Standard & Poor's 400	US Based Mid-Cap Stocks (400)	**3.6%**	**16.2%**
Russell 2000	US Based Small-Cap Stocks (2000	**4.3%**	**16.9%**
Dow Jones Transports	US Based Transportation Stocks	**2.0%**	**18.8%**
Dow Jones Utilities	US Based Utility Stocks	**0.1%**	**1.3%**
EAFE International Index	International Large Cap	**5.4%**	**9.2%**
MSCI Emerging Markets	Diversified Emerging Markets	**5.0%**	**7.4%**
Barclay Aggregate Bond	Intermediate Bond	**1.8%**	**-2.4%**
3 Month T-Bill	Cash Equivalent	**0.0%**	**0.0%**

Sources: *Bloomberg, vanguard.com, yahoo.com*

Central bank support continues without relent across the globe. They are all printing together, money managers are betting it will continue without trouble, and it is spurring this furious rally in stock and home prices. Many historical correlations are distorted, but it continues.

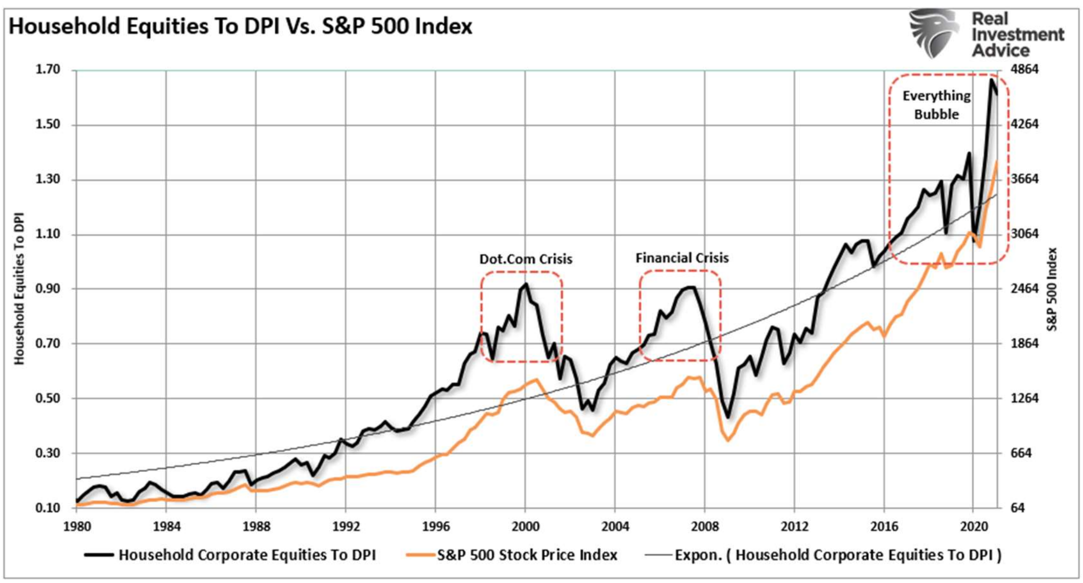
We saw the lumber picture above and we have written about the housing market many times. The Fed continues goosing housing by $40 Billion each month as it invents the money then 'buys' mortgage bonds, keeping rates ultra-low and boosting prices. It is great if you own your home outright. ***It is not so great if you want to buy one***, and in particular if you just entered the workforce only to see the home you grew up in jumped 25% in cost over the past year alone!

The home you grew up in did not get 25% better in a year (with no work done to it), rather your dollar was actually damaged by the Fed when it cranked 15 Trillion new dollars out of thin air … so you now need 25% more dollars to buy your old house. Home prices of course are one of many distortions caused by Fed monetary policy. The Fed has professed that their goal is to cause inflation. They've done it.

Like other asset prices, home prices rise too high then the marketplace of buyers catches the notion 'hey, this seems really crazy', then they step back. Putting dollars to the 25% inflation example above, consider that houses that sold for $400k a year ago are now going for $500k. In other words, it takes 1 whole extra dollar on top of the original 4 dollars to buy that house: same size, location, number of bedrooms and bathrooms, schools, etc. *It costs $100k more now!* Did the house change? Or, did the Federal Reserve destroy your dollar's purchasing power by 25%?

Whatever your answer, your child that grew up in that house, now just entering the workforce, needs another $100k (saved, after taxes) to buy that house she grew up in. We doubt she will thank the Fed for causing housing inflation … particularly once she figures out how many more hours she will need to work for that extra $100k (after taxes)! She is going to end up borrowing the money in all likelihood, owing the banks for the $100k and interest on it … ***for years***.

Inflation is good for stock portfolios initially too, as we have seen: this Ratio of Household Equities ownership versus Disposable Personal Income has hit an all-time high … trucking along with the S&P 500. So … at this point, households that own stocks ***love*** the Fed!



The Inflation relationship with stocks changes once companies raise prices to the point the Consumer balks. What typically happens is the Consumer backpedals from purchasing 10 widgets per month and only buys 7 or 8 widgets instead. That is the 'pricing point' where price increases fail to bring in more revenue. A company may initially bring in more dollars per widget, but the trade-off is it begins to sell fewer widgets, so revenue drops back down.

At some point, often soon after that 'price point' is discovered, the widget company announces it is absorbing higher costs for the ingredients that go into the widget production, including raw materials and labor, and can no longer pass through those price increases without having the number of units purchased drop. The arrival of that conundrum is often the inflection point for stock prices. Until that happens, we can continue to sail along.

Will that happen this quarter, next quarter, or somewhere down the road? We do not know, but we are alert that it could occur as soon as this quarter. We will be quite interested in the calls.

The Fed is hiding the impact of its inflation by financing the government policies that throw money all over the place: $600 stimulus checks, $1,400 stimulus checks, and now $300 monthly to 88 million families. Without all of this craziness, Consumers as a group would have balked long ago … buying fewer widgets everywhere. But, since the Fed creates more money, Congress then sends it to people, so they continue to buy and buy … all of which is good for stocks!

At some point, the Fed will have to stop buying $120B in bonds every month, including the $40B which goes to buy housing bonds. They will at some point also have to raise interest rates too. The challenge now is that they have fully trained markets to expect both forms of monetary easing virtually without end. So, they have essentially painted themselves into a corner. They cannot pull back from the printing or the upward climb in asset prices will almost surely stall.

'Covid relief efforts' saw nearly $8 Trillion created by President Trump in April 2020, $2.3T by President Biden in December 2020, then $1.9T in February, and now today another $3.5T of infrastructure stimulus. Meanwhile, the Fed continues pumping $120B monthly into asset prices. While fun now, we simply cannot see any clean way for them to stop printing money.

But for now, there is not a worry in sight. From a historic and 'technical' standpoint, there have been 35 years since 1929 (93 years in total) in which the S&P 500 did not close below its 200 Day Moving Average in the first half of the year (the red line in the chart below). There is tremendous technical strength in stocks now, regardless of whether the Fed is driving it or not. Here is a technical look at the S&P 500, with a potential target of 4420 in the days ahead. Of note, the S&P 500 stayed above the 200 DMA only 13 times (14% of the 93 years), meaning it at least declined to visit it in each of those other years. The S&P is presently 11% above the 200 DMA, so if it visits it this year, 11% would be a reasonable decline to expect, perhaps soon or this Fall. We suspect the Earnings calls and inflation comments will determine whether the upper target or the 200 DMA are visited next. Perhaps we will visit one then the other.

Chart 1: S&P 500 (SPX): Daily chart with moving averages

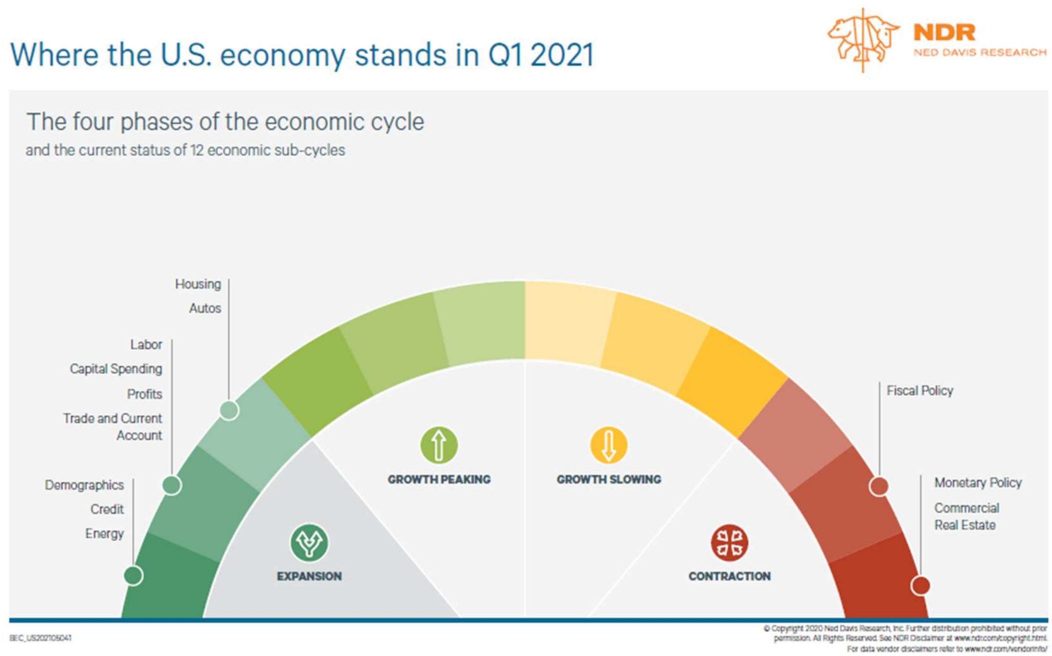
The SPX cleared 4238-4257 resistance to confirm a bullish cup and handle that sets up bullish summer seasonality (Signals for a summer rally) with upside potential to 4400-4420. Supports are 4257-4238 (prior resistance) and 4215 (rising 50-day MA) to 4168-4164 (June lows).

4,420 target ?

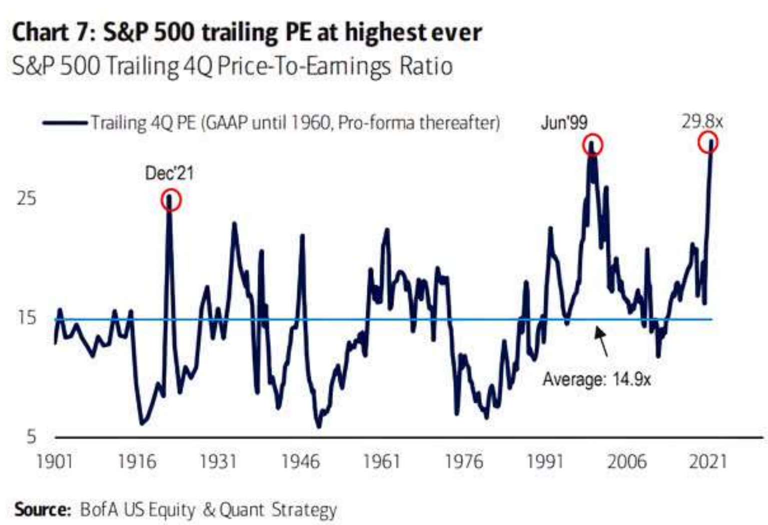
Source: BofA Global Research, Bloomberg

BofA GLOBAL RESEARCH

A risk to investors is that this *seems* like a no-risk market (and it may continue to act like one with such complacency as it is doing in the chart above) …but perhaps only until the Fed hints the punch bowl will have to be removed. In the chart below from Ned Davis Research, you can see the conundrum investors face as the real economy is ***roaring*** (green, left) … while the monetary policy is positioned in a place where it is creating obvious asset bubbles everywhere and it has become quite clear to major investors that the Fed will have to stop (right, red):

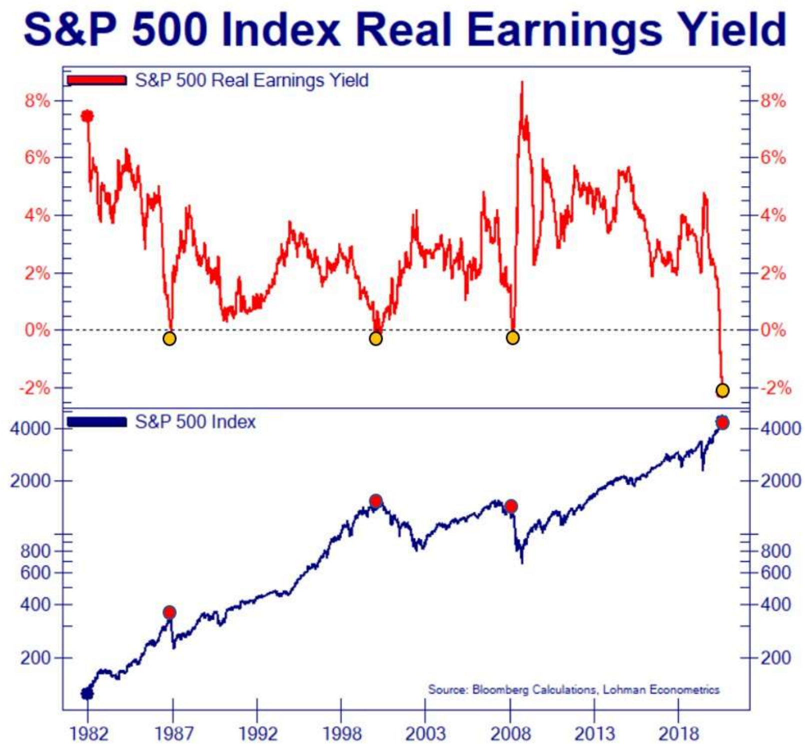


In other words, the economy is ***cranking***, <u>but</u> the Fed is going to have to stop fueling it at some point. This is the key chart for many investors: *the economy IS cranking! Yet the impact of the monetary policy, a major factor, must be taken into account in terms of future market direction.* Any market disturbance resulting from the Fed exiting its money printing policy could in turn negatively affect the real economy easily. They know this. Until volatility happens things can just chug along. The appetite for buying stocks regardless of the price is clear from the Price/Earnings ratio as we see here, more expensive than ***ever before***:



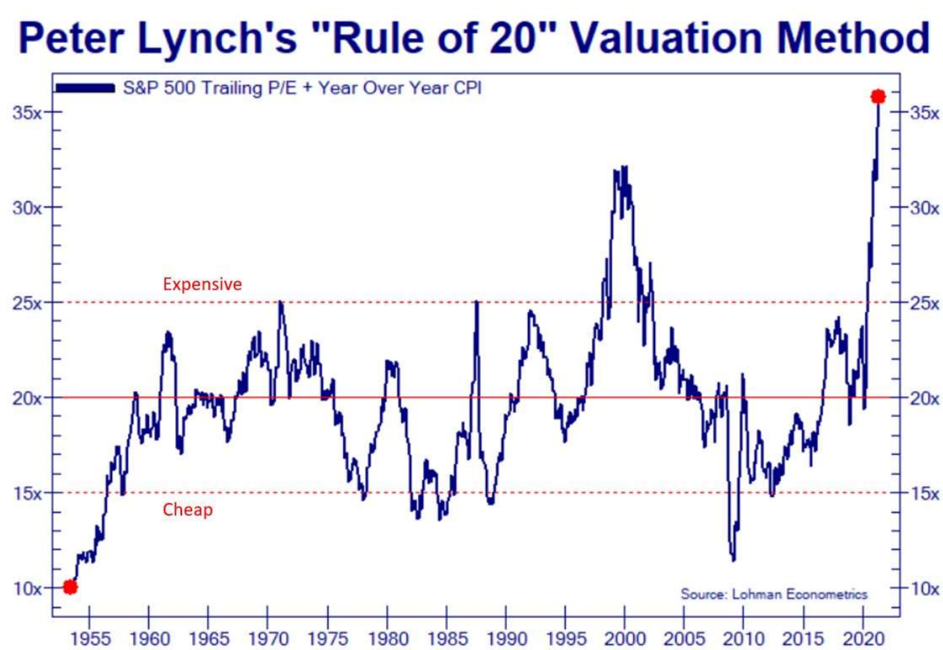
Today's ratio dividing the price of the S&P 500 by trailing earnings, has surpassed all others.

A similar valuation method tracks the valuation of the S&P 500 and its real earnings yield (earnings of the S&P 500 companies *minus* inflation, divided by the S&P's total valuation):

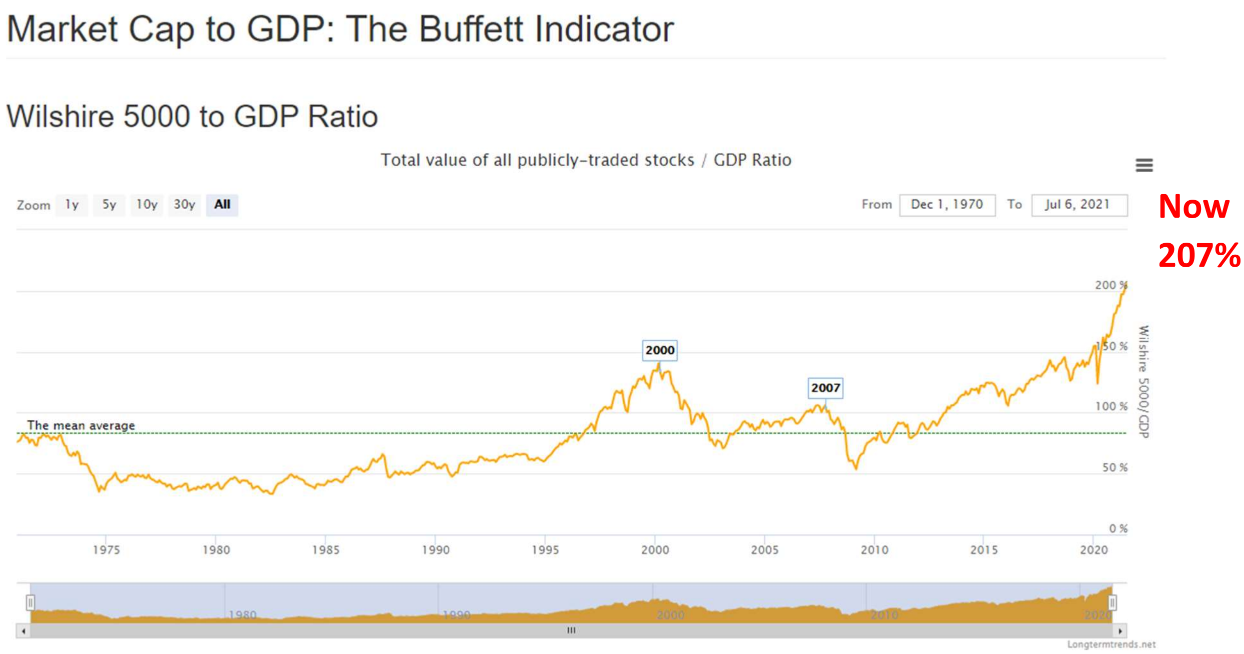


That metric has reached an all-time low! Of note, eyeball the circles above and you will observe that the orange circles above marked market tops in the S&P 500 below. Will it now?

Famed investor Peter Lynch tracked the trailing Price/Earnings ratio plus inflation (CPI), and he deemed a total over '20' to be expensive … but that was before the Fed's experiments:



And the Oracle of Omaha, Warren Buffett himself, measures valuations by taking the value of the broader Wilshire 5000 index then dividing it by Gross Domestic Product (all goods and services produced). Buffett's ratio has now hit 207% … versus just 150% during Y2K's bubble! All of these valuations suggest the 'recovery' has been more than priced in right here right now.



Your eyes tell you this market is historically overvalued. Your heart and your wallet hope it is not. We have been posting these charts (and attributing the relentless rise that destroys historical correlations all along the way) for several years. We do not know when it will matter. It is, in full fact, impossible to tell since central banks invent new money without ceasing.

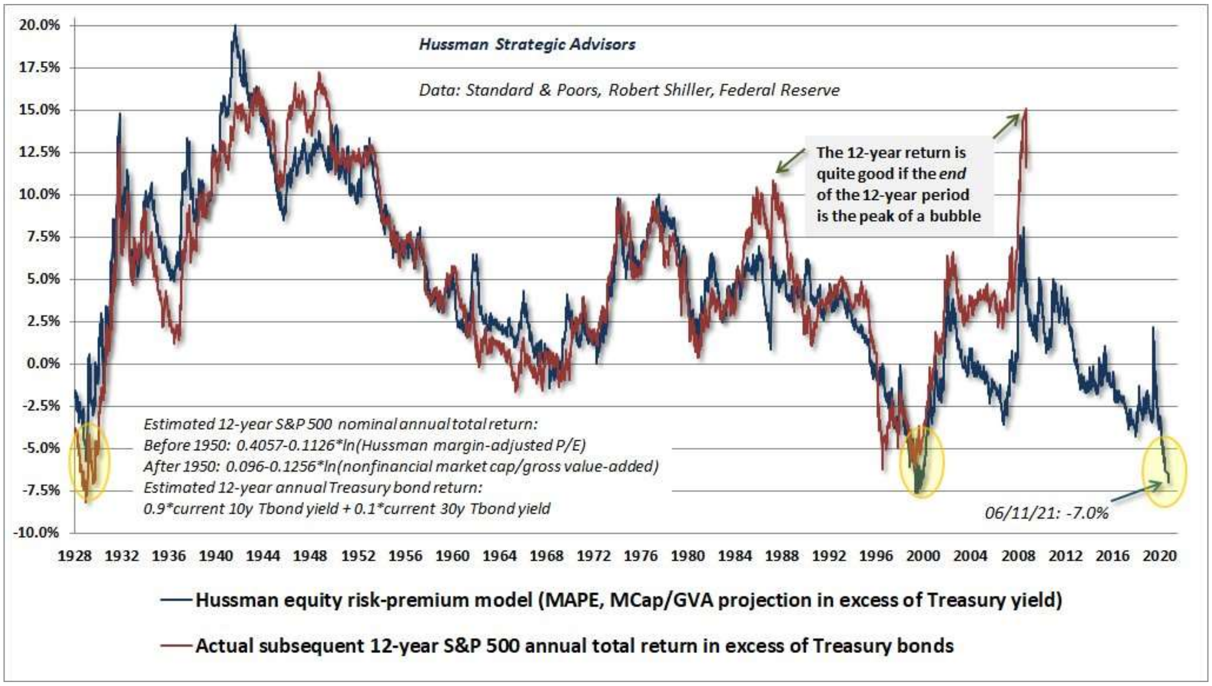
Respected advisor John Hussman thinks the Fed is in a box it cannot get out of, and he forecasts rather bleak expected future earnings, thus leading to very difficult stock returns. (That would assume that the Fed cannot successfully print money at the pace now underway.) Hussman has this to say about the current record-high valuations:[ii]

> ***"When investors form their expectations for returns based on price behavior, and price behavior is driven by investor expectations in turn, the feedback loop contributes to self-reinforcing bubbles. The situation is worse when investors ignore valuations in hopes of limitless "support" from policy makers, despite the absence of any reliable, mechanistic relationship – other than psychology itself – linking policy actions and security prices."***

In Hussman's chart that follows, notice that the S&P 500's actual subsequent returns (red line) normally tracks Hussman's wonky model (dark blue line), roughly right along it in fact, during the 12 years that follow. Hussman's model uses interest rates and 'cap weighted' price earnings ratios, but even without understanding the calculation itself, your eyeballs can easily see the correlation between the red and blue lines and is thus noteworthy.

Hussman's model forecasts a rough ride at **-7%** … something we all surely would rather not see.

Market participants recently surveyed apparently now expect 15% annual returns going forward … so anything near Hussman's result would be quite a shock to say the least.



-7%

No Thanks!

Hussman's work suggests that central bank (CB) intervention and fiscal stimulus create bubbles which overheat everything, and thus have to be backed off which then cools everything down for a while. When CBs stop printing (by choice or by being forced to by other countries), this 'monetary experiment's' rally will most likely come to an difficult end.

While we have long pointed out the ultimate challenge that money printing would present one day, and we are amazed it has continued. There is a phase in historic episodes where inflationary assets surge as the new money is printed, because those assets are able to have their prices raised by the asset owners for a period of time. Once that period passes, fortunes reverse and asset prices dive. This phase we are in may be just that phase.

That professional money managers have not only 'allowed' the money printing to continue, but have rather enthusiastically *encouraged* it to continue, may just be a reflection on human nature and greed, we do not know. 'Professional' money managers should be familiar with such monetary episodes throughout history, including how they end.

Time will tell whether we are on the lucrative phase preceding an end, and/or whether we have more upside to go. Is the strong economy strong enough to justify the relentless asset price increases? Or has the money printing exaggerated the trend? We continue to suggest that those who are fully invested keep a wary eye on the central banks. They are the key, or perhaps more accurately, their ability to keep printing money and using it to either increase or sustain current asset price levels is the key.

To move away from all of the over-valuation charts, and seek to end on a positive note, the table below published by Earnings Scout illustrates the success of the money-printing efforts.

S&P 500 EPS growth estimates continue to rise, but at lesser rate(s)

Date	2Q21E EPS Growth	3Q21E EPS Growth	4Q21E EPS Growth	1Q22E EPS Growth
2/1/2021	42.18%	14.05%	18.65%	18.21%
3/1/2021	45.90%	13.98%	14.59%	18.32%
4/1/2021	48.43%	15.32%	12.05%	17.74%
5/1/2021	55.70%	18.62%	15.63%	9.10%
6/1/2021	57.16%	19.63%	16.34%	5.88%
7/1/2021	59.34%	20.43%	16.76%	7.03%
7/15/2021	63.35%	20.88%	17.35%	6.55%
7/21/2021	65.65%	21.26%	17.80%	6.95%
7/22/2021	67.23%	21.34%	17.80%	6.87%

Source Earnings Scout

To date, Central Banks have indeed managed to use their newly minted money to suppress interest rates, make more money available for companies to borrow (whether they use it to expand their businesses or just buy back their own stock), and distribute some of the new money to the public in an effort to keep the public afloat in an inflationary environment.

The numbers are the numbers. Earnings per share have grown substantially since the COVID shut-downs, and no negative effects to companies have been allowed to manifest.

The table shows that as the weeks have gone by, the earnings *per share* have strengthened for Q3, and Q4 weakened then strengthened. As would be expected, once the COVID shut down impact rolls off, the rates of growth can be expected to return to more normalized levels.

We can see in the far righthand column that since February of this year, the anticipated growth rate for Q1 of next year, 2022, has slowed down notably however.

This time frame will also coincide with the timetable of our Fed as it has stated it will cease printing the $120B per month at the end of 2021.

What does it all mean when we look at everything together?

It means that stocks are expensive here, no question. And it means the growth pace can be expected to slow down as we move through the back half of this year. That all assumes that the policy continues to succeed, and it allows for stocks to continue to rise even further. It also presumes no other events will impact matters from the outside, such as consumption pulling back, coronavirus resurgence or geopolitical events that might affect real economic activity.

Time will provide the answer to all of those questions.

In the meantime, let us enjoy the hustle and bustle of a truly stimulating ***real*** economy, work hard, save, and enjoy each other. We'll do our best to identify the true turning point.

We hope you enjoy Summer 2021, call us if we can be of assistance at (614) 734-WLTH (9584)!!

The opinions and forecasts expressed are those of Mike Sullivan and may not actually come to pass. This information is subject to change at any time, based on market and other conditions and should not be construed as a recommendation of any specific security or investment plan. Past performance does not guarantee future results. An investor cannot invest directly in an index. The Standard & Poor's 500 (S&P 500) is an unmanaged group of securities considered to be representative of the stock market in general. The Dow Jones Industrial Average (DJIA) is a price-weighted average of 30 significant stocks traded on the New York Stock Exchange and the Nasdaq. The NASDAQ Composite Index is an unmanaged, market-weighted index of all over-the-counter common stocks traded on the National Association of Securities Dealers Automated Quotation System. The Standard & Poor's 400 Mid Cap Index tracks the stocks of 400 mid-size U.S. companies. The Russell 2000 Index tracks the stocks of 2,000 small U.S. companies. The Dow Jones Transportation Average (DJTA) is a price-weighted average of 20 transportation stocks traded in the United States. The Dow Jones Utilities Average (DJUA) is a price-weighted average of 15 utility stocks traded in the U.S. The Morgan Stanley Capital International Europe, Australia and Far East Index (MSCI EAFE Index) is a widely recognized benchmark of non-U.S. stock markets. It is an unmanaged index composed of a sample of companies representative of the market structure of 20 European and Pacific Basin countries and includes reinvestment of all dividends. Individuals cannot invest directly in an index. The Nikkei 225 Index is the Japanese equivalent of the US Dow. Price-weighted average of 225 stocks of the first section of the Tokyo Stock Exchange. The Hang Seng Index is a free float-adjusted market capitalization-weighted stock market index in Hong Kong. Investments in precious metals such as gold involve risk. Investments in precious metals are not suitable to everyone and may involve loss of your entire investment. These investments are subject to sudden price fluctuation, possible insolvency of the trading exchange and potential losses of more than your original investment when using leverage. Securities America and its Representatives do not make a market in, conduct research on, or recommend purchase or sale of securities mentioned.

[ii] https://www.hussmanfunds.com/comment/mc210614/