

Recession or Inflation?

It seems the primary purpose for the news today is to terrify us. If it is not about a pandemic, it is to convince us we will never achieve our financial goals because of the market's recent declines. If you are tuned in at all, you are reminded constantly that the market has reached an "official bear market". This is defined as a decline of 20% or more from the most recent market high.

Historically every market decline has its own unique reasons. The current episode of market declines have two primary causes. Inflation and the Federal Reserve's belated efforts to fight it by increasing interest rates. The war in Ukraine, higher energy costs and supply chain issues are contributors to these two main issues.

From March 2009 (when the equity market bottomed at the end of the Great Recession) through the end of 2021, equity markets went on the longest bull market run in history. Over those last three calendar years (2019 – 2021), partly because the 4th quarter of 2018 the equity market almost declined into bear market territory and despite a hundred-year global health crisis that carried off millions of people worldwide to their grave, the equity markets compounded at 20% plus per year growth. This was one of the greatest runs of all time.

It should be obvious that some part of the appreciation in equity markets was due to excessive monetary stimulation by the Fed. And to that extent, we are having to give some of that gain back, as the Fed moves to bring the resulting inflation under control. No government can increase money supply into the economy by 40% without inflation. We should want the Federal Reserve to fight this inflation and drive us into a recession if that is what it takes to bring inflation down. We do not want close to double digit inflation for the next 5 years. No one wants to pay 30-40% higher prices 4-5 years from now. If the cure for this disease is a recession or the possibility of, the cure is not more painful than the disease. Recessions (2 quarters in a row of negative GDP growth) are part of the business cycle.

For long-term investors, with long term goals, panic during market declines or recessions is not a plan. Our long term planning takes into account bear markets and recessions. It does not take into account exiting equity allocations in the middle of bear markets. It has proven to be a tragedy to many to which retirement plans may never recover. Our investment philosophy and planning focus is founded on accepting the idea that the only way to be reasonably assured of capturing equities' premium returns over time is by riding out their occasional declines.

We cannot insulate our clients from short term market volatility, but we can help minimize long-term regret – the regret that always follows a panic driven exit when equities resume their long-term advance. As they always have, 100% of the time in history, the equity markets have recovered and exceeded its previous highs.

We continue to counsel staying the course. Consider rebalancing to more equities as there are few times we get to buy the great companies of the world 20% off. We are always here to talk this through with you. Thank you for being clients. It is truly a privilege to serve you.

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