MULVIHILL

By the Way

Monthly commentary from Jack Way

"Blood sweat and tears"

A month for the record books that no one I know saw coming. It was the 15th best month for the S&P 500 in the last 50 years and the 2nd best November since 1980. It highlights what a crazy year this has been that despite the recent rip higher the market was flat over the past six months having peaked at 4589 in July and closing at 4604 last week. Lots of movement in between, but ended up at the same level; and here's another fun fact, the S&P closed at 4567 on November 30, 2021 and 4567.8 on November 30, 2023. A lot of blood sweat and tears was expended to go nowhere. In late October there was a sudden, and at least to me, unexplainable shift in investor sentiment from concern about the FED's ongoing mantra that interest rates would remain "higher for longer" to a wide consensus that inflation was being controlled, the FED was done tightening, rates had peaked, the economy was fine, and both bonds and stocks needed to be bought. To add to the demand most hedge funds and other aggressive portfolio managers had taken large short positions during the summer weakness in prices and became big buyers to get back onside. We are now at a point where both the S&P and NASDAQ are very overbought, and a bit of a rest wouldn't be a bad thing. Even if that were to happen, the strength and breadth of the recent market action should be more than enough to push prices higher through year-end and into the first quarter, and not forgetting that bull markets can and should stay overbought for long periods of time.

If you haven't seen the movie "The Big Short" I recommend it. It's a realistic portrayal of the equity management business and in particular being a contrarian investor. The rewards of taking a position that is opposite to consensus can be very rewarding, but often painful. Consensus is always right until it isn't, and that can take a lot longer than expected, during which time you will be losing money and perhaps worse, looking and feeling kind of stupid. I, like many others, expected the tightening policies of the FED to make a recession at least a likelihood in 2023. In fact, back in January the consensus of Wall Street strategists was for 2023 to show a negative return which as we well know is not the case. The forecast about the FED tightening was correct but the expected impact on the economy and markets was not as anticipated. As someone said, knowing the answer doesn't make you necessarily do the right thing. Which begs the question what do we do now. Sentiment indicators are now extremely positive and Wallstreet is overwhelming bullish; everything points to higher markets and with the exception of JP Morgan the last bear appears to have thrown in the towel. That means we're getting closer, but not necessarily ready for a bearish turn just yet. I wrote last month that I remain of the belief we will see a recession in 2024 that will precipitate lower prices. If the FED hasn't already tightened too long and too much and can keep us on a glide path to lower inflation and some economic growth, and then provide new easing before there are any serious problems, I will be proven wrong. In my mind that is asking a lot and I worry its more than the Board is capable of.

We can say we are very unlikely to see another bout of strength like we experienced last month. Especially impressive was the move in the 10-year U.S. Treasury Yield from 5% to 4.25% (which had a positive impact on stocks). It was the best month for bonds since 1980. The positive returns for fixed income securities continue to attract investors to money market funds yielding 5%, and now for the first time a bond ETF has surpassed $100 billion (the Vanguard Total Bond Market ETF).

The U.S. Presidential race is now less than a year away yet is not a big part of the conversation so far. That is likely to change in the near future as the potential impact on the market will be meaningful. The difference between a Biden budget or a Trump budget (or any other Democrat or Republican) will be very consequential to the economic outlook. Having said that, politics and geopolitics have had a minimal effect on markets for at least the last decade; Gaza being the most recent proof of that. I do take note that after the Middle East and Ukraine, the number one global concern is a fear China may become more aggressive toward Taiwan. I was not aware until reading about the upcoming (January 13th) election in Taiwan that the second and third place political parties are described as "China" or "Mainland Friendly". Maybe China won't have to use force?

On a final note, if anyone is concerned about the direction of the S&P or other markets the extremely high level of bullish consensus has led to very low prices for options, such that the cost of buying protection through puts or calls is very cheap.

Safe and Happy Holidays to one and all!

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Disclosures