Marketline August 2021

Stocks:

August brought another lift to US stocks. The Nasdaq in particular dished up a robust return, at 4%. But the S&P was nearly as strong, giving us almost 3% and the Dow exceeded 1%. Of course, we are moving into the season of volatility, namely September/October. It seems there's always something worthy of worry this time of year. Currently, we have the Treasury running out of cash in about the early October time frame, when the debt ceiling must be raised by politicians – a recipe for trouble. Also on deck is a $3.5 trillion dollar budget package along with the $1.5 trillion infrastructure package pending in Congress. Some of these enormous spending bills will no doubt be paid for by raising taxes, a prospect that can shake markets at least temporarily.

Against this background, Covid continues its grim march. Already some schools that had started for fall have closed or quarantined students, employers have delayed returning to offices, airline traffic is falling off, and the last employment number was quite poor. A hesitation has developed in the economic recovery. And the economy hasn't even seen a full measure of the expiration of extra employment benefits or the cessation of eviction moratoriums.

Meanwhile, plenty of stocks have reached all time highs. So, it's probably time to think about dialing back risk. We're always trimming large portfolio positions – meaning that if we bought a stock and its performance has been particularly outstanding, bringing it up to a high value inside your portfolio, we sell a few shares now and then. These sales mitigate the possibility that if that one stock tanks for some idiosyncratic reason, your entire portfolio won't be unduly affected. (Another way to say this is – we try to prevent the tail from wagging the entire dog.) But very high valuations call for more drastic action. In this vein, we've let Gray Television go entirely, and we've pared back Charles Schwab shares and a couple other names aggressively, depending on portfolio circumstances. Earnings season will start again in a month or two. With any luck, some stock on our 'watch' list will crater, and we'll have a shot at a good long term buy.

Overseas, results were about in line with our Dow, except down in Mexico, where the Bolsa surged! Prices there rose almost 5% as trade picked up and the country's economy rode the wave of demand for autos and electronics in the US. Though we don't formally follow the Hong Kong market any longer, China deserves special mention this month: Xi has embarked on a reordering of China's economy through regulation that has upset investors mightily. Several blue chip Chinese stocks have fallen 30%, 50%, some more, from highs late in 2020. Industries sideswiped by new rules include internet shopping and finance, learning institutions, gaming, and miscellaneous companies that collect data such as ride sharing and food delivery. The impetus behind the onslaught of heavy handedness is Xi's stated goal of reducing inequality both at the household level and in marketplaces – leveling the field for competition to take place. While Western observers have written that these actions will reduce innovation and risk taking, it is entirely possible that the opposite will occur. Our own country could benefit from a reduction in monopolistic practices.

Bonds:

Interest rates nudged up very slightly last month, barely enough to mention. The market is still struggling to decide whether we're facing inflation or a slowdown – and some have whispered that dreaded word 'stagflation', meaning both. So far, inflation is not proving very 'transitory'. And we are certainly in the midst of a soft spot in the economy. But like this pandemic, things are just simply going to move in fits and starts for some time. That's why the Fed is keeping the flood gates mostly open on the monetary front.

We're still fans of the 'low interest rates for a long time' thesis. We're also starting to buy into the idea that recessions are becoming politically unfeasible. This could mean endless 'QE' in the form of bond buying by the Fed and low short term interest rates, interrupted by occasional attempts to 'taper'. We expect these taper attempts to be met by market disruptions that discourage Fed action. In the eighties, 'bond vigilantes' – investors - caused big interest rate hikes at the slightest hint of inflation. Now we have a new form of vigilante-ism, where investors keep the happy drumbeat of ever higher stock prices and ever lower interest rates going, so long as the Fed cooperates by maintaining loose monetary policy. In this way and others, the Fed is hostage to the markets. In a practical sense, this means that credit will tend to improve and default risk will diminish – continuing to chase investors into lower quality product - but rewards from bond investing will also diminish.

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