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THE “YOU MAY NOT KNOW REPORT”

A PUBLICATION OF RETIREMENT LIFESTYLE ADVOCATES

Have Stocks Bottomed?

By Dennis Tubbergen

As this 11th issue of the “You May Not Know Report” is being assembled (October 26, 2022), the stock market, as measured by the Standard and Poor’s 500 is down 17% year-to-date.

Stocks, using the Standard and Poor’s 500 as the metric, have been down as much as 25% from the price levels that stocks enjoyed at the beginning of this calendar year.

That brings up the obvious questions. Have stocks bottomed here? Or, is there more downside for stocks before a bottom is in?

To attempt to answer this question, we will look at two different analysis tools. The first is a fundamental tool that looks at the total value of stocks divided by economic output (market capitalization divided by gross domestic product). The second is a technical tool that examines the relationship between total debt associated with markets (margin debt) and stock prices.

The fundamental tool of market capitalization compared to economic output is often colloquially referred to as "The Buffet Indicator" since stock guru, Warren Buffet, has stated it is his favorite stock valuation tool.

The chart below shows the historical value of "The Buffet Indicator".

Notice that at the recent market peak the total value of stocks was 243% of gross domestic product.

Compared to the tech stock bubble peak of calendar year 2000, that was an increase of 93%!

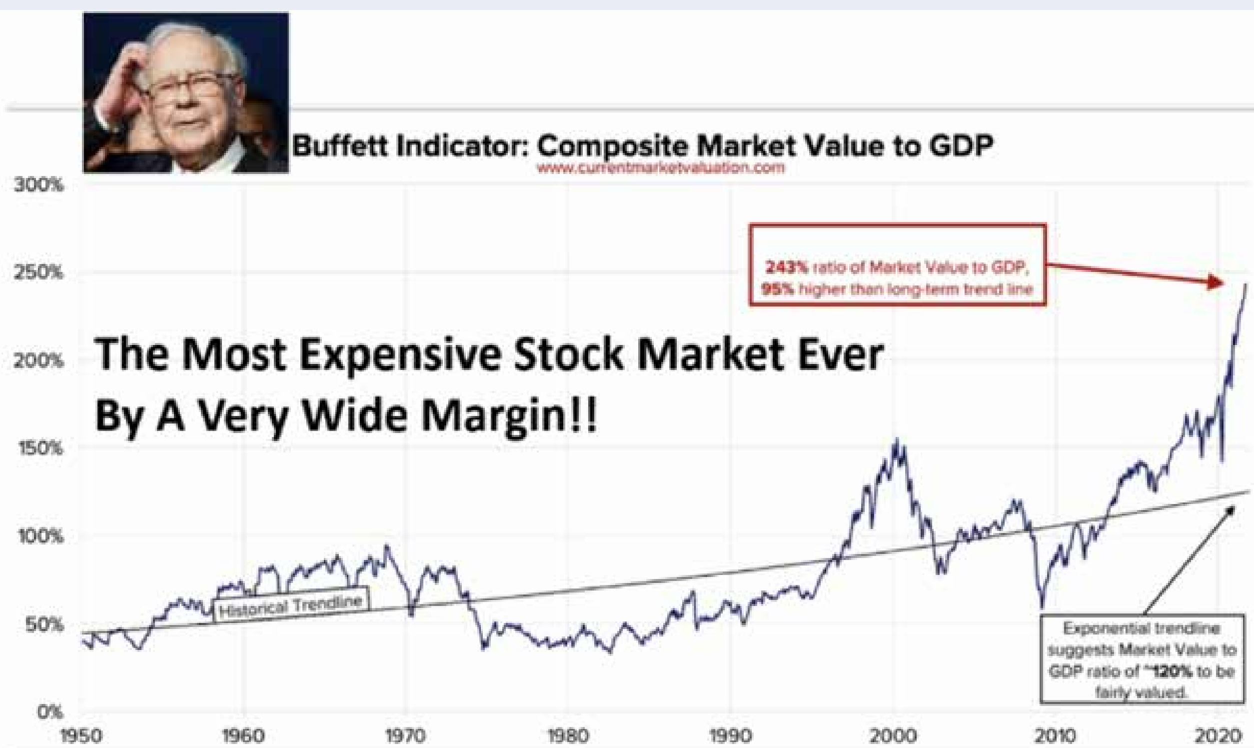
The current decline in stocks was not a surprise from a valuation standpoint.

Even after the recent decline in stocks, as of October 21, 2022, the "Buffet Indicator" stood at 158% of U.S. economic output[1].

While the publisher of the chart above concludes that the stock market is 'fairly valued', I would disagree.

First, notice the upward trajectory of the market capitalization to GDP trendline. If the relationship between market capitalization and GDP was between 50% and 100% from 1950 to 1970, what makes a current valuation of nearly twice that a fair valuation?

The short answer is, in my view, it is not a fair valuation. There are many factors that determine stock price, the most common and most reli



https://markets.businessinsider.com/news/stocks/warren-buffett-indicator-record-global-stock-market-boom-bubble-crash-2021-9 able being the simple formula that drives most any sound investment: what am I investing and what can I expect my return to be?

In the case of stocks, that's share price and earnings. What am I investing per share to buy the stock and what will be return be on my investment in the form of earnings?

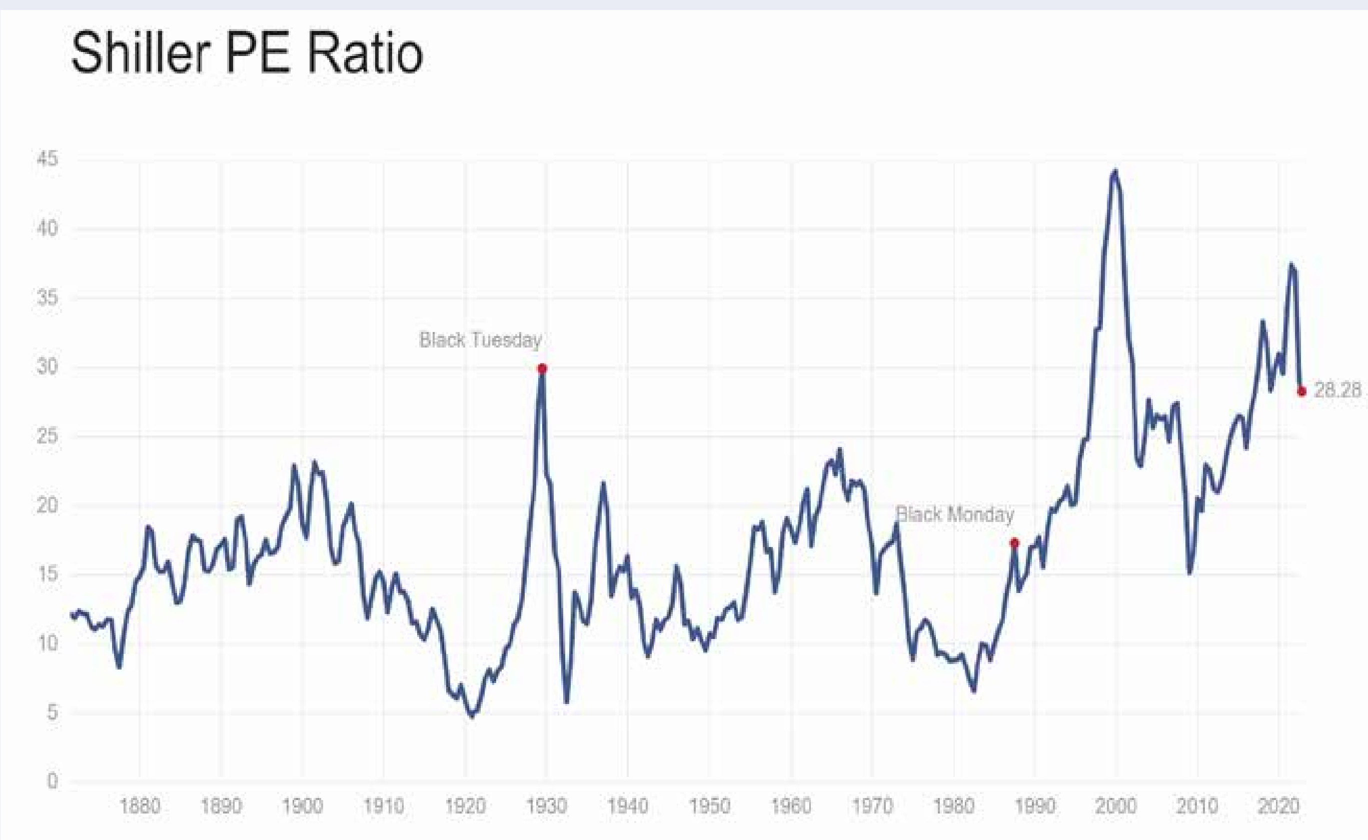
The chart below is a chart of the price to earnings ratio in the market going back to 1870.

Notice the current price to earnings ratio is about 28, not far from the valuation levels of 1929 prior to the 90% decline in stocks. It is also worth noting that current valuation levels using P/E ratio as a metric are higher than when the market decline began at the time of the Great Financial Crisis.

By both the Buffet Indicator measure and the PE measure, I would make the argument that stocks remain overvalued.

The second point I would make about the Buffet Indicator is that the denominator of the fraction is economic output or gross domestic product. As you are probably aware, the economy is contracting which increases the level of the Buffet Indicator.

While markets, including stock markets, rarely go straight up or straight down, I believe there is more downside moving ahead for stocks as the economy continues to contract.



Will the Federal Reserve Reverse Course?

The central bank of the United States, the Federal Reserve, has begun a course of increasing interest rates ostensibly to fight inflation.

The reality of these hikes, as I've state in the past, is that the US economy and the financial markets have become addicted to easy money and free-flowing credit. As the easy money and credit is withdrawn from the economy, markets will correct and the economy will contract. There is indisputable evidence presently that is occurring.

Stocks have had a miserable year as have bonds. If someone had told you one year ago, in November of 2021, that stocks would be down 25% over the next year and long-term US Treasury bonds would decline more than 30%, you may have laughed at the forecast.

Yet, that is exactly what has occurred.

And, economic conditions are continuing to deteriorate and the price of financial assets continue to decline. Americans are feeling the effects of failed Fed policy. This[2] from Michael Lebowitz:

> *We have reached a point where nearly two-thirds of all Americans are living paycheck to paycheck. So what happens if millions of those people suddenly lose their paychecks during the severe economic downturn that is ahead of us? In 2008, unprecedented numbers of Americans found themselves unable to pay their mortgages when the recession struck, and foreclosures surged to absolutely shocking levels. Unfortunately, we have set ourselves up for the same thing to happen again. Most Americans are literally teetering on the brink of financial disaster, and it won't take much to push them over the edge.*
>
> *According to a survey that was just released, 63 percent of Americans were living paycheck to paycheck in September…*
>
> | *As rising prices continue to outpace wage*

> *gains, families are finding less cushion in their monthly budget.*
>
> *As of September, 63% of Americans were living paycheck to paycheck, according to a recent LendingClub report — near the 64% historic high hit in March. A year ago, the number of adults who felt strained was closer to 57%.*

Why aren't more people alarmed by the fact that nearly two-thirds of the entire country is just barely scraping by from month to month?

If you do not have anything to fall back on, you are just one major setback away from extreme financial distress.

A job loss, an auto accident or a serious illness could hit at any time. If you suddenly experienced such a tragedy, how would you make ends meet?

A different survey that was recently conducted found that two-thirds of all working adults in the United States believe that they are "worse off financially" than they were 12 months ago…

> *As inflation pressures continue, two-thirds of working adults said they are worse off financially than they were a year ago, according to a recent report by Salary Finance.*
>
> *To make ends meet, many are dipping into their cash reserves or going into debt.*
>
> *Nearly three-quarters, or 72%, of consumers have less in savings than last year, a jump from 55% who said the same in February, the report found. And 29% said they have wiped out their savings entirely. The report is based on a survey of 500 adults in August.*

So most of us are living paycheck to paycheck, and most of us are also doing worse than we were in 2021.

Isn't that just great?

If things are this bad already, what will these numbers look like six months from now?

We continue to get even more evidence that we are plunging into a very painful economic downturn. For example, on Tuesday we learned that U.S. business activity has now contracted for 4 months in a row…

> *U.S. business activity contracted for a fourth straight month in October, with manufacturers and services firms in a monthly survey of purchasing managers both reporting weaker client demand, the latest evidence of an economy softening in the face of high inflation and rising interest rates.*
>
> *S&P Global said on Monday its flash U.S. Composite PMI Output Index, which tracks the manufacturing and services sectors, fell to 47.3 this month from a final reading of 49.5 in September.*

And just like we witnessed in 2008, home prices are starting to crash at an alarming rate.

In fact, it appears that prices are going down particularly fast in the western portion of the nation…

> *The study was conducted by Ed Pinto—director of the American Enterprise Institute's Housing Center. Pinto told Fortune that he predicts that the 'damage' will spread for the Northeast, with low and middle-markets being hit the worst.*
>
> *It's Northern California that leads the way, with San Jose experiencing a drop of 10.8 percent since September, followed by San Francisco at 8.5 percent, then it's Seattle at 8.2 percent, Denver at 5.8 percent, San Diego 5.2 percent, Portland 5.1 percent, Las Vegas 4.8 percent and Phoenix at 4.4 percent.*

Unfortunately, millions of Americans that purchased homes at or near the peak of the market could soon find themselves "underwater" on their mortgages.

Do you remember the last time such a thing happened?

It was a complete and utter nightmare. Countless homeowners ended up simply walking away from their mortgages, and that caused a giant mess for our financial institutions that took many years to finally sort out.

In so many ways, what we are going through right now is reminiscent of what we experienced in 2008 and 2009.

And just like we witnessed in 2008, most Americans are completely and utterly unprepared for what is ahead.

To me, that is quite strange, because at this point what is happening to the economy should be apparent to everyone.

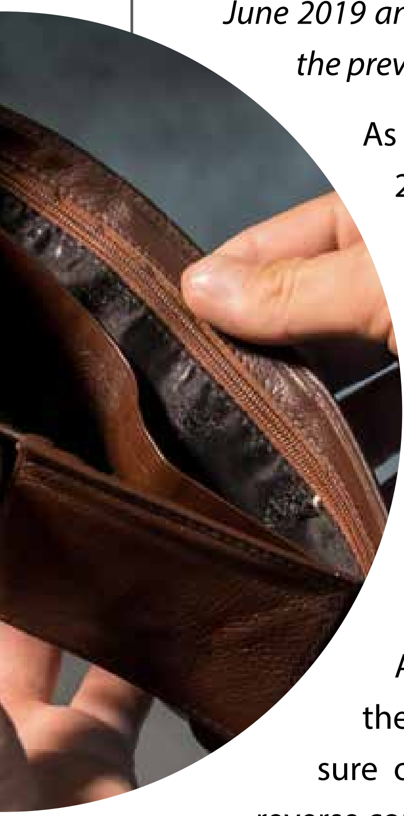
We are enduring the worst inflation crisis in decades, the housing market is starting to come apart at the seams, and economic activity is slowing down all around us.

The state of the U.S. economy has become a top issue during this election season, and pessimism about the future seems to be permeating just about everything.

In fact, at this point Americans are even becom-

ing more pessimistic about the long-term future of their children…

> *Americans have as little optimism as they have had at any time in nearly three decades about young people's chances of having greater material success in life than their parents. In all, 42% of U.S. adults think it is very (13%) or somewhat (29%) likely that today's youth "will have a better living standard, better homes, a better education and so on." This marks an 18-percentage-point drop since June 2019 and is statistically tied with the previous low in 2011.*



As Lebowitz points out, about 2/3rd's of Americans are living paycheck to paycheck, while those that have financial assets are seeing the values fall. We are witnessing what is, in my view, shaping up to be the perfect economic storm.

As the storm intensifies, there will be increasing pressure on the Federal Reserve to reverse course reducing interest rates and perhaps resorting once again to currency creation from thin air to give an addicted economy more of what it craves.

That pressure is now beginning to build. Many of the politicians presently in power are now pointing a finger at the Fed and insisting the Fed do more to prop up the economy. While the finger pointing at the Fed is not completely unwarranted in my view, there is also plenty of blame to lay at the feet of the Washington politicians as the Fed cannot stop currency creation until the Washington politicians balance the federal budget. This[3] from "Zero Hedge":

> *Back In July, we wrote "Democrats Prepare To Unleash Hell On Fed Chair Powell For The Coming Recession", in which we laid out the "cunning" Democrat plan to blame Fed Chair Jerome Powell for the economic hurricane that is imminent, as poll numbers started to slide and the Midterms looked like a disaster:*
>
> > *"It is important for the Fed not to overreach and trigger a recession unnecessarily, as part of its effort to bring inflation down," said Representative Hakeem Jeffries of New York, the No. 5-ranked House Democratic leader.*
> >
> > *"Inflation is a global problem, and is actually not as bad in America as it is in almost every other developed economy in the world," he told Bloomberg.*
>
> *Then, in September, none other than Senator Elizabeth Warren unleashed hell on the former lawyer, tweeting that:*
>
> > *"Chair Powell just announced another extreme interest rate hike while forecasting higher unemployment.* ***I've been warning that Chair Powell's Fed would throw millions of Americans out of work — and I fear he's already on the path to doing so****."*
>
> *Interestingly, we noted at the time that Senate Banking Committee Chair Sherrod Brown, an Ohio Democrat, defended Powell during an interview on Bloomberg Television. But that all changed on Monday, when in a sternly-worded letter Brown made it clear that he too is on team-*

fake Indian and that Powell needs to stop the hikes now (which he won't, but will provide just the right cover for Democrats when the catastrophic job prints start hitting).

> *"As you know, the Federal Reserve is charged with the dual mandate of promoting maximum employment, stable prices, and moderate long-term interest rates in the U.S. economy. It is your job to combat inflation, but at the same time, you must not lose sight of your responsibility to ensure that we have full employment.*
>
> *For the first time in decades, we have seen historic job growth, and workers have begun to see wage gains, gains that your prior actions to stabilize the economy helped achieve. Yet, many workers and their families are struggling under the weight of inflation."*
>
> *"However, a family's "pocketbook" needs have little to do with interest rates, and potential job losses brought about by monetary over-tightening will only worsen these matters for the working class. "*

Translation: leave inflation alone - which by implication means raise the Fed's inflation target to what 4%? 5%%? and instead just focus on preventing the economy from getting much worse.

And now, just two days later, yet another Democrat - and certainly not the last - has joined the chorus, when Senator John Hickenlooper sent a letter to Powell urging the Fed Chair to "pause and seriously consider the negative consequences of again raising interest rates."

You're hearing it here again – it is just a matter of time before the Fed reverses course, throwing in the towel on inflation and attempting to prop up the economy. It is highly likely that this pivot happens when the Washington politicians decide that more stimulus is needed. Given that 67% of Americans are now living paycheck to paycheck, that day may get here soon.

Housing Market Continues to Slump

As noted in this issue, the housing market is now following the stock market lower. This[4] from CNBC:

Mortgage demand fell last week to nearly half what it was a year ago, according to the Mortgage Bankers Association, as rates hit their highest level in 21 years.

Overall, demand for mortgages is at the lowest level since 1997.

Mortgage applications to purchase a home dropped 2% from the prior week and were 42% lower than the same week in 2021. The annual comparison continues to jump each week, as fewer buyers either want or can afford to get into this very pricey housing market.

Applications to refinance a home loan fell just 0.1% for the week, but only because they were so low to begin with – down 86% from a year ago. There are currently fewer than 150,000 qualified borrowers who could benefit from a refinance at today's rates, according to Black Knight.

Mortgage rates declined slightly to start this week, but are still well over 7% after beginning the year at around 3%. The average contract interest rate for 30-year fixed-rate mortgages with conforming loan balances ($647,200 or less) increased to 7.16% from 6.94%, with points decreasing to 0.88 from 0.95 (including the origination fee) for loans with a 20% down payment.

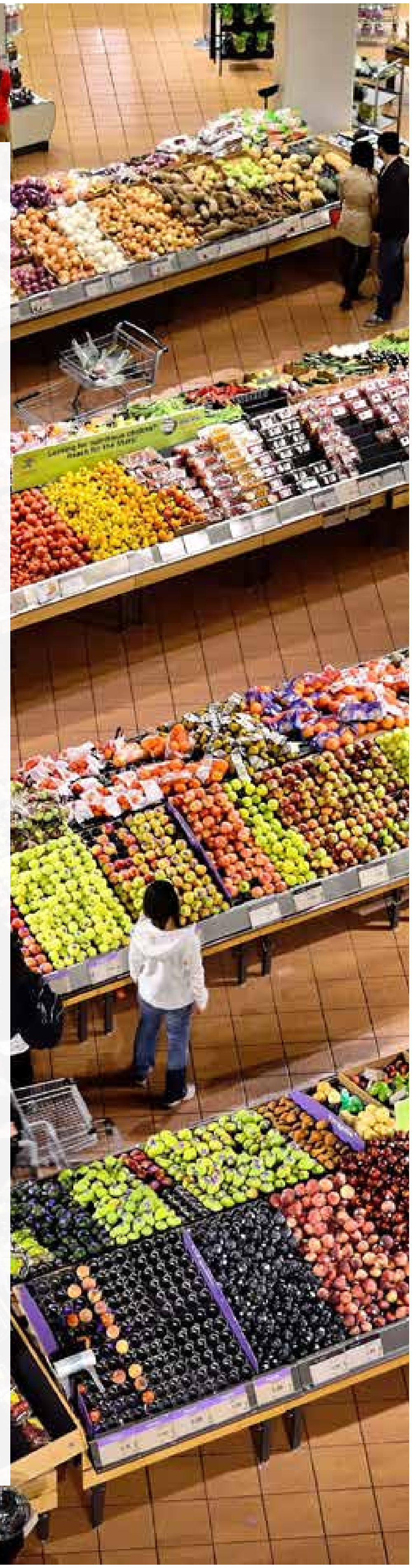
Federal Housing Administration loans, which come with lower rates and smaller down payment requirements, did experience a slight uptick during the week.

"Despite higher rates and lower overall application activity, there was a slight increase in FHA purchase applications, as FHA rates remained lower than conventional loan rates," said Joel Kan, an economist at the Mortgage Bankers Association.

The share of homebuyers applying for adjustable-rate mortgages remained high at more than four times what it was at the start of this year. ARMs offer lower rates but are considered a riskier product.

High interest rates are also weighing on home prices. While prices are still higher than they were a year ago, the gains are now slowing at a record pace. Homebuyers are also reconsidering their purchases. Pulte Group reported a 24% cancellation rate in its latest quarterly earnings report Tuesday and said it expected an even higher rate for the next quarter.

The signs point to a continued decline in housing as forecast here earlier this year.



Higher Food Prices Ahead?

As we discussed in the "You May Not Know Report" previously, nitrogen fertilizer production in Europe has declined significantly due to the high cost of natural gas which is required to manufacture fertilizer.

The UN is beginning to warn of future food shortages. This[5] from "Strange Sounds":

> *U.S. exports of nitrogen fertilizers jumped to a multi-year high this summer after surging natural gas prices in Europe drove up costs of producing the crop nutrient there, making U.S. shipments more competitive.*
>
> *The brisk U.S. sales highlight the far-reaching effect of the war in Ukraine on global food and energy supplies. Russia, under financial sanctions, is a major producer of fertilizer and natural gas, key in making nitrogen products to boost yields of corn and other crops.*
>
> *Since Russia's February invasion of Ukraine, Europe started weaning itself off Russian natural gas and a pipeline transporting ammonia from Russia to a Ukraine port shut down.*
>
> *Tight fertilizer supplies have driven up crop nutrient prices so much worldwide that the* ***United Nations warned this month of a "future crisis" of availability. European companies have been forced to close some fertilizer plants due to high costs.***

Inflation in one area often leads to inflation in another area. This is a perfect example.

November 2022 Special Report

The Approaching Derivative Implosion: How Your Bank and Investments May Be Affected

This month only, we are making available a free report titled, "The Approaching Derivative Implosion: How Your Bank and Investments May Be Affected".

To request your complimentary copy this month only, return one of the postage-paid reply cards included with this month's newsletter. You'll notice that we've included three reply cards with this month's newsletter; we've done that so you can request a copy of this report for anyone you know that might find this information helpful.

In this month's special report, we will discuss a topic that gets little attention: derivatives. This was one of the primary causes of the Great Financial Crisis and may be poised to become a problem again. In this month's report, you will get an overview of derivatives, how they work and their coming implosion which may be unavoidable.

This report is available for the month of November only.

Time Deposit Rates

At the time of publication, these rates were valid:

1-Year	1.80%
2-Year	4.10%
5-Year	5.20%

Call the office for details at

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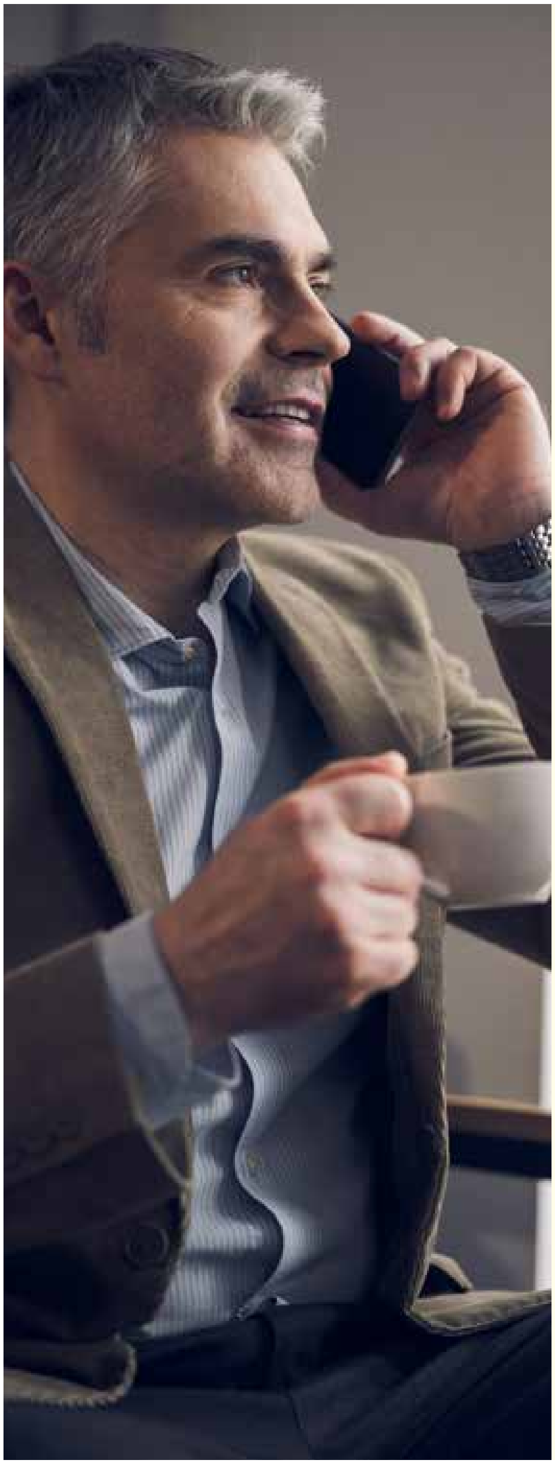

Resources to Help You Stay Informed

All these resources are available at the Retirement Lifestyle Advocates website:

www.RetirementLifestyleAdvocates.com.

As previously mentioned in this month's "You May Not Know Report", the weekly "Portfolio Watch" newsletter is available on the Retirement Lifestyle Advocates website. Each week, I give you an update as to where we are economically speaking and in the financial markets and where we are going based on my analysis.

The weekly "Headline Roundup" webinar. Replays are available on the website. "Headline Roundup" happens every Monday live at Noon Eastern Time. To get an invite to the live event, give the office a call at **1-866-921-3613**.

The weekly "RLA Radio" show and podcast.

We also have the RLA app available. All these resources are also available on the app.

You can download the YOURRLA app for free by visiting the app store (either Google or Apple) and searching under YOURRLA.

If you have questions when downloading the app or would like assistance, feel free to call the office. Our office phone is answered 8 to 5 Monday through Thursday and 8 to Noon on Friday.

Sources

1. https://currentmarketvaluation.com/models/buffett-indicator.php
2. http://theeconomiccollapseblog.com/teetering-on-the-brink-63-percent-of-americans-are-living-paycheck-to-paycheck/
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