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THE "YOU MAY NOT KNOW REPORT"

A PUBLICATION OF RETIREMENT LIFESTYLE ADVOCATES

Stock Bear Market Arrives

By Dennis Tubbergen

Last month, I wrote about one indicator that was indicating a strong probability of a stock market correction. For reference, I reprint that piece here.

Margin Debt Falls – Is a Serious Stock Correction Next?

A historically reliable predictor of stock market corrections just signaled that a deeper stock market may be coming. Margin debt declined meaningfully.

If you're not familiar with margin debt, it is a loan that is issued by a broker-dealer using the equity in an investment account as collateral. As a side note, tax-qualified retirement accounts like IRA's are not eligible for a margin loan, only non-qualified accounts.

Margin debt rules require that an account have 50% equity. A brokerage account with a $1,000,000 balance is eligible for a margin loan of $500,000. If the value of the securities in the brokerage account reaches $1,500,000, the amount of the margin loan could be increased to $750,000.

Conversely, if the value of the securities in the brokerage account falls to $500,000, the outstanding margin loan will have to be paid down until the account once again has 50% equity. There are two ways a margin loan can be paid down to achieve the required 50% equity; one, by adding more funds to the account until there is once again 50% equity; or, two, by selling securities until the account once again returns to 50% equity.

Often, this second method of selling securities is the one that is used. This creates selling pressure which can create downward pressure for stock prices.

Historically speaking, declining margin debt has been a fairly reliable leading indicator when forecasting stock market declines.

Notice from the chart (below), from Advisor Perspectives[4], the relationship between margin debt and stock market performance. The red line on the chart represents margin debt with the amount of margin debt illustrated on the left side of the chart.

Recently, margin debt approached $1 trillion before declining. Notice that prior declines in margin debt levels in 2000, 2007 and 2018 led to stock market declines. At this point in time, that pattern seems to be repeating itself.

Another important point to make is that margin debt levels at their recent peak were about 65% higher than at the market peak in 2007 at the time of the financial crisis.

According to data published by FINRA[4], margin debt declined 4.3% in March.

As last month's issue of the "You May Not Know Report" was hitting mailboxes, stocks began to fall. The chart[1] below (top) is a chart of the Standard and Poor's 500 Index.

Notice from the chart that the S&P 500 Index was at about 4500 when the May "You May Not Know Report" was written. As the June issue is being assembled during the third week of May, the S&P 500 Index stands at about 3900. That's a decline in about one month of 13% and from the 2021 year-end highs of approximately 19%, approaching the 'official' bear market measure of a 20% decline.

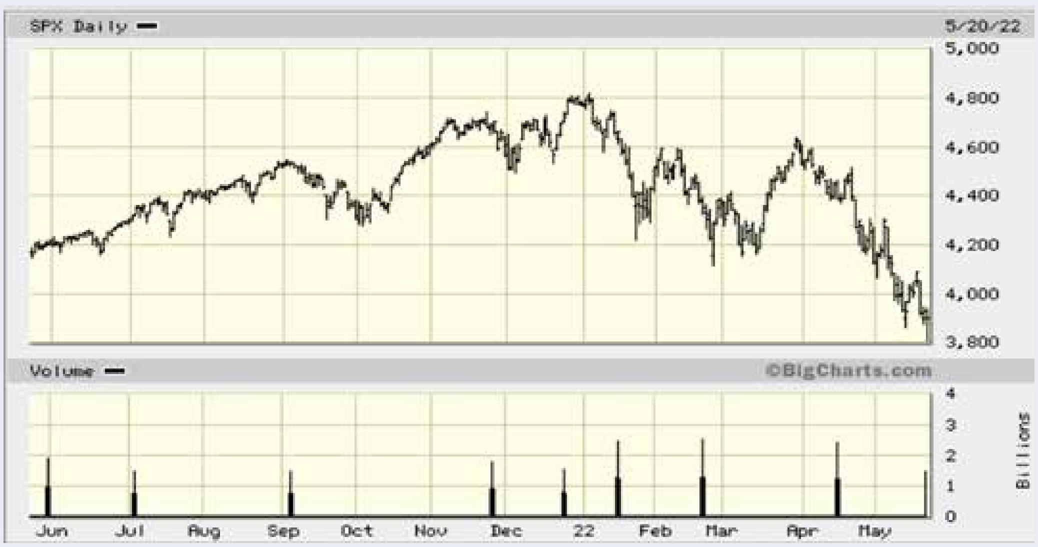
"Bloomberg" reported[2] that the S&P 500 has now declined (as of this writing) seven straight weeks, it's worst losing streak since 2001, the time of the tech stock bubble bursting. (See chart, bottom left.)

The Dow is down 8 straight weeks. That is the worst losing streak since May of 1923; ninety-nine years ago! (See chart, bottom right.)

Since markets rarely go straight up or straight down, a rally from these levels is likely, but in my view the primary stock market trend remains down.

That will likely mean a series of lower highs and lower lows from this point on.

Don't miss our mid-year special report being offered for the month of June: "Mid-Year Market Forecast: What to Consider Now for Your Money".



Recession Dead Ahead?

At the end of the first quarter of 2022, I made the statement that I believed the United States was probably in a recession.

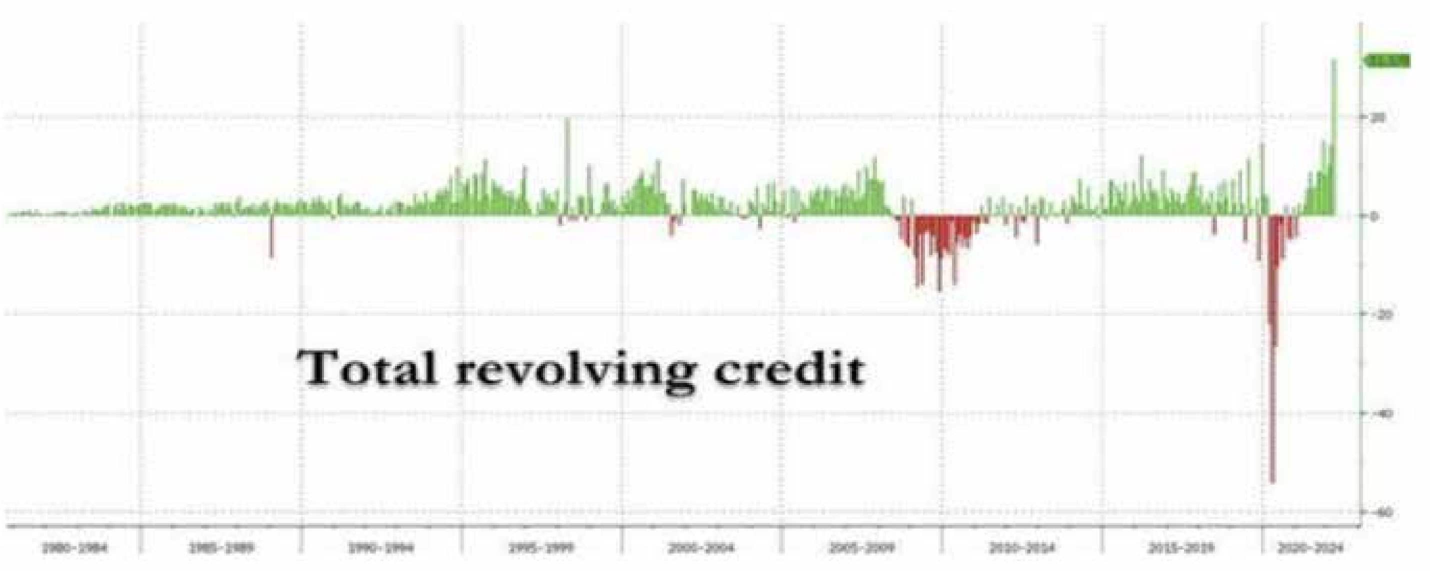
I still believe that is the case. By the time the economic growth numbers are ultimately revised, I believe that they will show the economy is contracting.

The economy up to this point has 'grown' via artificial means. Federal reserve currency creation and massive levels of government stimulus have masked the real state of the economy.

But, now that government stimulus has dried up, the real state of the economy is becoming more obvious.

Shockingly, consumer credit card debt doubled from February to March, leaving little doubt as to how many consumers are dealing with rampant inflation. This[3] from "Zero Hedge":

> *... the real stunner was revolving, or credit card debt, which more than doubled from the already elevated February print of $14.2 billion to a stunning $31.4 billion, the highest print on record... just in time for those credit card APR to start moving higher, first slowly and then very fast.*



While this unprecedented rush to buy everything on credit at a time when there were no notable Hallmark holidays should not come as much of a surprise, after all we have repeatedly shown that for the middle class any "excess savings" are now ***gone, long gone****...*

.. the fact is that most economists - such as those at Goldman Sachs - had previously anticipated that continued spending of savings by consumers (who they fail to realize are now tapped out) is what will keep the US economy levitating in 2022. Unfortunately, as today's consumer credit numbers clearly demonstrate, any savings that US middle class households may have stored away courtesy of stimmies, are long gone.

The implications are profound: any model that projected that US spending will be fueled by "savings" can now be trashed. And since this is most of them, the consequences are dire as they confirm - once again - that the Fed is tapering, QTing and hiking right into a consumer-driven recession which was not visible until now precisely because of all the credit-card fueled spending, which according to Deutsche Bank will begin in late 2023 and which according to Morgan Stanley can start in as little as 5 months. Today's data suggests that Morgan Stanley is right.

Additionally, a recent survey of CEO's found that 68% of them now believe a recession is likely[4]. This from CNN:

The mood in the C-Suite is darkening.

CEO confidence has tumbled to the weakest level since the beginning of the Covid-19 pandemic, The Conference Board said Wednesday.

For the first time during the economic expansion, CEO confidence is now in negative territory.

Worse, business leaders are bracing for a potential downturn caused by the Federal Reserve's quest to tame inflation.

A staggering 68% of CEOs surveyed by The Conference Board expect the Fed's war on inflation will eventually trigger a recession. The survey, fielded between April 25 and May 9, measured responses from 133 CEOs of mostly public companies.

The good news is that just 11% of CEOs anticipate a so-called hard landing, marked by a deep recession. The rest expect a "very short, mild" recession.

Importantly, business leaders are not necessarily preparing for an imminent recession. The survey did not specify when the downturn would begin, merely describing it as "over the next few years."

Still, the pessimism among CEOs is striking, especially given that the economic recovery is barely two years old and enjoyed blockbuster growth in 2021.

"Businesses are being challenged on so many fronts right now and CEOs have elevated expectations of a recession," Dana Peterson, The Conference Board's chief economist, told CNN.

That's despite the fact that by many measures, the US economy remains strong. Retail sales are growing at a healthy clip, the jobs market has nearly returned to pre-Covid levels of employment and businesses are spending aggressively.

Yet the economic environment has gotten tougher to navigate, with worker shortages, price spikes and the war in Ukraine creating challenges. Even some large corporations are struggling.

Walmart (WMT), the king of retail, dimmed its earnings outlook on Tuesday because of high inflation and supply chain constraints. Walmart shares plunged 11%, the company's worst one-day decline since October 1987.

Walmart is not alone. Sixty-one percent of CEOs surveyed by The Conference Board reported that economic conditions have worsened over the past six months, compared with 35% who said that during the first quarter. Just 14% of CEOs reported improving economic conditions.

Recession fears have been driven in large part by high inflation.

Prices are rising at such a rapid clip that the Fed doesn't have the luxury of merely tapping the brakes on the economy by gradually raising interest rates. To get inflation under control, the US central bank may have to slow the economy so much that it accidentally ends the recovery.

"Recessionary-concerns are real," Mike Sommers, CEO of the American Petroleum Institute, told CNN. He noted that history shows recessions often follow rapid interest rate hikes.

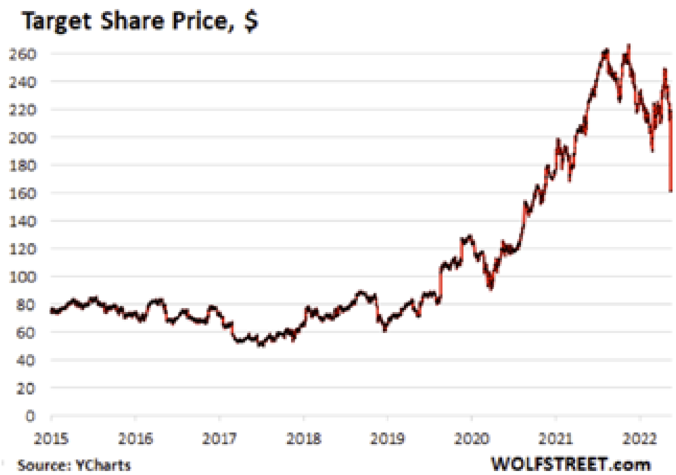
Perhaps that's one reason 60% of CEOs surveyed by The Conference Board expect conditions to worsen, up from just 23% who said that last quarter.

Finally, as the article above mentions, retail is slowing and retail profits are dwindling as a direct result of Federal Reserve induced inflation. This[5] from "Wolf Street":

Target reported today that its revenues, at $25.2 billion in Q1, beat by 4% the mega-stimulus-miracle Q1 last year when consumers, awash in government stimulus cash, had gone hog-wild. This was similar to Walmart, which had reported yesterday that its total revenues too beat that stimulus-miracle quarter last year by 2.4%. That's pretty good when you think about that buy-everything craziness that reigned a year ago in the most ridiculously overstimulated economy ever.

But both retailers reported that their costs surged – product costs, transportation costs, labor costs, and other costs. Target reported that its product costs jumped by 10.4%, and that selling and administration expenses rose by 5.6%; and that therefore operating income plunged by 43%, and that its operating margin (operating income divided by revenues) was only 5.3%, down from 9.9% a year ago, which was a shocker, and it blew out the fuse.

Turns out, inflation is eating up retailers' profit margins. "Throughout the quarter, we faced unexpectedly high costs, driven by a number *of factors, resulting in profitability that came in well below our expectations, and well below where we expect to operate over time," the earnings release said. Shares kathoomphed 25% during the day and afterhours to $161.61, and were down 38.8% from the peak last August:*



Target slashed its projection of its operating margin for the full year, squeezed further by inflation and cost increases and the supply chain chaos. It recognized that it wouldn't be able to pass on all the cost increases it's facing, though it would be trying.

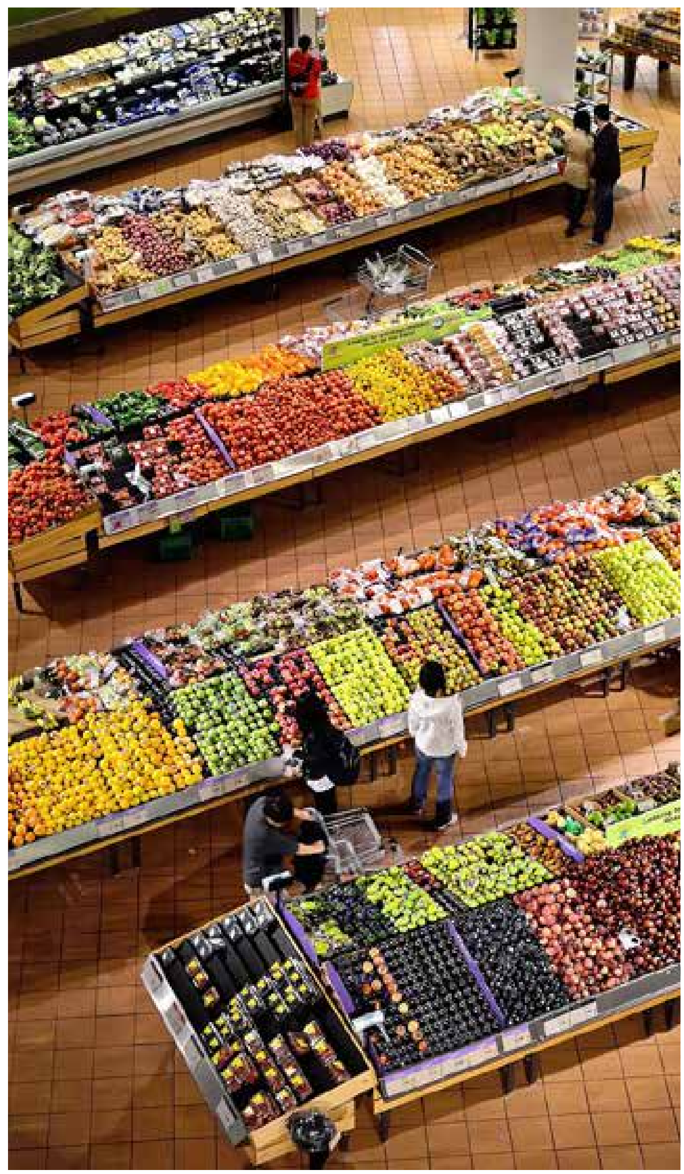
But wait… That plunge only took the share price back where it had been in May 2020 as the stimulus checks were hailing down on consumers. It just shows to what ridiculous highs these shares have been whipped and that even for viable big companies, the regression back to normal, wherever that may be, is going to be rough.

Walmart reported yesterday that its gross profit decline due to "elevated supply chain costs and product mix," with some customers shifting to lower-end products. And it said that operating expenses increased "primarily due to increased wage costs in Walmart U.S."

Revenues rose 2.4% over the stimulus-miracle Q1 last year, and that was pretty decent considering the craziness a year ago.

Retail is a low-margin business, and small cost increases can wipe out much of the margin. Walmart's cost of sales rose 3.5% and operating, selling, and administrative expenses rose 4.5%. And therefore, operating income plunged 23%, and net income plunged by 25%.

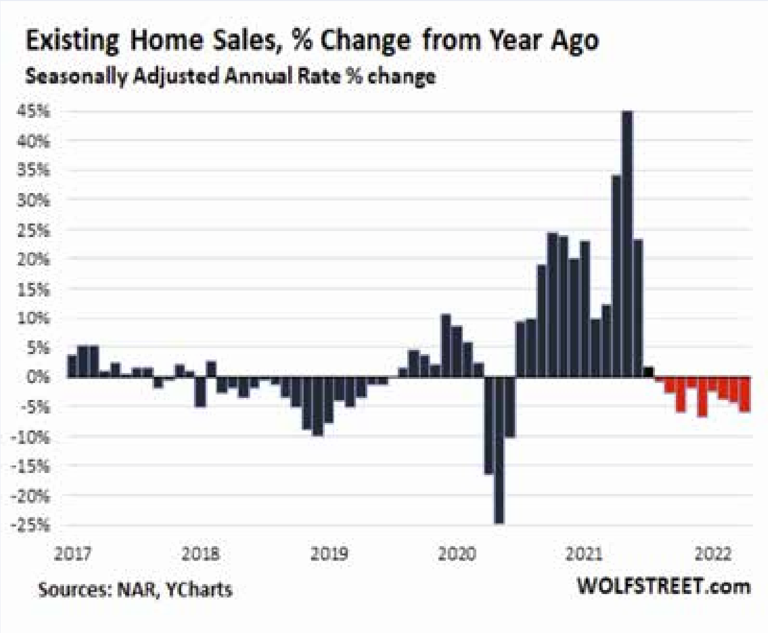
Walmart's shares dove 18% since it reported earnings yesterday and 24% since their peak on April 21.



I have been forecasting a decline in stocks as well as falling real estate prices. We have been witnessing falling stock prices, but as I write this, real estate prices are still holding their own and the real estate market seems strong.

That may now be about to change. This[6] from "Wolf Street":

Sales in the US of previously-owned homes – houses, condos, and townhouses – fell by 2.4% in April from March, based on the seasonally adjusted annual rate of sales, and were down 5.9% from a year ago, with a much steeper decline in condo sales (-13.9% year-over-year), than in house sales (-4.8% year-over-year), the National Association of Realtors reported today.



It was the ninth month in a row of year-over-year declines, even as supply of homes listed for sale continued to rise (data via YCharts).

"Higher home prices and sharply higher mortgage rates have reduced buyer activity," the NAR's report said. "It looks like more declines are imminent in the upcoming months."

The seasonally adjusted annual rate of sales, at 5.61 million, was the lowest since June 2020.

Sales of single-family houses dropped by 2.5% in April from March, seasonally adjusted, and by 4.8% year-over-year, to a seasonally adjusted annual rate of 4.99 million houses, the lowest since June 2020.

Sales of condos dropped 1.6% in April from March, seasonally adjusted, and by 13.9% year-over-year to a seasonally adjusted annual rate of 620,000 condos, the lowest since July 2020.

CNBC[7] had this to report on mortgage activity:

Mortgage rates actually fell slightly last week, but the damage has already been done to housing affordability. Both refinance and purchase loan demand dropped, pulling total mortgage application volume down 11% for the week, according to the Mortgage Bankers Association's seasonally adjusted index.

Mortgage applications to purchase a home declined 12% week to week and were 15% lower compared with the same *week one year ago. That was the first weekly drop in homebuyer demand since the third week in April. Mortgage rates have risen over 2 full percentage points since the start of the year, and home prices are up more than 20% from a year ago.*

The average contract interest rate for 30-year fixed-rate mortgages with conforming loan balances ($647,200 or less) decreased to 5.49% from 5.53%, with points increasing to 0.74 from 0.73 (including the origination fee) for loans with a 20% down payment.

Inflation isn't helping consumers feel particularly flush either.

"General uncertainty about the near-term economic outlook, as well as recent stock market volatility, may be causing some households to delay their home search," said Joel Kan, an MBA economist.

Applications to refinance a home loan continued their landslide, falling another 10% week to week. Refinance demand was 76% lower than the same week one year ago. Two years of record-low interest rates during the Covid pandemic incited a refinance boom which has now gone bust. There is simply a very small pool of borrowers who can now benefit from a refinance.

While dropping very slightly from the week before, the adjustable-rate mortgage share of total applications remained high at 10.5%. It was around 3% at the start of this year. ARMs offer lower interest rates and can be fixed rate for up to 10 years.

Did the Federal Reserve Know Inflation Wasn't Transitory?

Peter Schiff recently wrote an excellent piece in which he revealed that the Fed knew long before it took action that inflation wasn't' transitory. Yet, despite this knowledge, the Fed elected to begin talking tougher but elected not to take any action. This from Mr. Schiff's article[8]:

> *While most observers have focused on Chairman Jerome Powell's press conference last week as the clearest insight into the Fed's thinking, I think more can be gleaned from the extensive conversation two days later in Minneapolis between Christopher Waller, a member of the Federal Reserve Board of Governors (a current voting member of the FOMC) and Neel Kashkari, the President of the Federal Reserve Bank of Minneapolis (and an FOMC alternative member). In particular, Waller offered a very clear assessment of the Fed's battle plan.*

Right off the bat, he confronted mounting criticism that the Fed failed to read the economy accurately over the past 18 months, thereby grossly miscalculating policy, which let the inflation genie out of the bottle. His defense, which essentially boils down to "don't blame us, no one with mainstream credentials in government, economics, or finance saw this coming," is both bizarre and inadvertently illuminative. Not only does this ignore the 2021 predictions of former Treasury Secretary Larry Summers, who used to have at least some mainstream credibility, but it completely ignores all those like me who had been shouting from the rooftops that this danger was lurking. Waller's admission, which shows how deeply embedded Fed leaders are in their own echo chamber, is more of an indictment of the entire economic elite rather than an excuse for their errors.

Waller then admitted that inflation data that was released way back in September 2021 ***revealed to them that the "transitory story' that they had been spinning since the beginning of 2021, would no longer hold water. He explained that members of the FOMC were so alarmed that they immediately responded with plans to roll out new messaging that hinted strongly at tighter policy. Say what?***

They determined nine months ago that very high inflation had been running rampant for the better part of a year, that it showed no signs of slowing, that the Fed Funds rate (which was then at 0%, and likely 800 basis points below the rate of inflation) was adding fuel to the fire, and the only thing they were prepared to do was to start talking tougher?

The Fed did not implement its first rate hike (25 basis points) until March of this year, fully seven months later! *And during that entire time, it continued to expand its balance sheet by hundreds of billions of dollars through quantitative easing rather than immediately stopping the program or, better yet, reversing it.* ***That's insane. Captain, there is a huge gash in the hull of the ship but rather than try to repair the damage now, let's think about how we are going to word our next few press releases!***

Instead of taking bold steps back in the fourth quarter of last year to get ahead of the curve, or to at least not fall far further behind, the Fed irresponsibly took a slow and muted path. Given its admitted understanding of the conditions nine months ago, its actions seem hard to justify.

June 2022 Special Report

Mid-Year Market Forecast: What to Consider Now for Your Money

This month only, we are making available a free report titled, “Mid-Year Market Forecast: What to Consider Now for Your Money”.

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, you will discover:

- Our current stock analysis from a technical and fundamental perspective
- Where we think US Treasuries go from here
- Precious metals outlook
- Fiat currency forecast
- Strategies to potentially capitalize on these forecasts

This report is available for the month of June only.

Resources to Help You Stay Informed

All these resources are available at the Retirement Lifestyle Advocates website: **www.RetirementLifestyleAdvocates.com.**

The weekly "Portfolio Watch" newsletter. 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

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