

A Little Doubt Might Serve

Houston AAII Retirement SIG

Rohit Millstein

June 16, 2022

Caveat Emptor!

I am a Registered Investment Advisor Representative of Millstein Advisors, LLC, a Registered Investment Advisor.

This presentation is not a recommendation for any particular tactic, strategy, purchase, sale or other transaction. This presentation is informational.

The following are some ideas you may find useful. It is impossible for me to know whether any of these ideas are appropriate for your particular situation. As Members of AAII, I fully expect that you will be able to make that judgment for yourself.

Remember My Top Income Suggestion?

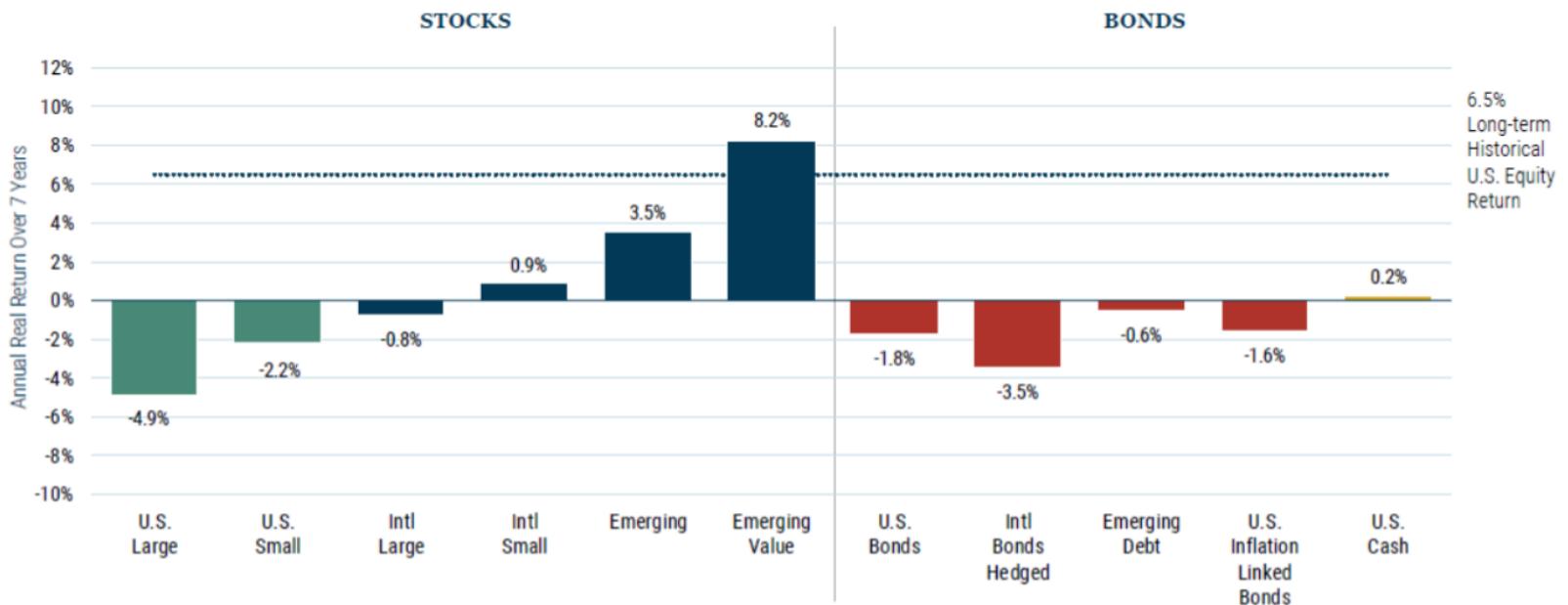
- In Mar 2021, I presented 8 income ideas. We revisited in Jan 2022
 - The central challenge for both presentations: rising yields
- The first idea was DNP, a closed end fund
 - Yield Mar 2021 = 7.6%
 - Yield Jan 2022 = 7.2%
- Yield when I started this presentation last Thursday night was
 - 7.16%
- Dividend is unchanged at \$0.065
- Who was betting DNP would go up in price?
 - *Perhaps a little doubt might serve....*

Where are the Markets Headed?

- That's a euphemism for whether we'll have a recession.
 - Of course, we will
 - But when?
- What follows are a lot more examples of things like DNP
 - Increasingly, my view is that we're all like Yogi Berra:
“It’s tough to make predictions, especially about the future”
 - Observations will come in no particular order
 - Your alternative explanations are welcome
 - Let's begin with one that appeared clear on valuation grounds
 - But then again, conventional wisdom is so very often mistaken

Jeremy Grantham of GMO

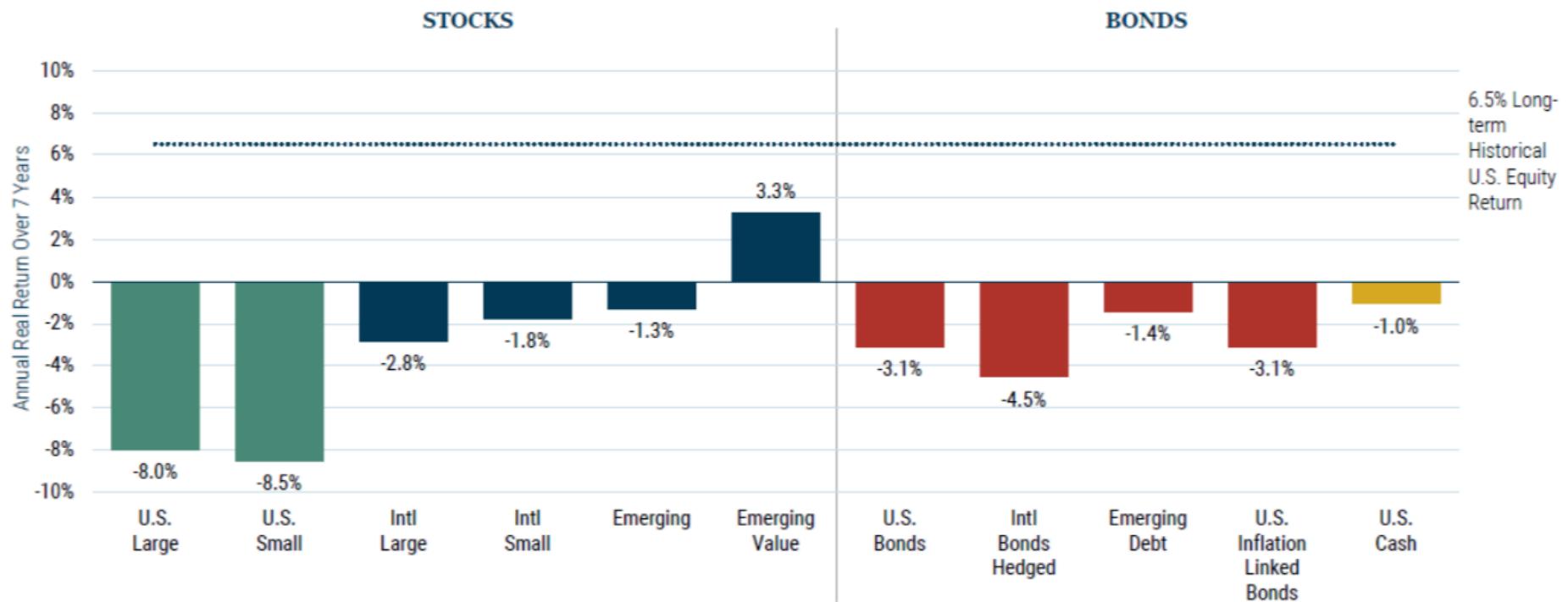
December 31, 2019



[Download](#) pdf here.

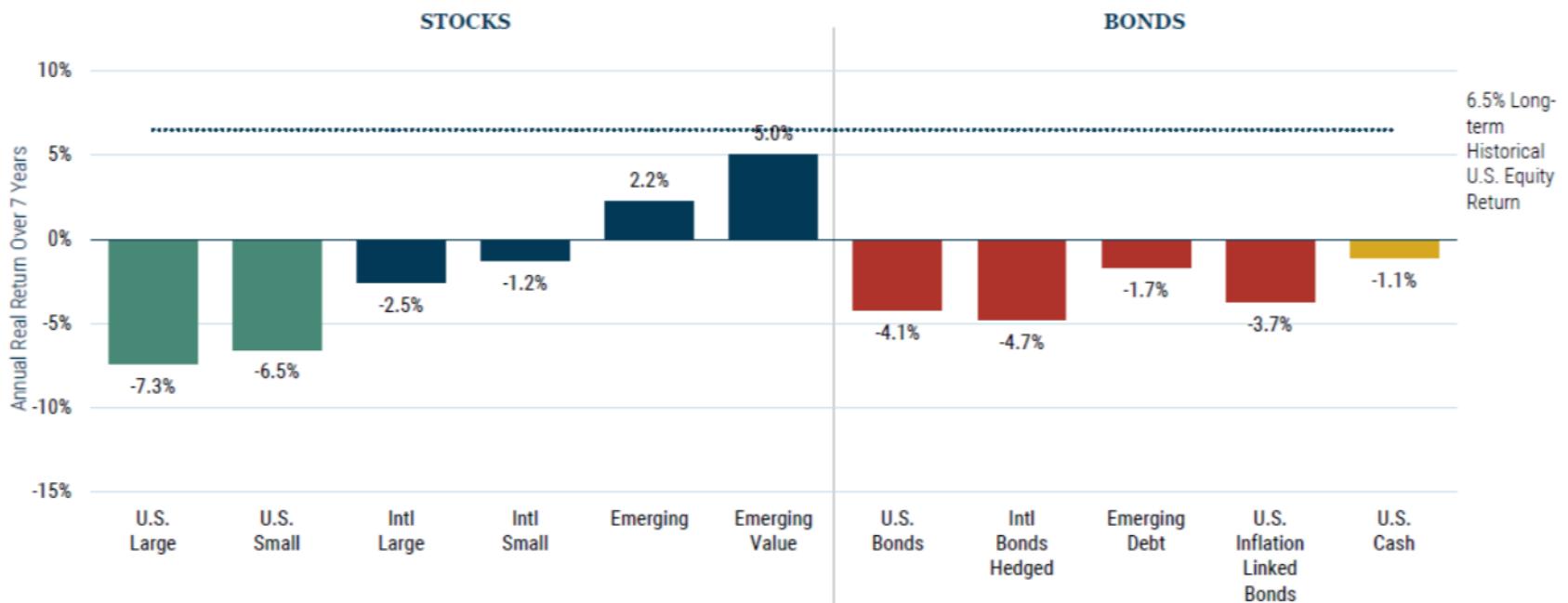
Everything looked worse; EM still relatively good

As of June 30, 2021



Getting Better...Time to buy those EMs ?

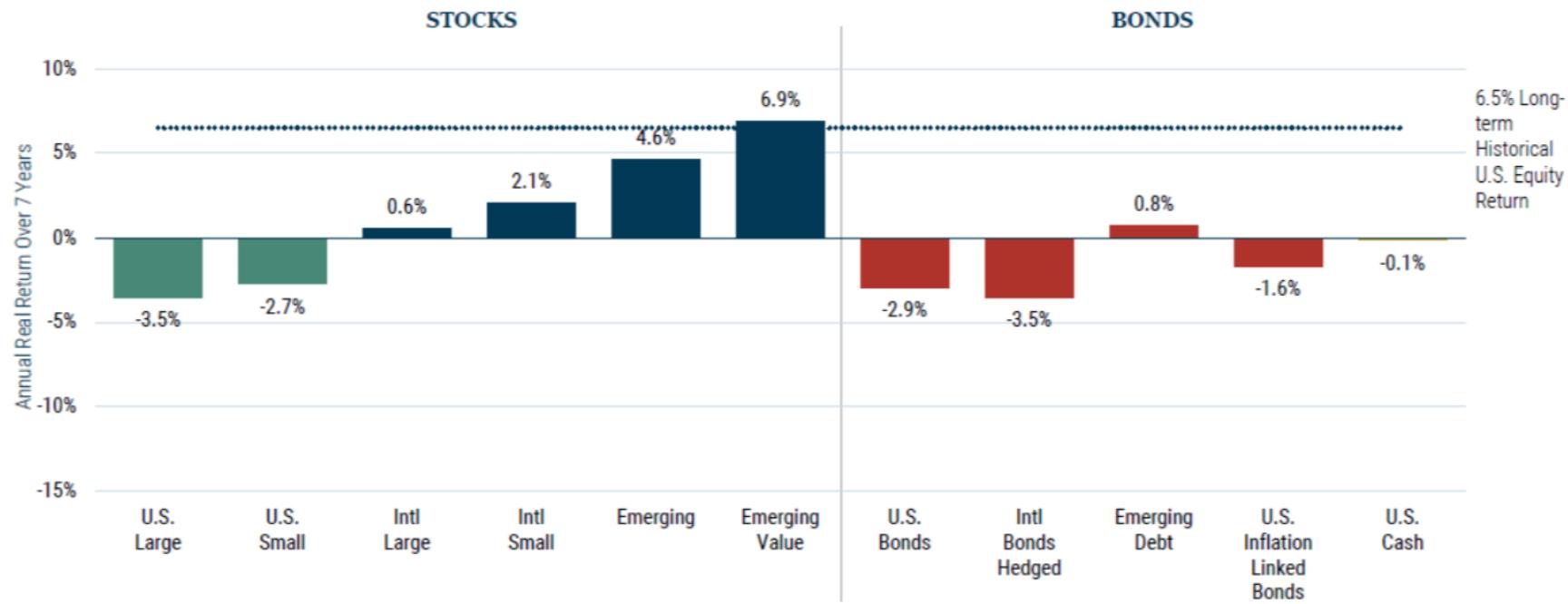
As of December 31, 2021



[Download pdf here.](#)

Really? Two Months into the War ??

As of April 30, 2022



And Here's How it Turned Out



Emerging Market Bonds Didn't Fare Well Either

Taking Credit

Emerging market government bonds are now below their March 2020 low



An individual has been described by a neighbor as follows:

“Steve is very shy and withdrawn, invariably helpful but with little interest in people or in the world of reality. A meek and tidy soul, he has a need for order and structure, and a passion for detail.”

Is Steve more likely to be a librarian or a farmer?

Let's do a poll.....

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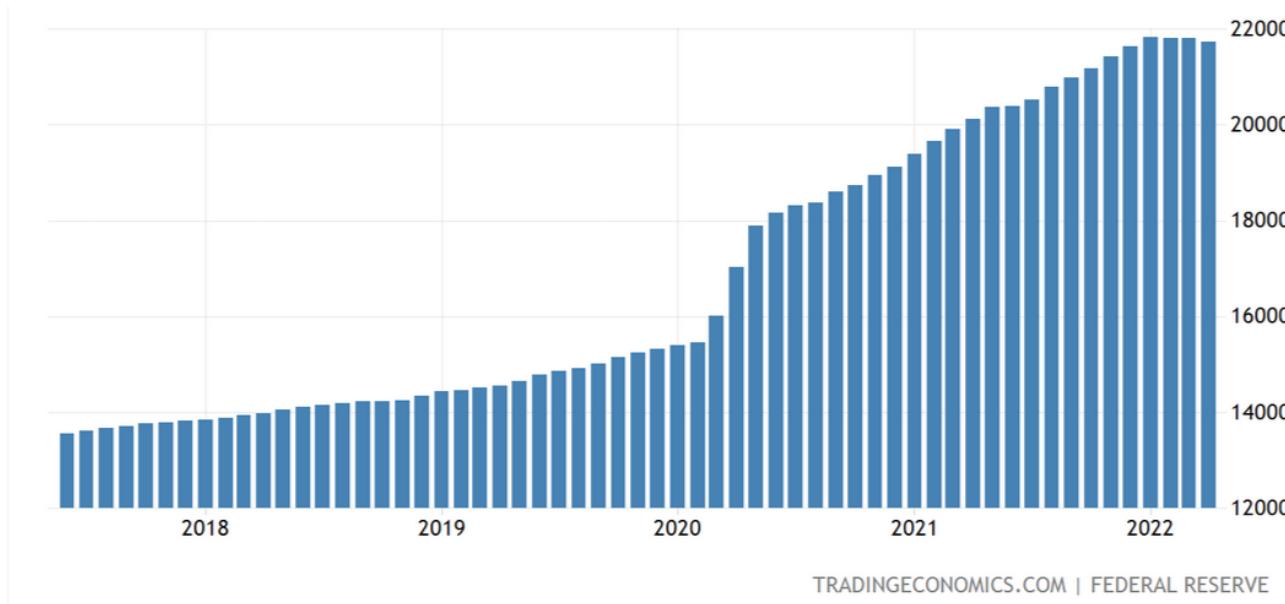
“Steve is very shy and withdrawn, invariably helpful but with little interest in people or in the world of reality. A meek and tidy soul, he has a need for order and structure, and a passion for detail.”

Is Steve more likely to be a librarian or a farmer?

There are more than 20 male farmers for each male librarian in the United States. Would that fact have changed your vote?

Inflation

- *Inflation is always and everywhere a monetary phenomenon*
-- So said (roughly) Uncle Miltie, as we called him, Milton Friedman
- And we have incontrovertible facts like this chart of M2:



What is Monetarism

- Investopedia: Monetarism is a macroeconomic theory which states that governments can foster economic stability by targeting the growth rate of the money supply. Essentially, it is a set of views based on the belief that the total amount of money in an economy is the primary determinant of economic growth.
- Actually, it sort of has a formal definition:

$$MV = PT$$

Where

M = Money supply

V = Velocity of Money

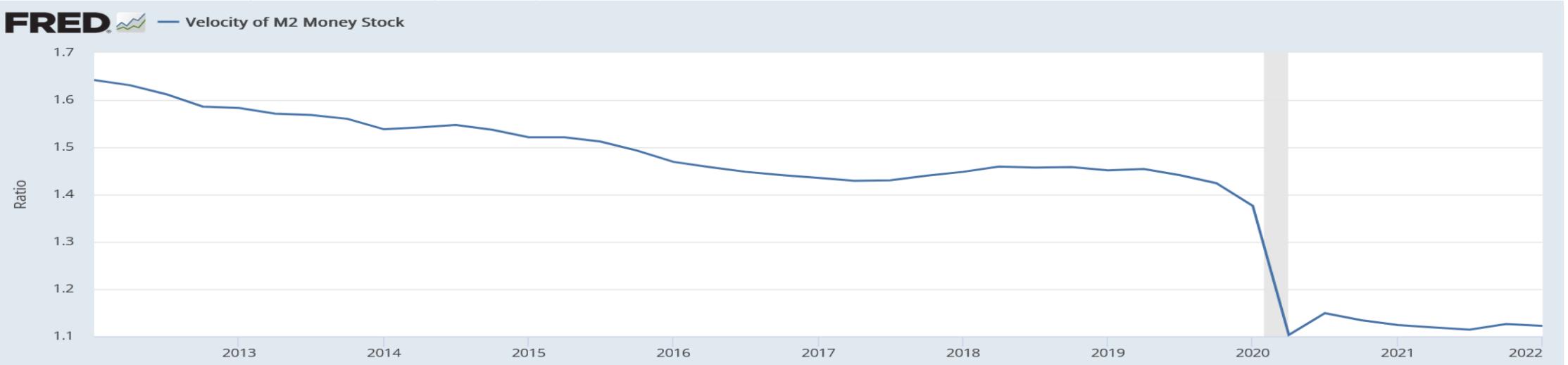
P = Average Price of all Transaction

T = Number of transactions

In other words, a tautology

- So note that the absolute level of money supply is **not** the *only* determinant of economic growth, but rather the product of the supply of money and its velocity.

Here's the Recent Dance of M & V



What's Their Product ??

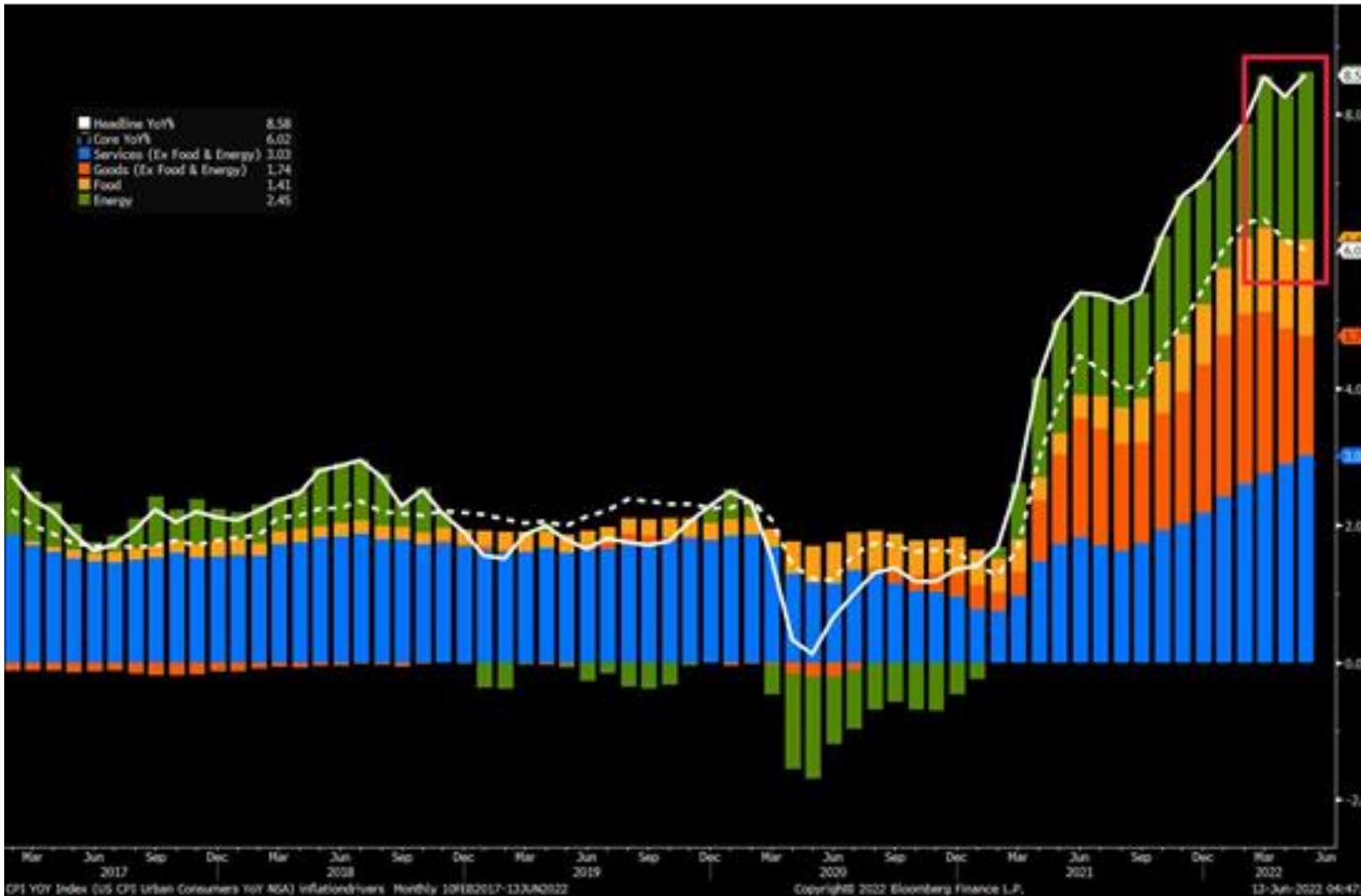
	M2 (Trillions)	Velocity	Product	Annualized Growth
7/1/2012	10.05	1.612	16.20	From prior row
7/1/2019	14.83	1.441	21.38	4.04%
1/1/2021	21.66	1.122	24.30	5.27%

While M2 has certainly grown a lot in the last 2-1/2 years, given the drop in velocity, it seems a stretch to argue that all of a sudden, the incremental growth rate in MV has led to an explosion of P.

Rather, it would seem that the “stories” – bottlenecks, supply chains, the unexpectedly quick and decidedly uneven reopening of the economy, Ukraine, etc – have a lot to do with the inflation we are seeing.

Will that mean that raising interest rates won’t do the trick?

The Sources of Inflation – Stories or M2 ?



More Fodder for Story Over M2



We Better Do Something

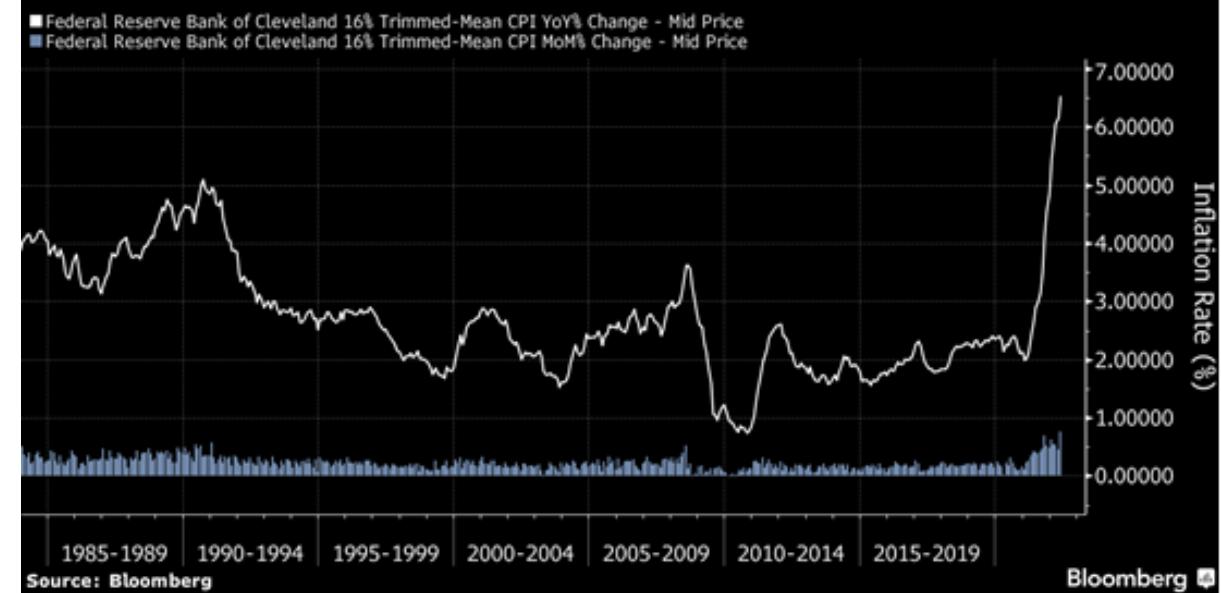
An Expanding Core

Core CPI rose for the third month running, to highest since last June



The Gloomy View from Cleveland

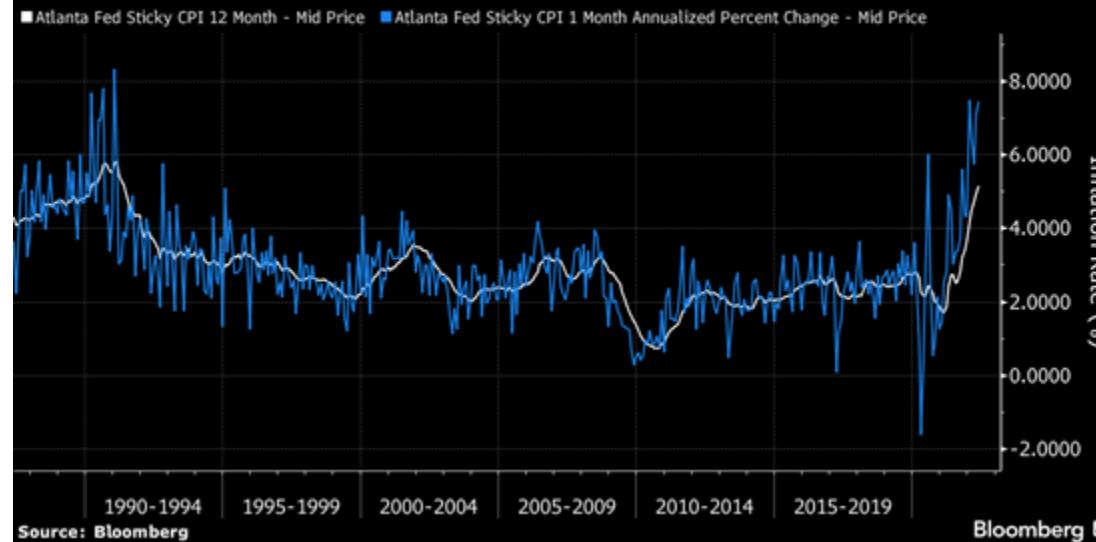
Trimmed mean inflation is at a record; don't try to blame outliers



We Better Do Something – Part 2

Inflation Gets Stickier

"Sticky" prices are rising the fastest since 1990



Source: Bloomberg

An Unwelcome Development

Consumers' long-term inflation expectations rose sharply last month

■ UMich Expected Change in Prices During the Next 5-10 Years: Median - Last Price



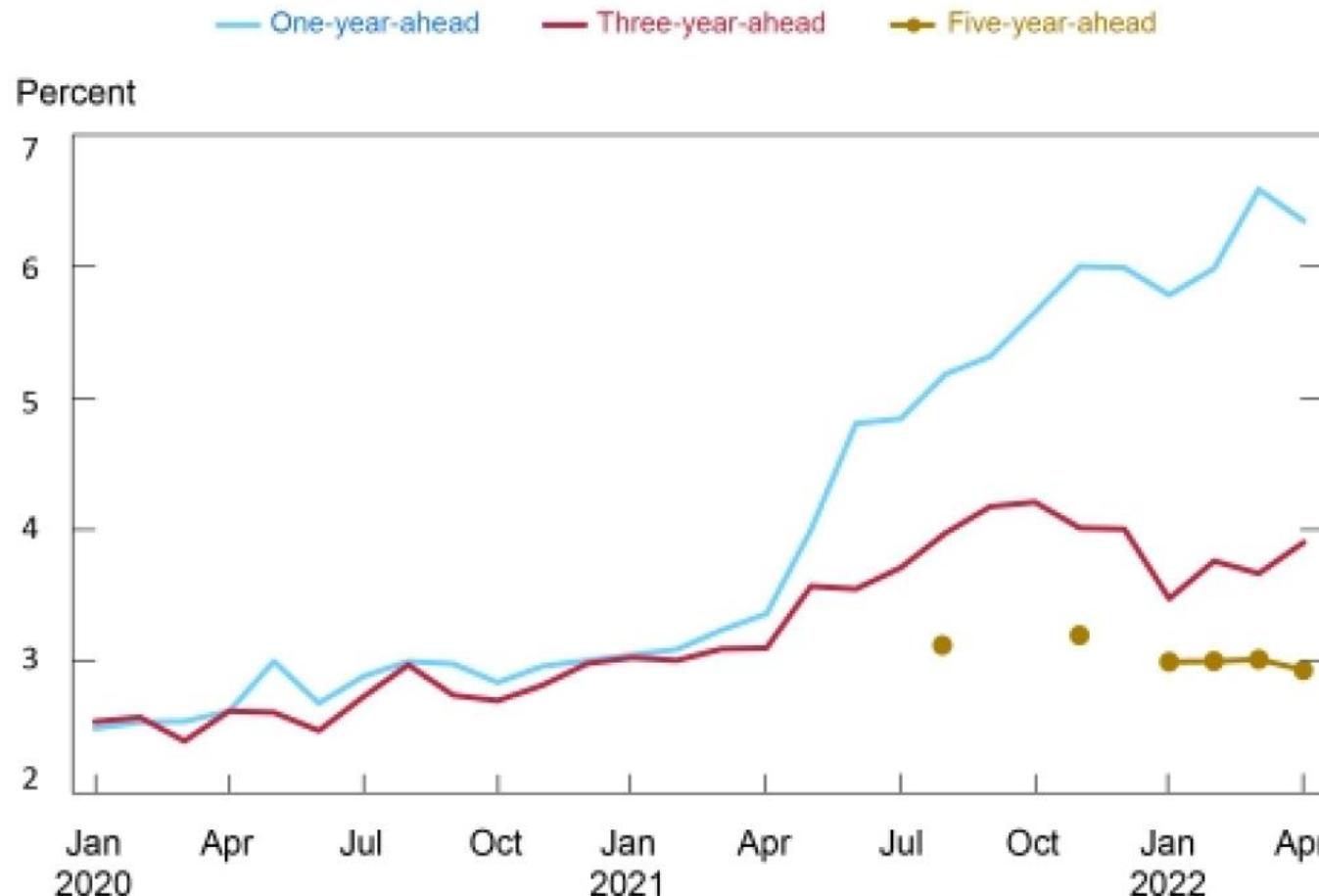
Source: Bloomberg

Or Do We?

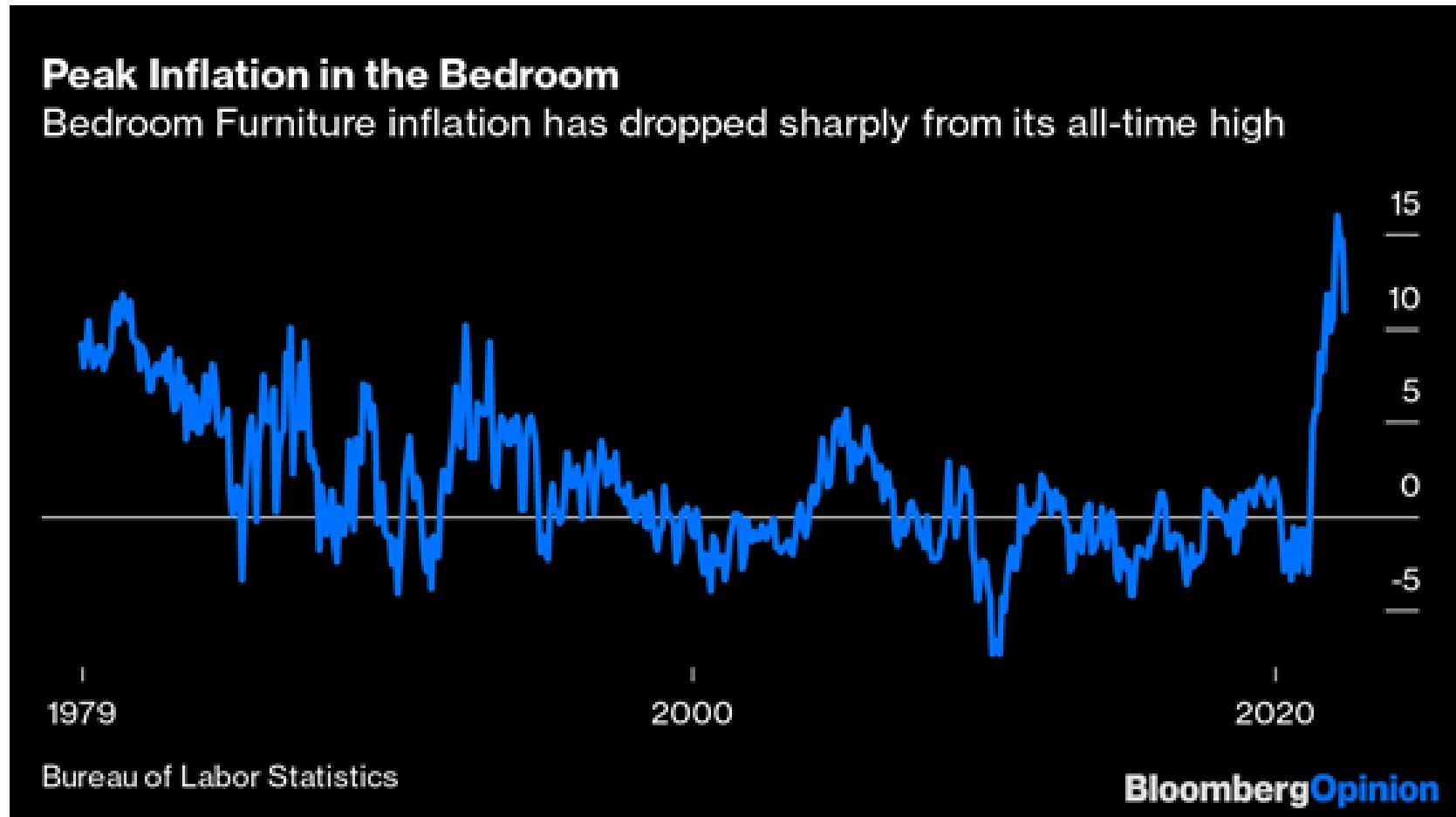


Near versus distant Expectations

Median Inflation Expectations



Or Maybe Just Stick With Your Current Bed



Is A Recession Coming?

Ten Points to Inversion

The yield curve is its flattest since it last inverted in early April

Market Matrix US Sell 2 Year & Buy 10 Year Bond Yield Spread - Mid Price



Source: Bloomberg

Three Is A Magic Number

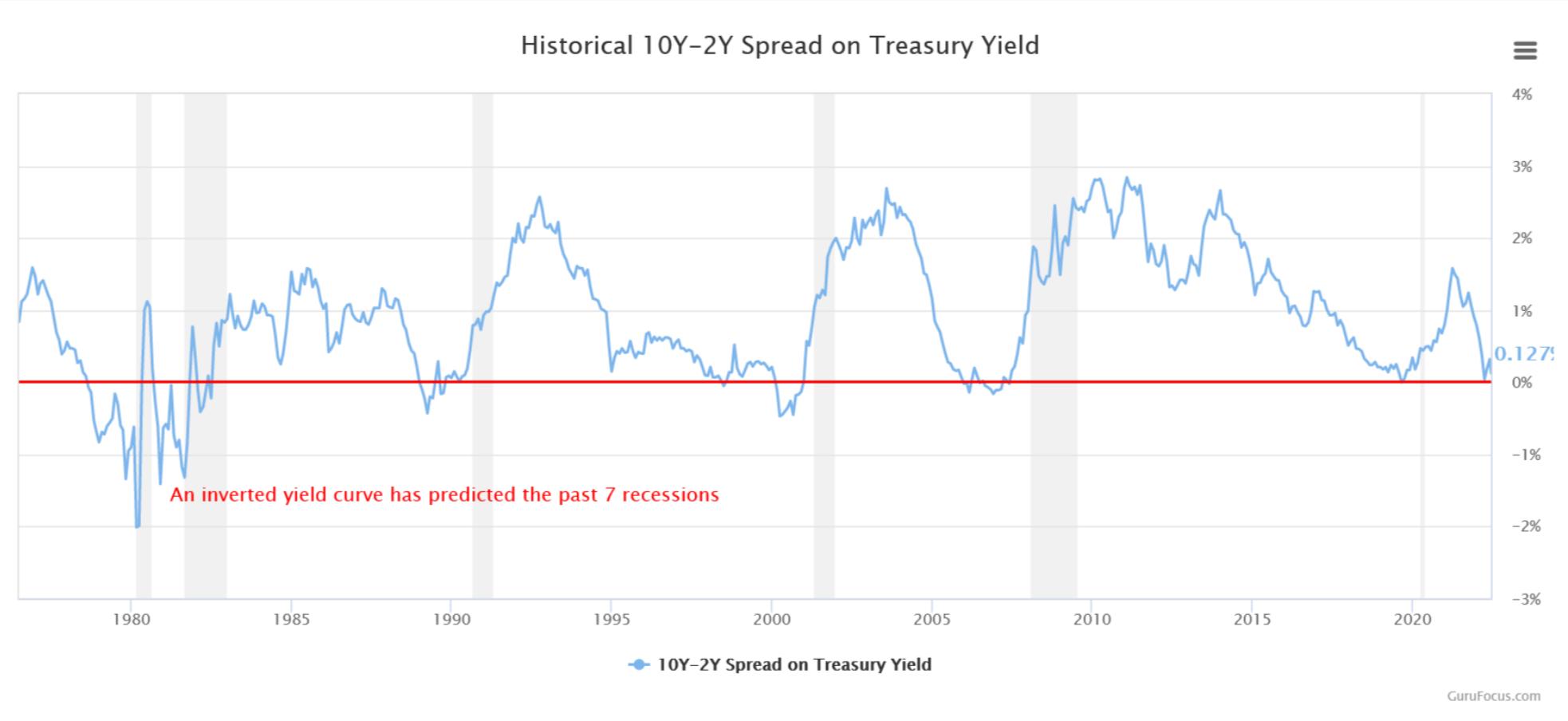
The 2-year yield broke the landmark, to hit its highest since Dec. 2007

US Generic Govt 2 Yr - Last Price



Source: Bloomberg

Is A Recession Coming?



Yes, says the 5- versus 30-year inversion

Warning Sign

Deepest inversion since 2000 highlights recession concerns

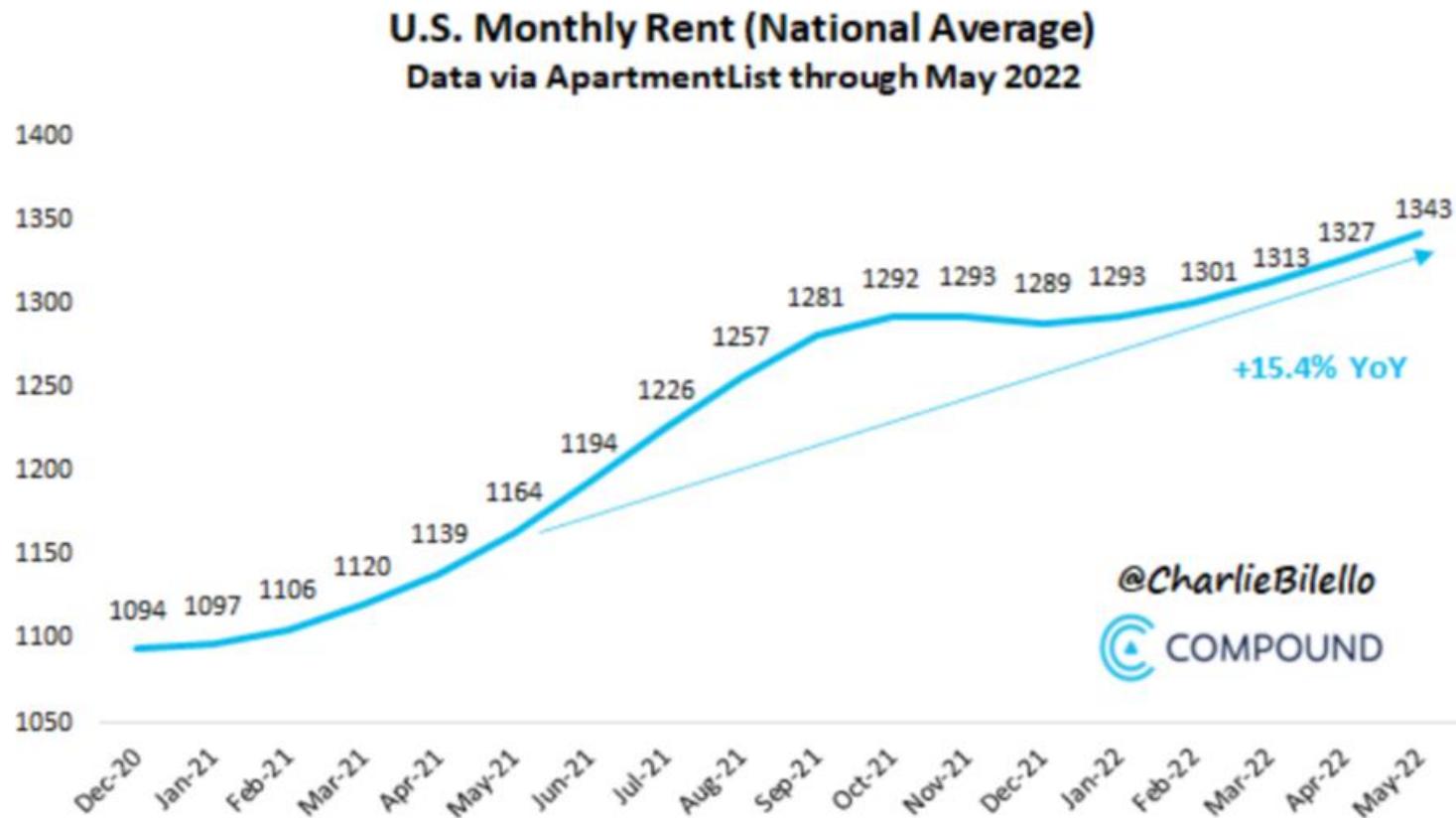


On the Other Hand

- The general idea of raising rates is to slow down durable goods purchases, from washing machines to houses
- According to this clip, however, that's not yet happening

<https://youtu.be/BOgvWHJc7-o?t=50>

No Slowdown Visible Here



Yet look at the multi-family REITs....

Equity Residential



AvalonBay Communities



Dec 10, 2021: Upgraded to Outperform at BMO Capital

Jan 3, 2022: Upgraded to Buy from Hold at Deutsche Bank

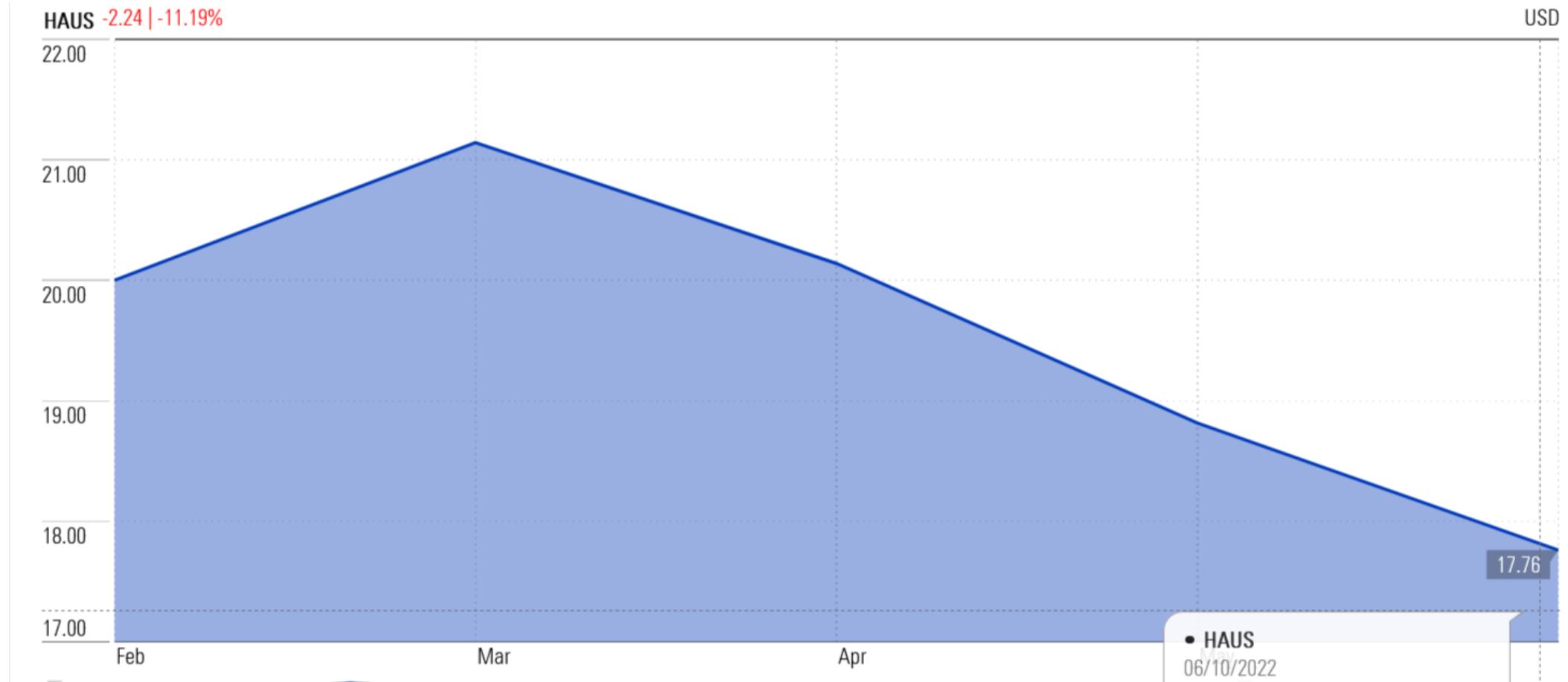
Camden Property Trust



December 07, 2021: Camden Property Trust started at buy with \$192 stock price target at Stifel Nicolaus

December 21, 2021: [Apartment Owners 'Golden Age' Primed to Continue in 2022](#) The Wall Street Journal Interactive Edition

A New ETF created as an “active pure play U.S. residential real estate strategy” has not had the greatest debut of all time.



Is It Yield Over Growing Rents?

- Yield on these REITs, even at their new lower prices, are rather modest given that the 2-year Treasury is now around 3.25%
 - Equity Residential 3.63%
 - Avalon Bay Communities 3.43%
 - Camden Property Trust 2.98%
- Well, maybe these stocks were owned only for yield and needed adjusting. But....

Homebuilders Are Not Yield – And Did Worse!



Share of income needed to cover housing costs



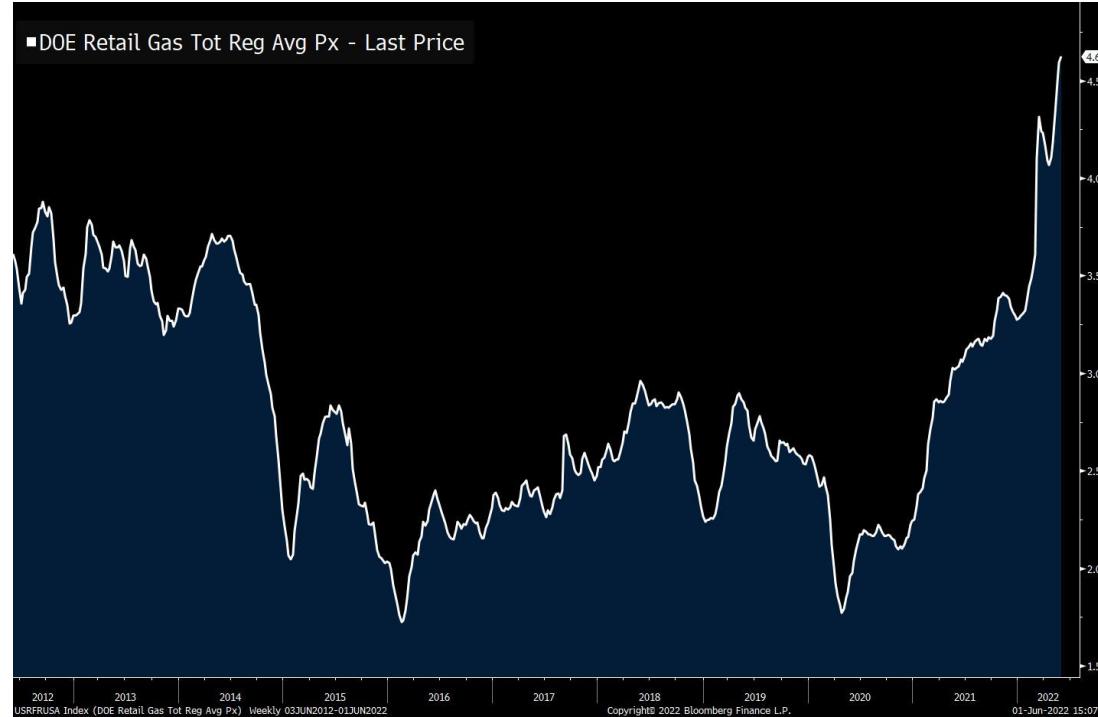
Source: Federal Reserve Bank of Atlanta

Maybe this is going to kill housing....

Conversely, cash buyers – funds – abound. Rents are rising.

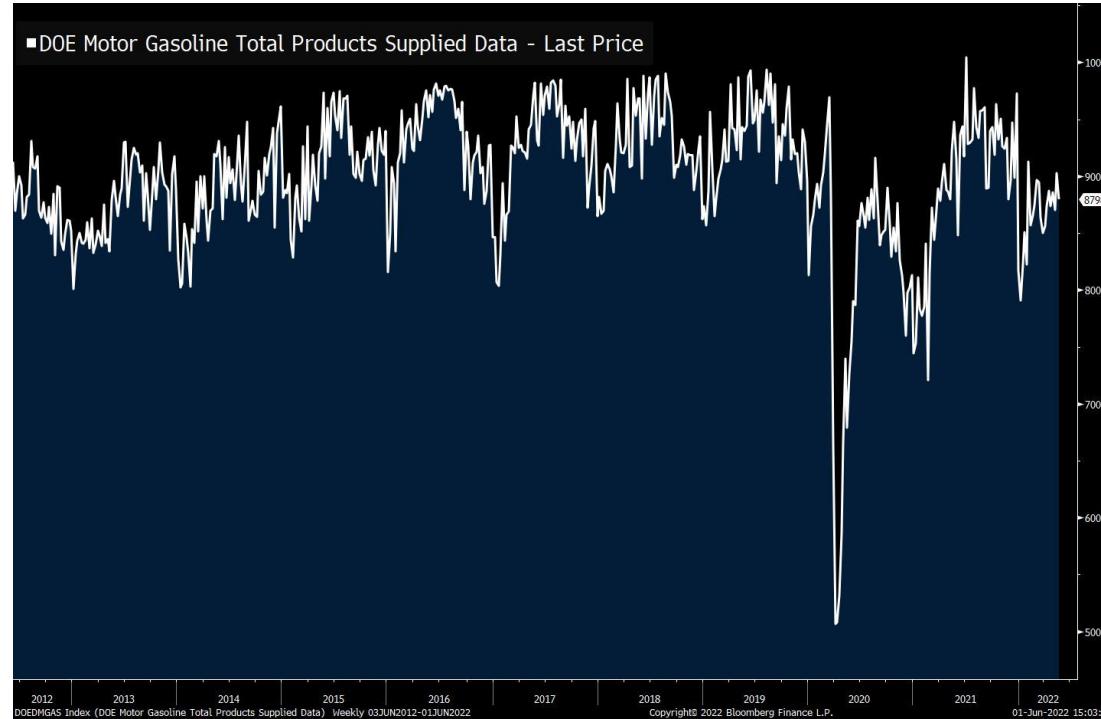
Will it crash – despite the need described by the Century 21 CEO?

Gasoline Prices



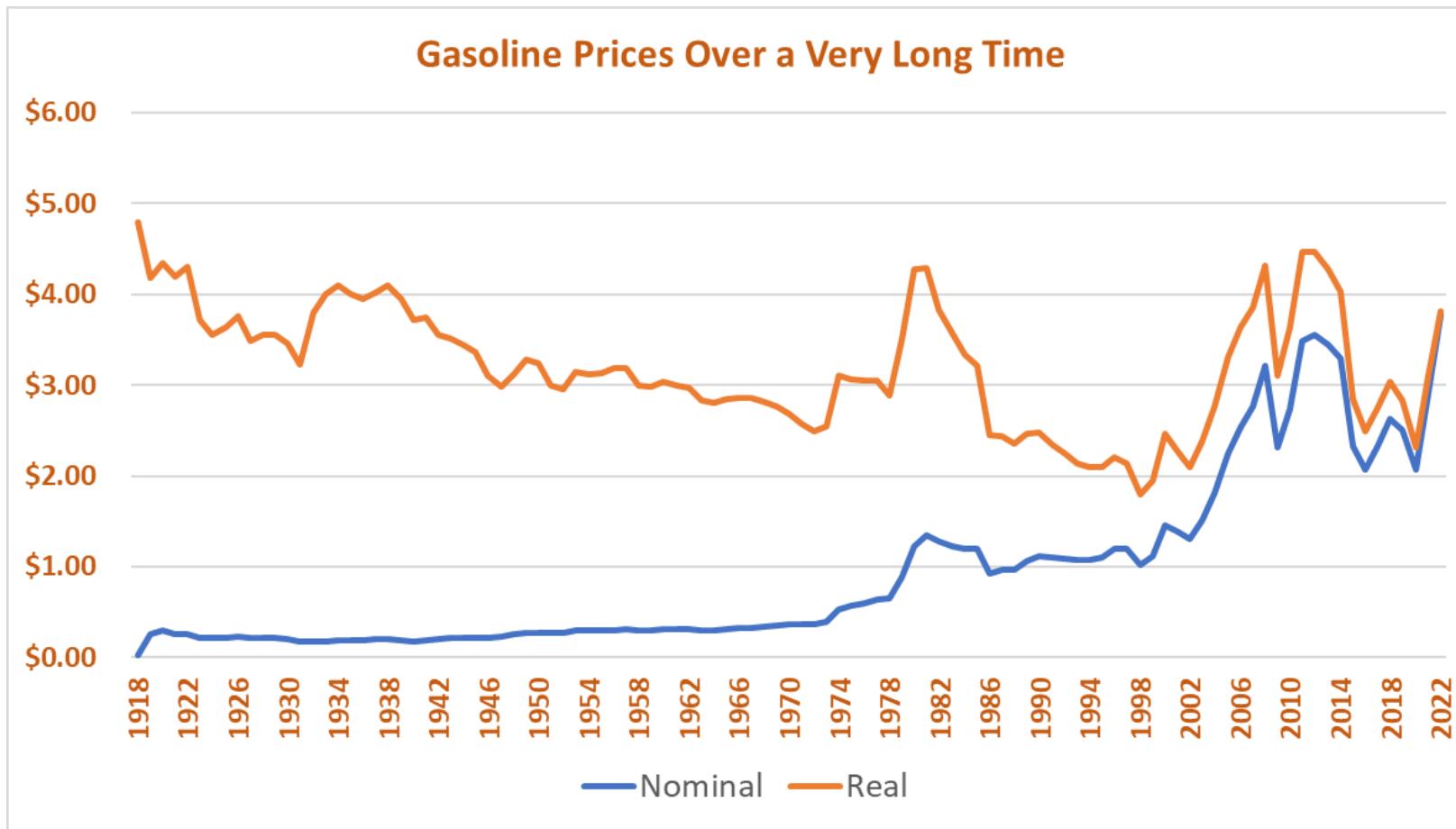
Everyone knows the price is up. A lot. Is this from too much M2, or even M2 x V ??

Gasoline - Consumption

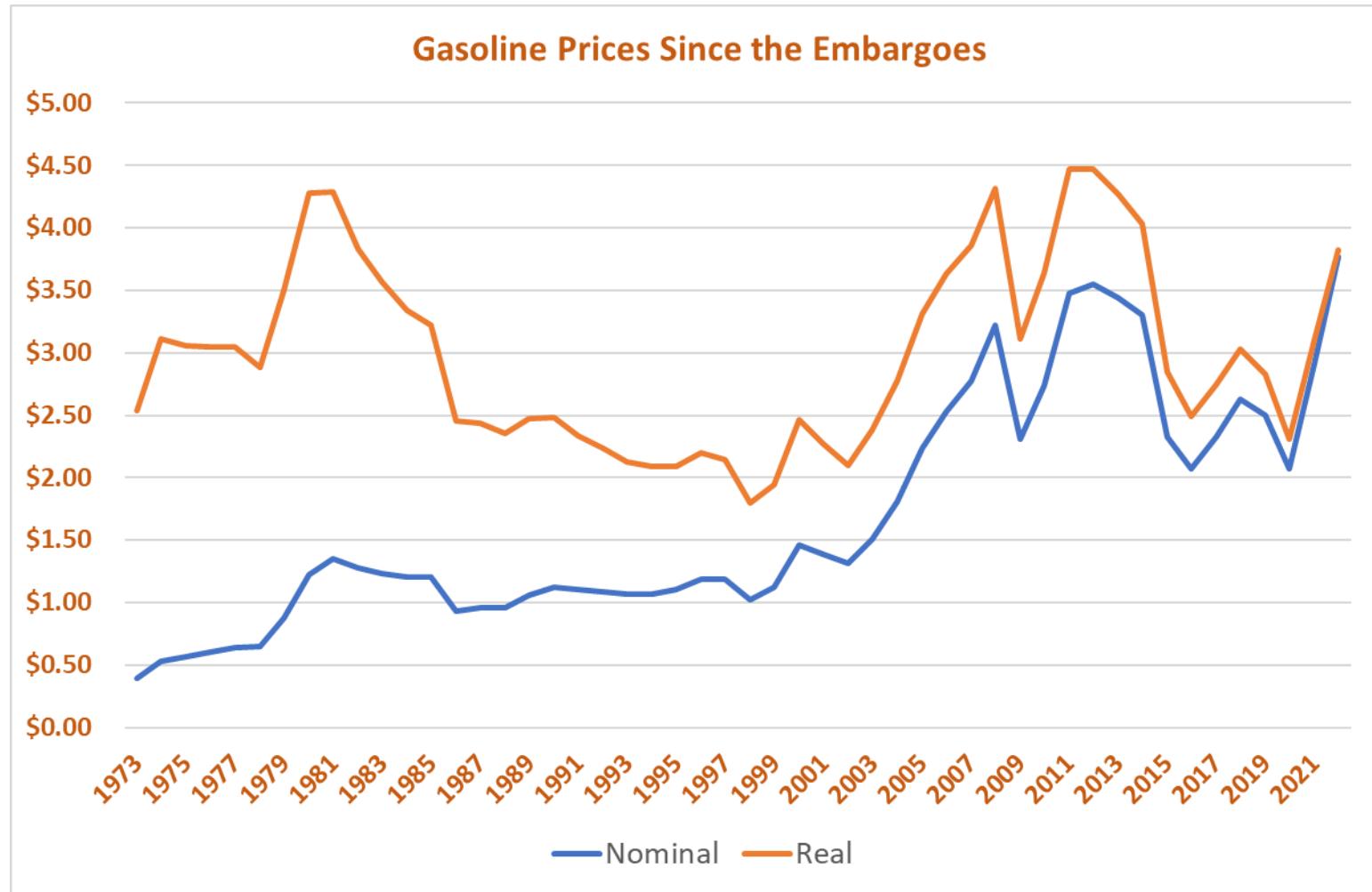


Gasoline Consumption “remains below 2019 levels. Here's a 10-year chart of weekly [consumption based on DOE data](#)” (Courtesy of Bloomberg “5 Things...” Note)

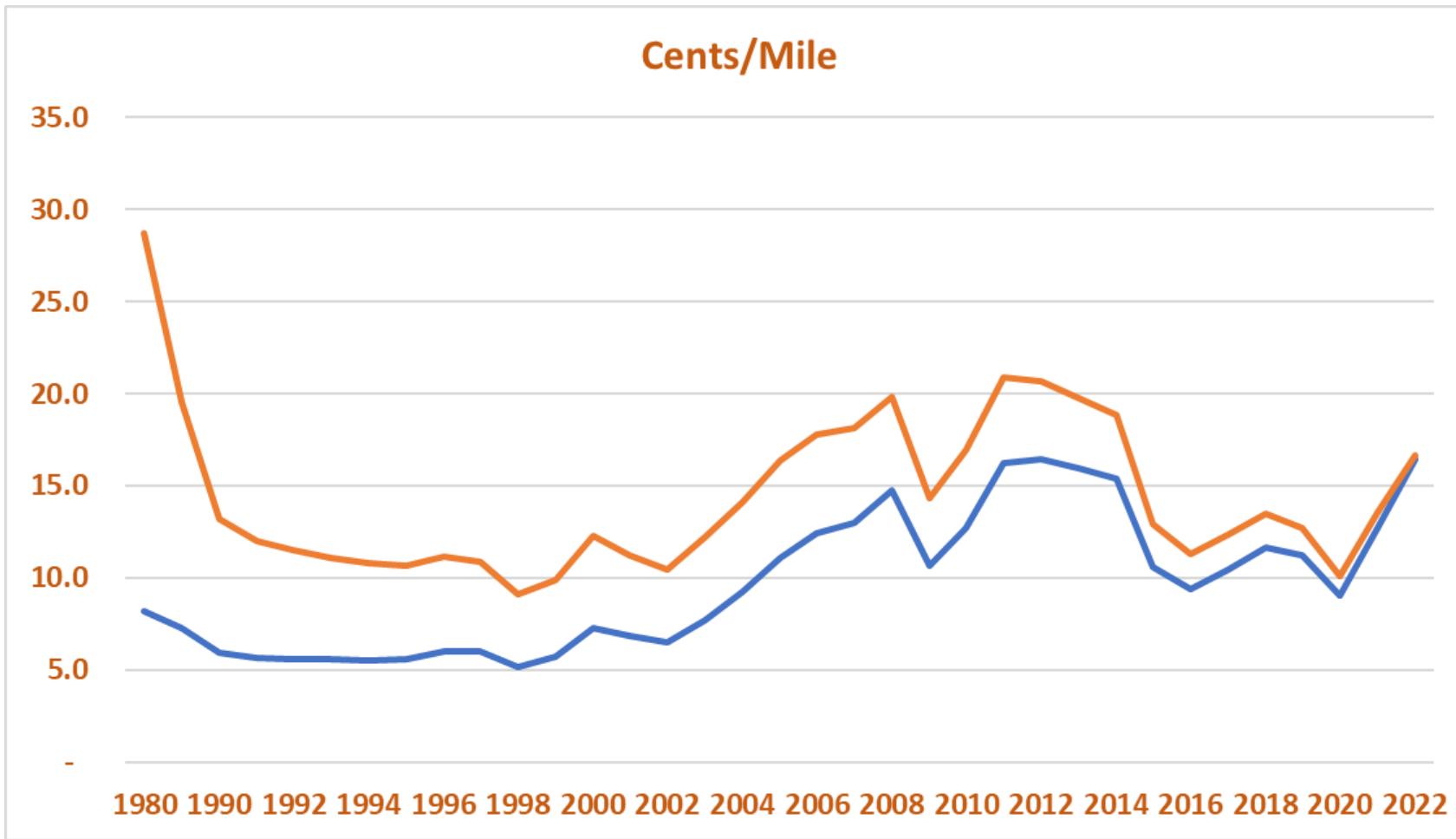
Actually, Prices Aren't Even *THAT* High



If We Consider Only Post-Embargo Times



What About Improved Mileage?

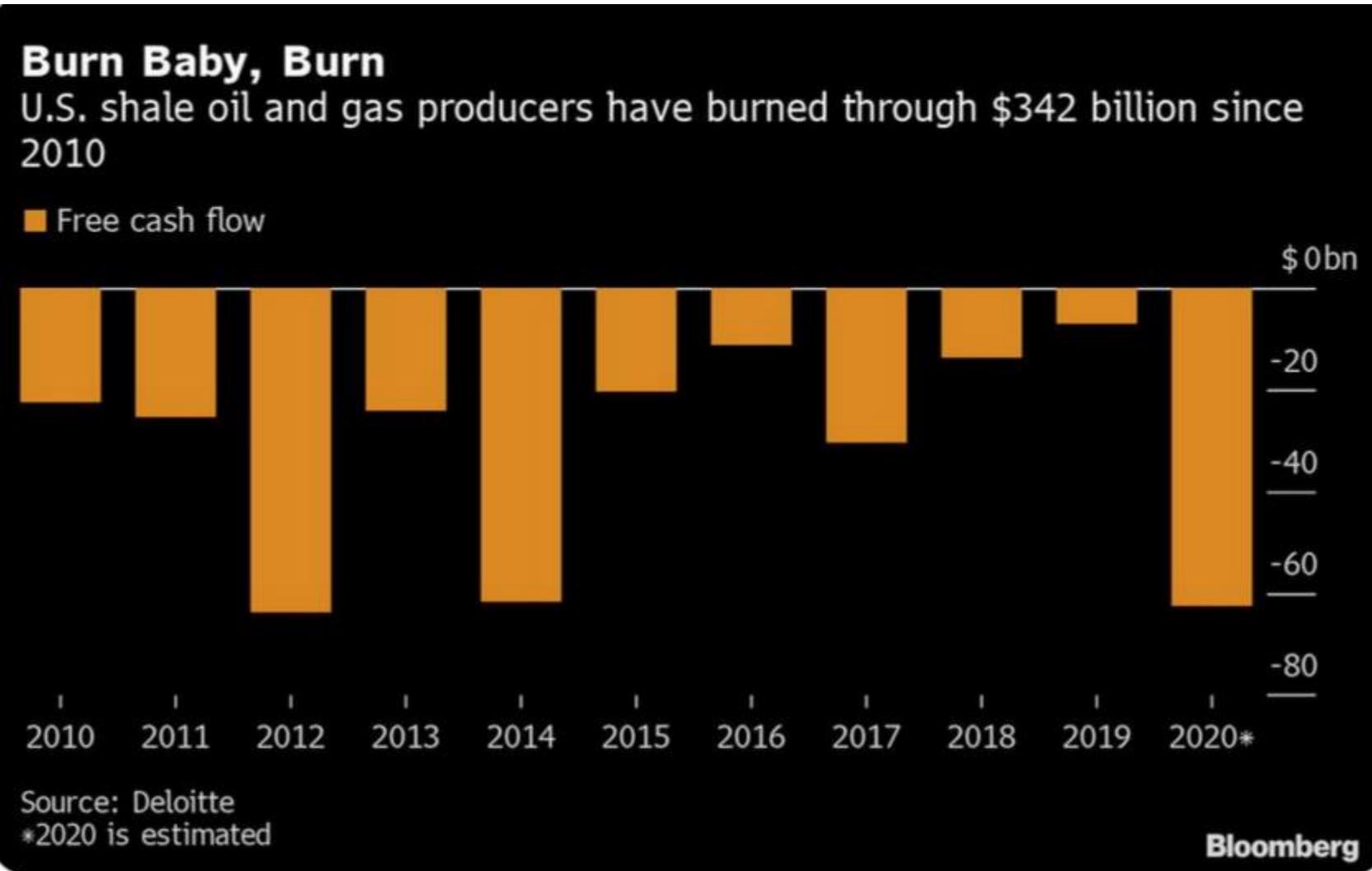


Note: Last fleet mileage reading was 22.9 for 2020. Same figure is used for 2021 & 2022 although it is almost certainly higher (2019 was 22.2), so this chart very likely *overstates* the latest costs/mile.

Drill Baby Drill ??

- “High prices aren’t good for us,” Mike Wirth, CEO of Chevron, said during [a June 7 event](#) sponsored by the Center for Strategic and International Studies. “They never last. In our industry, demand always moves faster than supply. Incentives are there for the producers to produce. This is not always the most popular thing, but allow markets to work.”

Then there's the cash burn



Besides, We're *ARE* Producing

Weekly U.S. Field Production of Crude Oil

 DOWNLOAD

Thousand Barrels per Day

15,000

10,000

5,000

0

1985

1990

1995

2000

2005

2010

2015

2020

— Weekly U.S. Field Production of Crude Oil

 Source: U.S. Energy Information Administration

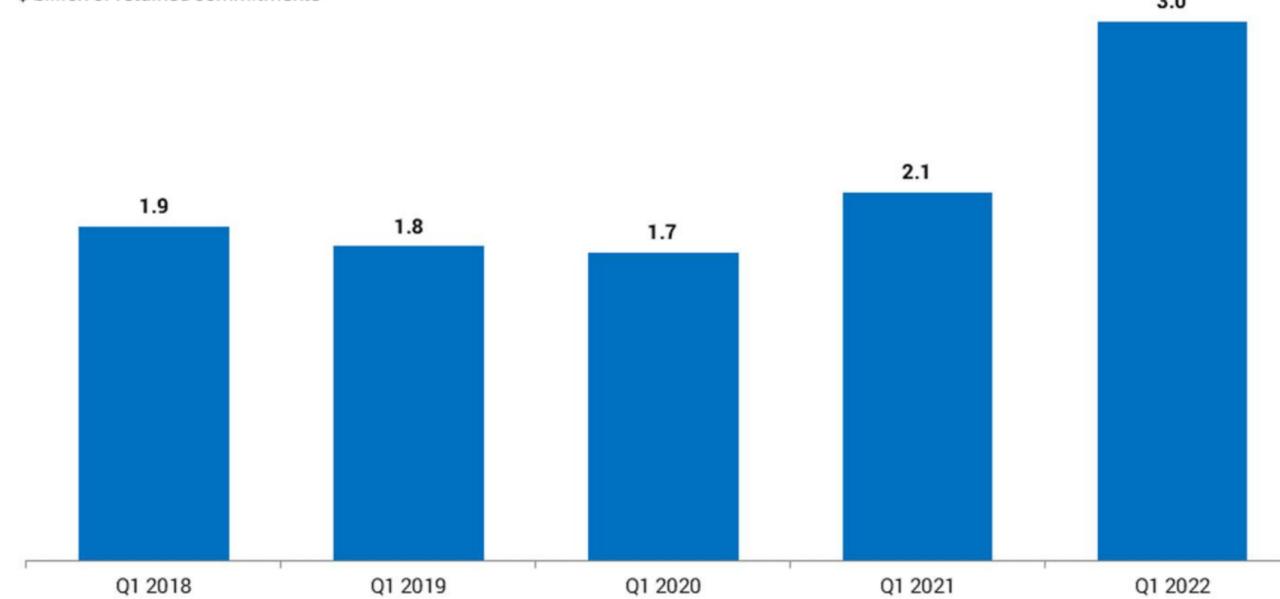
<https://www.eia.gov/dnav/pet/hist/LeafHandler.ashx?n=PET&s=WCRFPUS2&f=W>

Are We Heading To Recession?

Q1 Middle Market Origination Volume Exceeded Expectations

- Q1 2022 origination was a solid quarter
- Over 70% of origination activity was with existing borrowers

First Quarter Middle Market Origination Volume*
\$ billion of retained commitments

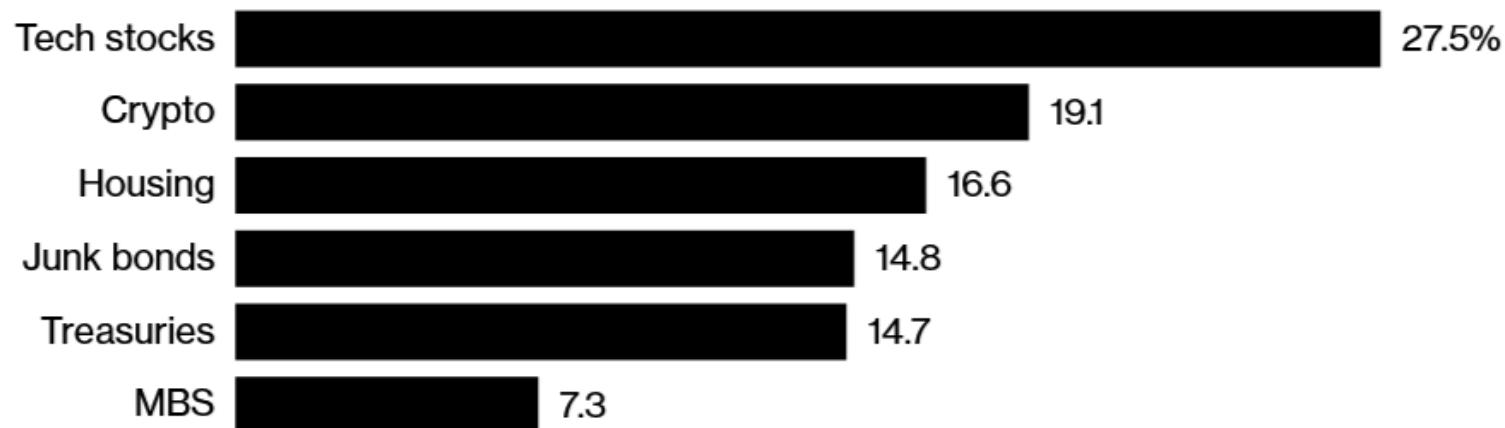


Just the view from one BDC, Golub Capital. They have been firing on all cylinders

Who is Going to Get Hurt?

Tech Stocks and Crypto Are Most Exposed to QT

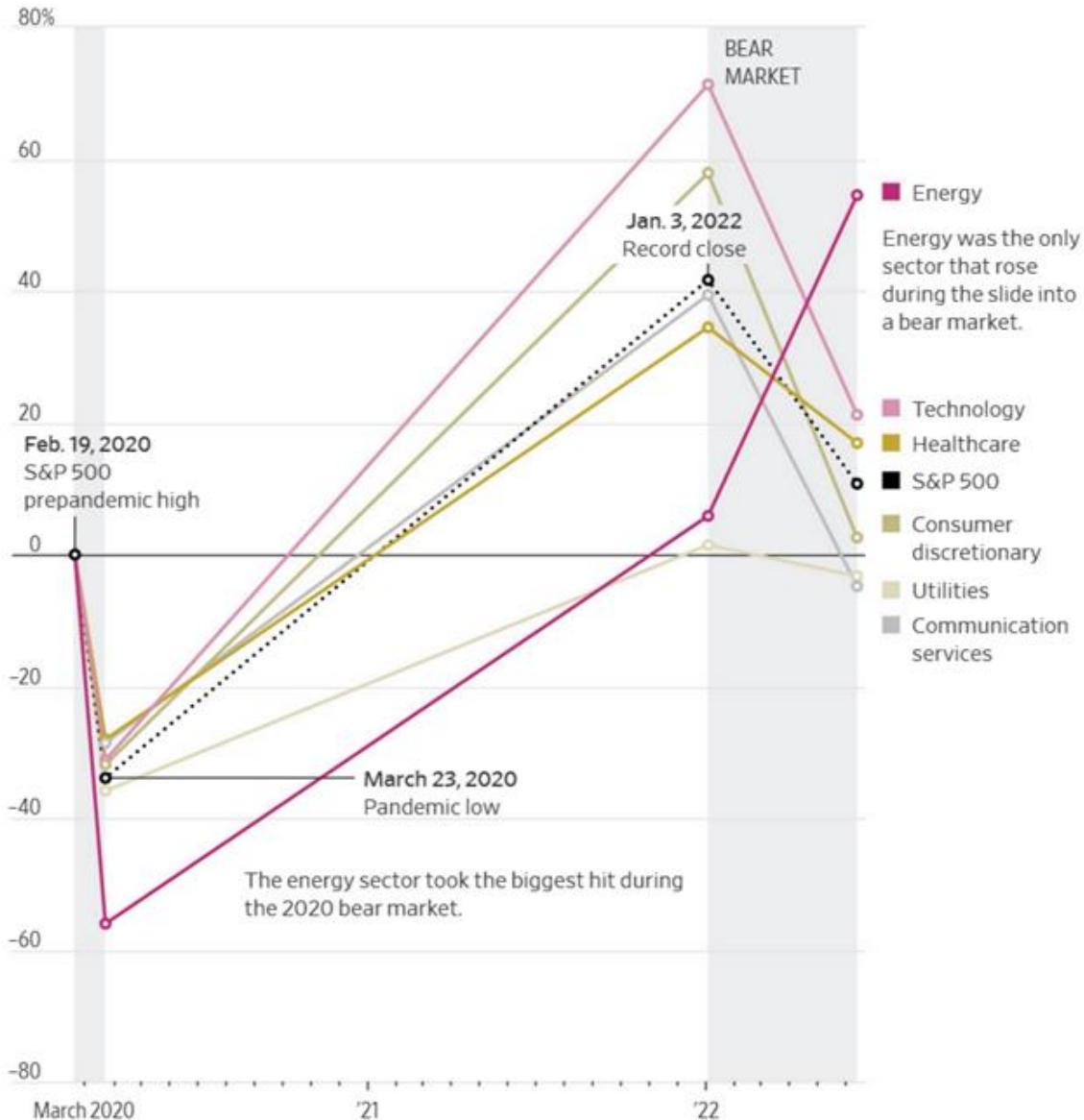
According to 47% of respondents



Source: MLIV Pulse survey running May 31 to June 3. Respondents were asked 'Which asset class remains most vulnerable to quantitative tightening? Pick one of the following'

From a Bloomberg survey. Not scientific. Remember Steve, though.
Look what's actually happened...

S&P 500 performance by sector, change from prepandemic high on Feb. 19, 2020



Tech stocks were up 70% and are now up “only” 20%, a 29% drop

Consumer discretionary stocks were up ~58% and are now up about maybe 5%. *That's a drop of 34%*

But that isn't anyone's story...

Really, Are We Going to Have a Recession?

The headline reads:

Nobel Laureate Shiller Sees ‘Good Chance’ of a US Recession

The subtitle reads:

Downturn could result from a self-fulfilling prophecy, he says

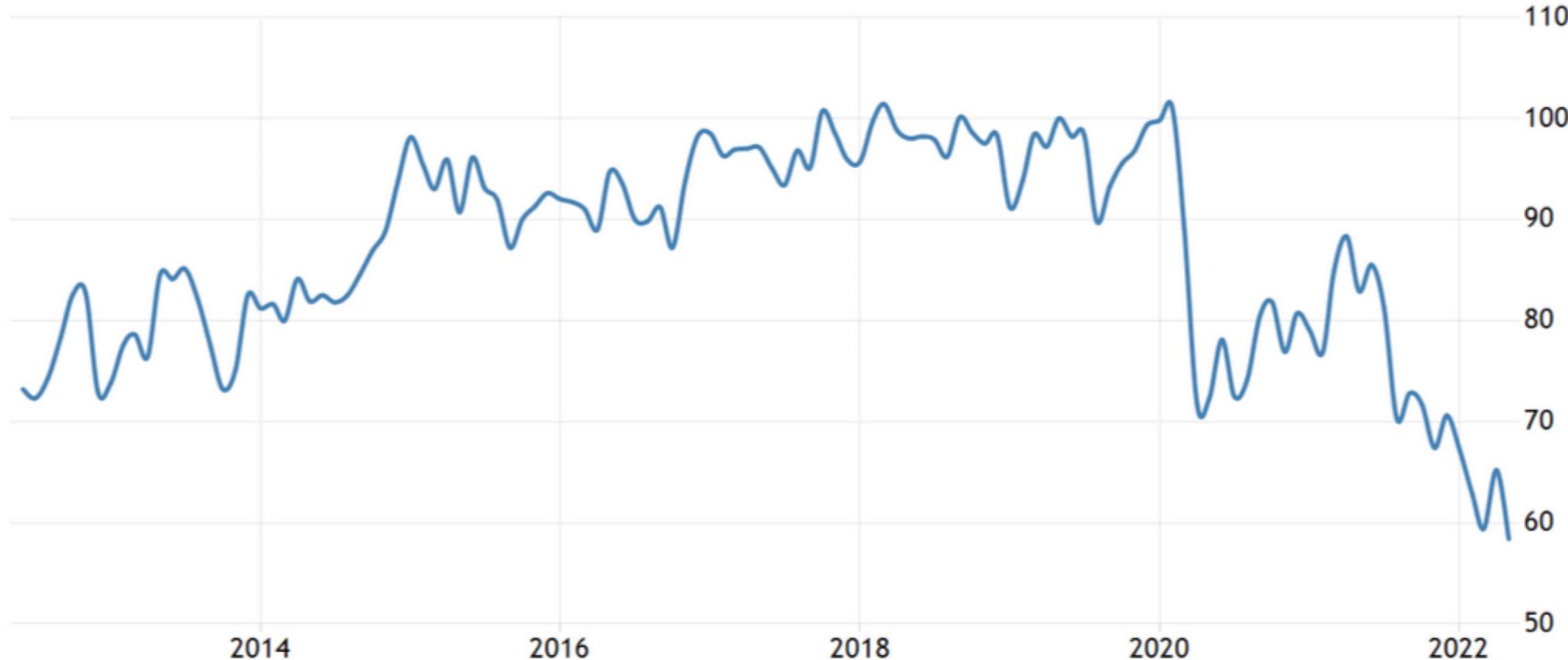
While the body of the article reads only that:

Nobel laureate economist Robert Shiller sees a “good chance” of a US recession that’s at least in part the result of a “self-fulfilling prophecy” as investors, companies and consumers grow increasingly worried about a downturn.

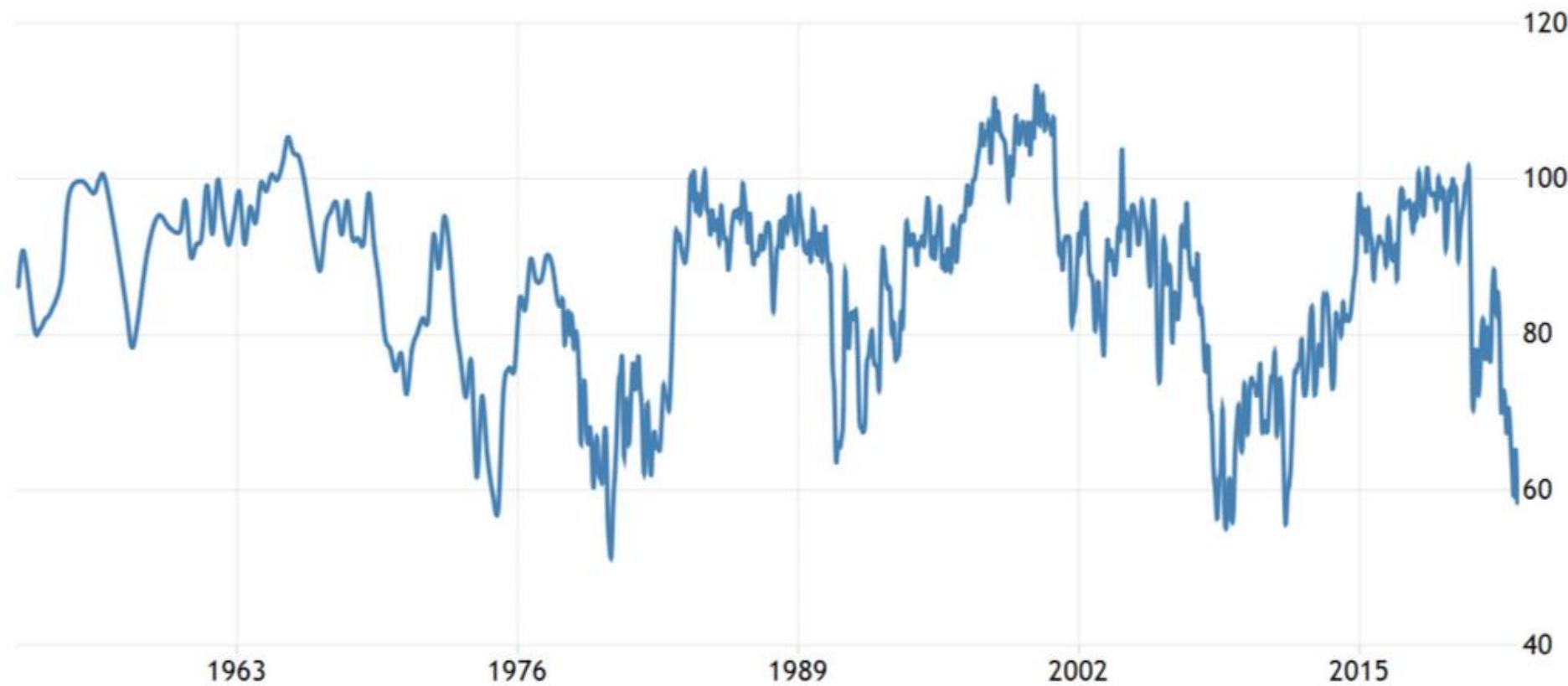
“The fear can lead to the actuality,” said Yale University professor Shiller, author of the 2019 book “Narrative Economics: How Stories Go Viral and Drive Major Economic Events.”

Consumer Sentiment

“...an increasing number of US households say the economy is headed in the wrong direction. That...could lead consumers and companies to turn more cautious, planting the seeds of a downturn...”



We have been here before though...



Employment & Politics

- Since 1940 – when BLS data are readily available –
Growth in Employment has averaged 120k/month

However

Under GOP Presidents: 67.7k

Under Dem Presidents: 170.3k

That's for calendar years. If you use the first Oct 1 after the election:

Under GOP Presidents: 78.5k

Under Dem Presidents: 158.0k

<https://www.bls.gov/webapps/legacy/cesbtab1.htm>

A Pattern in Previous Recessions

- The recessions since WW II have at least two patterns. Can you spot them?

July 53 to May 54

May 57 to Apr 58

Apr 60 to Feb 61

Dec 69 to Nov 70

Nov 73 to Mar 75

Jan to Jul 1980

Jul 81 to Nov 82 – Double Dip

Jul 90 to Mar 91

Dec 07 to Jun 09

May to Apr 2020

- <https://www.history.com/news/us-economic-recessions-timeline>

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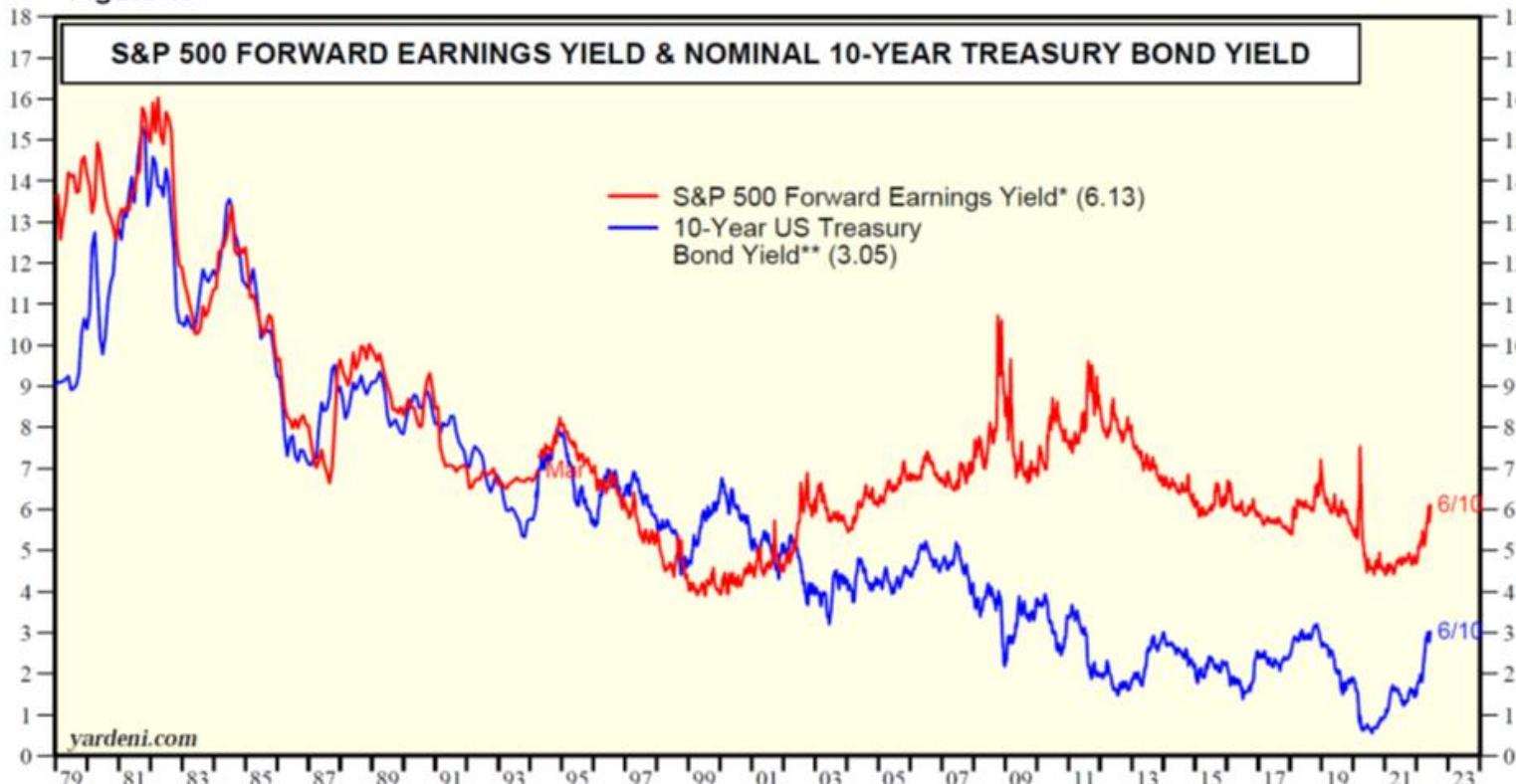
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Where to Stocks: The Fed Model

- Earnings Yield (inverse of P/E) compared to 10-year Treasury yield

Figure 1.



* Year-ahead forward consensus expected earnings divided by S&P 500 stock price index. Monthly through March 1994, then weekly.

** Monthly through March 1994, then weekly.

Source: I/B/E/S data by Refinitiv and Federal Reserve Board.

From early 2020,
spread has dropped
from ~4.5% to
about 3.0%

At least on average

Fed Model – Home Depot

- P/E for HD = 17.68 (Tuesday's close, TTM earnings)
- Earnings yield, E/P = 5.66%
- HD 2.375% of 3/15/51 YTM = 4.43% (Wednesday morning)
- Premium to take on equity risk is now 123 bps
- End of 2021:
 - EPS was \$11.94
 - Price was 415.01 (Tuesday's close was 278.67 !)
 - Earnings yield was 2.88%
 - Bond yield was 2.81%
 - Premium was just 87 bps
- For HD, equity is now considerably more attractive compared to bond

Fed Model – Alphabet

- P/E for GOOGL = 19.31 (Tuesday's close, TTM earnings)
- Earnings yield, E/P = 5.18%
- GOOGL 2.25% of 8/15/60 YTM = 4.18% (Wednesday morning)
- Premium to take on equity risk is now 100 bps
- End of 2021:
 - EPS was \$112.20
 - Price was 2897.04 (Tuesday's close was 2134.31 !)
 - Earnings yield was 3.87%
 - Bond yield was 2.69%
 - Premium to take on equity risk was 119 bps
- **For GOOGL, equity is a bit less attractive now than before**

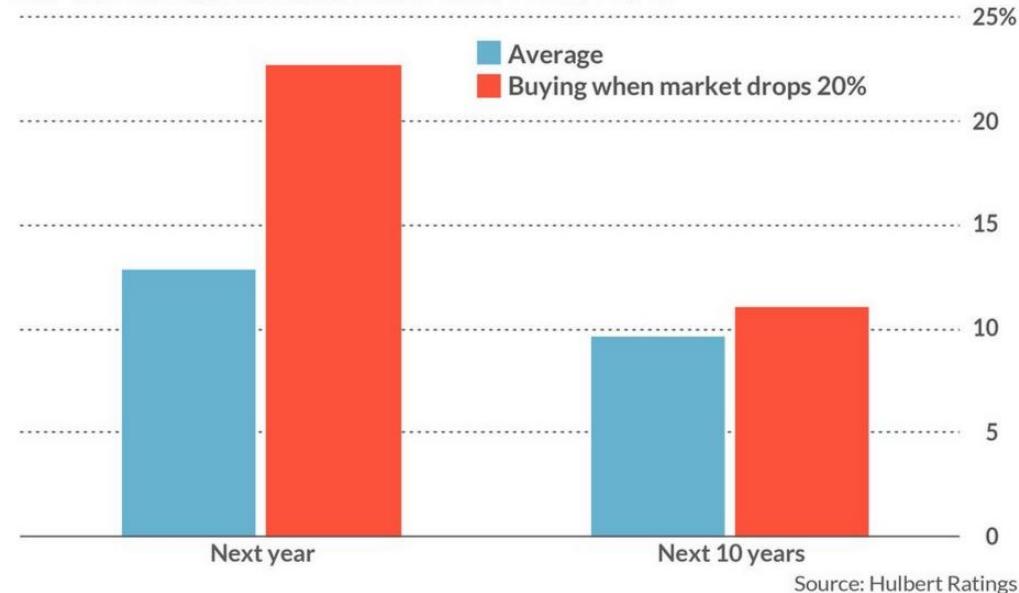
Fed Model – Electronic Arts

- P/E for EA = 46.14 (Tuesday's close, TTM earnings)
- Earnings yield, E/P = 2.17%
- EA 2.95% of 2/15/51 YTM = 4.67% (Wednesday morning)
- Equity risk *costs* 250 bps
- End of 2021:
 - EPS was \$2.67
 - Price was 131.90 (Tuesday's close was 127.37)
 - Earnings yield was 2.02%
 - Bond yield was 3.20%
 - Cost to take on equity risk was “only” 118 bps
- Just buy the bond? Hmm....
 - Perhaps the message is that high P/E stocks need to come down compared to bonds

Mark Hulbert is less Equivocal

Buying when market drops 20%

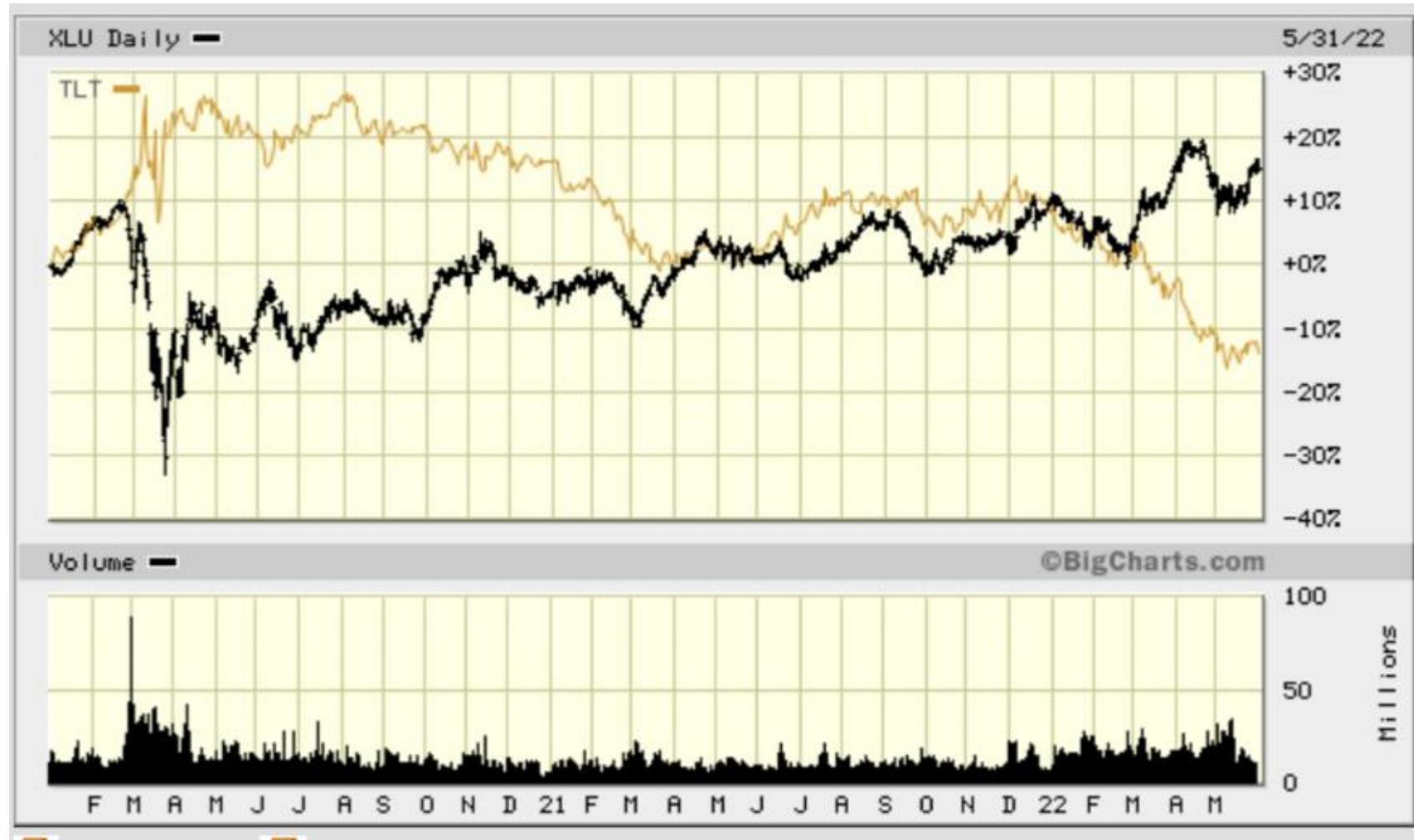
S&P 500's annualized total return since World War II



"I analyzed how you would have done if, in every bear market since World War II, you bought stocks on the day the S&P 500 closes below the 20% loss threshold. Sometimes that day came near the end of the bear market, and in other cases the market continued falling before eventually turning up. But on average you would have done very well.

And you wouldn't have had to wait that long to do so. Over the 12 months following your buys, your average total return would have been 22.7%...more than double the stock market's long-term average..."

But It Feels Different to Me Lately



Why Only Now?



Yield now ~3.0%

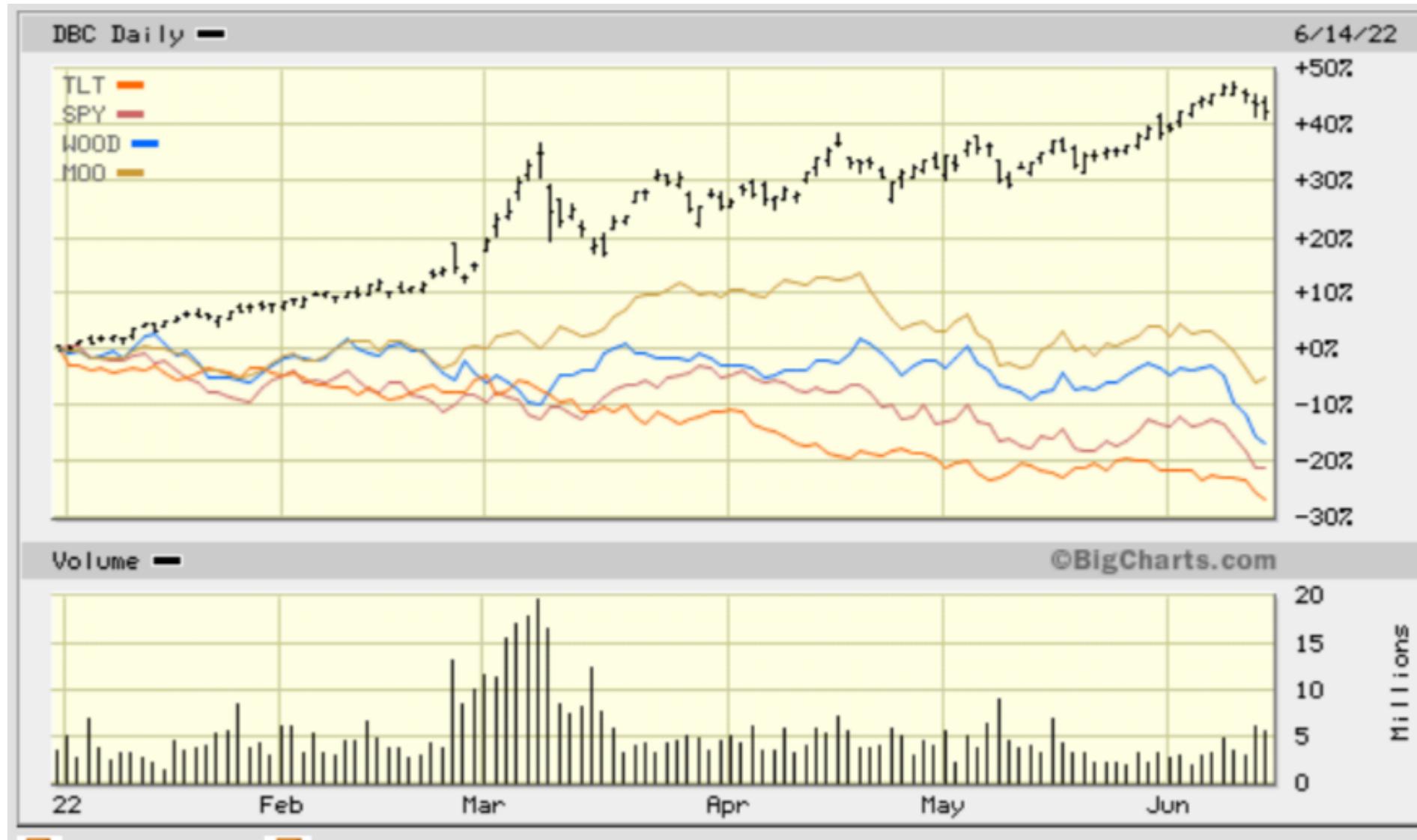
Yield before the big drop was ~2.67%

What changed?

It's Different for Resources, Too



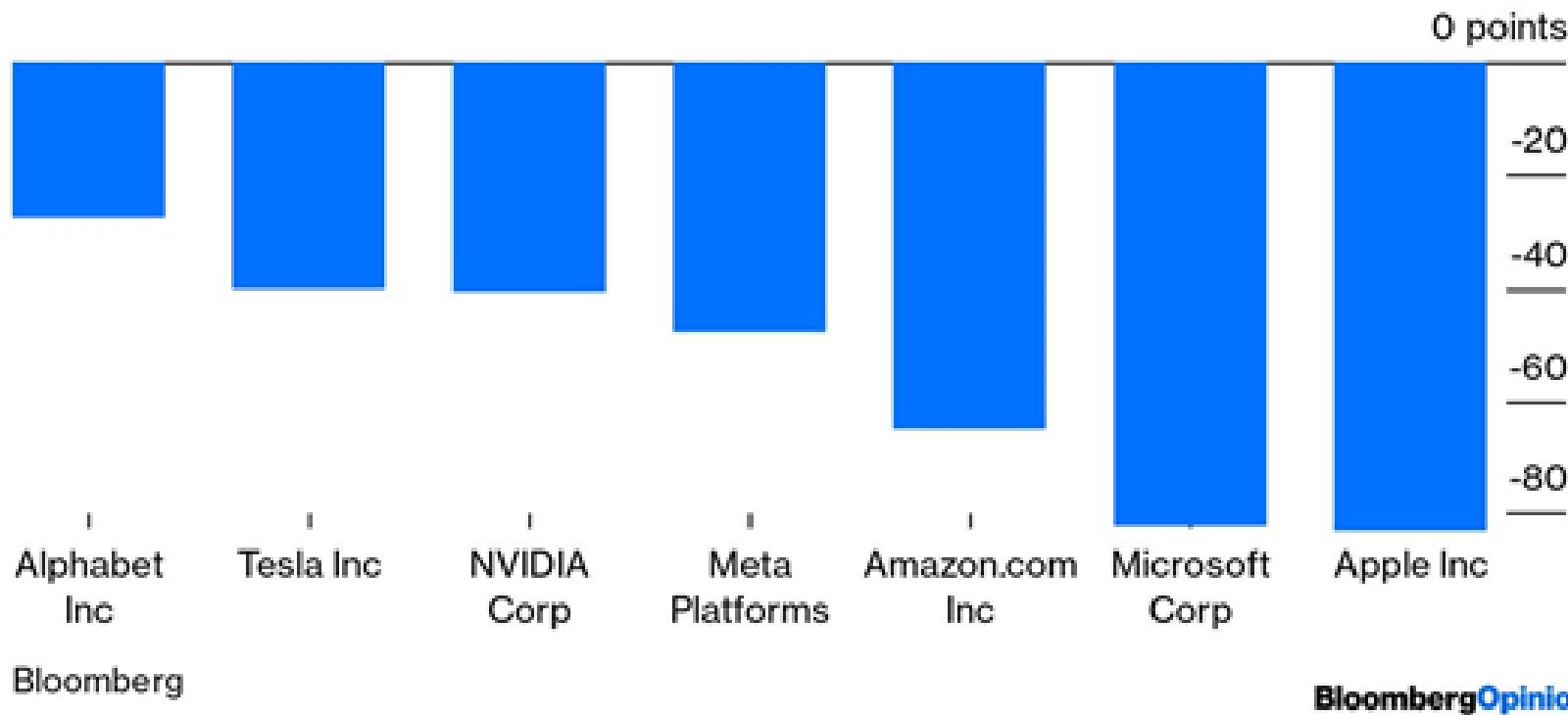
It's Different for Resources – Zooming In



Was it all Cathy Wood's Darlings?

The Stocks That Made The Bear

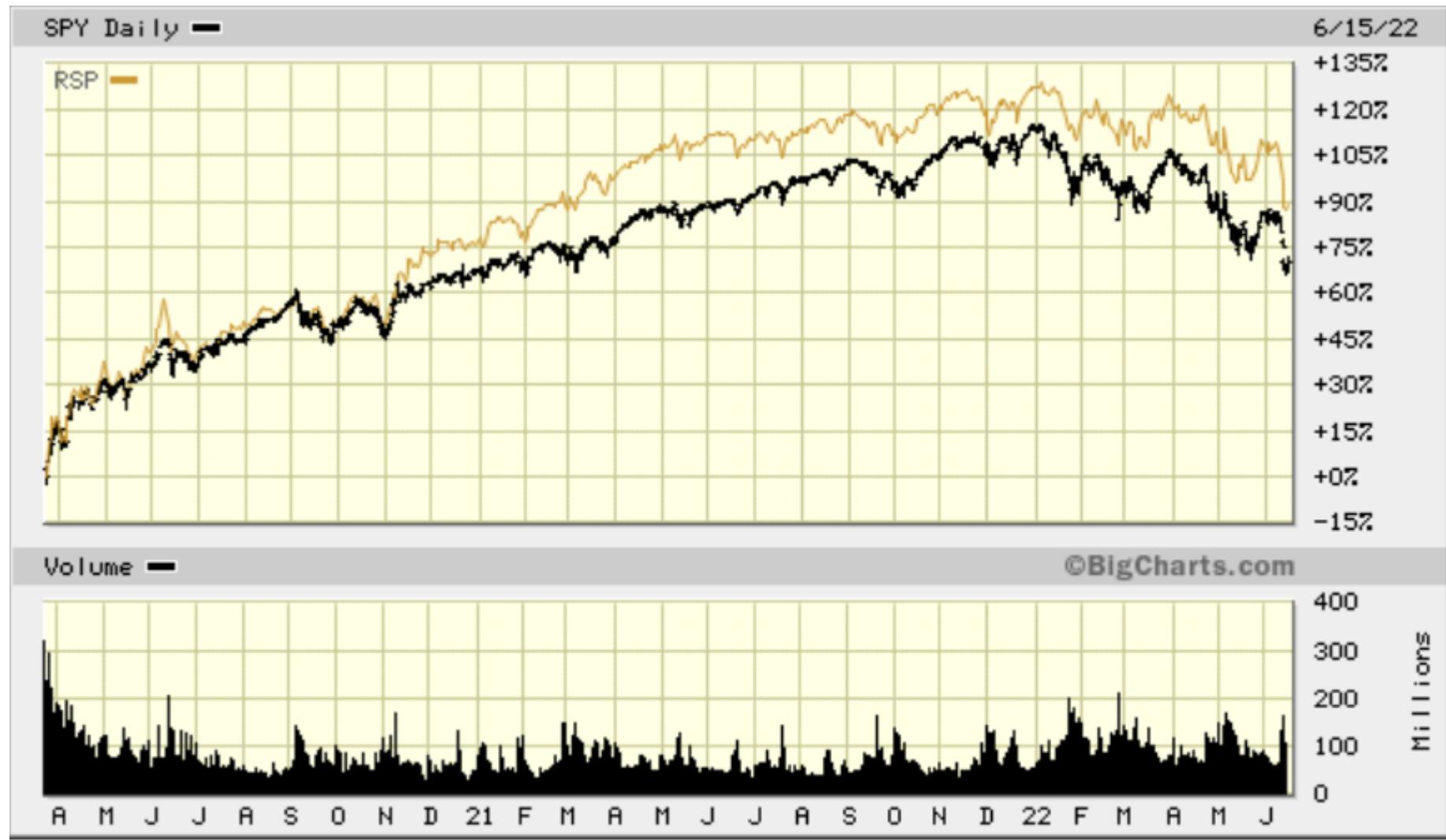
Seven companies lost more than 25 S&P 500 index points since the high



RSP is Equal Weighted – And Similar



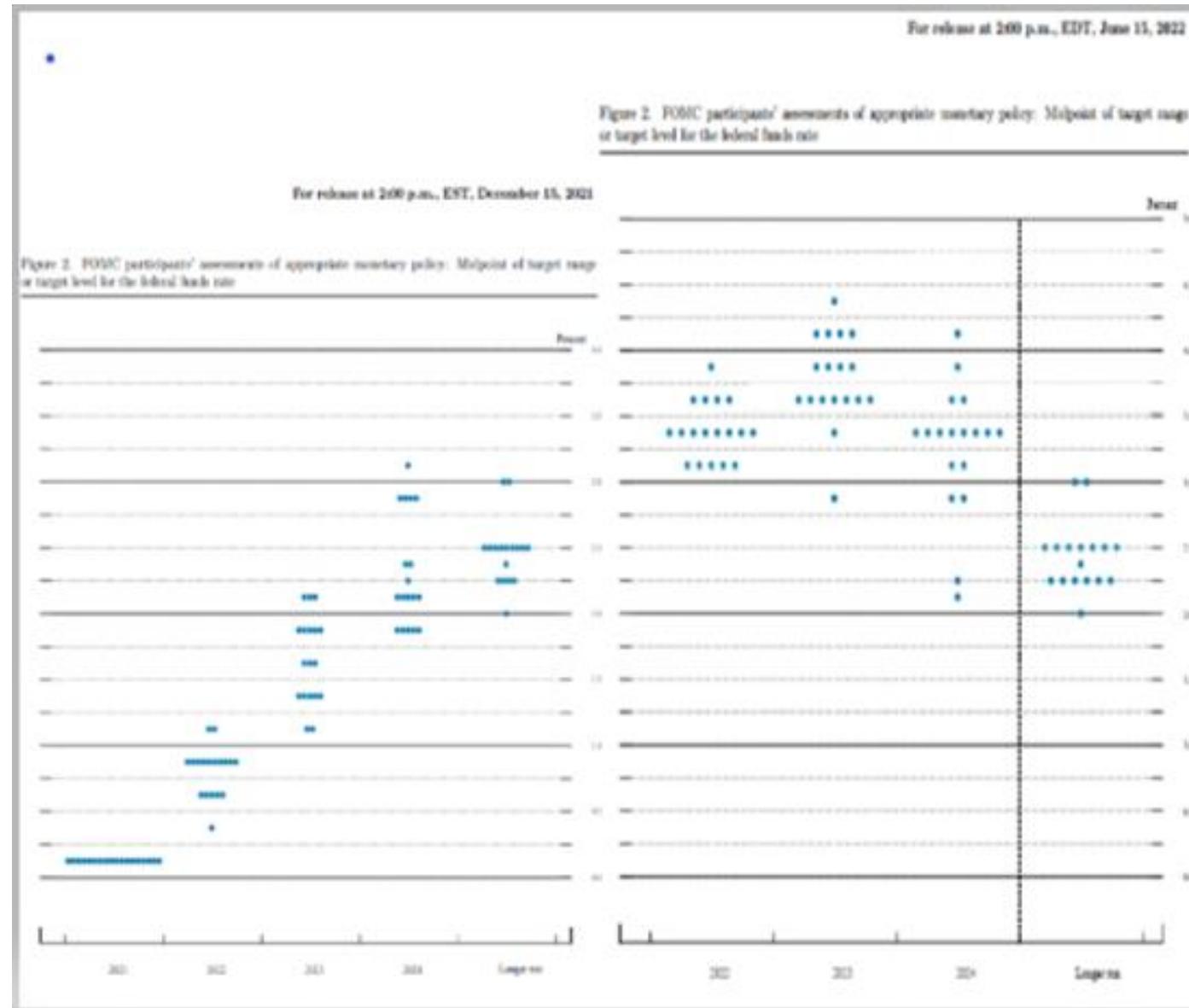
Who Woulda Thunk ?



Don't Fight The Fed

The dot-plot from the Dec FOMC mtg

Only one member predicted the Fed funds rate above 1% in 2022 and only one above 2% in 2023



The dot-plot from yesterday

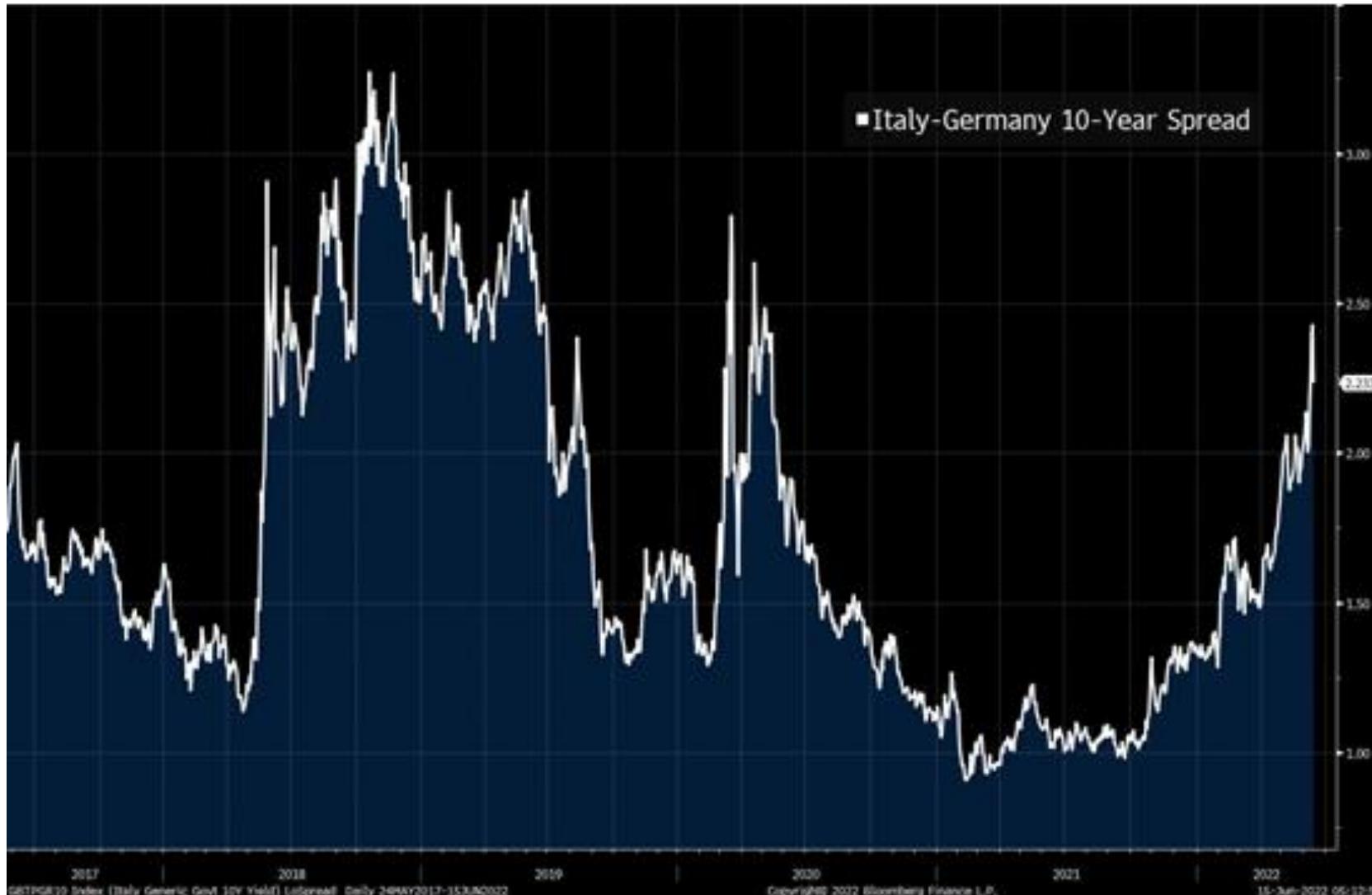
Everyone is above 3% by the end of 2022. But it goes no higher.

Denial?

RohitMillstein@yahoo.com

281 236 9800

Another Exogenous Worry - Fragmentation Risk



Greece, Too

