The Oak Financial Times

A Quarterly Publication
Spring 2024
Written and Published by Oak's Investment Team

"I'm up on the tight wire
One side's ice and one is fire
It's a circus game with you
and me"
-Tight Rope,
Leon Russell

Many of the Federal Reserve Board members recently said they believe the future is ok. Growth will remain above potential through the end of 2025, unemployment will remain at secular lows and the key inflation indicator they use called core PCE will also remain elevated. The Fed previously implied they wanted to cut short term interest rates three times before the year end. We are confident that even the Fed does not believe these things add up, inflation and higher rates go together, not the opposite.

The Fed is clearly left with a Hobson choice. This idea was introduced by Thomas Hobson and explains when there seems an apparent freedom to take or reject something offered, yet in fact there is no real alternative. The options the Fed is stuck with are either they cut rates and reignite inflation or they keep rates where they are, which will damage the economy as borrowing costs and debt servicing costs remain high. The equity markets are currently "priced for perfection" so the choice left to make is a very difficult one.

With yields currently high the U.S. budget problems continue to build, and should the debt continue its ascent the government will need to make critical moves. It's currently estimated that should nothing change, the debt will grow one trillion dollars every 100 days. The prudent thing to do would be to trim liabilities, but cutting entitlement programs or raising the age to collect Social Security have always been considered the third rail of politics. Even though Social Security benefits are only fully funded until the mid-2030s, politicians will not address cutbacks for fear of not getting re-elected.

A meltdown in the markets could have taken place a year ago when several regional banks faced bankruptcy and commercial office buildings hit the skids. A lending facility was put in place to avoid banks collapsing and further calamity. The bank term funding program moved the

Oak Financial Group, Inc.
"Planting a seed for the future"

1177 High Ridge Road
Stamford, CT 06905

Phone: (203) 329-9043
Toll Free: (800) 322-1479
Fax: (203) 968-9152

www.oakfingroup.com

If you know anyone who would benefit from our services please have them view our website, www.oakfingroup.com or call our office at 203-329-9043.

bad debt off the bank balance sheets and onto the Governments' balance sheet for one year to allow the banks time to fix their problems. The Standing Repo Facility is another program that was utilized during this banking mess. It was established in 2021 and it allows banks to borrow emergency overnight cash from the Federal Reserve and was therefore helpful last year, when banks needed liquidity. Yet we question their benefit as we noticed in the last Fed meeting, they removed the line that banks are sound and resilient.

To keep long term interest rates from rising Janet Yellen issued short term Treasury bills instead of long-term bonds which they were able to do with all the money they had in the repo facility. As those funds have dwindled the Government is going to have to issue longer term bonds unless they come up with some other gimmick.

The Federal Reserve fully understands this and therefore will have to either lower or eliminate their quantitative tightening program. They would no longer buy bonds which would lead to rising interest rates, especially if outside borrowers do not show up at the auctions. Only a recession would cause interest rates to drop, not something any administration would want in a Presidential election year.

While we would expect a correction in equities to take place in the second quarter of this year, we would expect the current authorities to attempt to engineer a bounce in the second half of this year as an incumbent President tends to have tools to prop things up heading towards election day.

If the Fed starts to cut interest rates during the summer months, it should set the stage for a resurgence of inflation going into 2025. This could also usher in a correction in equities as history tells us that markets typically bottom out roughly 200 days after the first rate cut. A rise in inflation next year should cause a weakening of the U.S. dollar and make owning tangible assets more enticing than financial assets.

In the deflationary period of the 1930's you would have wanted to own gold and bonds but not stocks. During the inflationary 1970's you wanted to own commodities and gold but not stocks and bonds. In the 1990's, with inflation dropping, you wanted to own only stocks and bonds.

Recently Steve Leesman of CNBC said that if you are not confused, you're not paying attention. With geopolitical problems around the world, a division between folks on both sides of the political aisle, and ongoing deficits out of control, paying attention should be a priority for capital preservation.

The Public Buys The Most At The Top And The Least At The Bottom

Many investors judge their returns using a narrow time scope, one month, one quarter, one year, etc. Yet the real goal of investing is to buy low and sell high as often as possible throughout your investing lifespan. This holds true for all investment sectors as time, geography demographics are so important. What many investors may not know is that it is not uncommon to wait many years or even a decade to break even.

The roaring twenties produced a large rise in equities enticing investors who felt like they missed out, to buy at the market top and sadly experience the 1930's zero return for the full 10 years. The 1980's and the 1990's were very strong back-to-back performing decades. However, the 2000's followed this strength and proved to be another lost decade providing flat to negative returns for those participating.

Several of the top stocks in the 1980's never repeated as top performers. The hottest stock in 1999 was Cisco Systems, which was the company that was believed to be the one to build out the internet, it has never recovered from its peak of 2000. Lucent Technologies, one of the most widely held stocks during the tech bubble, is

no longer around as it lost its competitive capabilities and was absorbed by another company in 2006.

The early '80's represented the beginning of the bond bull market which saw a peak in long term interest rates of over 15%. About forty years later in March of 2020 they hit their all-time low of close to 0.50%. Interest rates have since risen to 5% as it is believed that deflation is in the rear-view mirror. It is possible that the next forty years may be the reverse of the previous ones causing long term yield to rise, but we would not be surprised if there were some rollercoaster moves in yields along the way.

Had an investor held a basket of commodities during the decade of the 1970's the compound annual return was double digits. That same investment during the 1990's declined, but had you bought back the commodities in 2000 it would have been a homerun going forward.

U.S. stocks have outperformed their international counterparts for the past 15+ years, leading many investors to massively overweight the U.S. The current belief is that diversification has detracted from returns and there is an uncomfortable amount of worldwide money concentrated in a small number of American names. Given today's rich U.S. valuations, non-U.S. stocks should offer a healthier balance in client portfolios.

Japan is the poster child for long periods of underperformance with its market peak at 40,000 in late 1989 and first rising above that level this year. Corporate governance and the better use of capital for individual businesses should be a driving force for continued stock appreciation. In addition, Japanese households have most of their assets in cash practically earning nothing. Should they start to move off the sidelines from cash into equities, the amount of dry powder they are sitting on could be extremely beneficial to Japanese equities.

India has quietly become the most populated country with 1.4 billion people, surpassing China due to Chinas' former one child policy. The combination of a highly educated workforce and a young demographic profile should be a prescription for an outperforming market in the years ahead. Additionally, friend shoring is aiding India as U.S. companies are moving their manufacturing facilities to India as well as Mexico.

The darlings of the investment world do not always stay on top and being flexible within portfolios is important. Bonds have been a good place to invest over the past forty years as yields have fallen and prices have risen. Bonds should continue to be a good tactical vehicle, however buying and holding them may no longer suit investor's needs. As rates have risen since 2020 bond managers and many passive ETFs have experienced negative returns. It has been reported that more assets are currently in bonds versus equities. We wonder what the public will do when they realize what they thought were safe investments turn out to be the opposite, again.

We're looking out for opportunities that present themselves, sometimes being unloved or under-owned in a previous decade is a good place to start.

Death of a Salesman?

It may seem ironic to talk about job losses when we are still in a sub 4% unemployment environment. We have been hearing and reading about lot of signals that these losses could creep up in the future or have already started to do so. The proverbial salesman may need to look for new work or start collecting unemployment soon.

The National Bureau of Economic Research (NBER) is the organization that calculates the average household and payroll employment figures. Their work represents the broadest measurement of labor markets in the US and their data shows negative movement in the jobs market. The labor market has not been robust or dynamic, its negative changes over the past twelve months are

consistent with past recessionary periods.

Worker Adjustment and Retraining Notifications (WARN notes) require many businesses to provide early warnings of business closures and/or layoffs. Depending on the state where the job and/or company are located in determines how much lead time people get about their employment status. The idea is to allow for transitions for those affected employees into their next job or living situations etc. The amount of WARN notes issued in January were on average at the same level issued in 2009.

Moody's tabulated that 182,000 layoffs were announced in the first two months of 2024. Macy's announced they would lay off 28,000 employees by the end of 2025 and Google continues to reduce their workforce. In their Q4 2023 earnings they disclosed they recorded employee severance and related charges of $2.1 billion for the year and expect an additional $700 million for 2024 layoff charges, meaning more layoffs ahead.

Severance packages have drastically changed recently as well. Employees that were let go in 2020/2023 were given healthy exit packages lasting many months. Today they are much shorter, with some only being a couple of weeks at best. When an employee is collecting a severance, they are not calculated in the unemployment rate, so as these payouts become shorter it is possible the unemployment rate creeps up quicker, especially if finding a new job proves difficult.

When a job is lost, people alter their spending habits. Often that shift is not enough, and consumers are forced to dip into their savings or retirement accounts to help pay bills. For the first month ever in the history of the $2 Trillion Vanguard Total Stock Market Index Fund, it experienced net redemptions in January. This is due to the combo of several factors, investors pulled out money, retired early, did not contribute to their accounts, or are not opening 401(k) accounts anymore.

The number of people entering the workforce or staying in the workforce may be lessening and the workweek has declined massively. Although technically more people are being calculated as "working" according to the payroll survey, under a microscope the message changes. Americans are working less hours than before or being forced to work multiple jobs to make up the hours they lost. Over the past six months the change in full-time employment has gone negative. We are even learning that 2024 college graduates are starting to have job offers rescinded.

Job cuts matter and will heavily impact the labor market and permeate into the economy. The combination of unemployment rising, persistent inflation and fewer jobs means a weaker labor picture overall. The American worker could continue to muddle on, or accept a lower paying job, but we will continue to watch the vitals of our "salesmen".

CONCLUSIONS

1. Absent an exogenous event, it seems the recession that was widely expected appears to be pushed back to 2025.
2. The country is carrying a massive amount of debt and it's growing. The easiest way to combat debt is lower rates, however that comes with many consequences. The downside to this is that it vastly reduces the standard of living for the bulk of the population as costs of goods/services skyrocket while incomes do not keep pace.
3. Deglobalization is becoming a powerful secular theme, reindustrialization or onshoring makes us less dependent on the rest of the world.
4. Moving to a multi-polar world creates wars, tariffs, and sanctions which we have already seen evidence of over the past few years. We should expect this to continue regardless of which party remains in power.
5. Despite a low unemployment rate, we are seeing signals that the workforce is beginning to weaken.