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THE FOURTH TURNING (REVISITED)

In previous newsletters we have discussed the theory of the four turnings, the four inner patterns of 20–25-year generational junctions. The authors of this idea, Neil Howe and William Strauss, had estimated the fourth turning would start around 2005. This turning represents a crisis; “it is a decisive era of secular upheaval, when the values regime propels the replacement of the old civic order with a new one”.

Mr. Howe and Mr. Strauss projected things like a spreading virus, a government shutdown leading to defaults on Wall Street and Russia and Iran forming an alliance against the U.S. causing oil and gold to soar. Although their prediction of when this would occur was a little off, they are still prescient as a lot of their ideas are coming to fruition.

The world used to operate as a unipolar world with the U.S. being the undisputed leading major power because it had the strongest military and a thriving economy. This has changed.

China is a main rival to the U.S. Other countries are gaining traction, especially as Russia, Iran, Saudi Arabia, and China bond over their plans to move away from trading on the U.S. dollar system as well as no longer purchasing U.S. treasury securities.

Global wars have broken out in the last few years. For many decades the U.S. was the worlds policemen, yet we are now considered to be weak and unable to fight on multiple fronts. The debt this country has built up through the years has hindered its previous stature. American politicians are still fighting over releasing funds to support allies such as Israel and protecting Ukraine as the first line of defense for NATO, arguably showing more potential U.S. weakness. South America is becoming more vicious than ever before as a cocktail of drugs, guns and migration is fueling gang violence across the region. In the past few years millions of migrants are fleeing to the U.S. for safety and better lives. As it stands now our financial system cannot handle all the immigrants and it is causing massive divisions within our

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government. The risk of global wars in the future remains.

The covid virus taught our country a lesson; it needs to be prepared as it seems inevitable that another virus strain could appear and threaten the economy down the road. Being prepared means bringing back domestic manufacturing capacity, enabling the U.S. to produce goods needed without relying on trading partners. Hospitals and transport facilities should also be logistically positioned to be able to react at lighting speed should a pandemic like event occur yet again.

The public seems unaware that the banking crisis on and around Wall Street has not been fixed. Instead, the Federal Reserve applied a band aid to it last winter. The Federal Reserve acted quickly to halt a banking crisis by bailing out four of the

largest regional banks but has not addressed the losses that other small and large banks and other financial institutions have incurred. There is no current solution offered should any of these institutions head south.

Small businesses are the backbone of our economy, as well as the largest employer of Americans. Many of these companies will need to renew their debt/loans at substantially higher rates as they come due. At the same time banks are refusing to lend money to them due to their unhealthy or underwater balance sheets.

The current mantra on Wall Street is the economy will experience a soft landing where earnings hold up and inflation dissipates. The legendary Bob Farrel said that when all experts and forecasts agree, something else is going to happen. It is usually true that if earnings rise

while interest rates decline all will work out well, but we are not willing to bet on that.

The stock indexes have been flat to down for the past two years even though they experienced large moves up and down throughout that time. We continue to expect these types of swings to occur during the remainder of the decade. From the end of 2021 until the Fall of 2022 the S&P 500 fell about 25% and the Nasdaq fell 35%, then a sizeable rally occurred. We currently believe that a decline will take place in the first two quarters of this year. We then expect the Federal Reserve to panic and create liquidity in the markets, which should set us up for another significant rally. Oak's strength through the years has been to minimize drawdowns experienced by the markets; while pinpointing exact timing is difficult, we stand ready and prepared to avoid the next one.

“Investment success doesn’t come from “buying good things,” but rather from “buying things well.”

-Howard Marks, asset manager

Many investors are working under the premise that the ideas which succeeded in the last decade will continue to follow through in this decade. We do not share this sentiment and think that it is time to re-hit the books and especially focus on

the fundamentals of value investing.

Last year was a challenging year for portfolios that were not grossly overweight the magnificent seven stocks (Alphabet, Apple, Amazon, Meta, Microsoft, Nvidia and Tesla). Well-respected Wall Street experts were calling for a recession and continued that call throughout the year. Various indicators were signaling that the economy was slowing and that markets were

potentially headed for big trouble.

The leading economic index, which provides an early indication of significant turning points in the business cycle and where the economy is headed, declined all of 2023. The yield curve inverted (where long term rates are lower than short term rates) and a big decline in small cap stocks also implied that businesses were in danger.

In 1999 we learned that owning a handful of technology stocks for too long was a recipe for a crash within a few short years. We believe today the magnificent seven are coming up on their own expiration dates. While valuation alone may not be as reliable as a short-term indicator, we do not completely ignore the concern over very lofty valuations. We prefer to look for and buy undervalued assets that have a margin of safety which can help avoid participating in all the major downdrafts in the markets. We think looking beyond the seven most expensive stocks that drove the indexes higher last year could help a portfolio in the future.

Unfortunately, many of the legendary value gurus that we invested with for decades are either no longer with us or have retired from the business. Michael Price and Marty Whitman have passed away and Wally Weitz, Chuck Akre, Dan Janis, Dan Fuss and Bill Gross have all retired. We have learned countless lessons from these titans that we think will be

useful to put to work in the months and years ahead.

We believe that if we were sitting in a room with our value heroes, they would tell us to focus on the risks that we see ahead and invest elsewhere. Its not the bus you see that hits you, it's the bus that you don't see that take you out...and therefore we are trying to think as they would.

We think they would want us to keep a close eye on who the holders of U.S. government debt are and where they are domiciled. For example, we are watching what is called the "yen carry trade" This is when investors borrowed the Japanese yen at a low interest rate to purchase other countries' currencies because their countries paid a higher interest rate on their bonds. As Japan has been fighting deflation for about thirty years, if they do not stabilize their currency, it will cause significant problems, yet in doing so it could unravel this massive trade and cause a black swan event.

We also think those value minds would want us to focus on the movement of interest rates, especially the U.S. government bond yields. Government bond yields have risen at the fastest pace in history due to the Fed waiting too long to control inflation, massive government spending on both sides of the aisle and the U.S. Treasury in essence printing money. Corporate yields have fallen as many companies refinanced their debt during the covid led low rates and temporarily helped their balance sheets. Fascinating prospects as well as land minds will unfold in this arena.

Looking back in history in 2001, 2008 and 2020 when the Fed called for a soft landing and cut interest rates, a recession proceeded. It is hard to think this time will be different. Our strategy is to seek out opportunities to buy things well, especially in a time where there are a lot of expensive investments around and risks, we would like to avoid.

THE INTEREST IN INTEREST

Since the 1980's the world has believed that bonds were bought for safety and stocks were bought for higher returns and this creed rang true for forty years. This understanding was implanted in almost all investors' brains, and it will remain that way until people

realize that something has fundamentally changed. Two years ago, we advised our clients that the world was in an "everything bubble" which also meant the safety reputation of bonds was in question. Although we anticipated risks, we were surprised along with everyone else to see that the

U.S. Government long bond could suffer an almost 50% loss within a two-year span. The safety net had a gaping hole in it and some investors not paying attention lost a lot of money.

The idea that bonds would suffer after such a long and outstanding distinction was based on several components.

During covid, we saw trillions of dollars get pumped into the economy; many regional banks, households, and businesses were given financial help from the government. Many entities had more money in their pockets thanks to the government than before we even learned what covid was. This extra spending cash combined with wages increasing during covid, deglobalization and other government measures caused goods and services production to soar. As the bill for all of this economic boost has now come due, we are seeing long-term interest rates catch up with short-term interest rates.

There are multiple reasons for Oak to believe that long term interest rates will rise this decade. History has taught us

that interest rates fall in recessions, but we need to understand this may or may not occur during the next recession. Our inclination is that at the end of the day they will, however keeping an open mind helps while investing. Current factors such as slowing globalization, deficit spending by politicians, and lack of foreign purchases of U.S. debt are some of the major factors that should keep interest rates climbing over the next several years. Keep in mind that this might not be a perfect staircase up and could have some wiggles during this move which may provide us with investment opportunities.

The last forty years were the golden years for investing. Looking backwards we can now deduce that declining interest rates acted like rocket fuel for

risk assets. Should we be correct that rates will rise for an extended period of time, then we can assume that the players who took outsized risk using leverage could experience a lot of pain. Private equity firms, venture capital firms, and pensions will need to adjust to the changes that could take place.

The rise in interest rates moving forward should present an outstanding opportunity for retirees to lock in yields with safety instead of loading up with equities and real estate as they had done in the past. We should point out that we still think there is some juice left to squeeze in the bond market going into 2024, but we are specific in what we are owning and the timeline in which we own bond investments.

CONCLUSIONS

1. Equity markets could experience a sizeable pullback in the first half of the year. This could cause the public to panic and sell indiscriminately, allowing us to put money to work at more opportune levels.
2. A lower dollar has historically created a bull market in commodities and precious metals, assets we believe will outperform equities and bonds in this decade.
3. Should the Fed cut interest rates while inflation is not fully contained, bond prices may once again fall, and yields could rise. In this scenario we could see long-term interest rates at high single digits before the end of this decade. Which would allow investors to lock in some solid yields without having to take
4. Deficits are out of control; the entitlement programs need to be readjusted but politicians feel they cannot get re-elected should they vote to alter entitlements. As the public needs proper adjustments to continue this democracy we would expect change to take place in 2028 and potentially in the shape of an independent party. Note 2024 elections are slated to be a wild ride.

