

Little Bit Softer Now



Highsmith, Carol M, photographer. *Wall Street bull, New York, New York.* [Between 1980 and 2006] Photograph. Retrieved from the Library of Congress, <www.loc.gov/item/2011630801/>.

Oh man – Christmas Eve at the Gross household and we have problems. My new automatic toilet seat didn't lift as quickly as it should, and when sitting, the seat didn't feel as warm on my bum as advertised. Have to get the plumber out here ASAP, Christmas Eve or not.

To add to my woes, the infamous Gilligan's Island trial ended the day before Christmas Eve with a resounding order for me not to play music louder than 60 decibels, whereas pre-trial, Laguna Beach noise ordinances decreed residents couldn't play outdoor music louder than...60 decibels. Say what? After six weeks in court during Covid and a lawyer's tab of several hundred thousand dollars, my confusion runneth over. I tend to think judges and lawyers have something going on – tit-for-tat like – but I don't dare mention it. Ssssh! Wouldn't want social media to start another rumor.

My 50-something-year-old judge was appointed by ex-governor Jerry Brown many years ago. It was hard to see her though with covid mask and all. She crinkled her eyes (of that I'm sure), every time the plaintiff's attorney played his pre-recorded Gilligan's Island video tapes that proved either they were louder than the ocean at low tide, or that I was trying to annoy him – he being in his mid 50's and oblivious to Gilligan's Island reruns. The judge being even slightly younger seemed more inclined to like

music by 50 Cent or Usher, so she ruled I couldn't play Gilligan's louder than I wasn't suppose to play it before. Hmm, Laguna Beach justice I suppose. A bona fide "hanging judge" at the shore. And big headlines! Maybe Trump will promote her to the Federal bench before he unceremoniously departs in a few weeks.

But away from Gilligan, the Skipper and the S.S. Minnow and on to more important matters like "Wonder Woman 1984" reviews (100% green tomatoes -- don't think of watching) and maybe the Bubblicious stock market. OK stick to the market Bill, you know your many critics think you're way too into yourself and all. So why is it that stocks are so high and IPOs like DoorDash soared 80 percent on its first day of issue and Airbnb (which I first thought was a new commuter airline) jumped 110 percent, giving it a market cap of \$100 billion the first day (it's a home rental company). Yikes I've grown too old or have been listening to Cramer too long. I thought IBM was a bargain six months ago with its 10 P/E and 5% plus yield. Guess not – Robinhood and momentum rule. Value and dividends are so pre-Covid.

Anyway – I want to reemphasize what I futilely wrote in my last outlook of a few months ago. This market is driven – yes – by intense speculation, but also by fiscally pumped, central bank-primed corporate earnings, which when discounted to present value by near zero nominal and in many cases negative real interest rates, produce record stock prices. A lot of these record breaking index days are justified, so don't put me down as a perma bear just yet. But two main points of caution:

1. Fiscal rescue packages in the trillions have performed their Keynesian duty of supporting the U.S. (and global?) economy with a government backstop in hopes that the private sector will reassemble to pre-Covid levels and beyond. So far so good. But think about it, at least beyond the current \$900 billion package. What if the reassembled economy, absent a large amount of office space, retail stores, and new Boeing airplanes, etc. doesn't create a capitalist creative destruction replacement in short order? And how many fiscal packages can the stock market stand before it realizes that GDP is now opioid-like, dependent on more and more dollars from Washington that turn our Republican supply-side capitalistic behemoth into a – gasp! – "universal income-like" sluggo similar to Europe? To avoid that, it seems to me, requires unemployment to return to pre-covid levels. Fed Chairman Jerome Powell has said as much – but we're far, far from it. Are we now permanently suckling on a "trillion dollar" fiscal deficit teat? If so, the problem is not how to finance it – the Fed can and will. The problem is we all know that Nordic and European stock markets trade at much lower P/E ratios than DoorDash, Snowflake or even Microsoft. And the U.S. economy is beginning to resemble those economies more and more. IBM here we come – just maybe.
2. Stock prices and P/E ratios are affected by interest rates – but not just because their yields can be compared to bond yields – risk adjusted. Pundits rightly point out the huge yield spread between ATT 10-year bonds (2.4%) and ATT equity (7.25%) as a perfect example favoring stocks. I agree. But low interest rates, especially low real interest rates, are a fundamental factor (Robinhood groupies skip this part) in the discounting of expected forward earnings, which when inserted in a dividend discount model produce higher and higher stock prices the lower they go. With the 10-year Treasury inflation adjusted TIP yielding a negative (1%), it's hard to even mathematically insert his number into a Gordon discount model. My point though is that the 200-basis point decline in real 10 year treasury yields since January 2019, has been instrumental in the 50% price increase in the S&P 500 over the same period. How significant is academically debatable depending on volatility and risk comparisons of the 10 year TIP and the VIX, but let me suggest that "a lot" of the market's appreciation over the past two years, especially for growth stocks, has been due to lower real interest rates.

If so, then much like trillion-dollar fiscal deficits, real yields must stay substantially negative for stocks to rage like that symbolic charging bull sculpture on Wall Street. Growth stocks, SPACs, and the Teslas of 2020 may struggle to please day trading Robinhoods. My favorite market sector is the natural gas pipeline group, with yields between 9% and 12% for investment grade stocks with certain tax advantages. Take a look at MMP, BPMP and EPD. TSLA? In the hands of the Robinhood gods I'm afraid it's definitely overvalued.

The market's music in 2021 should not resemble "50 Cent" played (not at my house) at 100 decibels in 2020. Gilligan's Island at 60 or less is a better call. A little bit softer now!