BROKERAGESELECT NEWSLETTER

Taxes

Index Mutual Funds and Index ETFs are constructed differently and have different rules for taxes. In a tax-deferred account like an IRA, it doesn't matter. In a taxable account, open-end index mutual funds can throw off taxable capital gains even if you don't sell any shares. ETFs typically avoid capital gains until you sell.

ETFs

Just because it's an ETF, does not mean it is necessarily low-cost. It is important to read the fine print and expense ratio disclosures. Some ETFs carry expense ratios above 1%. Others can be very low, like 0.02%. Make sure to compare ETFs by strategy, underlying index and cost.

Crooks

In uncertain times, scammers abound. They take advantage of fear. These days high-pressure schemes to protect against inflation or a market crash are common.

Perspectives

This week the markets got another hot inflation report. This sent interest rates shooting higher. The 10-year US Treasury yield broke above 2% for the first time since the summer of 2019. The persistent inflation raised the probability that the Federal Reserve will need to raise the Fed Funds rate by at least 25 bps at the March 16th meeting. The expectation is that the Fed will need to continue to raise rates throughout 2022 to combat higher prices. Raising rates is tricky business. Raise them too little and inflation can stay stubbornly high. Raise them too much and the Fed could throw the economy into recession. The market is a discounting mechanism. Prices move in anticipation of a range of possible future outcomes. The S&P500 index, in response to inflation, rising rates, and the possibility of recession, has fallen about 8% from its January high. The Nasdaq is down 14% from its November 2021 high. Investors clearly are making adjustments. High flying stocks trading at ultra-high multiples of earnings have been taken down far more dramatically. Some are down 50%, 60% or more. Those stocks probably should never have traded at those heights but with rates near zero and speculation abounding, prices were bid way up for companies with exciting plans but with no profits for years. In today's environment, appetite for such stocks is not there and prices have tumbled. On balance, it is probably a good thing that speculative excess is being wrung out of the market. Investors again are turning their attention to fundamentals and some sense of value. This week, geopolitics threw a wrinkle in the story. Fears of a Russian invasion of Ukraine sent investors selling risk assets and buying safe havens like US Treasuries. In fact, when reports circulated of a possible invasion over the weekend the 10-year rate reversed course and dropped back below 2%, to 1.91%. It's hard to handicap whether Russia will move on Ukraine. If an invasion happens, in the short-run, stocks will be under pressure. Treasuries will likely rally. Oil, natural gas and other commodities will rally. Russia is a key producer of aluminum, nickel, oil and natural gas.

"Dow's up!"

Something Else

Honey & Co.'s Super Granola.

For Eight Bowls:
600g rolled oats
225g of mixed nuts
130g maple syrup
100g coconut oil
1/2 tsp. ground ginger, 1tsp salt

1) Mix the oats and nuts in a large bowl. 2) heat oven to 350. 3) put syrup, coconut oil in a saucepan constantly stir bring to a boil. 4) pour over oat mix. 5) add ginger and salt. 6) spread over two baking sheets. 7) bake in the oven for 15 minutes. 8) mix and then bake for another 15 min. 9) Bake until dark, golden color. 10) remove and store in an airtight container. Keeps for a month.

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Ultimately, the impact will be muted. Not to ignore any loss of life but the Ukraine is a small country. Its GDP is about $165 billion. As a comparison, Apple's annual net income is about $100 billion.

Out Of The Box

An important question facing the market is whether stock prices can hold up against a backdrop of rising interest rates. If the economy is returning to normal, so should rates. The 2-year Treasury is almost back to where it was prior to the COVID slump of March 2020. Corporate earnings reports for the 4th quarter 2021 are by and large coming in strong. According to FactSet, with 72% of S&P500 companies reporting, 77% beat expectations. With the market in a correction and earnings rising, the market's forward price-to-earnings ratio has moved from about 22 times to 19.7 times. With rates likely to move higher, the multiple is probably going to continue to move down. If corporate earnings per share can keep rising, it can offset. Having said that, the stocks that are trading at the highest multiples are likely to have the greatest multiple compression. These stocks tend not to have profits so there isn't much to counter P/E compression. It is always prudent to buy stocks that sell at reasonable prices. This is especially true in periods where there is less appetite for risk. Investors should look for lower P/E stocks that have some growth. With inflation still a factor, shares of companies that have pricing power are attractive as are firms that are involved in commodities like metals and agriculture. Investing in countries where the economy is commodity based, could also be profitable. However, while these commodity plays are fine for today, it is not a given that inflation will continue at the same pace. Recency bias is a strong force in markets and it is risky to assume that trends continue forever. The markets position towards recent trends and if there is a sudden change, a violent swing in the opposite direction can happen. Speculative money was pouring into high valuation e-commerce and so-called "disruptors", when conditions changed, money left just as fast. Looking for lower valuations might lead investors to non-US markets. Valuations are lower in Europe and Japan and in some emerging markets. The US has outperformed other developed markets by large margins. Under conditions where multiples are challenged, this could change.
