

Reverse Polish Notation

The current stock market has something in common with reverse Polish notation. For those unfamiliar with financial calculators, reverse Polish notation requires that you input the numbers first and the operation that you want to perform on them second. Initially, it feels counterintuitive and takes some getting used to, but in the end, you get why it works. Although not a perfect analogy, it sounds a bit like current stock valuations.

The Stock and Bond Markets

If we look beneath the surface, the current level of the market makes sense given the potential return of alternative investments. The power of lower interest rates should not be underestimated. If we look at the recent return of the stock market in the context of lower rates, its performance is quite rational.

Low interest rates, although a boon to borrowers are a problem for savers. As Howard Marks of Oaktree says in his recent missive, "the lower the fed funds rate is, the lower bond yields will be, meaning outstanding bonds with higher interest rates will appreciate. And lower yields on bonds means they offer less competition to stocks, so stocks *don't* have to be cheap to attract buying. They, too, will appreciate. And if high-quality assets become high-priced and thus offer low prospective returns, then low-quality assets will see buying – implying rising prices and falling prospective returns – because they look cheap relative to high-quality assets.

Most decisions in investing are relative decisions. Investors try to find the most attractive opportunity so as to be able to achieve the highest risk-adjusted return... Changing the risk-free rate has the potential to reset the returns on everything."

As Marks opines "lower demanded returns due to the alternatives, lead to higher valuations. Lower rates mean higher prices for stocks just as they do bonds."

Within the context of current low rates (ten-year Treasury bonds which yield .5% to .75%), stock market valuations do not look extended.

Ongoing Cause of Investor Angst – High Levels of Uncertainty

- Investors have been on a roller coaster, not expecting the sharp selloff in the stock market in March and equally not expecting the sharp recovery in the stock market in the last few months. People are concerned about what comes next.
- The U.S. Presidential election may be contested this fall. In the absence of a decisive victory for either presidential candidate, the potential for civil unrest is feared.
- The pandemic has made the differences between the have and have nots more extreme. Those without the resources to support themselves during the crisis were more likely to lose their jobs and were also less likely to benefit from increasing asset prices. Some businesses and jobs may be permanently lost, and the vast Congressional divide increases the anxiety of business owners and workers who need further stimulus funds to stay afloat.
- The U.S. continues to strain our international relationships which negatively affects the value of the dollar.

Investing in an Uncertain World

- Given the alternatives, we continue to prefer the stock market.
 - Bonds do not offer the protection they once did given the low level of interest rates.
 - We use a diversified approach, having exposure to a Biden presidency or to another Trump presidency, with a dose of stocks that should do well under either administration.
 - The volatility of the market gives us periodic attractive investment opportunities.
- Gold continues to be appealing.
 - The gold stocks have corrected and offer a lower entry point than this summer.
 - Currency debasement continues to be a concern. The dollar appears to be in a longer-term downtrend due in large part to our increasing levels of debt and the possibility of a U.S. credit rating downgrade.
 - Our status as a reserve currency continues to be questioned by other countries.
- Have sufficient cash to take advantage of market selloffs and the risk of job loss.
 - Although the market goes up ~70% of the time, there is added risk if you need money when the market is down.
 - If you are retired, keep one to two years of needed income in cash.

The American spirit and energy never ceases to amaze. While election uncertainty looms large, we will get through this!

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