TCM INSIGHTS

ECONOMIC REALITIES

Lately, it seems as if the stock market's fate hangs on the actions of the Federal Reserve, rather than the actual earnings, dividends, and price movement of the S&P 500. Key datapoints, such as the number of job openings exceeding the number looking for work and the U.S. leading the world in oil production have become seemingly irrelevant.

The financial media has become more hyper focused than ever on the "crisis of the day" and how it has either sent stock prices "soaring" or "plummeting." Lately, the media's focus has turned squarely on what the Fed may or may not do with short-term interest rates. If the Fed cuts rates, it is an indicator that the economy is weakening, but stocks will rise on the news. Conversely, if they raise rates, the economy is seen as strengthening and prices will fall on the news. In short, the media focuses on markets rising on news that the Fed believes the economy is weakening, and markets falling on news of strength. Does this narrative really make sense to anyone?

The True Value of Companies

The difference between the enduring value of companies and the short-term volatility of stocks is not academic. The ability to make the distinction largely determines one's success or failure as an investor.

Staying the course in investing is key. Following the massive selloff last Christmas Eve, the S&P 500 is up over 20%. Succumbing to the fear of stock price volatility while ignoring the stability of the underlying companies would have been a financially devastating decision.

Investors do not need to be economic experts to make sound decisions on whether companies lose their sustainability overnight. Stocks are much more volatile than companies, and emotions are the most volatile of all.

A month ago (July 10th), Fed Chair Jerome Powell was set to deliver testimony to Congress. Major financial media outlets treated the event as if it were a cliffhanger, with the U.S. economy hanging in the balance. In fact, CNBC used the following headline: "Walking a Tightrope Over Niagara Falls." The subheading was that the "Fed chief faces tough task in congressional testimony." Such reporting is insulting to the intelligence of rational human beings.

In his testimony, Powell affirmed the Fed's openness to a rate cut, were the economy to warrant one. He also indicated that uncertainties continued to weigh on the economy. What was the market's response? The S&P 500 briefly rose to 3,000 for the first time in history.

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Trent Capital Management

August 8, 2019

Several economic realities must be stated at this point. First, the Fed is always open to cutting (or raising) rates as economic conditions warrant. This is one of its major responsibilities and one in which they have been executing for decades. Second, there are always uncertainties present in the economy. If there weren't, investing would be an easy and very predictable process. Nobody to date has devised a scheme to consistently predict the future with certainty.

A more healthy narrative, and one in which we espouse, sounds like this: "We hope that the Fed doesn't see a need to cut rates even more, because it would confirm their belief that the economy remains strong, corporate earnings and dividends should continue to rise, and our portfolios should continue to experience gains over the long run. There will always be uncertainty in the markets, and it is the investors that discipline themselves to exercise patience and discernment that will ultimately be successful in the markets."

Rational investment professionals usually have a narrative much different from, and sometimes the opposite of, the financial media's narrative.