GOOD NEWS!

The headline above is one you will seldom see in the newspapers or hear from the talking heads. As we celebrate our July 4th holiday, let me remind you that the holiday commemorates the year 1776. Yet 1776 was a very difficult year. General George Washington was on the verge of being fired as the leader of the revolution, for most of the year, after losing New York to the British and, in general, celebrating "masterful" retreats and not victories. In the final days of the year, Washington scored victories in Trenton and Princeton to begin 1777 with good news.

We too can celebrate how far we have come from a difficult year. On March 12 of last year, I was interviewed on Bloomberg Radio. Here is part of the transcript:

"Let's get back to John Burke. You know one of the things that people are trying to identify here, as the stock market rout deepens, is 'when is capitulation?' Do you even try to think about that, or is that just that falling knife thing is just too risky?"

(Sidenote — "don't catch a falling knife" is a long-held Wall Street adage that you should not buy when prices are declining quickly)

Responding, "Well, hey, Paul, you know, picking up on what I was saying before, I think it's time to buy. The reason being that the market going lower from here is to say that this pandemic will not be contained."

The Bloomberg interviewer responded somewhat incredulously, "talk about buying in a market like this! You have to talk time horizons, is this a longer-term bet that eventually we'll return to some sort of a bull market again, sometime in the future?"

It turns out I was a little early on my call to buy, as the market continued to decline over 10% before hitting a low nine days later on March 23. The S&P 500 is up 70% since March 12, and the reason is simply that the pandemic is nearly over, thanks to vaccines produced by pharmaceutical companies both here and abroad. That's good news.

Runners have a saying: If you don't know where the wind is, it is at your back. The point is that you don't realize the wind is at your back until you turn into it. And we should try to enjoy the wind when it is at our back. In a financial sense, the wind is now at our backs.

While we always worry, right now clients seem to be worried more than one would think, given all the good news. The pandemic is running its course, corporate earnings are the best we have ever seen, consumer debt is low, and interest rates remain at historically low levels (more on them shortly).

What's more, the economy, if anything, has yet to hit its stride. Supply chain constraints mean that you can't get furniture, bikes, pools, cars, and even new homes, to name a few consumer items on backlog. Some constraints are the result of a still-raging pandemic in supply countries like India and Brazil. The very strong pace of the economic recovery has semiconductor manufacturers, for one, struggling to keep up. Constraints are also being caused by a shortage of workers. Ships are waiting in port. Trucks are parked waiting for drivers. How hot will this economy be once these issues start to get resolved? Economic growth (GDP for example) is already at historically high rates.

We'd like to be invested in stocks when the constraints ease because stocks benefit from strong earnings, which derive from a strong economy.

Many of you, however, point out to us that all these supply shortages are going to result in higher inflation. We agree that is something to keep an eye on. In fact, higher inflation is already here. April's CPI increase (the key inflation reading) was 4.2%, one of the highest readings in many years. May's CPI increase, 5% over the past year, is the biggest 12-month inflation spike since 2008. This has caused interest rates to rise by about 1% since last August's low, but that was an all-time low. Rates are still well-below long-term averages. The much watched 10-year Treasury rate is at about 1.5%. It has traded between just over 3% and that 0.5% low over the past 10 years. In the 10 years before that, 3% was the low end of the range. In fact, at these rates, even though home prices have soared, homes are still affordable because mortgage rates are still low by historical measures.

Federal Reserve Chairman Jerome Powell says that inflation will only be high temporarily. It has been pointed out that Powell is not an economist, unusual for such an important economic position. Given rising inflation and supply chain issues, perhaps he is wrong about inflation.

The good news about inflation concerns is that we should receive a warning if it is going to impact the economy. Interest rates would likely head higher as bond investors demand higher rates to offset the effects of inflation. We think we'll be able to see the problem developing. We'd be worried if that 10-year Treasury rate gets near 3%.

We'd also be worried if it turns out the pandemic is not near its end. As with interest rates, we think we should see signs of that worsening as well, in the case counts.

Over the years, we've written quite a few of these newsletters and penned quite a few emails. Surely you've noticed that we don't like to see clients get in and out of the market. It doesn't work out well very often. In fact, let me conclude with the closing to that Bloomberg radio interview:

"John Burke, thanks so much for joining us. I really appreciate your thoughts there. John Burke, strategist and CEO at Burke Financial Strategies. Lisa, John was one of the, uh, I say relatively rare people we've heard over the last week or so saying, you know, here's a time to buy. Most people as they look at this taper, I think they're a little bit more inclined to kind of just stay on the sidelines here."

Now granted, not all of my markets calls have proved to be as prescient as the one from last March, and there is no way to know for sure what the markets will do. Inflation may hit us quicker than we think or the Covid virus may reassert itself, knocking stocks down. We can't say for sure. But we are more inclined to think that you should head off to enjoy your summer — with the wind at your back.

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