MOULTON WEALTH MANAGEMENT INC.

# *MOULTON HOT MINUTES*

*SPECIALIZING IN RETIREMENT AND TAX PLANNING*


1220 N. MULLAN ROAD
SPOKANE, WA 99206
509-922-3110

DONALD J. MOULTON
CFP®, RFC

*www.moultonwealth.com*

RIAL R. MOULTON
CFP®, CPA/PFS, RFC


## Week of November 13, 2023

Last week's newsletter reviewed recent economic data. But it also reviewed why we use research partners, as well as a typical work day. You can read it here: *Newsletter - Moulton Wealth*.

*ATTEND OUR…*

**RISK MANAGEMENT**

**LAST OF 2023!** **SEMINARS** **LAST OF 2023!**

BRING A GUEST

- **NOVEMBER 15TH @ 9:30 AM – SPOKANE**
- **NOVEMBER 29TH @ 11:00 AM – RICHLAND**

**(BOTH HAVE BREAKFAST)**

CALL **509-922-3110** TO RESERVE A SEAT *OR IF YOU WANT A SECOND OPINION ON YOUR PORTFOLIO!*

Last week's radio show discussed the freight recession. It also reviewed the newest research from Investech, one of our research partners. You can listen here: Your Money Matters – Moulton Wealth.

***Please see our new website www.MoultonWealth.com. Of the many improvements, the most important is we now host podcasts of past radio shows, allowing you to listen at your convenience. You can also read all the past newsletters and take the test to find your Risk Number.***

We recently updated our economic models through 2024.

Good news.

The most recent data suggests the economy should move into one of our best economic constructs for the stock market, but not until the latter half of next year. Until then, we continue to urge caution. If you can protect your principal, you can better participate in what we think will be favorable market opportunity, instead of just trying to recoup losses.

Of course, as always, the data may change, and with it our opinion.

Before you begin thinking that ~ 8 months until that favorable economic construct isn't long, and as such just staying the course couldn't cause too much damage, think again. In the 8 months ended March 9, 2009, the S&P-500 fell -46%. During the 8 months ended May 1, 2000, the NASDAQ fell -49%.

The current market is not "strong", despite what you may hear. Yes, this year is up if you consider the major, large cap indices. But they are cap weighted and as such, they are overly influenced by just a few large companies.

The Russell 2000 is an index of 2000 small cap companies. Since they are smaller, they don't have the deep pockets and financing options to "ignore" bad economics. As of Friday, October 27th, this index was the lowest it's been all the way back to pre-Covid, in late 1999!

The S&P-500 is cap weighted. That means that larger companies count more than smaller companies, in calculating the index's return. On the one hand, one could reasonably ask, "Who cares why it's going up, as long as it is going up?" But in reality, strong, durable market advances are characterized by broad participation across the bulk of companies, not just a few companies

***Listen to Rial's and Don's radio show,***

## *"Your Money Matters"*

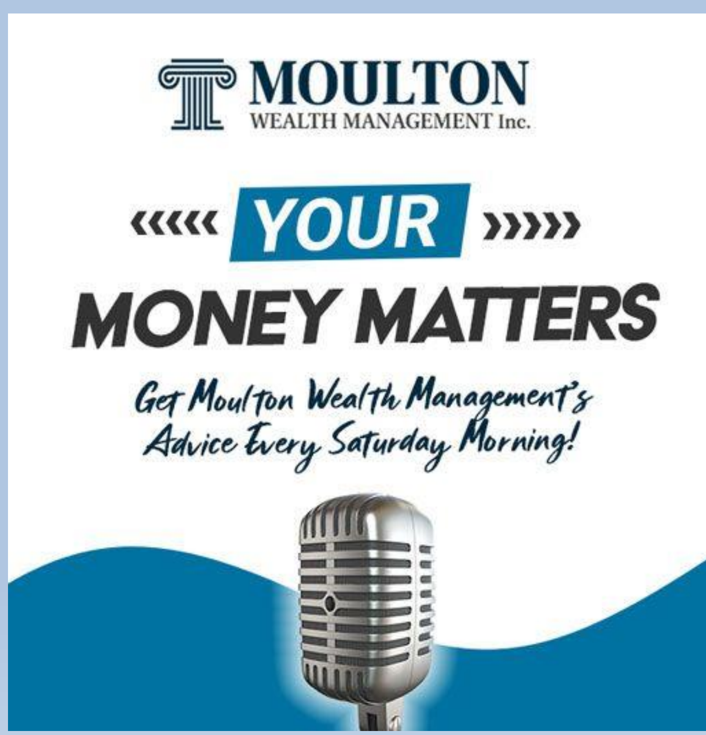
***every Saturday Morning at***

***8:00 am on KXLY radio channel 920 am in Spokane***

***and at 9:30 am on NewsTalk Radio Channel 870 am in the Tri-Cities Area***

***listen live at [www.newstalk870.am]() again at 9:30 each Saturday morning***

**Or visit our website [moultonwealth.com]() for podcasts**



doing very well and the rest doing poorly. More importantly, if those top few companies begin moving down, look out below.

Société Générale tells us that 89% of this year's S&P-500 return has been due to the performance of the 10 largest stocks. This means the other 490 have contributed an aggregate 11%.

Is this unusual? It's the most lopsided since 2008, which, by the way, was the Great Financial Crisis when the S&P-500 lost -57%.

This last week was a good microcosm of this effect. If we compare the week's returns of three different exchange traded funds (ETFs) we find.

- SPY (S&P-500) which is cap weighted +1.36% for the week.
- RSP (same S&P-500) but not cap weighted -0.59% for the week.
- IWM (Russell 2000 small caps) -3.08% for the week.

Obviously, the lopsided performance continues.

Meanwhile the S&P-500 is still very expensive, near all time highs on some metrics. Usually a stock becomes expensive because investors think future earnings will justify it. In other words, I'm willing to overpay today because I think in XX months or years, earnings will have grown so much, my purchase price will have been a bargain.

With that in mind, where are earnings headed over the long term?

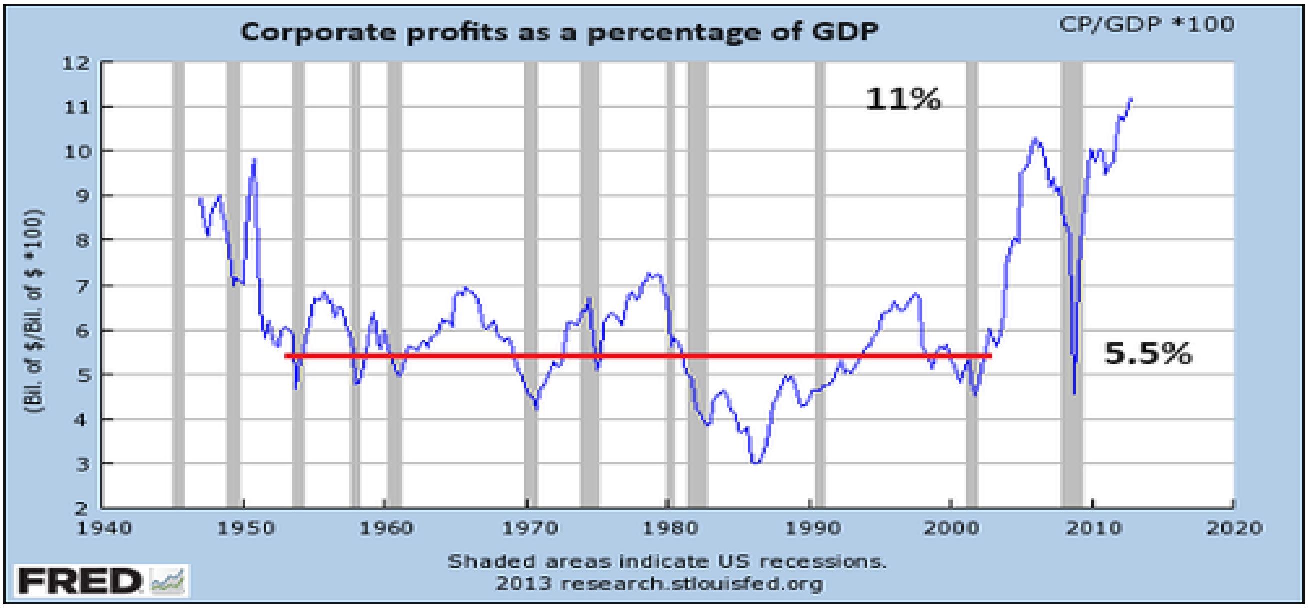
We discussed this on the radio show a couple weeks ago, but let's review it in more depth. Charles Smith via *OfTwoMinds* blog laid out his…

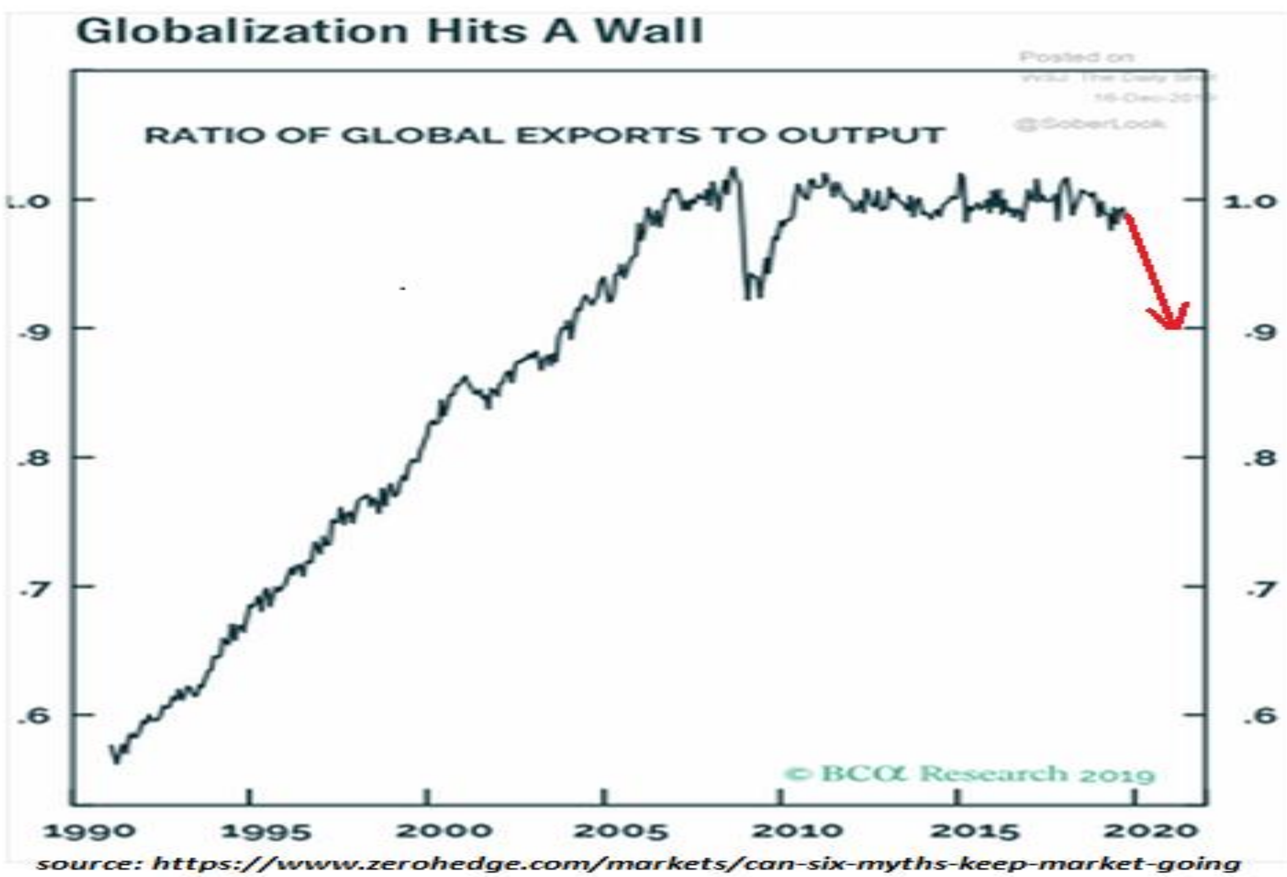
***"Six reasons corporate profits could fall by 50% in the coming months and years. With that, he warns, could come a 2/3 decline in stock prices."***

The first reason is **reversion to the mean**. Profits are currently double their historical average as a percent of Gross Domestic Product (GDP). Whenever they've been extended above or below the average, they eventually returned to it. This has many causes, not the least of which is competition. But there are more reasons to come.

The second reason to expect a decline in corporate profits is that **the boost phase of globalization has ended.**

Right after China was accepted into the World Trade Organization in 2001, U.S. corporate profits skyrocketed higher, in both nominal dollars and as a percentage of GDP. This should




make sense, as corporate America outsourced jobs to low wage foreign countries like China. It also allowed corporations to bypass expensive environmental concerns. All that savings went straight to the bottom line.

Given the supply chain issues during Covid, coupled with places like China becoming "less cheap", the ratio of global exports to corporate output has likely peaked.

The third reason cited by Mr. Smith is that **quality and durability have been gutted.**

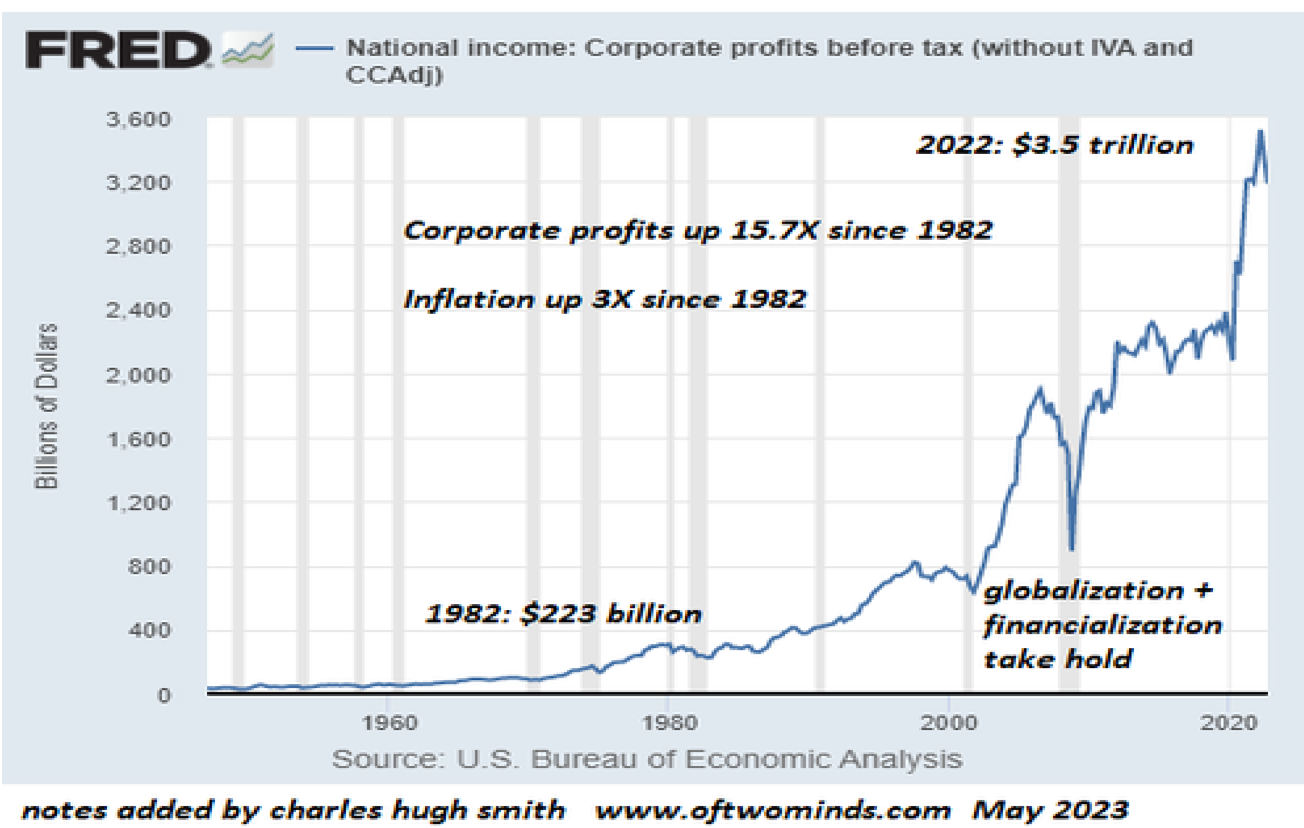
Hyper-globalization provided ideal cover for a systematic collapse of quality and durability. We all have heard of, and worse experienced, *planned obsolescence* along with *shrinkflation*. This systematic process of providing less and less for more money, has probably bottomed. An appliance won't likely be expected to drop from a 5-7 year life expectancy to 2-3 years. In fact, there's already a movement to bring production back to the U.S.

The fourth reason is that **hyper-financialization has also entered the decay / collapse phase**. We've talked about this extensively, and much of the blame can be placed on the Federal Reserve's own doorstep.

The Fed decided to artificially "manage capitalism" starting with Greenspan, but really taking off under Bernanke, Yellen and then Powell, since the Great Financial Crisis. Keeping rates artificially low, allowed corporate profits to balloon in two ways.

1. It allowed consumers to buy more "stuff" than they would otherwise been able to, driven by low interest rates and free money.
2. It allowed corporations to borrow at very low rates, using the money to buy out competition as well as buy back shares. Fewer shares means higher "earnings per share" outstanding.

Of course, it also spawned asset bubbles.



With inflation now making it clear that such reckless Fed behavior does, in fact, have bad consequences, it's unlikely that we will return to it.

The fifth reason is **<u>the asymmetric distribution of the economy's output favoring corporations at the expense of labor is finally shifting</u>**.

The economy pendulum swings in decades long arcs.

In the 1920's up until WWII, it favored corporate America over the working person. There weren't paid days off, or unemployment, or sick days. You worked to get paid, and pretty much did what you were told.

Starting after WWII and extending until the 1970s – early 1980's it swung the other direction, with workers gaining a larger share of their work's profits. Much of what we consider "workers' rights" were instituted, unions were born, and a family could be supported by a single income earner.

But in the 1980s up until now, it swung the other way again. Corporations, and their executives, have made massive wealth gains compared to the average worker. Unions fell out of favor, and few families could survive on a single income earner.

In Mr. Smith's words, "*after 45 years of capital skimming $50 trillion from labor, rising rates of disability, unfavorable demographics, systemic healthcare inflation and social dynamics are pushing labor costs higher"*.

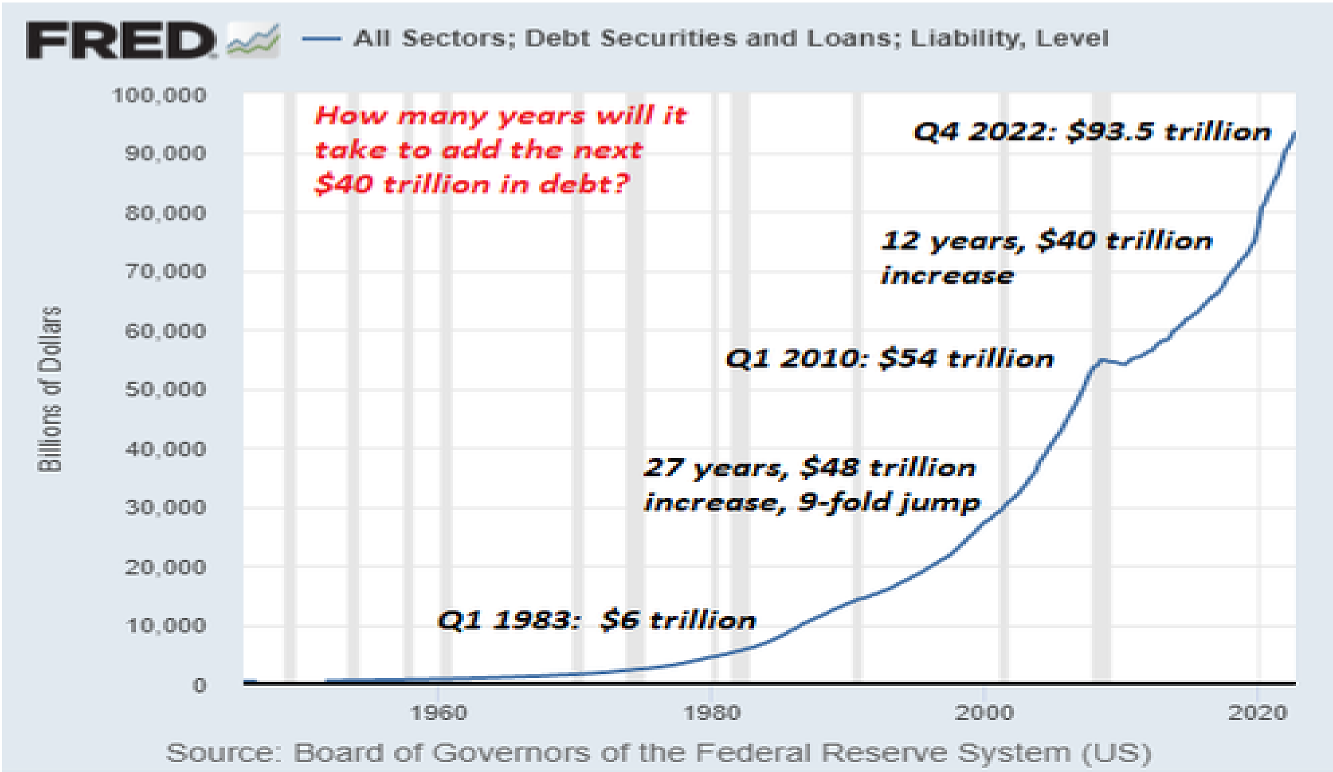
Finally, **<u>debt saturation</u>**. This aligns with higher interest rates, and simply means our debt levels have been maxed out. Consumers, corporations, and governments have reached levels of debt that limit how much more they can take on, without unintended consequences, and/or slashed spending.

I would note that these dynamics apply equally well to consumers, corporations and countries outside of the U.S.

Mr. Smith goes on to explain that U.S. corporate profits hit $3.2 trillion in the first quarter of 2023, roughly 12.3% of GDP.

Should profits decline to the historical average of 5% it would imply earnings of $1.3 trillion, although he points out that in a 'real recession' they could fall all the way to 3% of GDP or $800 million.

If profits fell from $3.2 trillion to $1.3 trillion it implies a 60% decline. However, stock prices would likely fall even farther because they would no longer be supported by the *"unsustainable, one off of hyper-financialization, hyper-globalization and zero interest rates."*




***notes added by charles hugh smith www.oftwominds.com 5/23***

The good news is corporate profits equaling 5% of GDP is very "normal" throughout history, and a very healthy rate.

BUT…

It could be disastrous for those who think the "*highly distorted funhouse, which lost touch with reality*" is actually sustainable.

Now is the time to act. Take advantage of what we consider a historic bear market rally to reposition yourself into a more defensive portfolio allocation.

***If your goal is to protect what you have during economic market contractions so you can more fully participate in the next expansion and bull market, you should reduce risk in your investments now rather than continue holding the same portfolio you've had the last 10 years.***

We strongly suggest that investors who are retired or close to retirement should be the latter.

# *If you're positioned to protect against the downside, then the extent of such is not so much a concern.*

And the extent could be significant.

The Great Financial Crisis was triggered by the popping of a bubble in real-estate. ***The bubble in real-estate today is bigger by most measures.***

The Dot.com bear market was triggered by the popping of a bubble in equity valuations. ***The equity bubble is bigger today by most measures.***

Neither the Dot.com nor the Great Financial Crisis bear markets had inflation, or nearly as much debt across consumers and businesses as we have today.

If the Dot.com bubble resulted in the S&P-500 falling ~ -50% and the NASDAQ falling over ~ -80%...

If the Great Financial Crisis saw the S&P-500 fall ~ -57% and the NASDAQ falling over ~ -50%...

# *How much might a market fall with levels exceeding both of those along with inflation and higher leverage?*

You don't have to remain locked into the same approach as you had when these risks didn't exist. You are allowed to protect yourself. You can step away and then come back when the risks decline. Call us to find out how.

# *It's time to focus on return of your money rather than return on your money.*

***If you still have the same portfolio allocation you had during the bull market, we would ask "why"? The risk profile of the economy and market has changed***

***dramatically and will likely continue to rise. Wouldn't it make sense to adjust your portfolio to what is actually happening?***

To be clear, we'll have a great buying opportunity at some point in the future. Usually that happens with the market crashing and most investors disgusted with the thought of investing. If you lose much of your net worth, participating will be difficult.

## ***"You can't buy low if you don't sell high."***

Patience and asset protection will be key.

## ***Don't wait until you have suffered unrecoverable losses before taking action.***

In the Great Financial Crisis, the S&P-500 fell 24% from the start on October 9, 2007 until the Lehman bankruptcy on September 15, 2008. That was close to a year, and not that far off from what we've lived through so far.

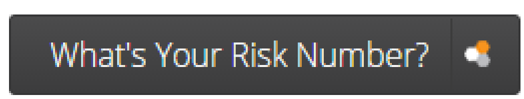
Then in just over a month from September 15, 2008 to October 27, 2008 the S&P-500 fell ***ANOTHER*** 28.8%. And from September 15, 2008 to the ultimate bottom, about 5 months later, it fell ***ANOTHER*** 43%.

Not only do bear markets normally unfold in three stages with the last being the most virulent, it also demonstrates that risk happens slowly and then all at once.

## ***What is your defensive plan? There's still time.***

Call or attend a seminar to hear about ours.

*Remember, we have a feature on our website: [www.MoultonWealth.com](http://www.MoultonWealth.com) to help you measure your risk tolerance. The problem with trying to decide how much risk to take is we all want to be aggressive when the market is going up, but conservative when it's going down. That's why a sell discipline is important. However, the first line of defense is always our allocation. This approach to measuring risk gives a number by making investors trade off gains and losses. Just click the button to see where you stand.*



**Get a physical!** We invite you to attend a seminar and come in for a “financial physical”, even if you think your current approach is fine. Much like going to the doctor for a physical despite feeling great, you want to make sure any negative issues you may not be aware of are caught early and addressed. For example…

- Do you need a process to help manage losses during the next bear market?
- Have you addressed your investment process and adjusted it for what is going on in the world?
- If not, what are you waiting for?

***At the bottom of the 2007 - 2009 bear market the S&P-500 index returned to levels last seen in 1996.***

***The drop didn’t retrace only a few months or even a couple years.***

We discuss many of these issues and more on the weekly radio show and invite you to listen.

## WEEKLY FOCUS – THINK ABOUT IT

***“Six reasons corporate profits could fall by 50% in the coming months and years. With that, he warns, could come a 2/3 decline in stock prices.”***

Yours truly,

**Rial R. Moulton, CFP®, CPA / PFS, RFC**
*Certified Financial Planner™*

**Donald J. Moulton, CFP®, RFC**
*Certified Financial Planner™*

P.S. Please feel free to forward this commentary to family, friends, or colleagues. If you would like us to add them to the list, please reply to this e-mail with their e-mail address and we will ask for their permission to be added.

***Oftwomindsblog.com/blog.html***

***The Barclays Global Aggregate Bond Index*** *(formerly Lehman Brothers Global Aggregate Index), is an unmanaged market-capitalization-weighted benchmark, and tracks the performance of investment-grade fixed income securities denominated in 13 currencies. The index reflects reinvestment of all distributions and changes in market prices.*

***The Barclays U.S. 1-10 Year TIPS Index*** *is an unmanaged index composed of inflation-protected public obligations of the U.S. Treasury that have a remaining maturity of one to ten years.*

***The Barclays U.S. Aggregate Bond Index*** *is an unmanaged benchmark index composed of U.S. securities in Treasury, Government-Related, Corporate, and Securitized sectors. It includes securities that are of investment-grade quality or better, have at least one year to maturity, and have an outstanding par value of at least $250 million.*

***The Barclays U.S. TIPS Index*** *is an unmanaged index composed of all U.S. Treasury Inflation- Protected Securities rated investment grade, have at least one year to final maturity, and at least $250 million par amount outstanding.*

***The Barclays U.S. Treasury Index*** *is an unmanaged index composed of U.S. Treasuries.*

***The CDX IG 12*** *is a benchmark high-grade derivatives index, which measures the cost of insuring a basket of U.S. investment-grade corporate debt against defaults.*

***The Chicago Board Options Exchange Volatility Index (VIX)*** *tracks the expected volatility in the S&P 500 over the next 30 days. A higher number indicates greater expected volatility. Common usage: The Chicago Board Options Exchange Volatility Index (VIX), a barometer of market volatility.*

***The Dow Jones Industrial Average*** *is a widely followed market indicator based on a price-weighted average of 30 blue-chip stocks that trade on the New York Stock Exchange which are selected by editors of The Wall Street Journal.*

***The Dow Jones Wilshire Real Estate Securities Index (RESI)*** *is used to measure the U.S. real estate market and includes both real estate investment trusts (REITs) and real estate operating companies (REOCs). It is weighted by float-adjusted market capitalization.*

***The JP Morgan Emerging Market Bond Index*** *is a total-return, unmanaged trade-weighted index for U.S. dollar-denominated emerging-market bonds, including sovereign debt, quasi-sovereign debt, Brady bonds, loans, and Eurobonds.*

***The JP Morgan EMBI Global Diversified Index*** *tracks the performance of external debt instruments (including U.S.-dollar-denominated and other external-currency-denominated Brady bonds, loans, Eurobonds and local market instruments) in the emerging markets.*

***The JP Morgan GBI-EM Global Diversified Index*** *tracks the performance of local-currency bonds issued by emerging market governments.*

***The MSCI World Index*** *is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of developed markets. The MSCI World Index represents 23 developed market countries.*

***The MSCI All Country World Index*** *is a market-capitalization-weighted index composed of over 2,400 companies, and is representative of the market structure of 46 developed and emerging market countries. The index is calculated with net dividends reinvested in U.S. dollars.*

***The MSCI EAFE Index*** *is an unmanaged, market-capitalization-weighted equity index that represents the developed world outside North America.*

***The MSCI Emerging Markets Index*** *is a free float-adjusted market-capitalization-weighted index designed to measure the performance of global emerging market equities.*

***The NASDAQ Composite Index*** *is a market-value-weighted index of all common stocks listed on the National Association of Securities Dealers Automated Quotations (NASDAQ) system.*

***The Russell 1000 Index*** *includes 1000 of the largest U.S. equity securities based on market cap and current index membership; it is used to measure the activity of the U.S. large-cap equity market.*

***The Russell 2000 Index*** *includes 2000 small-cap U.S. equity names and is used to measure the activity of the U.S. small-cap equity market.*

***The S&P 500 Index*** *is a capitalization-weighted index made up of 500 widely held large-cap U.S. stocks in the Industrials, Transportation, Utilities and Financials sectors.*

***Investing Terminology***

***Alpha*** *is a measure of a portfolio's return above a certain benchmarked return.*

***Alternative Investments*** *are investments that are not one of the three traditional asset types (stocks, bonds and cash). Alternative investments include hedge funds, managed futures, real estate, commodities, and derivatives contracts.*

***Asset-Backed Securities (ABS)*** *are bonds backed by a pool of loans or accounts receivable and commonly include payments from credit cards, auto loans and mortgage loans.*

***Austerity*** *refers to measures taken by a country's government in an effort to reduce expenditures and a budget deficit.*

***Beta*** *is a measure of the volatility or systematic risk of a security or a portfolio in comparison to the market as a whole.*

***Book-to-Price Ratio*** *is the inverse of the price-to-book ratio, which is calculated as the market value of a security divided by its book value. A lower the price-to-book ratio for a security may mean the security is undervalued, and vice versa (the higher the book-to-price ratio, the better the value).*

***Commercial Mortgage-Backed Securities (CMBS)*** *are pools of commercial mortgage loans that are packaged together and sold to the public. They are usually structured in tranches, or classes of risk, so that investors can determine how much risk they want to take on. In general, CMBS carry less prepayment risk than loans backed by residential mortgages.*

***Corporate Bonds*** *are debt securities issued by corporations to raise money; these bonds usually pay higher coupon rates than government or municipal bonds.*

***Correlation Risk*** *refers to the change in the marked to market value of an asset when the correlation between the underlying assets changes over time.*

***Credit Ratings*** *are an assessment of the risk of default of a company or country. The higher the credit quality (or rating), the lower the perceived risk of default.*

***Cyclical Sectors or Stocks*** *are those whose performance is closely tied to the economic environment and business cycle. Managers with a pro-cyclical market view tend to favor stocks that are more sensitive to movements in the broad market and therefore tend to have more volatile performance.*

***Debt-to-Equity Ratio*** *is calculated as long-term debt divided by common shareholders' equity, and measures the amount of a firm's leverage, or debt.*

***Donor Advised Funds*** *are private funds administered by a third party and created for the purpose of managing charitable donations on behalf of an organization, family, or individual.*

***Duration*** *is a measure of a security's price sensitivity to changes in interest rates. Specifically, duration measures the potential change in value of a bond that would result from a 1% change in interest rates. The shorter the duration of a bond, the less its price will potentially change as interest rates go up or down; conversely, the longer the duration of a bond, the more its price will potentially change.*

***Excess Returns*** *are investment returns from a security or portfolio that exceed a benchmark or index with a similar level of risk.*

***Grantor Retained Annuity Trust*** *is an estate planning technique that minimizes the tax liability existing when intergenerational transfers of estate assets occur. An irrevocable trust is created for a certain term or period of time. The individual establishing the trust pays a tax when the trust is established. Assets are placed under the trust and then an annuity is paid out every year. When the trust expires, the beneficiary receives the assets estate and gift tax free.*

***High Yield Debt*** *is rated below investment grade and is considered to be riskier.*

***Managed Futures*** *strategies use futures contracts as part of their overall investment strategy. They provide portfolio diversification among various types of investment styles and asset classes to help mitigate portfolio risk in a way that is not possible in direct equity investments.*

***Market Capitalization*** *is calculated as the number of companies shares outstanding multiplied by the share price, and is used to determine the total market value of a company.*

***Momentum*** *is the rate of acceleration for an economic, price or volume movement; it is used to locate trends within the market.*

***Mortgage-Backed Securities (MBS)*** *are pools of mortgage loans that are packaged together and sold to the public. They are usually structured in tranches, or classes of risk, so that investors can determine how much risk they want to take on.*

***Option-adjusted spreads*** *estimate the difference in yield between a security or collection of securities and comparable Treasuries after removing the effects of any special features, such as provisions that allow an issuer to call a security before maturity.*

***Peripheral Eurozone Countries*** *are those countries in the Eurozone with the smallest economies.*

***Price-to-Book Ratio*** *is calculated as the market value of a security divided by its book value. A lower the price-to-book ratio for a security may mean the security is undervalued.*

***Private Foundations*** *are charitable organizations that do not qualify as public charities by government standards. A private foundation is a nonprofit organization which is usually created via a single primary donation from an individual or a business and whose funds and programs are managed by its own trustees or directors.*

***Quantitative Easing*** *refers to expansionary efforts by central banks to help increase the supply of money in the economy.*

***Recapitalized/recapitalization*** *refers to injecting fresh equity into a company or a bank, which can be used to absorb future losses. This generally takes place through the company issuing new shares. In the case of a government or organization recapitalizing a bank, it usually results in the government or organization owning a stake in the bank.*

***Spreads****: Yield spreads represents the difference in yields offered between corporate and government bonds. If they tighten, this means that the difference has decreased. If they widen, this means the difference has increased.*

***Standard Deviation****: Statistical measure of historical volatility. A statistical measure of the distance a quantity is likely to lie from its average value. It is applied to the annual rate of return of an investment, to measure the investment's volatility (risk). Standard deviation is synonymous with volatility, in that the greater the standard deviation the more volatile an investment's return will be. A standard deviation of zero would mean an investment has a return rate that never varies.*

***Treasuries*** *are U.S. government debt obligations that are backed by the full faith and credit of the government. Often, they are used as a proxy for a risk-free asset when comparing other risky assets.*

***Yield Curves*** *illustrate the relationship between the interest rate, or cost of borrowing, and the time to maturity. Yields move inversely to prices. The Barclays Capital 1-10 Year US TIPS Index: Barclays Capital 1-10 Year US TIPS Index measures the performance of inflation-protected public obligations of the U.S. Treasury that have a remaining maturity of one to ten years.*