MOULTON WEALTH MANAGEMENT INC.

MOULTON HOT MINUTES

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Last week's newsletter discussed the recent Gross Domestic Product (GDP) announcement. GDP is announced net of inflation. In other words, they take the actual GDP (gross GDP), subtract inflation, and announced "real GDP" which means ex-the impact of inflation. The inflation number they use is not the Consumer Price Index (CPI) that we all hear about, but instead the "Chain Weighted Price Index" embedded in the GDP calculation. As should make sense if you think it through, the lower the inflation number that is subtracted from gross GDP, the higher the announced “real GDP”. Turns out the Chain Weighted Price Index was much lower than “our” CPI. You can read the newsletter here *Newsletter - Moulton Wealth*.

Last Saturday’s radio show discussed the recent jobs number, as well as the Fed’s decision not to change rates. As importantly, we reviewed the Fed statement, which intoned that rate cuts may be further into the future than most believed. The market didn’t like it. Maybe more importantly, though, was what happened to three banks in three continents. All wrote off large commercial real-estate losses, with the two that are publicly traded taking double digit, one day losses in their stock prices. We’ll talk more about this today. 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.

In a recent newsletter (you can read it here ***Moulton Minutes January 22, 2024***) we reviewed Discover Financial Services’ earnings, as a possible proxy for both bank credit risk, and consumer strength.

But this week, an arguably more important earnings announcement shook the banking sector. New York Community Bancorp (NYCB) is a large, regional bank. It was considered one of the success stories in the banking sector, actually having participated in purchasing some of the distressed assets from failed Silicon Valley Bank.

Remember this was just short of a year ago.

On Wednesday, January 30th, they announced their earnings. Analysts had expected earnings of +$0.27/share. Instead the bank announced a loss of -$0.36/share.

Even though that was a huge “miss” on earnings, it wasn’t necessarily the worst of the news.

The reason for the big loss was a massive addition to their loan loss reserve, specifically for commercial real-estate.

Last quarter, when they announced earnings, they included loan loss provisions of $62M. One quarter later, they announced provisions for loan losses of ***$552M***.

LISTEN TO RIAL'S AND DON'S RADIO SHOW,

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EVERY SATURDAY MORNING AT

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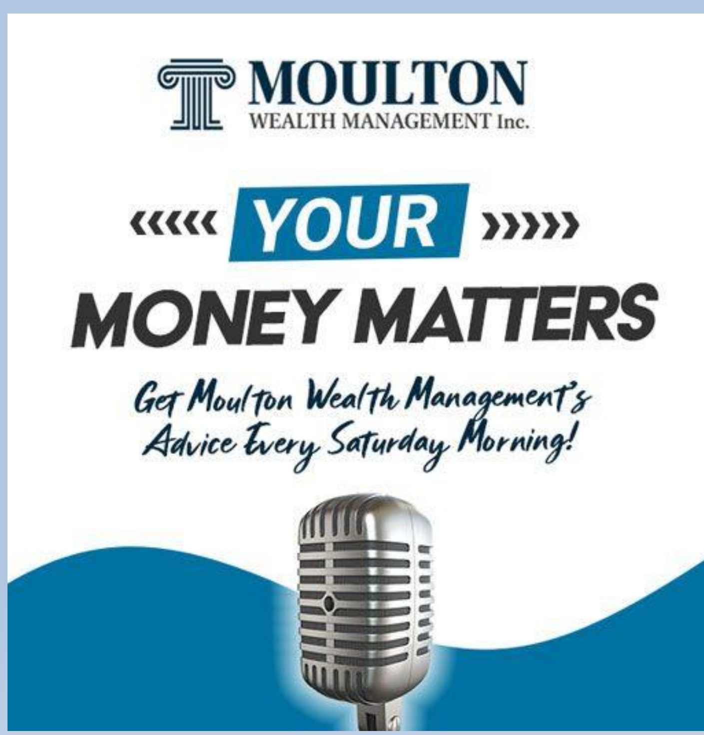

That's an increase of 890% in loan loss provisions, in a quarter.

In their notes they stated they expect losses of $185M on just two loans, but set aside the additional provisions for other possible losses.

You decide, should we be…

1. happy that just two loans were the bulk of the problem?
2. terrified that just two loans were the bulk of the problem?

As mentioned, the stock market was not impressed.

Their stock fell almost 45% in two days, as of Thursday's close. This decline wiped out about the last 20 years of the stock's gains, ***including dividends***.

Speaking of dividends, they also cut their dividend rate by 70%, from $0.68/share over the trailing 12 months, to an announced $0.20/share over the next 12 months.

This should be a reminder that stocks can fall; a lot.

Especially since the Great Financial Crisis, but arguably for the last 25 years, the Fed has pursued a policy of actively pumping up stock prices, through a strategy of ZIRP (zero interest rate policy) and QE (quantitative easing) which is essentially printing money.

While that policy may have pleased Wall Street, it also created bubbles in just about all assets. These include stocks and bonds, but also real-estate; including commercial real-estate.

But as the old saying goes, what goes up, must come down.

What should come as no surprise, we meet with a lot of people to discuss their investments. More and more we hear investors explain that they can handle a lot of risk. And as "proof" they explain they didn't sell in 2022, when the market went down for 10 months, loss less than 30% (on the S&P-500) of its value, and wiped out 10 months of gains.

Please remember, in the Dot.com bubble the market fell for 3 straight years and lost close to 50% of its value. Those losses erased 6 years of gains, including dividends. Also from the market peak in 2000, to permanently regaining that peak took about 12-1/2 years. In the Great Financial Crisis, the market fell for 18 months and lost almost 60% of its value. Those losses erased 13 years of gains, including dividends. Also from the peak in late 2007 to permanently regaining that peak took about 5-1/2 years.

AND THIS ALL HAPPENED WITH THE FED ACTIVELY TRYING TO PUSH UP STOCK PRICES, BECAUSE OF NEXT TO NO INFLATION.

We've opined (warned?) for some time that we live in a global economy. And in a global economy, there are cross-investments.

On the same day that NYCB announced their losses, and the staggering increase in loan loss reserves, Japan's Aozara Bank did likewise. Analysts had expected a $200M profit from the bank, but it reported a $200M loss instead. The culprit? It had large loans outstanding on U.S. commercial real-estate. Its stock fell -20% on the day it announced, the most one day decline allowed in their stock market.

Not to be outdone, Switzerland's Julius Baer, a private bank, saw its CEO resign after it needed a $700M provision for losses on loans. This was also due to commercial real-estate loans, but not from U.S. properties, instead from Austria's Signa Group.

In their report, Aozara Bank made some startling admissions. They discussed their current U.S. based commercial real-estate loans. Specifically they discussed their loan to value (LTV) ratios. Just like loaning money on a home, banks want to retain a margin for error. Therefore, on commercial real-estate, they want to make sure their LTV is well below 100%, and usually closer to 60%. This means their loan is only about 60% of the value of the property, so they have good coverage in case they need to repossess and sell to get repaid.

The bank discussed their current, average, LTVs for loans on properties in some major U.S cities.

1. New York – 155%
2. Washington DC – 172%
3. Chicago – 211%
4. Los Angeles – 176%
5. San Francisco – 168%
6. Across all other markets in the U.S. – 163%.

In other words, they are significantly "upside down" on their average U.S. commercial real-estate loans.

A Wall Street Journal article about the subject had this to say…

"Some of the biggest risks come at the maturity of loans, which tend to run 5 to 10 years. As cheap loans, from an era of low rates and high prices come due, landlords are increasingly unable to find new loans to replace them."

Of course Wall Street proclaimed they were caught off guard by all of this, and assured their investors "no one could have seen it coming". In other words, don't worry about your losses, they were unavoidable.

Yet we've been warning for over a year. Maybe the only thing surprising is that it's taking so long to manifest.

To be fair, most banks have already reported their fourth quarter earnings, so we don't expect a series of bad reports… yet.

But it's striking when a major regional bank feels compelled to increase loan loss reserves from $62M to $552M in just three months.

Meanwhile the market continues to climb, largely on the back of the "Magnificent 7". The Magnificent 7 is the name given to the largest 7 tech stocks, now dominating both the S&P-500 and the Nasdaq 100. Since the indexes are weighted based on company size, the performance of these 7 stocks far outweigh their numbers.

In the S&P-500, these 7 account for 28% of the index's performance. The remaining 493 stocks account for the other 72% of performance. For the Nasdaq 100 it's a blistering 39%.

As long as these 7 stocks keep rising, it will be difficult for the market not to follow. Of course if they decline, the same will happen in reverse.

How does that work in the real world?

Last Friday, with less than an hour to go in the trading day, the S&P-500 was up 1.3%. At the same time there were 1.8 times more stocks down for the day in the index, than were up for the day. The down volume was 1.6 times higher than the up volume, on the New York Stock Exchange.

What's this tell us?

There were some very big sellers behind the scenes Friday. Remember, at market turning points, the big guys like to unload stocks by getting rallies going, which entices individual investors to jump in and keep it going, which in turn is when the big guys begin unloading their positions at favorable prices.

Lance Roberts recently noted that the price to revenues ratio of the Magnificent 7 is now 10.3 times ***REVENUES***. What's that mean? To be paid back for buying one share of stock at the current price, an investor would need to receive 10.3 years of their share of the company's revenues (sales). Not profits, revenues.

After the Dot.com bubble exploded, then Sun Microsystem's CEO, Scott McNealy, wrote about how crazy it was for his stock to once trade at 10 times revenues.

'At 10 times revenues, to give you a 10-year payback, I have to pay you 100% of revenues for 10 straight years in dividends. That assumes I can get that by my shareholders. That assumes I have zero cost of goods sold, which is very hard for a computer company. That assumes zero expenses, which is really hard with 39,000 employees. That assumes I pay no taxes, which is very hard. And that assumes you pay no taxes on your dividends, which is kind of illegal. And that assumes, with zero R&D for the next 10 years, I can maintain the current revenue run rate. Now, having done that, would any of you like to buy my stock at $64? Do you realize how ridiculous those basic assumptions are? You don't need any transparency. You don't need any footnotes. What were you thinking?'

Sun Microsystems was actually a profitable technology equipment maker, not a crazy, no sales internet company.

In the ensuing crash, Sun Microsystems saw their stock price fall about 90%.

Attend a seminar or call the office to find how adding a defensive strategy to your portfolio could help because…

The ledger is stacking up, and not to the positive.

Sure the market comes back, eventually…

How long can you afford your portfolio to be down significantly?

Currently risk free rates approximate 5% compared to what the market "might" make (or more importantly lose) over the coming months, and considering the growing mountain of evidence of an oncoming recession, it seems negligent not to at least explore your options.

This is even more important if your spouse is not as savvy about investments as you are.

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.

What's Your Risk Number?

Remember, we have a feature on our website: 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

Commercial Real-Estate Loan Losses Are Beginning to Show.

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.

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.*