Quarter 3, 2023 Client Letter: The (Predictable) Rise Of The Alternatives To Stocks

After a mostly rising stock market (as measured by the S&P 500 Index) through half the year, the 3rd quarter saw the stock market reverse course…declining 3.5%. No need to despair; this slight haircut only reduced the stock market's year-to-date return to about 12%. From a historical perspective, it is still better than the average for an entire year, let alone nine months.

So, what's the culprit for denting this once unshakable stock market that has withstood the unprecedented campaign to raise the Federal fund rate in a record short time? Until now, the higher cost of money has barely slowed all aspects of our economy. So, why is there a pause in the stock market ascent now?

No one knows the definitive answer to the sudden stock market reversal, but let me take an educated guess. In addition to rising oil prices, a potential Government shutdown, and derision regarding the Ukraine/Russia conflict, it's possible that investors are finally cluing into the fact that the Federal fund rate might be elevated for a while. Prior thinking was, and for many still is, that rates will climb to highs, and once the powers that be see inflation subside (which has already started in certain areas), they will begin a rate-easing program. Hmm… guess again, Maestro!

We have said it (written it) in the past that the Fed historically will only ease once they break something. And quite frankly, why would they? Why lower rates unless the economy contracts due to a tight money supply? If you think the Fed will anticipate the need for a looser money supply, that won't happen. The hope is that it does; if they do it correctly, lookout, here comes the proverbial… Soft landing! We can hope, but from a historical perspective, this typically is not the case.

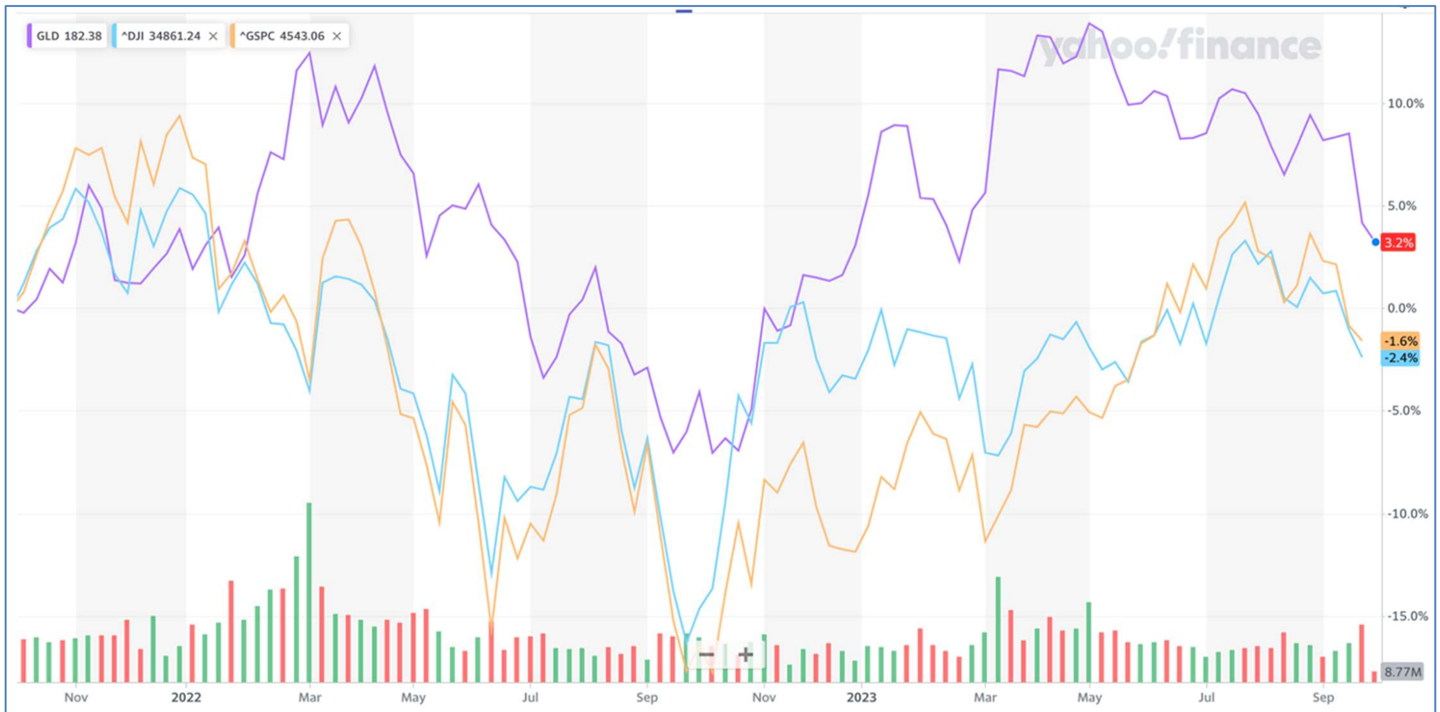
So, the Fed is giving the impression we may be here for a while…elevated rates, at least in comparison to the near-zero rate fantasyland we lived in for almost a decade. A fed funds rate north of 5% has opened the eyes of many investors to alternative investments to our beloved stock market. This is a good thing… but only when used in the proper context, not as a replacement for stocks. It's made things very interesting. Enough so, I think it's valuable to put these latest few years into perspective.

This time around, the fervor for alternatives is not for high growth speculative ideas such as crypto currencies. It is the exact opposite. Investors are clamoring for ***safer assets***. And if possible, ones that will capitalize on higher interest rates while being protected on the downside.

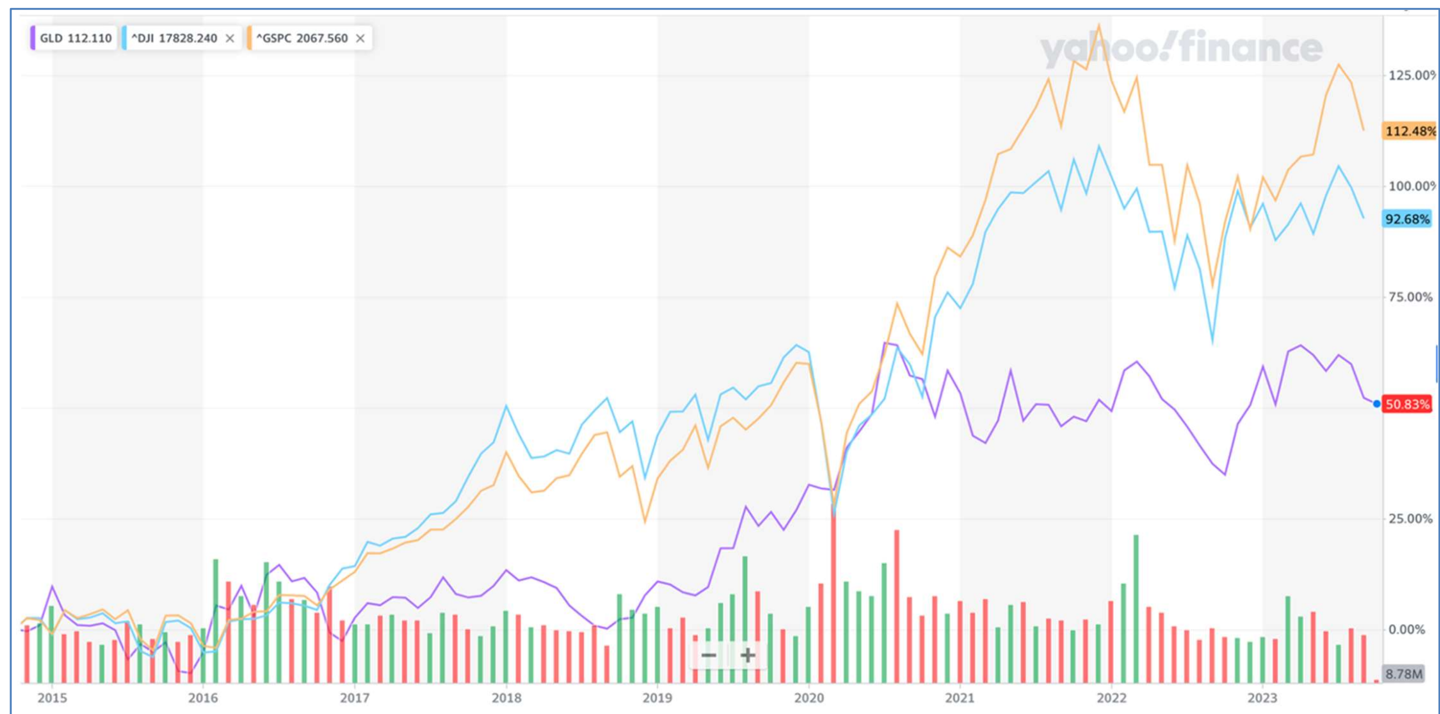
We'd have to be hiding under a rock to not have heard the great rates you can get on US Treasury Notes or even short-term bank products, such as CD's. As mentioned, a great way to secure decent income with little exposure to market risk. If this doesn't quench the thirst for a safer alternative to stocks, an old friend that moves up solely based on someone else's willingness to pay a higher price has become popular (again)… Gold!

In short timeframes commodities, specifically gold, gets it's due. The past two years are no different. The chart below clearly demonstrates that gold has returned just over 3%, while the stock market, represented by the S&P 500 Index (S&P) and the Dow Jones Industrial Average (DJIA) are down 1% - 3% for the same period. The precious metal has served its purpose… I guess.

Note: *Nothing contained herein this letter should be considered investment advice, research or an invitation to buy or sell any securities*



Gold has held onto its value over this short period, but what has it done over an actual investment period? Let's say ten years. The chart below shows that both indices doubled (or nearly doubled) the returns of the bullion over the past ten years.



While the past two years can be discouraging to stock investors, it is important to have a proper long-term perspective. We are not investing for a two-year period. If you are, you shouldn't be invested in the stock market. This is a long-term venture, and the above chart clearly shows the benefit of viewing it as such. The long-term investor will be rewarded for his/her patience and commitment to the stock market.

We live in an instant gratification world. In entertainment, we want to laugh within six seconds (i.e., Tik Tok videos). Our kids melt down in sports when they strike out in their little league baseball game. They want to get a hit now! Rather than go out and dine in a restaurant, we place online orders for delivery. Yes, it's more efficient, but it speaks to our unwillingness to sit and wait in a restaurant.

Well, the investment world is no different. In today's 24/7 news cycle, combined with how easy it is to make investment trades, it is not hard to understand why people are unwilling or question the value of staying invested in stocks when the alternatives du jour seem so much better.

In the examples above, we are probably better off not succumbing to our short-term needs/desires. In investing, it is the same. Switching gears from a wealth-building strategy that has historically worked (i.e., buying stocks and holding them) might give you comfort in the short term, but it will only hurt you in the long run.

Keep your eye on the prize (long-term wealth) and ignore the alternatives. At least that's what history tells us… and you know what they say about history!

Have a great holiday season, and we look forward to connecting in the new year!

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