GOLD GLITTERS!!

May 2023 **Letter No. 118**

Coming soon:

The next "big thing" that might affect market trading (in the near term) could be the "debt ceiling" discussions in Congress. Our fiscal situation is such that we have once again bumped up against another all-time high level of debt that, by law, we must not surpass and can only be lifted by Congress. The negotiations are highly partisan and each side of the aisle routinely lays blame on the other. From a purely historical perspective, we got here via excess spending by both major political parties while each was the majority in charge. Audacious "news" headlines are likely coming, but these are more often more opinion-based attacks depending upon the political persuasion of the publishers of said headlines. Nonetheless, the road to a resolution is expected to be raucous and filled with rhetoric. I always bristle when I hear either side say that the opposing party "wants to shut down the government," or that one party "wants to destroy the 'full faith and credit' of the U.S. Dollar." We've been through this before and yet, here we are, still standing.

Market rally of 2023 still alive:

The "line of least resistance" is still "up" for the U.S. stock market. The daily volume levels have been so-so, the Volatility Index (the "VIX") continues to take out 'lower lows,' which simply means that daily volatility in the markets is in decline. We have had fewer "scary wild days" of big price swings. I believe this too shall pass. One of my biggest concerns going forward is the growing significance of fewer and fewer stocks that have a greater influence on the major stock market averages themselves, and the impact that might have on many individual investor returns going forward this year and next *(more on this phenomenon at the end of this letter)*.

Gold Glitters:

Maybe it took a lot longer than it should, but gold has finally made a significant advance recently. Gold, silver, and platinum, also referred to as "precious metals," have historically been considered an asset class unto itself while serving as an alternative to what is otherwise called "fiat," the paper and coin

money issued by sovereign entities around the world. Many forms of fiat have come and gone, but the precious metals are still with us today. Gold is still denominated in U.S. dollars around the world, although there are believed to be efforts underway to potentially change that in the future. This arrangement has resulted in gold performing one way domestically and quite another in other economies. Gold has hit all-time highs in the past two years in some developed country currencies, but not quite yet here in U.S. dollars.

Figure 1: 15-years of Gold (100oz June futures**), April 2008 to Current** *(Chart courtesy of Refinitiv)*

Looking at Figure 1 above, you can see two significant developments. First, on the far left you can see an initial "topping" action at about the $1,925 per ounce level in the third quarter of 2011. This was followed by a much extended consolidation period that lasted all the way to April 2020 (the big "U" in the middle) where we finally made a new all-time top at the $2,089 per ounce mark. Two more attempts have been made since to take out this last high, once in March 2022 and then again right now. There is an old saying on Wall Street, "They like to knock three times before entering," and if you focus on the right-hand side of the above chart, this appears to be a third knock. For all practical purposes, my technical analysis suggests we are there, although no one can predict the markets with any certainty.

For those who have been bullish on gold for these past 15 years or longer, this has been a long-awaited development. Now that there is a possibility for prices to advance, it feels as though hardly anyone is here to celebrate. According to the latest "Commitment of Traders" report, a measure of bullishness or bearishness by participating futures contract traders, we are only witnessing modest bullishness at this juncture, and well behind the levels seen at the other two recent tops mentioned above. [1] That is being viewed by many as a "contrarian indicator," and as such, there are some hard-core gold bulls who believe that a breakout to the upside this time around could really find some significant buying support from those who aren't convinced a new high is coming. Of course, this is only speculation and we will know when we know. For now, the set-up looks intriguing at the least, and potentially powerful at best. My guidance: Continue to accumulate. Gold (and silver and platinum) often does well in times of inflation and economic uncertainty.

S&P 500 Index Dominance:

The S&P 500 Index is considered to be the leading barometer of the market. It accounts for nearly 80% of the market value of the U.S. equities market. Given this status as a market leader, it's no secret that Wall Street has created a massive amount of investment product that "mimics" this major index. The strategy behind these products is often referred to as "indexing." This is a passive investment strategy (little trading required), but it has also become a significant method for individuals to get stock market exposure in the modern era.

Most large retirement plans (such as 401(k) and 403(b)) give their participants a limited choice of funds from which to choose in order to construct their overall retirement plan investment strategy, and a popular choice that is utilized are "index funds". There is a little secret that the vast majority of these investors don't know. While most believe that the method of indexing is a good way to get diversification, the formula for how the S&P 500 Index is constituted has been favoring the largest companies at the top of the heap, resulting in fewer and fewer stocks that have now become so dominate to the index itself. This has become the tail that wags the dog. According to *The Wall Street Journal* *("Apple, Microsoft Dominate U.S. Markets…" 3/22/23)* just two stocks now constitute 13.3%

of the overall S&P 500 Index. Further, only 10 stocks of the total of 503 stocks constitute a whopping 27% plus of the S&P 500 Index *(I did the math)*, so the concentration here is obvious. [3] But here is another little known fact; of the 10 largest stocks, five of them are considered to be a part of the tech complex, while a sixth is an insurance company with considerable holdings in that sector as well. If you are bearish on the near-term outlook for tech (for the record, I am), but you have a large share of your 401(k) in an investment tracking the S&P 500 and more in large-cap growth funds, you may be top-heavy in assets you may not otherwise choose to hold if you weren't "indexing." This concept gets to the heart of what follows.

If one examines the largest stocks occupying the top of the S&P 500 Index over several decades, they will learn that such sustained and steady growth started from a much lower base, not from an enormous one. I believe it is likely a mistake to expect rapid growth from companies that have already matured to a point of near complete saturation. Thus, when we see that the current composition of the S&P 500 is so dominated at the top with such narrow leadership, it brings one to question what more is left in the tank. Further, why should we want to assign such rich multiples on the "price/earnings" and/or "price/revenue" of these already huge and mature companies? Not everything involving investments always makes sense. I think it has been this way for a while now, but this is also the reason why I have been recommending, where appropriate, "under-weighting" the large-cap growth stocks that so many investors hold in their retirement accounts via these "index" strategies. Further, it may take a long time for these kinds of equities to adjust to more historically normal valuations, providing they do so at all. There is no assurance that they will, but the history books of the stock are filled with examples of this happening over and over again, so perhaps this is where past is prologue once again. This is my view, and as such, where appropriate, I continue to recommend keeping an underweighted holding of large capitalization "growth" stocks and other investments, and in particular, this would include the S&P 500 "indexing" strategy.

As always, Buck Kipper and I are here to have the conversation of reviewing your asset allocation models, as well as to discuss your "bigger picture" issues

such as your long-term retirement planning, your estate planning, how to talk to your heirs about your financial affairs, and more. One last note; our season of snow, ice, and cold just seems to not want to quit this year here in Rhinelander. It is time! We are all very anxious for it to turn. Like the markets, the weather has seasons too!

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1 https://www.cftc.gov/MarketReports/CommitmentsofTraders/index.htm
https://www.cftc.gov/dea/futures/other_lf.htm

2 **https://www.spglobal.com/spdji/en/indices/equity/sp-500/#overview**

3 https://www.wsj.com/articles/apple-microsoft-dominate-u-s-markets-after-faang-trade-fizzles-d6f10309

Past performance is not indicative of future results. The Standard & Poor's 500 Index is a capitalization-weighted index that is generally considered representative of the U.S. large capitalization market. Diversification and asset allocation do not ensure a profit or protect against loss. There are special considerations associated with international investing, including the risk of currency fluctuations and political and economic events.

Investing in emerging markets may involve greater risk and volatility than investing in more developed countries.

The risk of loss in trading commodities and futures can be substantial. You should therefore carefully consider whether such trading is suitable for you in light of your financial condition. The high degree of leverage that is often obtainable in commodity trading can work against you as well as for you. The use of leverage can lead to large losses as well as gains.