May 13, 2022

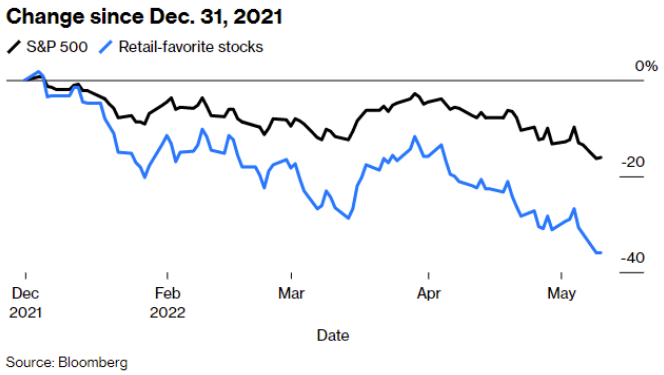
Raymond F. Saleeby, Jr
President

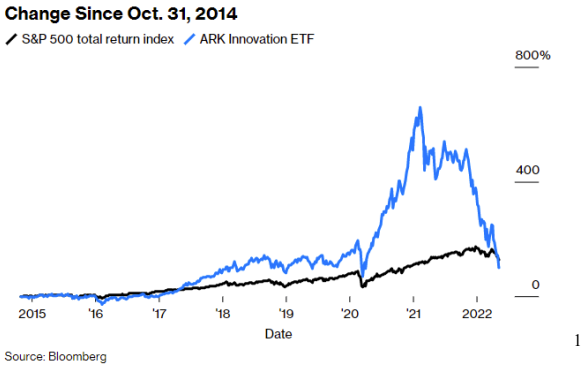
Saleeby & Associates, Inc.

Where Trust And Confidence Are Paramount ™

Market Volatility

Last year the stock market went up dramatically surpassing most investors' expectations. What is more surprising is that it did so with very little volatility and variance. This year we have seen the opposite and many of the excesses and bubbles from last year have popped. The buy the dip mentality and buy a stock thinking someone will pay a higher price regardless of the fundamentals seems to have paused if not stopped as illustrated in the charts below:

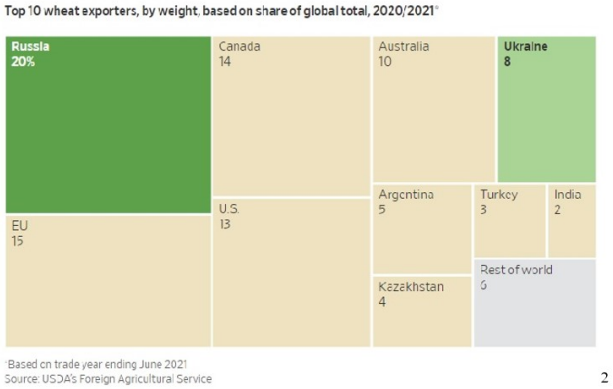




Many times, investors cannot sell what they want so they sell what they can. Therefore, good quality stocks can go down regardless of fundamentals. As we write this newsletter, cryptos are imploding and many people think we will have further declines. I believe there are two main reasons that have driven the stock market down with a substantial increase in volatility. The first is the Russian invasion of Ukraine. This has accelerated existing high inflation rates irrespective of the social and political ramifications. This is especially true for agriculture and energy related products and services. I believe we will continue to see higher prices and shortages related to these two industries.

In agriculture, seed oil (which is vegetable oil derived from plant seed) is scarce, and prices have skyrocketed causing an increased shortage in pasta and other wheat related products. Since China's intense Covid lock-down began in March 2022, energy prices have been affected in a positive way. This, in turn has stunted China's economic growth and will likely slow down their manufacturing and exportation of goods, disrupt the supply chain, and could cause higher inflation. It is mindboggling that China refuses to use vaccines developed by the west which are far more effective than China's vaccine. On the other hand, it might be a blessing in disguise since we are seeing lower than normal prices for oil due to the Covid lockdown in China affecting demand. At this point, it appears that Russia and Ukraine are at a stalemate and the war will probably last longer than many of us thought which would not be good for the fight against inflation or supply chain issues.

Macro Repercussions



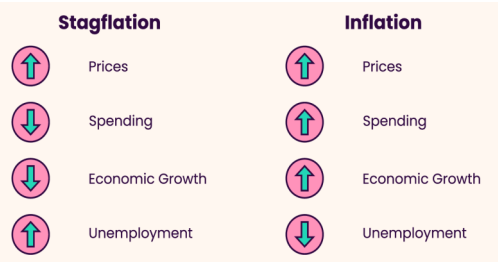
2

I believe the Ukraine war is bringing down the world. As stated by the World Bank, "Russian's invasion of Ukraine has triggered the largest shock to commodity markets in nearly 50 years, with high price levels expected to persist until at least the end of 2024."[3] "Wheat prices in particular are forecast to jump by more than 40% this year, the bank predicted in its report. Russia is the world's largest exporter of the grain, while Ukraine had been expected to export up to 20 million tons of wheat during the current season, equivalent to about 10% of global wheat exports, the bank said."[3]

It has been a threat to globalization and economic growth with higher global inflation. According to the UN Food and Agriculture Organization (FAO) "The resulting global gap between supply and demand for food and feed could raise international food prices by a further 8 to 22 per cent above their already elevated levels."[4] "Food costs account for 17 per cent of consumer spending in advanced economies but a much higher proportion in developing countries. For example, in sub-Saharan Africa, food accounts for 40 per cent of consumer spending."[4] "But, according to the FAO, nearly 50 countries depend on Russia and Ukraine for at least 30 per cent of their wheat imports."[4] Unfortunately, this will adversely impact mostly people who cannot afford it.

The war will also cause many countries to increase their defense spending including the United States and countries that border Ukraine and Russia. I believe there will be increased hostility among countries, especially large ones like China, India, and the United States. Ironically, our economy seems to be doing the best compared to China, Russia, and Europe but global growth will certainly be reduced. Distribution costs will increase, supply chains will see more disruption, and there will be geopolitical consequences. In my opinion, the west will be forced to spend more money on the old oil and gas infrastructure versus putting that same money towards a decarbonation infrastructure. I also believe there will be increased hostility among poor countries such as Africa or Arab countries which could lead to civil unrest. But there are many other repercussions from this war. I believe Putin underestimated the Ukrainian people and now he is trying to save face. Knowing what he knows today, I do not believe he would have started this war, but I fear he won't stop until he wins, which is frightening.

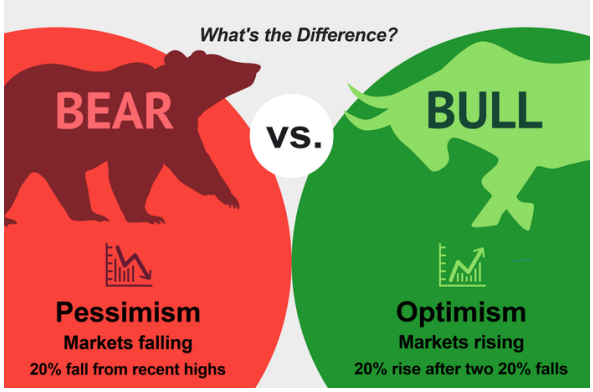
Another major issue, I believe, is the Federal Reserve underestimating inflation. For a long time, they claimed that inflation was due to supply chain constraints. However, now they are changing their tune and playing catch up. In some respects, this is like the 70's Arab oil embargo crisis which caused inflation to reach double digit rates leading to a recession. It not only caused inflation but also stagflation for several years. Stagflation is simply slow growth and high inflation. Now we are confronting two major crises: the Ukrainian Russia war and the Covid shockwave leading to extreme demand with crippling supply chain issues. This has driven the Fed to react and possibly make up for lost time.



Macro Repercussions (Continued)

When the Covid pandemic first started, the Fed was forced to use practically all measures to save the economy. The government injected an incredible amount of liquidity (approximately $9 trillion) into the system. That worked effectively but now we are starting to see the effects of that liquidity with substantially higher inflation. Currently, the Federal Reserve is in a very tough spot. If they tighten too much and too fast, it may cause a recession thereby affecting corporate profits, shrinking P/E ratios, and lowering stock prices. In addition, the Fed can have more impact on affecting demand for goods and services than the supply so they can only do so much. On the other hand, if they do not do enough, we could have uncontrollable inflation, like in the 70's when the Federal Reserve pushed the economy to extremes by raising rates dramatically to substantially lower inflation. Ideally, a soft landing would be what stock market investors want to see but getting there is challenging.

The stock market is seeing the bull and bear fight over what the outcome might be. At the end of April, "The S&P 500 has fallen almost 13% so far this year and is on track for its worst January to April performance since World War II. The Nasdaq was trading in a bear market, down more than 20% from the all-time high of 16,057, hit on Nov. 19. The tech-heavy index is on track for its worst first four months on record, according to Dow Jones Market Data"[5] "Performance bears this out. With four months behind us, the S&P 500 Index is off to its worst year-to-date start since 1939, according to Dow Jones Market Data (*WSJ*)."[6] For right now the bears seem to be winning. At the end of April, the Nasdaq was down 21%. "The Nasdaq dropped 4.2% Friday, bringing its losses for the month to more than 13%, its worst showing since October 2008. The index is down 21% in 2022, its worst start to a year on record."[7] Mike Santoli of CNBC stated on May 10, 2022 that the average decline for every Nasdaq stock is around 49% from their 52 week highs. The bond market is not faring well, and the 30-year treasury bond is down 18% this year. "The Bloomberg Global Aggregate Index, a benchmark for government and corporate debt total returns, has fallen 11% from a high in January 2021. That's the biggest decline from a peak in data stretching back to 1990, surpassing a 10.8% drawdown during the financial crisis in 2008. It equates to a drop in the index market value of about $2.6 trillion, worse than about $2 trillion in 2008."[8]



I believe the Federal Reserve wants to orchestrate a soft landing where interest rates decrease, and inflation subsides to 3%-4% from 8.3% in April, which is the highest rate in 40 years. In addition, the Fed wants to limit the impact on relatively full employment while reining in wages that seem to be out of control. What we are more likely to experience is stagflation.

Labor Market Challenges

Right now, wages are not keeping up with inflation. Inflation is like a tax on all of us. It significantly impacts lower waged employees who can barely keep up. In 2020-2021 our government subsidized many families and companies with the Covid relief fund. Still one-third of the working population earns less than $15 per hour. ”Over 50 million US workers make less than $15 per hour, according to a new Oxfam America report.”[9] “The report from Oxfam America finds that there are over 51.9 million US workers — about a third of the labor force — who are making less than $15 per hour, or about $31,000 per year working full-time. Henderson said this level of pay "is just not livable."[9] “Henderson said an hourly rate of $15 ‘depending on where you live really isn't enough to cover all of the basic necessities, especially if you have children.’ According to Child Care Aware of America's calculations and methodologies, the national average childcare price was $10,174 a year in 2020, about a third of what a full-time worker earning $15 would make.”[9]

“Raising the minimum wage would be especially beneficial for working mothers, workers of color, and rural workers. The Oxfam America report found that four in 10 people of color make less than $15 an hour.”[9] This is devastating especially since their wages are not keeping up with inflation. The $15-$25 per hour workers are also getting hit hard. Most of them do not have an inflation hedge, house, other real estate, stocks, or a retirement plan that can offset some inflation increases. Therefore, many people are forced to live paycheck to paycheck and prioritize which bill gets paid first.

This is one reason why we saw 4.5 million people quit or change jobs in March which was the highest record ever. I believe there are two jobs for every person looking for employment. If someone offered a better wage or benefits, they would likely switch jobs to capture the increased income to stay afloat. In addition, we are seeing an increase focus to organize labor and some big behemoth companies (ex: Amazon, Starbucks, Apple) are experiencing partial unionization efforts. Thus far it has not been overly successful but who knows what may come. However, with largely full employment and inflation the average worker has more employment power and less purchasing power than in decades.

According to the LendingClub Corporation, “50% of Americans who earn more than $100,000 a year now live paycheck to paycheck.”[9] “67% of Americans living in cities live paycheck to paycheck.”[10] The U.S. is still very much a consumption society but by raising rates the consumer will pair back their spending. According to a LendingClub report, “At the start of 2022, 64% of the U.S. population was living paycheck to paycheck, up from 61% in December and just shy of the high of 65% in 2020.”[11] “Forty-nine percent of survey respondents resided in suburban areas, with approximately one-quarter each living in urban (26 percent) and rural (25 percent) areas, yet PYMNTS’ research finds that 67 percent of consumers living in urban areas and 68 percent of consumers living in rural areas are more likely to live paycheck to paycheck.”[10]

The Great Disconnect: Markets vs. Economy

I believe the stock market seems disconnected with the current economy, good corporate earnings, and how stock prices have reacted recently. Although the economy seems to be slowing down it is still doing very well especially in respect to unemployment. "2021 was the most profitable year for American corporations since 1950."[12] "Profits surged 35% last year, according to data published on Wednesday by the Commerce Department, driven by strong household demand, which was underwritten by government cash transfers during the pandemic. In all four quarters of the year, the overall profit margin stayed above 13%, a level reached in just one other three-month period during the past 70 years."[12] "The latest Fed data suggest that Americans accumulated some $4.2 trillion in extra savings since the end of 2019."[12] Historically we still have very low interest rates and the economy growth rate is well above average, although declining. However, the stock market is discounting what will happen six months down the road. We all know the Federal Reserve is going to try and slow inflation by using tools that slow the economy. However, one doesn't want to slow the economy to the point where it greatly increases unemployment and crowds out funding for social programs by increasing government interest rates on new national debt. Right now, our debt (GDP) is at a very high level which for some people is troubling. If we end up going through a recession it will certainly exacerbate these problems.

I believe we have seen a dramatic increase in retail investors participation in the stock market the last couple of years. This has been caused by low interest rates, momentum in crowd investing along with many investors having meme stocks in their portfolios. The Covid outbreak has caused people to stay home with time on their hands. Scott Wapner, a CNBC host, interviewed Tony Pasquariello, Goldman Sachs global head of hedge fund coverage, regarding the market. Pasquariello said, "A quick step back. In 2021 the retail investor put more money into the market than they had in the prior 25 years combined. And like I said, that strength carried through to Q1 $200 billion of inflows into equity mutual funds and ETFs in the first quarter. And then April just kind of got weird. Now there is always a tax date, funding, there is always a tax seasonal to be aware of but it's continued. We've continued to see a pattern of outflow ever since then."[13] In addition, most retail investors were probably not around 40 years ago when we had the last large inflation spike. I believe the retail investor is more short-term oriented and aggressive than the average institutional investor. This would explain one of the reasons for the increased volatility.

Many of the Covid related stocks that benefited from the lockdown are suffering the most right now. Companies that have no earnings or very little earnings are selling at a high price-to-earnings ratio and are among the stocks being hit the hardest. This is especially true for the high-tech companies, many of which have only been traded a few years. You may ask what seems to be working for investors in all this gloom… commodity stocks (i.e., oil and gas) and defense stocks (due to Russian hostility). Utility stocks are also performing well which is somewhat surprising because they usually go down when rates increase; however, utilities pay good dividends which are typically higher than U.S. Treasuries and at the same time have the potential to increase distribution. In addition, some consumer defensive stocks are also doing well if they are able to increase prices without losing market share.

Conclusion

In conclusion, I believe many of the stock market indices do not truly represent the magnitude of correction for most publicly traded companies this year. The stock and bond markets are trying to gauge the decreasing credit worthiness of many corporations and what the effect on companies will be if the Federal Reserve does not orchestrate a soft landing. As mentioned before, many of the stocks that have been hit the hardest are in the technology area and many have extremely high price-to-earnings ratios or are not profitable. Also, recently issued SPACs (Special Purpose Acquisition Companies) and many of the momentum stocks and Covid related stocks have been hit extraordinarily hard. In addition, increased inflation has taken away almost all positive adjustments for inflation returns for most financial assets. This obviously leads to negative returns.

One may ask, what should investors do? I believe in looking long-term, having patience, and diversifying not only by asset class or industries but also with international and hybrid securities… Secondly, buying companies with few competitors and barriers to entry with pricing power to offset increased costs such as labor, transportation, materials, inventory, etc. Plus, companies that can maintain profit margins while not losing customers to a competitor. It is also important to have a good balance sheet and cash flow to weather unexpected events, especially with high interest rates and a weakening economy. Lastly, a strong management team is key for companies to weather a storm and continue to perform. In my experience, many industries go through downturns yet only a few companies are successful at leveraging the situation and outperforming the rest, which is largely attributed to good management. In other words, be selective and look for quality companies.

We will eagerly wait to see if the Federal Reserve can orchestrate a soft landing. They will have to balance increased inflation with high employment levels to soften the economy without damaging it at the expense of unemployment or a severe downturn in growth. One caveat… if we were to increase productivity that could help the situation; or if there is a decision for Russia to end the Ukraine war that could also help. Let's hope for the best. Thank you for your business and patience.

Optimistically Yours,

Raymond F. Saleeby
President

Footnotes

1. Wang, Lu and Papuc, Andreea. "Crypto, Meme Stocks, and SPACs: Charts From a Market Rout". Bloomberg. Retrieved from https://www.bloomberg.com/news/articles/2022-05-12/nasdaq-s-p-500-price-dips-cause-investor-pain 12 May 2022
2. Newman, Jesse and Patrick Thomas. (2 May 2022). "Facing a wheat crisis, countries race to remake an entire market of the fly". The Wall Street Journal. Retrieved from https://www.wsj.com/articles/ukraine-war-wheat-shortfalls-high-prices-11651503940 9 May 2022
3. Jamal, Urooba. (27 April 2022). "The Ukraine conflict has triggered the biggest commodities price shock in nearly 50 years and the impact on food and energy is set to last until 2024, the World Bank says". Business Insider. Retrieved from https://www.businessinsider.com/ukraine-war-has-led-to-the-biggest-commodity-price-shock-in-50-years-2022-4 9 May 2022
4. Terazono, Emiko and Robert Wright. (8 April 2022). "World food prices hit new record on impact from Ukraine war". Financial Times. Retrieved from https://www.ft.com/content/5212871a-d2d3-41ef-99fe-400ed33859e8 9 May 2022
5. Sonenshine, Jacob and Jack Denton. (29 April 2022). "DJ stocks are tumbling to cap worst 4-month start to a year in decades". Dow Jones News. 9 May 2022
6. Sherry, Charles. (4 May 2022). "A may letter to clients: The Fed gears up for shock and awe". Horsesmouth. Retrieved from https://www.horsesmouth.com/a-may-letter-to-clients-the-fed-gears-up-for-shock-and-awe 9 May 2022
7. Banerji, Gunjan and Caitlin Ostroff. (29 April 2022). "Tech rout drags Nasdaq to worst month since 2008". The Wall Street Journal. Retrieved from https://www.wsj.com/articles/global-stocks-markets-dow-update-04-29-2022-11651217787 9 May 2022
8. Ritchie, Greg. (22 March 2022). "This is now the worst drawdown on record for global fixed income". Bloomberg. Retrieved from https://www.bloomberg.com/news/articles/2022-03-23/global-bond-losses-deepen-to-11-from-2021-high-most-on-record?sref=Ro2vIlyD 9 May 2022
9. Hoff, Madison. (22 March 2022). "A third of US workers make less than$15 an hour, and they're struggling to make ends meet". Business Insider. Retrieved from https://www.businessinsider.com/one-in-three-us-workers-make-less-than-15-2022-3#:~:text=The%20report%20from%20Oxfam%20America,%22is%20just%20not%20livable.%22 9 May 2022
10. LendingClub Corporation. (4 April 2022). "Half the share of the wealthiest Americans now live paycheck to paycheck". PR Newswire. Retrieved from https://www.prnewswire.com/news-releases/half-the-share-of-the-wealthiest-americans-now-live-paycheck-to-paycheck-301516467.html#:~:text=Key%20takeaway%3A%20Exactly%20half%20the,from%2048%25%20the%20previous%20month 9 May 2022
11. Dickler, Jessica. (8 March 2022). "As inflation heats up, 64% of Americans are now living paycheck to paycheck". CNBC. Retrieved from https://www.cnbc.com/2022/03/08/as-prices-rise-64-percent-of-americans-live-paycheck-to-paycheck.html 9 May 2022
12. Boesler, Matthew. (30 March 2022). "Profit soar as U.S. corporations have best year since 1950". Bloomberg Businessweek. Retrieved from https://www.bloomberg.com/news/articles/2022-03-30/2021-was-best-year-for-u-s-corporation-profits-since-1950?sref=Ro2vIlyD 9 May 2022
13. Wapner, Scott. (5 May 2022). "There's a question of whether the retail investor has 'spit the bit,' says Goldman's Tony Pasquariello". CNBC. Retrieved from https://www.cnbc.com/video/2022/05/05/short-u-s-corporate-through-buybacks-could-replace-the-retail-investor-says-goldmans-tony-pasquariello.html?&qsearchterm=goldman%20sachs 9 May 2022

Did You Know

7 top benefits of Roth IRAs that you don't want to overlook
https://www.fool.com/investing/2022/04/17/7-top-benefits-of-roth-iras-that-you-dont-want-to/

Warren Buffett says he wouldn't pay $25 for all the bitcoin in the world - and Charlie Munger blasts the crypto as 'stupid' and 'evil'
https://markets.businessinsider.com/news/stocks/warren-buffett-charlie-munger-bitcoin-crypto-cryptocurrency-investing-berkshire-hathaway-2022-4

Warren Buffett and Charlie Munger called out stock-market gamblers, dismissed bitcoin as worthless, and underlined the risks of inflation. Here are their 12 best quotes from Berkshire Hathaway's annual meeting.
https://www.businessinsider.in/cryptocurrency/news/warren-buffett-and-charlie-munger-trashed-bitcoin-rang-the-inflation-alarm-and-revealed-new-apple-and-activision-blizzard-purchases-here-are-12-key-takeaways-from-berkshire-hathaways-annual-meeting-/amp_articleshow/91269563.cms

Selling your investment property? Here's how to defer taxes with a 1031 Exchange
https://www.wsj.com/articles/1031-exchange-real-estate-11648062172

As home sale prices surge, a tax bill may follow
https://www.nytimes.com/2022/03/25/your-money/home-sale-tax.html

Capital gains are the profits you make from selling your investments, and they can be taxed at lower rates
https://www.businessinsider.in/finance/news/capital-gains-are-the-profits-you-make-from-selling-your-investments-and-they-can-be-taxed-at-lower-rates/articleshow/79520921.cms

Ukrainian soldier says Elon Musk's Starlink satellites 'changed the war in Ukraine's favor' as they're helping troops stay online amid Russian strikes
https://www.businessinsider.com/elon-musk-starlink-satellites-helping-ukraine-fight-soldier-2022-4

Supermarkets are limiting the amount of cooking oil people can buy as the Ukraine war leads to shortages and surging prices
https://www.businessinsider.com/supermarkets-retailers-limit-cooking-oil-purchases-ukraine-war-sparks-shortage-2022-5

I tried a new test that screens for 50 kinds of cancer. What I learned.
https://www.barrons.com/articles/testing-new-cancer-screens-galleri-51650584753

Diagnosing tumors a home? The digital transition of healthcare is here
https://www.fool.com/investing/2022/05/08/diagnosing-tumors-at-home-the-digital-transition-o/

U.S. military spending vs other top countries
https://www.visualcapitalist.com/u-s-military-spending-vs-other-top-countries/

Fleeing Russian soldiers left behind key military documents that indicated Putin had plans to seize all of Ukraine, officials said
https://africa.businessinsider.com/military-and-defense/fleeing-russian-soldiers-left-behind-key-military-documents-that-indicated-putin-had/hmkdsnj

Did You Know (Continued)

How we renovated our house so it was perfect for working from home
https://www.wsj.com/articles/renovated-house-perfect-working-from-home-11651255647

Get these specialized inspections before you buy a waterfront home
https://www.wsj.com/articles/waterfront-home-inspections-11651084785

Florida flights face worst delays in years thanks to private jets and space launches
https://www.yahoo.com/now/florida-flights-face-worst-delays-134026976.html

Pickleball, a paddle sport with a whimsical name, is becoming big business
https://www.cnbc.com/2022/04/24/pickleball-translates-into-big-business-with-tournaments-investments.html

Saleeby & Associates, Inc.

Achieving your goals is our passion

11301 Olive Blvd.
Creve Coeur, MO 63141

Phone: 314-997-7486
Fax: 314-997-1417
E-mail: rsaleeby@cutterco.com

Check us out at saleebyandassociates.com