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FINANCIAL SERVICES, INC
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989 W Washington St., Suite # 101
Marquette, MI 49855
(906) 226-8711
www.mommaerts-mahaney.com

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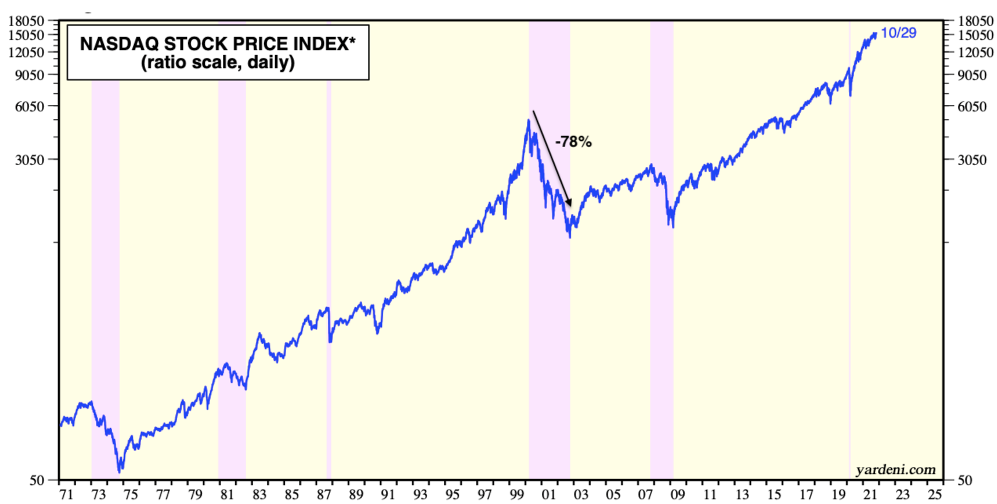
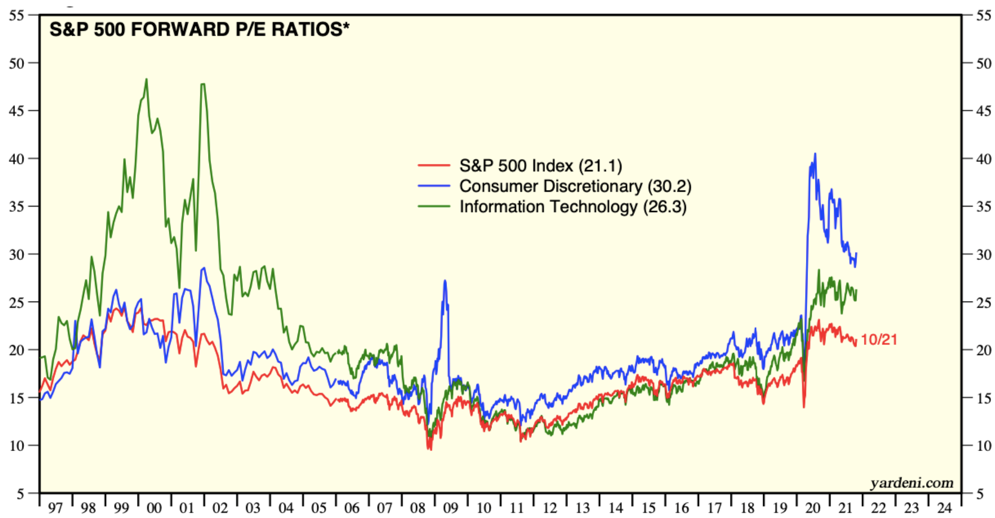
This Time is Different

Jon C. Mommaerts Certified Financial Planner®
Robert Kea Chartered Financial Analyst
J. Matthew Tuccini Certified Financial Planner®
Jason J. Rolling Financial Advisor

Sir John Templeton, the founder of Templeton Investments, is widely regarded as one of the greatest investment minds of the last century. He famously wrote in his *16 Rules for Investment Success*; "the four most costly words in the annals of investing are*, "this time is different."* We agree. More often than not, dismissing troubling economic data or rationalizing overvaluation has proven costly. The *dot-com* stock market bubble during the late 90s' is an excellent example. (The Nasdaq index best represents the internet and technology sectors.)



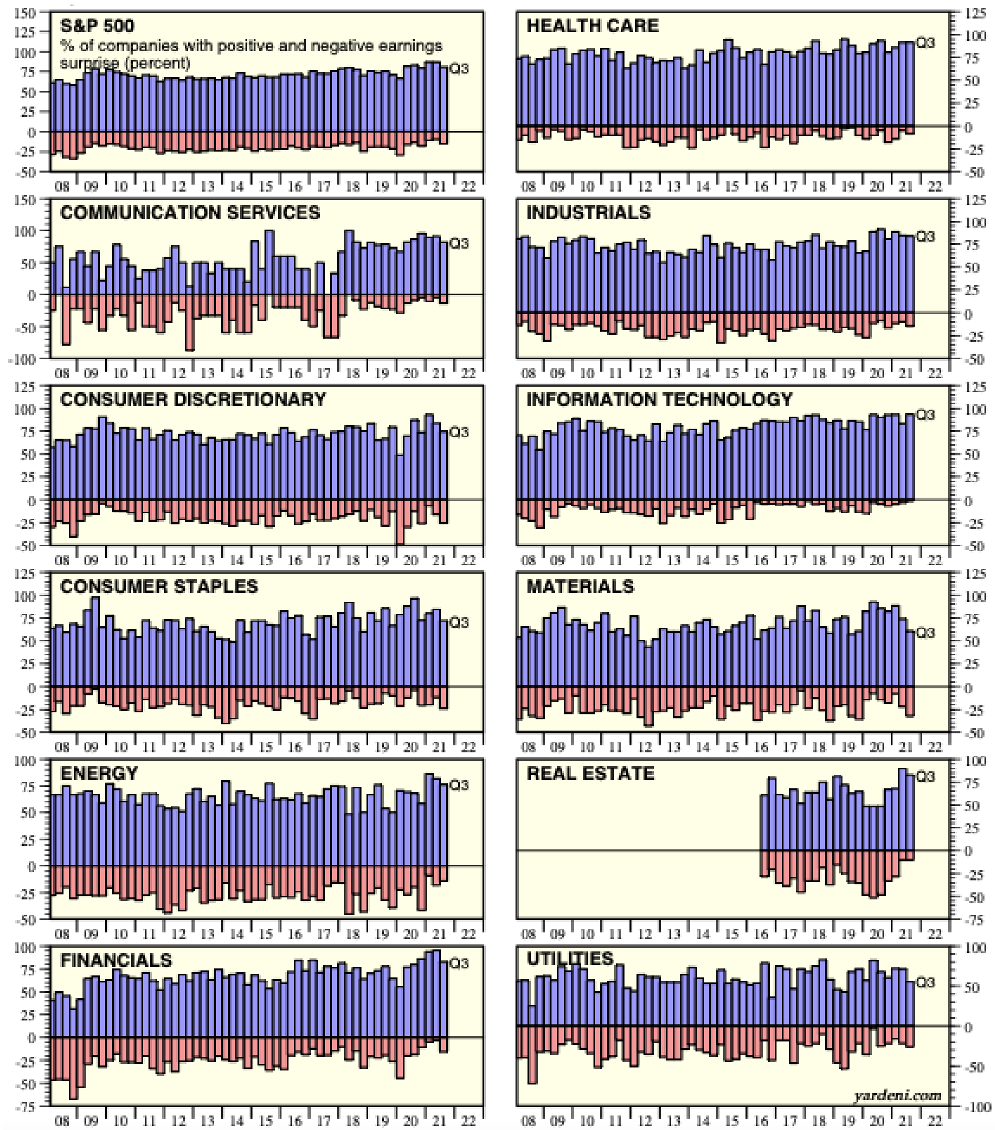
The World Wide Web was forever changing the way we lived. Despite not fully understanding the eventual economic impact of the internet, many investors speculated about the potential success of any company considered to be an internet company. This created a massive surge in the price of shares in internet-related stocks. The majority of these companies had not yet produced any earnings, many were pre-revenue. As stock prices went higher and earnings didn't, the price-to-earnings ratio (P/E) of information technology stocks ballooned to almost 50X, by far the most overvalued reading stocks had ever displayed. We were assured by countless pundits there was no need to worry, "this time is different".



They explained that earnings no longer mattered. What mattered were *clicks and eyeballs,* aka website traffic. Website traffic would eventually translate into revenue and earnings. When and how much were not important. We also were told not to be concerned that the most highly-priced companies were selling their products for less than their cost of production. Eventually, these companies would have a dominant market share and be able to dictate whatever price they pleased. Starting in March of 2021, the Nasdaq dropped 78%, giving up 5 years of gains. It took almost 20 years for the Nasdaq to regain its March 2000 highs. It turns out things weren't so different at all.

We tell this story as a reminder of why we have remained fully invested in stocks, and why we will likely lower stock exposure in the not-too-distant future. We've written quite a bit about how impressive corporate earnings have been. We've also acknowledged that much of the earnings surge is likely attributable to ultra-easy monetary policy and deficit spending. We've expressed our concern, but written less about, the longer-term economic ramifications of easy monetary policy and deficit spending. Most notably, the eventual need to tighten monetary policy to control inflation. This creates a credit crunch on the excessive levels of debt that have been accumulated. Higher debt service and less credit in the economy lead to economic contractions, lower earnings, and bear markets.

Before jumping into those topics, let's marvel one last time at the now completed Q3 earnings season. Q3 earnings crushed expectations. It's interesting to note how broad-based the earnings *beats* were. Not only did 85% of companies beat expectations, but each sector also outperformed their respective earnings expectations.

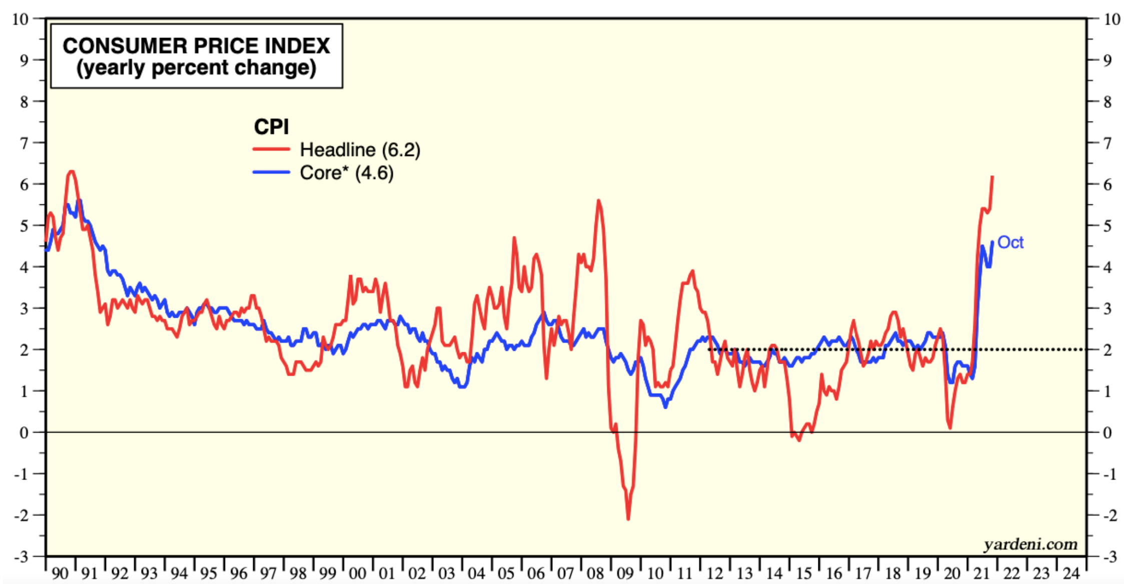


Please excuse us while we digress for a moment. We received a lot of feedback on our most recent commentary, *Sonny and Cher,* which highlighted the early Q3 earnings results. For the most part, you appeared less interested in what we had to say about earnings and more interested about our opinions on Sonny and Cher. As the British would say, some of your feedback was quite "fruity". Not surprisingly, the only feedback that truly surprised us came from our millennial friends, "who are Sonny and Cher"? As disturbing as this question is, we searched for a more generationally appropriate theme song for the millennials. While our dog placed its paws over its ears and howled, we listened to millennial music in hopes of finding a relevant chorus. We did not. How about we compromise? The Go Go's released *We got the beat(s)* in 1981, and everyone knows and loves the Go Go's. So, let's move along.

We are economists by trade. More specifically, we are econometricians. An econometrician is someone that uses historical data and mathematics to build models that forecast the economy. These forecasts are a critical component in the development of our capital market expectations. Our expectation is that historical relationships repeat themselves. **We have yet to identify any examples where excessive deficit spending has been a successful long-term strategy for an economy.** That said, it is also true that deficit spending does generate economic growth in the short term. The trillion-dollar question is, when does short-term become long-term.

In 1998 technology stocks were overvalued. Technology stocks then doubled in value between 1998 and March of 2000. P/E's went from the low 30s' to almost 50. While selling technology stocks in 1998 eventually paid off, ideally, technology investors would have held their positions a bit longer before selling. Our view is that we are facing a very similar quandary today.

Our expectation has been that the next bear market will be a result of the Fed's need to fulfill its "price stability" mandate. That's a fancy way of saying control inflation.



Despite our view that the current Fed Chair's monetary policy has been overly stimulative, the current administration has expressed concern that the Fed is not doing more. We think it is likely that a more progressive Fed Chair will be appointed to replace Powell. We will leave you with a riddle; What does a Fed Chair do when the inflation rate is considerably higher than their target inflation rate? Answer; Change the target rate. We would not be the least bit surprised to see the target inflation rate adjusted higher. This would further allow the Fed to hold off enacting tighter monetary policy, which would likely make the short-term last longer.

We hope everyone has a wonderful Thanksgiving break this year and you are able to visit with everyone we all so dearly missed seeing last year. At MMFS, we would like to give thanks for knowing each and every one of you. You make our lives more enjoyable!

Happy Thanksgiving,

The Mommaerts Mahaney Team

Jon C Mommaerts, CFP®: Jon is a Principal of Mommaerts Mahaney Financial Services, Inc. He has over 30 years of experience working with professionals and those about to retire. He is a member of the Financial Planning Association, as well as a member of the Preferred Financial Advisors.

J. Matthew Tuccini, CFP®: Matt has over 17 years of experience working in the financial services industry with vast experience in retirement planning, tax strategies, and financial planning.

Robert Kea, CFA: Bob has over 30 years of experience in portfolio management. He was a founding member and Co-Head on Putnam's Asset Allocation Group, which managed $12Bn in both retail and institutional assets.

Jason Rolling, Financial Advisor: Jason has been in the financial services industry for the past 15 years. His financial experience includes retail banking, consumer & commercial lending, bank management at the local, regional and SVP level, wealth management, and financial planning.

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Mommaerts Mahaney Financial Services, Inc. provides advisory services through ERTS Wealth Advisors, LLC, a registered investment advisor.
989 W. Washington Street, Suite 101   Marquette, MI 49855
(906) 226-8711