

All Kinds of Records.

ONE DAY In July

A Note from our Founder

October 4, 2021

Records are falling, or close to falling, across the financial industry. On the following five pages, we picked several to display for you. Does it mean a market correction is coming? No. Could one of these indicators signal a market correction or a sideways market is coming? Yes.

Remember that Fidelity Magellan Fund manager Peter Lynch said, "Far more money has been lost by investors trying to anticipate corrections than lost in the corrections themselves."

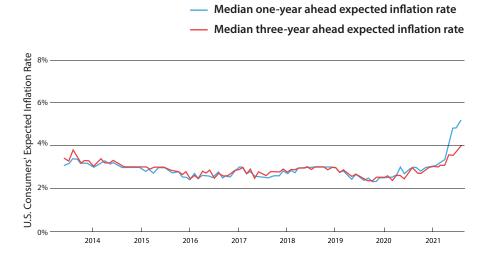
What is important is that investors temper their expectations for returns after the enormous market runup over the past 18 months.

~ Dan Cunningham



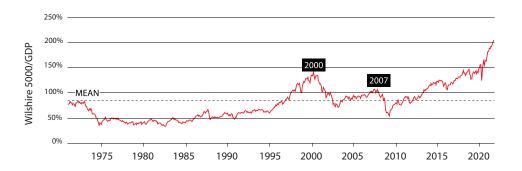
Lots of Records! Inflation Expectations

The latest *Survey of Consumer Expectations* released by the New York Federal Reserve shows that U.S. consumers expect a 5.2% inflation rate one year from now. This is the tenth consecutive monthly increase and a new high since the survey began tracking this data in 2013. Over the medium-term horizon, defined as three years, inflation expectations also jumped to a new series high of 4.0%.



Lots of Records! The Wilshire 5000-to-GDP Ratio

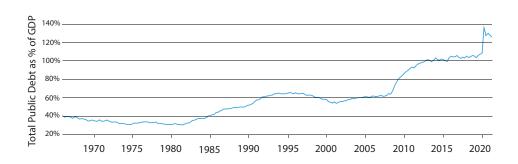
Back in 2001, Warren Buffett noted that the "market value of all publicly traded securities as a percentage of the country's business [i.e. the ratio of total Market Capitalization to Gross Domestic Product, (GDP)]... is probably the best single measure of where valuations stand at any given moment." The Wilshire 5000 is widely accepted as a benchmark for the U.S. equity market and is considered a measure of total Market Capitalization. The current ratio of the Wilshire 5000 to GDP is 204.02%, the highest measure since the index was established in the early 1970s.



- https://archive.fortune.com/magazines/fortune/fortune_archive/2001/12/10/314691/index.htm
- https://www.longtermtrends.net/market-cap-to-gdp-the-buffett-indicator/

Lots of Records! Debt-to-GDP Ratio

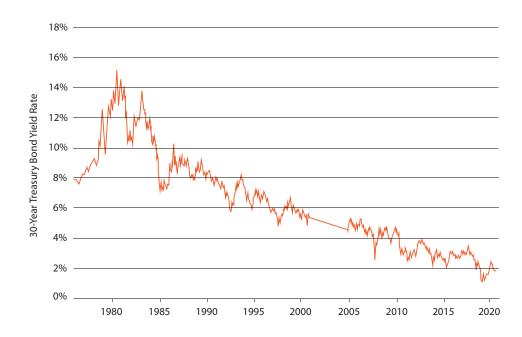
This measure compares what a country owes to what it produces. The higher the debt-to-GDP ratio, the more likely the country will fail to repay it lenders. This increased risk of default could cause a financial panic. A study by the World Bank found that if the debt-to-GDP ratio of a country exceeds 77% for an extended period, it slows economic growth. Total public debt as a percent of GDP peaked in the second quarter of 2020, but remains at historically elevated levels.



- https://fred.stlouisfed.org/series/GFDEGDQ188S, U.S. Office of Management and Budget and Federal Reserve Bank of St. Louis, retrieved from FRED September 22, 2021.
- https://www.investopedia.com/terms/d/debtgdpratio.asp

Lots of Records! U.S. Treasury Rate - 30-Year Bond Yield

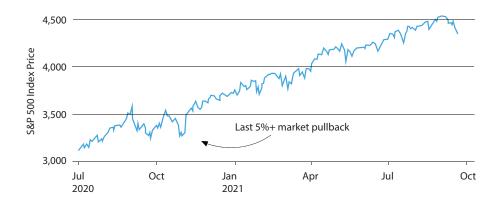
The yield on 30-year Treasury bonds hit an all-time low in April 2020 and remains at historically depressed levels.



Note: The U.S. Treasury suspended issuance of the 30 year bond between 2/15/2002 and 2/9/2006. Source: https://www.macrotrends.net/2521/30-year-treasury-bond-rate-yield-chart

Lots of Records! S&P 500 Record Highs

By September 2, 2021, the S&P 500 beat its record high for the 54th time this year. A sell-off on September 20, 2021 resulted in the index closing 4.1% below its new record high. The index hadn't fallen that far from a record since Oct. 2020, and achieved its longest stretch without a significant pullback since a 404-day run that ended on Feb. 2, 2018.



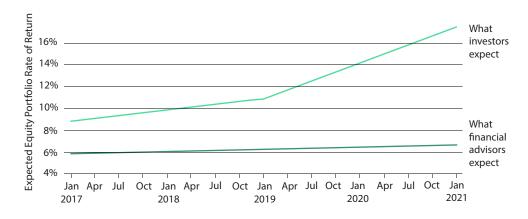
https://markets.businessinsider.com/news/stocks/stock-market-news-today-sp500-54th-record-close-of-year-2021-9

https://www.cnbc.com/2021/09/19/stock-market-futures-open-to-close-news.html

https://www.marketwatch.com/story/risk-of-hard-stock-market-valuation-correction-is-growing-says-deutsche-bank-heres-why-11631292209

Setting Reasonable Performance Expectations

To reach your financial goals, your long-term investment plan should consider long-term return expectations to help prevent you from saving too little or too much. An early 2021 survey by Natixis reveals that investors expect to earn 17.3% above inflation on their equity portfolios this year and average annual returns of 17.5% over the long-term. This contrasts sharply with the much lower performance expectations of advisors. The gap between investors' and advisors' expectations has grown in recent years.



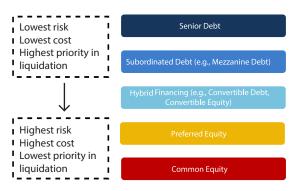
Note: Expectations depict average annualized returns above inflation.

Source: https://www.cnbc.com/2021/06/23/wealthy-investors-expect-to-earn-average-annual-returns-of-17point5percent.html

A Tour of the Capital (Structure)

A company's capital structure illustrates how it uses debt and equity to finance operations. Equity represents shares of ownership; stockholders share in the company's future profits, but they do not expect to be repaid for their investment in cash. In contrast, debt is borrowed capital, generally repaid with interest. Financing via debt tends to be easier to procure. Companies relying more heavily on debt vs. equity have a high leverage ratio and an aggressive capital structure (riskier for the investor). As in your personal investment portfolio, a more aggressive balance sheet can lead to higher growth rates vs. a conservative capital structure.

The capital structure is a stack of different types of equity and debt obligations. The example here is ranked by increasing risk to the investor, increasing cost for the company, and decreasing priority in a liquidation event (i.e., if a company goes bankrupt, paying back the senior bondholders gets first priority, while common stock holders are last in line).



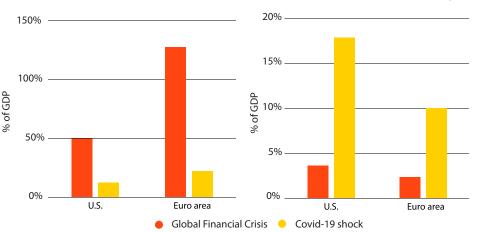
- https://pitchbook.com/blog/what-is-capital-structure-and-how-does-it-work
- https://www.investopedia.com/terms/c/capitalstructure.asp
- Image: https://scalefinance.com/capital-structure-what-it-is-and-why-it-matters/

Money Printing - the Current Scenario vs. 2008 - 2009

Earlier this year, BlackRock Investment Institute compared the amounts of economic loss and resulting government fiscal stimulus experienced during the 2008-2009 Global Financial Crisis (GFC) vs. the lost GDP and fiscal support during the Covid crisis. Their findings show that, despite Covid estimated to cause only 25% of the economic loss (as measured as a percent of GDP), the resulting fiscal stimulus by the U.S. and Euro area topped 4 times the amount put forth during the GFC. In other words, 4 times the amount of "solution" for a problem ¼ the size (from an economic perspective).



...but more than 4x the fiscal response



Source: BlackRock Investment Institute, with data from Haver Analytics, March 2021.

Note: The charts show BlackRock's estimate of the cumulative GDP loss from the GFC (2008-2009) and BlackRock's expectation for the Covid-19 (2020-2021) and the discretionary fiscal support for the US and euro area during each period.

Inflation Is Partly About Expectations

"Inflation is one of those behavioral things that, once everybody starts worrying about it, that's when inflation takes root."

- Julia Coronado, a former economist at the Fed

Former Fed Chairman Ben Bernanke has argued that the Fed's focus on anchoring inflation expectations has been the "most important factor over the long haul" in the behavior of price inflation. Inflation expectations matter because they can affect how businesses and people behave, in a bit of a self-fulfilling prophecy. Fed Chairman Jerome Powell noted, "If people believe that prices will be pretty stable, then they will be - because they won't ask for very high wage increases and people who sell things won't be asking for high price increases. Once that psychology sets in, it tends to perpetuate itself."

Sources:

- https://www.brookings.edu/blog/up-front/2020/11/30/what-are-inflation-expectations-why-do-they-matter/
- https://www.brookings.edu/product/explaining-the-inflation-puzzle/
- https://www.npr.org/2020/09/04/909590044/transcript-nprs-full-interview-with-fed-chairman-jerome-powell

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