



HIGHTOWER

FARR MARKET COMMENTARY

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Angered by Facts

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There is a running group conversation on Twitter during every live TV program including the CNBC shows. All sorts of people react in real-time to whatever pundits and talking-heads have to say. The comments are positive and negative, but the negative comments are often scathing and inappropriately personal. I was on *Halftime Report* for an hour this Tuesday and was called wise, old, too negative, an idiot, and the only guy worth listening too on CNBC! My thanks to the kind folks. Consistent among the comments has been criticism of negativity and especially those who suggest a recession may be likely.

With so many emotionally charged issues in the headlines, I find myself more desperate for facts, and facts seem even more elusive in emotion-charged opinion pieces masquerading as journalism. This bias has been ever-present in the investing world. Buyers magnify the positives and sellers isolate the negatives. Focusing on positives *or* negatives make decision making much easier. Focusing on, and weighing both, simultaneously is much harder and, of course, necessary.

Benjamin Graham and David Dodd wrote *Security Analysis* in 1940. It remains the bible of fundamental, long-term investing and is the foundation for Warren Buffet's entire discipline. Long-term fundamental investors want to buy businesses that make money, are increasing profits, are growing sales, have strong cash flow, have limited debt, and have barriers to entry for potential competitors. They eschew fads and popular manias like crypto currency that have none of the former attributes. They tend to be a bit boring too because they won't invest in new, hot companies before they are profitable, and some of those new companies turn into gang-buster successes. Graham, Dodd, and Buffet are content with waiting to see the numbers and foregoing the initial price surge. They may have been among the first folks in investing to say, "Show Me the Money!"

Just because someone tells you how much money they have made in Bitcoin, doesn't mean it's appropriate for you or that you should buy it. One of our rules for investing is that we have to understand how a company is making its money. This rule kept us from buying Enron 20 years ago.

I chose the title, "Angered by Facts" because the facts may be unwelcome and may make TV viewers angry, but responses be damned, the facts support an increasingly difficult operating environment as the Federal Reserve continues to increase the cost of money in order to tame inflation. Period. Nine of the previous thirteen Fed tightening cycles have resulted in recessions. According to BCA Research, an inverted yield curve (when shorter term treasury bills and notes yield more than longer term) between the 2-year and 10-year treasury has occurred in 7 of the last 8 recessions while an inverted gap between the 3-month and 10-year yields has occurred 8 out of 8. The 2-10 spread has inverted, the 3-month to 10-year has not. The US economy is driven about 68% by consumer spending, and the consumer is facing higher and higher prices. If they are spending all their money on food, rent, and gas; they don't have any left over to drive extra demand. Like it or not, the facts support the likelihood of a recession.

Recessions are not fun, but they are not the end of the world. Investing based on sound fundamentals, avoiding emotion and hubris and having a clear investment discipline and strategy allow investors to endure tough times and enjoy brighter days in the future. The average market decline during a recession is about 30%. While it could drift lower than the average, our recent low was down 24% for the S&P 500. Much of the pain is already behind us.

Finally, the other wish I'm hearing is that all of this down-turn stuff just be over and done. Sadly, there isn't a way to schedule or rush economic cycles or the market's response. Patience, discipline, and dispassion are the navigational keys. Enjoy the summer. Turn off the tv. Try not to worry too much. My grandfather used to tell friends not to worry and that he would do the worrying for them. Please know that I fell close to his roots and will be worrying for you. We are at our desks every day following our companies, studying earnings, looking for opportunities, and talking with clients. Call us if we can help in ANY way.

Peace,

Michael

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