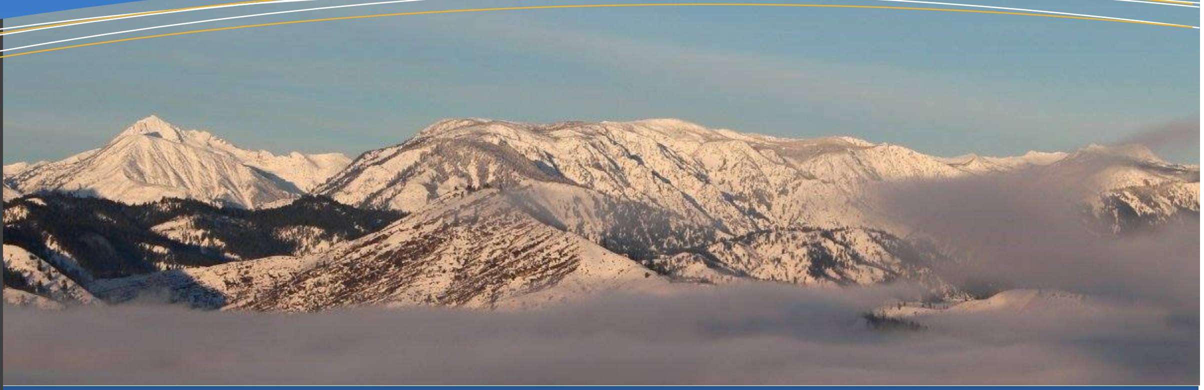
Financial Wanderings

December 2020

A masterful examination of the previous month's financial events, written by Brad Blackburn, CFP ®
(and made even awesomer by Andrea Dickerson)



Brad Blackburn, CFP ®

Financial Advisor
Blackburn Financial
121 Cottage Ave
PO Box 775
Cashmere, WA 98815

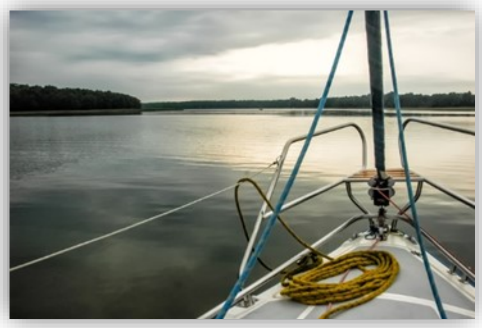
509-782-2600

brad@blackburnfinancial.net

What can stop the stock market?

Just before the pandemic, I wrote a terribly timed article entitled "nothing stops the stock market." Of course, stocks promptly took one of the steepest, deepest dives in history, and I had a good laugh at myself (while also crying a little). However, that article looks a lot better in hindsight. At the moment I'm writing this, the S&P 500 is up more than 15% in 2020. If a global pandemic and one of the worst recessions in history couldn't keep the stock market down for more than a couple months, what will?

While I do think the stock market is a little too enthusiastic, there are many reasons to be optimistic. News of highly effective vaccines is the most important reason for optimism, but the election brought good news for the stock market too. Under a divided government, gridlock is likely to reign. That means the Trump tax cuts won't be reversed, and the big tech companies aren't as likely to be hassled. On the trade war front, while high tariffs with China are likely to remain, the trade war will be waged much less chaotically. Finally, the Fed is committed to keeping interest rates low even if inflation finally starts to rise.



A favorite axiom of the financial world is "the stock market hates uncertainty." If that's true, it explains the optimism in the markets. If there's one thing we gained over the last month, it's certainty. Of course, the news isn't all good. The pandemic is growing, shut-

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(What can stop the stock market?..........................Cont. from page 1)

downs are here again, and the economy is slowing. Further, we haven't experienced lockdowns without the government shoveling trillions of dollars into the economy – which isn't likely to be repeated anytime soon. So, the coming months might be hard. However, even if we fall into another steep recession, the stock market may ignore it because promising vaccines are merely months away.

At this point, I'm not sure what can slow down the stock market. However, times like this are often when stocks surprise investors. In the same way that the best time to buy stocks is when there's "blood in the water" (March 2009 for example), the best time to sell stocks is often when the water is calm and beautiful. That's certainly not a recommendation to sell all your stocks and hide the money in your backyard. But investors should keep their guard up and not get complacent – especially when the future looks rosy.

Desperately seeking inflation

Since the 2008 financial crisis, predictions of high inflation have been rampant. While those predictions have proven wrong, they made perfect sense. After all, the government was aggressively stimulating the economy, the Fed was printing money, and the unemployment rate was falling to historic lows. Those are precisely the things that are supposed to cause inflation – yet, we haven't seen it. We've been having our cake and eating it too, and now, during the Covid Crisis, we're eating the entire bakery. Will we ever pay the price for our gluttony?

There are many theories as to why we haven't seen inflation. The most compelling is that we are living through a time where technology and globalization are rewriting the rules of economics. Between new technologies and an inexpensive global workforce, there's always a way to make something cheaper. If one business boldly tries to raise its prices, its competitors are ready and willing to undercut them. It's hard to get inflation when businesses can't raise prices.

Inflation isn't all bad. In fact, the Fed has a goal of 2% average inflation. The most important reason policymakers want a little bit of inflation is to give us a cushion against deflation. Deflation actually sounds pretty good: "Prices on everything going down? Sign me up!"

The problem is the economy can fall into a "deflationary spiral." When prices go down, people naturally wait to buy things. Why buy that cool new gadget today when it's going to be cheaper in a few months? But, when everyone stops buying stuff, that means less demand, which makes prices go even lower, which causes people to spend even less… That's the deflationary spiral, and it's hard to escape.

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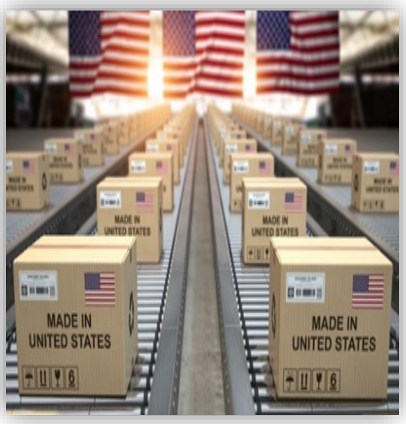
(Desperately seeking inflation……………………….Cont. from page 2)

While a little bit of inflation may be helpful, a lot of inflation is not, and that can be a tricky thing to balance. At some point, all of this government stimulus may finally cause inflation to spike, but that's not the only inflationary risk. If one of the outcomes of Covid-19 and the trade war is that we'll manufacture more stuff right here in America – that could also mean higher prices.



So, the Fed wants more inflation, but not too much, and definitely not deflation.

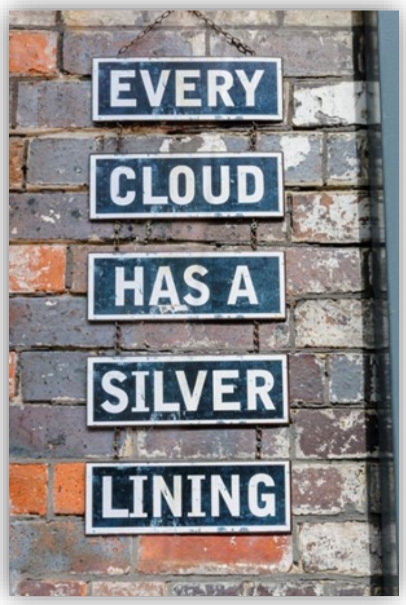
In recent years, we've walked that delicate line successfully, but it may become more difficult in the future.

Does this count as a recession?

Although the Covid recession was the deepest since the Great Depression, there may be a silver lining. Economists generally agree that recessions, while painful at the time, can lead to a healthier economy over the long term. A recession can work like pruning a tree. When you cut the least productive branches, more productive branches can flourish.

In the same way, when the least productive businesses fail, it clears the way for the more productive businesses to grow and flourish – and we're left with a healthier economy that can grow far beyond the glory of whatever the pre-recession economy was.

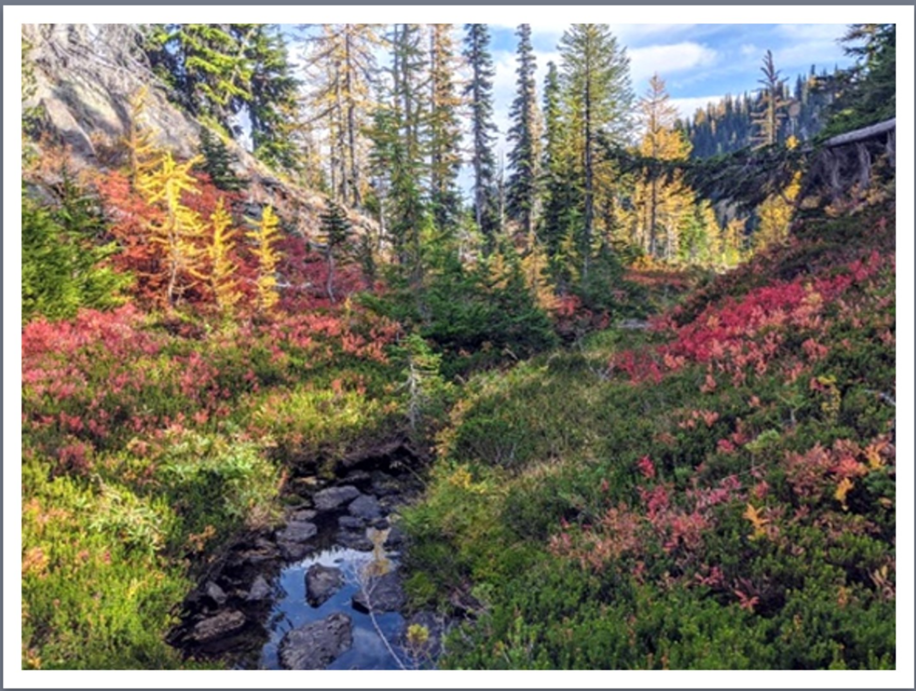
Remember that before Covid, this was the longest stretch in modern history without a recession. Historically, recessions tend to occur every 6-7 years. If we've got that whole "recession thing" out of our system for a while, that would be a very positive thing for stock market investors.

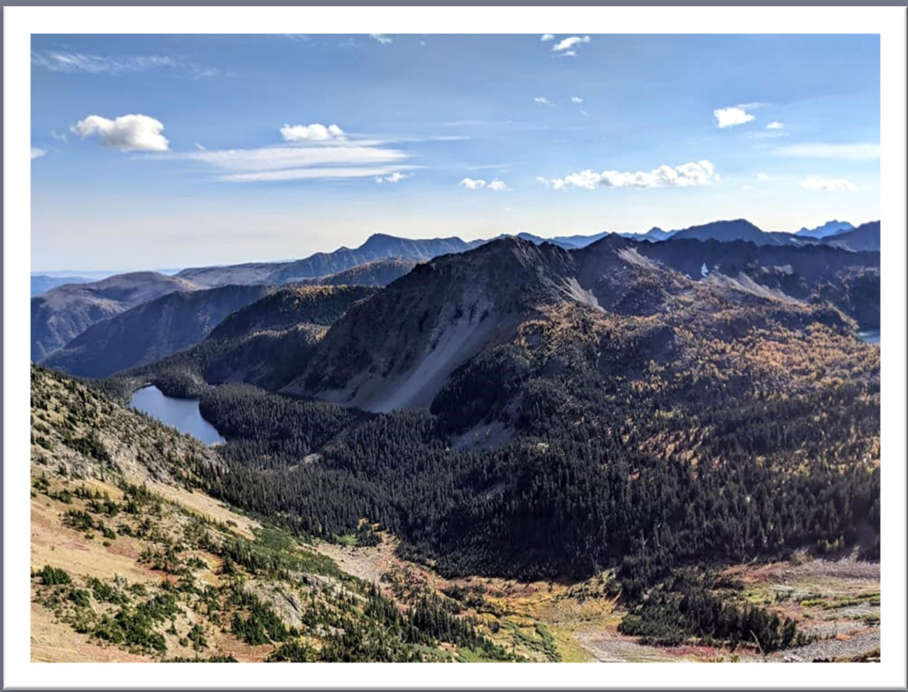


However, this has not been a typical recession. Far from pruning the weakest branches, we've propped them up with trillions of dollars in stimulus. All of that stimulus clearly helped make the recession less bad, and the recovery stronger. But it may not set the stage for another long stretch of economic growth the way a typical recession can.

Probably a mountain or a lake

Beautiful fall colors in the Chiwaukum Range near the Scottish Lakes High Camp





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