November 19, 2024

Dear Client,

Re: **November 2024 Newsletter and December 2024 Conference Call**

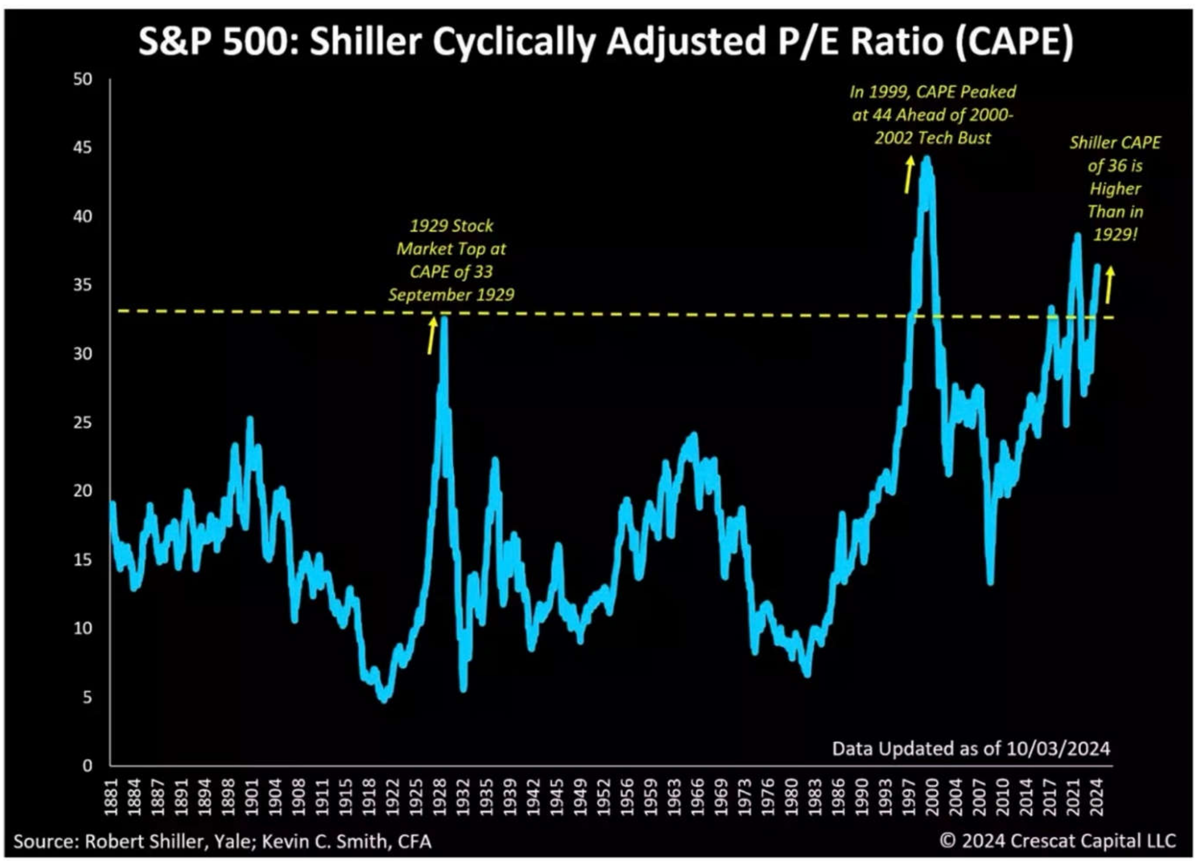
SEA of LOVE

This year has been a good year for stocks, especially for the broad market in contrast to last year when 7 stocks largely led the S&P 500 Index.[1] However, in the true sense of your wealth, one year isn't as important as it is the long term. In other words, one up year in the stock market pales a poor comparison to one year of a tremendous downturn.

Deutsche Bank published a report today that delivered a dose of perspective for those who forgot their stock market history and are getting overly excited by this rally.[2] The report looked at the past 25 years and coincidently, I have said the same thing to you when we have met to go over your account.

Since stocks have had a good year, I would like to remind everyone it hasn't always been this way and this is why we diversify our portfolios. As chart 1 illustrates, the U.S. stock market valuation (CAPE ratio) is higher than in 1929, but slightly under the valuation of the dot com crash in 2000.[3] Nonetheless, based on this valuation measure, the stock market appears to be very expensive and may be one reason why Warren Buffett is reducing his stock exposure.

Chart 1: Schiller Adjusted Valuation Guage



When George W. Bush was the 43rd President of the United States, the U.S. Government budget deficit was running at approximately $250B per year. Today, it is running approximately $1 trillion every 6 months with an outstanding debt load of $36 trillion and counting.[4]

Under President Bill Clinton, the budget was in surplus, even if it was for a short period of time. The problem with budget deficits is threefold. One, they must be paid back, but it is seldom that governments ever do that. Rarely do governments default on their debts, although Argentina and Russia did, but instead they inflate their way out of it. The best example of this in modern history is the Weimar German Republic that inflated their massive war reparation debt owed to the allies after World War I. Second, large government borrowing crowds out private sector borrowing, making it more expensive for companies and individuals to borrow. Since the U.S. Federal Reserve cut interest rates ½ of 1% in the summer of 2024, long term interest rates as measured by the U.S. 10-year Treasury Bond increased to 4.6% as did the 30-year mortgage rate almost reaching 7% once again. Third, large deficits most likely push inflation up, if you believe the late Milton Friedman who said that inflation is a monetary phenomenon.

In my opinion, high government spending in the past few years is largely responsible for the increase in stock prices because government spending props up the economy. Inflation can be found in goods and services, but also in stocks and real estate. For example, if you bought your home for $500,000 and now it is worth $1,000,000, isn't at least a good amount of the price increase inflation? If you sold your house and bought another one, you would get an equivalent home for the same amount of money that you sold yours. That too is inflation. Inflation makes you think that you are richer, but you are not.

Globalization under President Clinton hit a high mark for the American economy and has since declined with increased protectionism, especially between the United States, China, and Europe. Globalization brought in an era of low inflation with the importation of cheap manufactured goods from China and Asia. Now that globalization is virtually dead, inflation may begin to rise once again over the long term.

Most people think that the 2000 dot com stock market crash was caused by what former U.S. Federal Reserve Chairman Alan Greenspan termed “irrational exuberance” or an overvalued stock market, when in fact the stock market crash was the result of an economic shift in the global economy that was affected by deglobalization and improvements in technologies.

One must remember that there are stretches of time in which the stock market does not do very well. For example, the technology index (QQQ) took 13 years to recover after the decline in 2000 (See chart 2).[5] Although the S&P 500 (SPY) performed better than the QQQ after the dot com crash, it took 8 years for the S&P 500 to break even from the year 2000. The 1970's was a poor period for stocks as well.

Chart 2: High Technology Index (QQQ) 2000-present

Source: Big Charts

Chart 3: Standard and Poor's 500 Index (SPY)

Source: Big Charts

Markets don't go up forever. Although people remember the good times for the markets, they rarely remember the down periods. It is just too painful. Yet we have had several years of declines in 2000, 2008, 2009, 2015, 2020, and 2022 which have left the historical returns of the market rather muted.

Below is a table of the most widely used indexes from the year 2000 to year-to date (YTD). As you can see, returns are quite different from the past two years because from time-to-time, markets have declined significantly

Table 1: Various Market Annualized Returns From 2000-YTD

100% All Country World Index	7.21%
Dow Jones Industrial Averages	8.63%
Bloomberg Aggregate US Index (bonds)	3.69%
Nasdaq Composite	9.91%
Russell 2000 (Small caps)	8.46%
S&P 500 Index	8.60%

Even with the inevitable stock market downturns, there is a case for staying the course with a reasonable number of stocks. If inflation becomes a major issue, stocks may help solidify purchasing power much better than bonds will. Periods of extremely high inflation are unkind to both stocks and bonds, but much less so to stocks. The 1970's and early 1980's are a perfect example of this when inflation was overheating.

My Take on Bitcoin and Gold

Since Donald Trump won the presidential election, Bitcoin has been on a tear. At this juncture, Bitcoin is at a tipping point and is becoming quite acceptable in the investment community and with the investment public.[6] The reason is simple: The trend of the global deficits, increased government spending, and associated increases in the money supply make Bitcoin one the hardest forms of currency. After all, the world is on a fiat standard (paper money) backed by nothing, and the value of the currency depreciates every year. However, Bitcoin, like gold, can only be minted in a restricted quantity. Therefore, Bitcoin and gold are stores of value.

Chart 4: One Year Performance of Gold via the GLD Exchange traded fund

Source: Big Charts

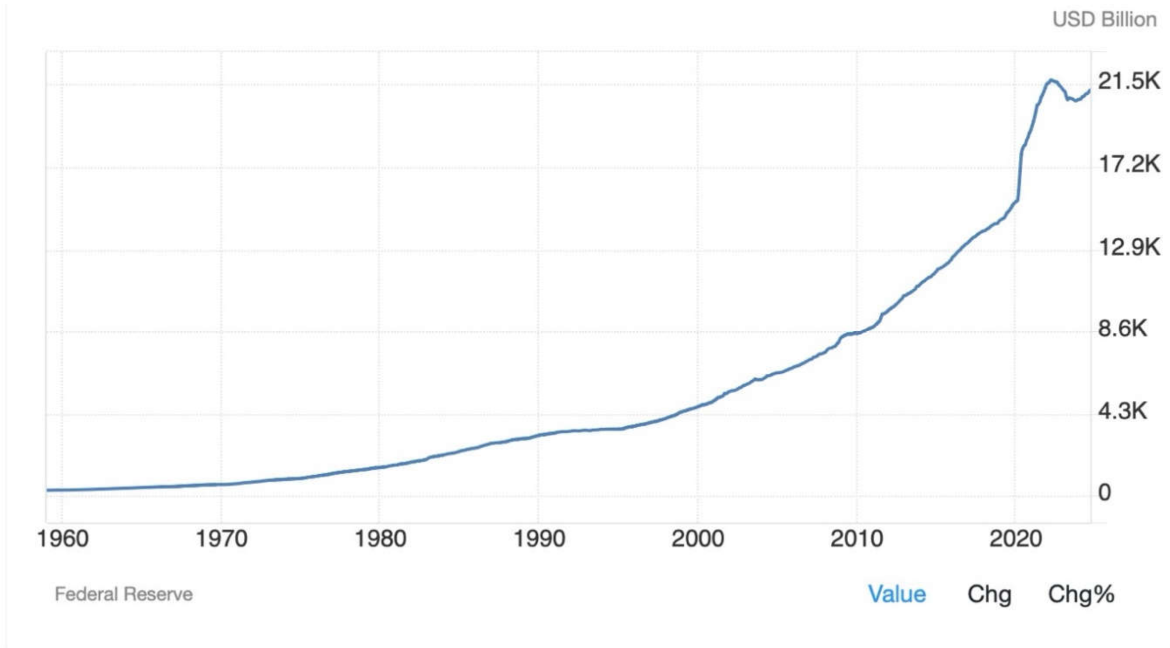
Chart 5: Bitcoin Performance YTD 2024

Source: Big Charts

When an asset class is near its top, many assume that it's too late to buy and the opportunity for investing is gone. In some cases, this is very true, but in others this is patently false. At times, rising or declining prices are signaling a change in the fundamentals and in this case, I am of the opinion, that the rise in Bitcoin's price is due to the inflationary impact of the U.S. Government deficit.

During the COVID-19 pandemic, the government spent over $3 trillion keeping a massive economic downturn from occurring. However, large deficit spending is still occurring within a strong economy although the pandemic is over. The deficit has reached over $7 trillion in the past four years and $1.86 trillion in 2024 alone. The interest on the borrowed money alone assures that the deficit will be running $2 trillion per year for the foreseeable future. Deficits require printing more dollars to cover the borrowing. As the money supply grows to support the deficit, the dollar decreases in value in relation to Bitcoin and Gold which are fixed and have limited supply.

Chart 6: United States Money Supply as Measured by the M2



With the continual printing of money, it is no wonder that inflation is so sticky and that the U.S. Federal Reserve will have trouble, as other central banks, in dramatically lowering interest rates.

Gold and Bitcoin are stores of value when compared to the purchasing power of the dollar because their purchasing power increases as the purchasing power of the dollar decreases. The U.S. Dollar has lost 98% of its purchasing power since 1971, while gold on average has increased roughly 10% per year.[7]

Bitcoin has a similar scarcity value like gold, but it is digital. Both Bitcoin and gold are volatile, and it may not be the best time to jump in. However, there is no doubt that deficit spending, government mismanagement and inflation could make Bitcoin one of the global hard currencies. Although our firm, BFSG, views cryptocurrencies as speculative, in my personal opinion, it seems that having a reasonable allocation to Bitcoin when the time is right could make sense.

Gold offers a counter cyclicality hedge to a decline in stock prices, in some cases. We will be reducing our US stock exposures shortly and add gold miners and gold. Other than that, we are staying the course but will make changes as conditions dictate.

Chart 7: Countercyclicality of Gold Stocks and Gold

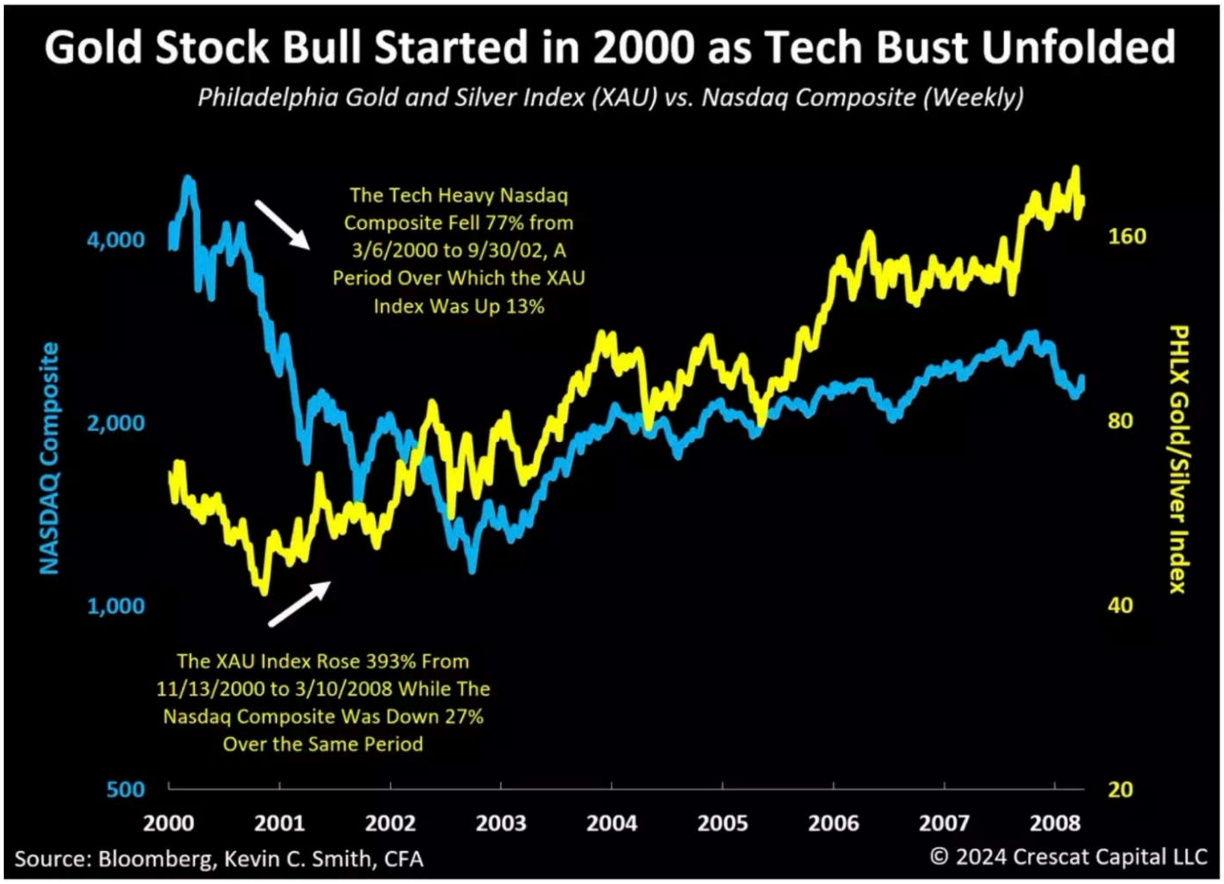


Chart 8: Gold and Gold Mining Stocks Hold Up During Turmoil

As you may know, Steve Novikoff has decided to retire at the end of 2024 after over 40 years of incredible service and work. We want to thank him for his dedication, hard work and professionalism and we will miss him. For those of you who use Steve and you need a referral for another tax preparer, please feel free to call myself or Arash and we can give you a few names.

Please join us for our upcoming conference call (please see details below) when we will discuss the potential outcomes and fallouts that could affect the economy and the stock market from the recent elections and our roadmap for investing.

Our conference call will be on **Tuesday, December 3rd at 6:30 PM**. We look forward to seeing you there!

Please click here to join the Conference Call.

Or Telephone: 1 (720) 707-2699
Webinar ID: 955 8799 7509
Passcode: 388235

International numbers available: click here

Best regards,

Steve Yamshon, Ph.D.
Managing Principal

Footnotes:

1) The S&P 500 Index is designed to be a leading indicator of U.S. equities and is commonly used as a proxy for the U.S. stock market.
2) Source: Deutsche Bank, "Lessons from the 1st Quarter Century of the Millennium" (November 2024). The report looks at asset returns and economic data from across the world stretching back over 200 years in places. The first quarter century (QC) of the 2000s is set to be the second worst in real terms for U.S. equities out of nine QCs since 1800, and the first one where they've under-performed Gold (+6.8%).
3) The CAPE is a cyclically adjusted PE based on a rolling 10yr inflation adjusted earnings series rather than spot or forward earnings.
4) Source: FiscalData.Treasury.gov. https://fiscaldata.treasury.gov/americas-finance-guide/national-deficit/
5) The Nasdaq-100 Index is U.S. stock market index comprised of the largest 100 non-financial companies listed on the Nasdaq stock exchange. The index is dominated by technology companies and is commonly used as proxy for U.S. large cap technology performance.
6) Crypto is a digital currency that can be used to buy goods and services, but uses an online ledger with strong cryptography (i.e., a method of protecting information and communications with codes) to secure online transactions. Unlike conventional currencies issued by a monetary authority, cryptocurrencies are generally not controlled or regulated, and their price is determined by the supply and demand of their market. Investments in cryptocurrencies involve various risk factors, including, but not limited to, liquidity constraints, operational and execution risks, and potential for extreme price volatility and complete loss of investment. BFSG currently considers cryptocurrencies to be speculative.
7) Source: https://watcher.guru/