STOCK THINK TANK

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BOB IACCINO

Bob Iaccino has spent nearly three decades in the markets trading commodities, futures, forex and equities. He got his start on the floor of the Chicago Mercantile Exchange. He went on to Smith Barney, Germany's Commerzbank, and soon became a chief market strategist and risk manager. Bob ran his own commodity pool, invested in a fund of funds as a principal and member of the investment committee and later worked for a boutique oil-trading firm. In 2015, Bob and his partner Mike Arnold founded Path Trading Partners. Bob and Mike launched The Stock Think Tank to help investors learn how to properly balance risk and reward in their personal stock portfolios.

A Bear Market in Sh*t, A Bull Market in Quality

Our core portfolio does not have Bitcoin in it and we have no plans to own it. But let's talk about it for a second. Follow me here.

First, let me go into what triggered this. Coinbase went from being the number one downloaded app to the number 300 downloaded app in the App Store. On July 15th, Jackson Palmer, is the founder of Dogecoin, essentially called cryptocurrencies a fraud on Twitter.

One part of the thread said, "After years of studying it, I believe that cryptocurrency is an inherently right-wing, hyper-capitalistic technology built primarily to amplify the wealth of its proponents through a combination of tax avoidance, diminished regulatory oversight and artificially enforced scarcity."

Palmer went on. "Despite claims of 'decentralization,' the cryptocurrency industry is controlled by a powerful cartel of wealthy figures who, with time, have evolved to incorporate many of the same institutions tied to the existing centralized financial system they supposedly set out to replace," he wrote.

Now, why does that matter for what we talk about in this newsletter? I'm not sure that it does, but it pushed me to look at some other things.

Let's go with Bitcoin as a proxy for crypto. Bitcoin fell 56% from it's all-time high. A bear market is defined as a drop of 20% or more from a recent high. So 56% surely qualifies.

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That led me to look at **GameStop (GME).** GameStop fell 66% from its high. **AMC Entertainment Holdings (AMC)**, the movie theater chain, fell 53% from its high.

This struck me as similar to the blowing up of the tech bubble in the 2000s. A few stocks blew up first, but the rest of the market continued higher for a couple of years. Speculators continued to push a market upward but market breadth seems to be turning negative, at least for now.

As Investopedia.com explains it "market breadth refers to how many stocks are participating in a given move in an index or on a stock exchange." So, that means many stocks are rising when the overall index is rising, and vice-versa.

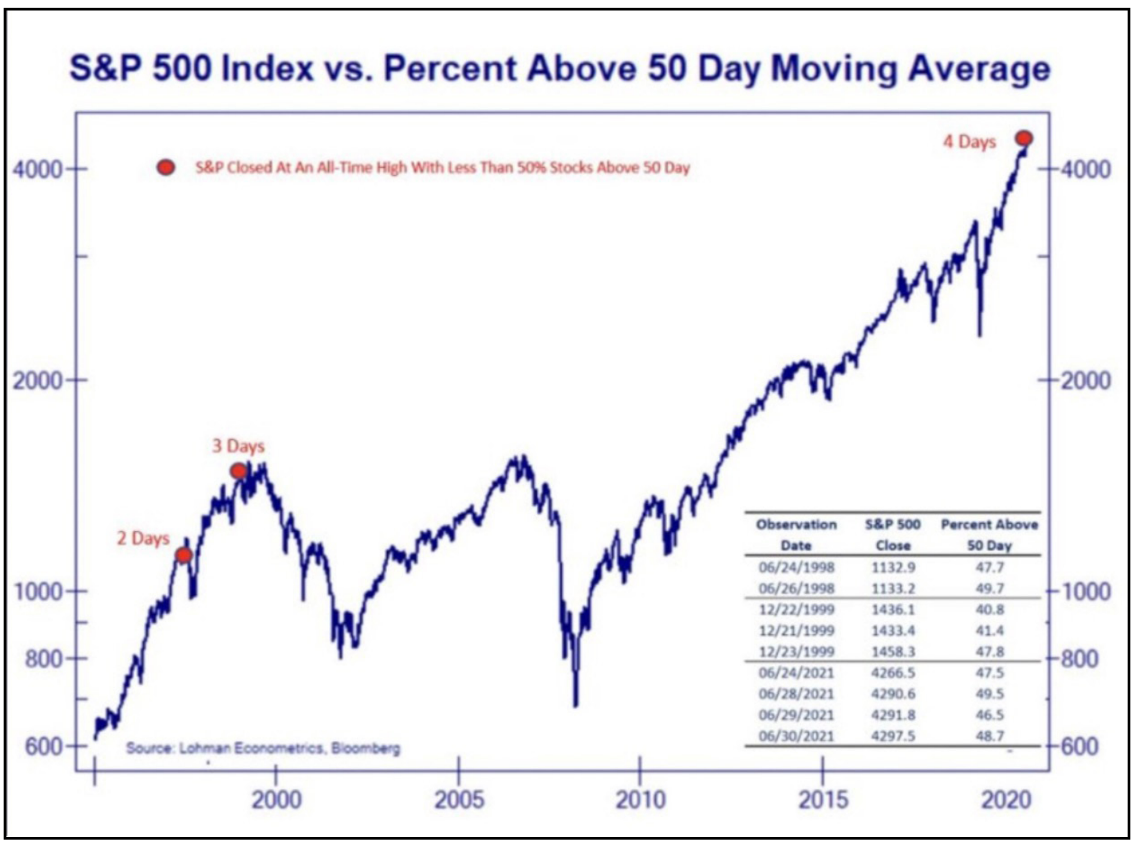
Let's take the S&P 500 for example. If the S&P is going to new highs, yet it's being driven by just 12% of the stocks in the index, that's poor market breadth. Rather, you want to see the majority of the stocks rising when the index is making highs. That's a healthy market.

We're not seeing that. As a matter of fact, the S&P 500 recently made new all-time highs with less than 50% of the stocks in the index above their 50-day moving average. That's only happened nine times since they've been tracking it.

Again, it's not a sell signal, but we are starting to see some weakness. We're starting to see it in the preliminary earnings, where the banks for the most part are producing blowout earnings per share (EPS) yields and pretty good revenue yields, yet their stocks fall, at least initially.

Now, that could be because yields were falling at the time. We're still seeing signs of stronger inflation, and that inflation that may not be transitory, as the Fed is predicting.

The consumer price index (CPI) inflation again beat expectations. The producer price index (PPI)



Observation Date	S&P 500 Close	Percent Above 50 Day
06/24/1998	1132.9	47.7
06/26/1998	1133.2	49.7
12/22/1999	1436.1	40.8
12/21/1999	1433.4	41.4
12/23/1999	1458.3	47.8
06/24/2021	4266.5	47.5
06/28/2021	4290.6	49.5
06/29/2021	4291.8	46.5
06/30/2021	4297.5	48.7

also beat expectations this month, showing that there's not really any relief in the input sector of the manufacturing economy. This is all before any significant sign of wage increases, which we are now seeing.

Companies are actively competing for employees because of the scarcity of employees. Seventy percent of inflation is made up of wage inflation, which is why we have not seen inflation for basically the last two decades — because real wages really haven't kept pace with GDP.

However, when you give somebody a raise, you generally don't take it back. A pay cut leads to a disgruntled employee who quits.

So how does Bitcoin, market depth and inflation getting a foothold through wage inflation all connect to what we do? In short, I think it means we have another year-and- a-half of a bull market, which is probably not the way you expected me to connect those dots.

Maybe this qualifier will make it easier to understand. I expect another 12 to 18 months of a bull market in the kind of investments we like at **Stock Think Tank.**

Confused? Maybe this will help.

The Fed thinks that inflation, which is higher than the Fed had expected, is going to be sustained for a bit longer before it drops. This was made clear at the June Fed meeting and at Fed Chairman Jerome Powell's semi-annual testimony before Congress in July.

I disagree because of the wage component. But I believe there's going to be a bull market in high-quality stocks because you're starting to see what I would call "a bear market in shit" — basically, crypto and meme stocks.

GameStop is in a bear market. AMC is in a bear market. Bitcoin is in a bear market. Tesla is another one, down 27% from it's all-time high. That's a bear market.

Not everything is in a bear market, however, and as a matter of fact most stocks are not. Many are not even in correction territory, which is down 8% to 10% from a recent high.

But shit is in a bear market now. It's already there. People aren't noticing because the indexes are making new all-time highs, but garbage is in a bear market now. That to me leaves us with the potential for the rest of it to be pulled down by the weight of that garbage, and that does generally happen. It did in the 2000s with dot-com stocks. Eventually.

Old Economy

So why do I think **Stock Think Tank** type stocks will continue higher? Because monetary policy run by the Fed and fiscal policy run by Congress is all about printing money and putting it back into the economy. When the government puts money in the economy, it doesn't go into GameStop and it doesn't go into AMC. It goes into the companies that donate to campaigns. It goes into the old economy.

Now, it might indirectly go into a company like Tesla because of potential green subsidies in the infrastructure bill, which we haven't seen yet. Some of it might go into stocks like EV automakers and solar companies. But it's not going to go into the sh*t stocks, it's not going to go into sh*t coins and it's not going to go into Bitcoin, either.

Understand, when I say "go in to," I don't mean the government buying stock. Rather, I mean the government supporting certain industries through spending. Look, if a government contract goes out to build bridges, it's probably going to **Caterpillar (CAT)**, which is the kind of stock we would look at. If they're buying a missile-defense system, it's going to **Lockheed Martin (LMT)** and **Halliburton (HAL)**, both stocks we have held recently in our core portfolio.

Wage increases mean inflation is actually starting to pick up steam. It's called "wage-push inflation" and it happens when wages start to increase and businesses must charge more for their products or services in order to pay those higher wages.

So how does that lead to a bull market in quality stocks? Wage-push inflation can cause an inflation spiral as people go out and spend their increased pay.

Inflation is fine as long as the wage cycle continues to go up as fast or faster than the inflation cycle. Something the government can do to offset that is individual subsidies, such as the stimulus payments or universal basic income through the tax code, which is starting with the child tax credits now coming monthly to many Americans. It's not sustainable but it can provide temporary relief, though it does nothing to slow inflation.

That's what they've been doing so far. I suspect, given that we have a Democratic Congress and Democratic president, that it's likely to continue in some way, shape or form.

What historically kills bull markets is the Fed raising interest rates to slow down the economy and slow demand. To get people saving rather than spending. Inflation is here, so people's ability to afford things is going to ebb away. They're starting to get wage increases to offset inflation, but at some point prices outrun people's ability to pay. That's when the Fed steps in and raises rates to cool the economy off.

But they're not doing that and they're actively saying they're not going to do that anytime soon. I don't think runaway inflation is permanent, but it's not transitory, either. Let's call it longer-lived than the Fed thinks.

The Feds should be looking at raising rates and pulling back asset purchases so that inflation doesn't get out of hand. I'm not talking about runaway '70s inflation. I'm talking about consistent inflation above 2% that causes people to go in and say, "I need a raise. I can't make it anymore week-to-week."

Right now, 60% of millennials earning more than $100,000 say they're living paycheck to paycheck. Another report says there's nowhere in the United States that a person earning minimum wage can afford rent. Nowhere.

Rent is part of the inflation component. One problem is that the policy of forcing increased minimum wages, which is really what extending and augmenting unemployment payments does, means people are making $3,000 a month to stay home compared to making $2,500 a month at their restaurant job.

Of course they're going to stay home. Hell, even if they were making $3,200 a month at their restaurant job they're still going to stay home for $3,000. Restaurant work is tough.

I know some people who collect unemployment and do small projects. One woman was a waitress where my wife used to work. She is doing proofreading for people on the side for cash and collecting unemployment benefits. When you combine the unemployment benefits and the tax-free proofreading cash she is making, she is much happier sitting home with her multiple cats vs. waiting tables.

The point is, inflation alone isn't going to stop the bull market because the way that inflation stops a bull market is when the Fed tightens to control it. Companies don't pay rising costs, we do. And as long as we are doing it, companies that make money and are publicly traded will trade higher.

Stocks I'm Watching

We had asset inflation before we had price inflation. Asset inflation is equities and housing. I would argue that "inflation" actually goes on the positive side of the ledger for a bull market.

Inflation actually helps stocks until the Fed comes in and tries to stop inflation. Now that I've made my case for inflation over the last couple of newsletters, I'm going to start making my case as to why we're going to be invested in quality stocks during an inflationary period as opposed to getting defensive.

Often, that means owning stocks we've bought and sold in the past: Home Depot, Disney, Lockheed Martin, Microsoft, 3M, CVS, Progressive, UPS, Ford, Tractor Supply Company, Target, Best Buy, Dollar General, Remax, Big Lots.

Electronic Arts is actually a solid company from a balance sheet perspective. Constellation Brands, Kroger, Booz Allen Hamilton, Foot Locker, Allstate, Canadian Pacific, Accenture, Check Point Software, Regeneron, Apple, Intel. Those are all quality stocks. We will stay away from stocks such as Tesla because of the volatility.

In the month of May, we actually underperformed the S&P 500. We were down 81 basis points (0.81%) and the S&P was up 65 basis points (0.65%).

But I almost look forward to a month of underperformance. This is a strange but common mindset that comes from being a trader for as long as I have. We were on a massive winning streak with seven months in a row of positive performance and in six of those we beat the return of the SPY. When that happens, I actually start to get nervous.

I almost want a down month. Strange as that might sound, I'm almost looking forward to one because then we can start a new winning streak. It makes more sense when I say it this way: I like the beginning of a win streak much more than I like the end of a win streak.

In terms of simple math, we are now up 39.88% through June and the SPY is up 13.82%. We're returning right around three times the S&P 500 without being in any high-volatility names.

So I expect a continuation of the bull market in quality stocks. Look at solid stocks, take a good-sized position and control your risk — because there will be an epic collapse, based on what's going on. I expect a 2001 bubble-type of collapse, and it was the sh*tty stocks that started falling early in 1999 and 2000.

Nevertheless, the bull market went on for some time after that.

So the sh*t stuff is already in a bear market but the rest of the market has yet to follow, so we are going to continue to buy high quality socks. This is going to be a good time period for us to expand the lead we've developed over the SPY since January,

In terms of watchlist stocks, **Ford (F)** is going full into autonomous and electrification. compared to other U.S. car companies, they are taking a big swing. But it's not even that. I know some people that own some major Ford truck dealerships, both commercial and retail.

One of the guys said to me that this time of year usually has about 125 trucks on the lot. He's got four right now. The reason is mostly the chip shortage, but also a general shortage of most components. He also said they are preparing for a "substantial" price increase to consumers.

When those materials shortages end, the explosion of sales is going to drive earnings. I still like **UPS (UPS)** because of the reopening and people actually going shopping, and I think their gains from the pandemic are permanent.

Aptiv (APTV) is an autoparts name and I like auto parts right now. I also like **O'Reilly Automotive (ORLY)** because of the car shortage. When people can't buy new cars or used cars they tend to try and get their old car to last a little bit longer which means that auto parts companies do well. I still like the longer-term story of stocks like **Uber (UBER)** and **Lyft (LYFT)**, because I think they're going to come back gangbusters as the economy continues to reopen.

I like but you won't see that in our core portfolio. And yes, over the next few days, stocks such as Disney, Lockheed Martin, CVS, Walmart, will get a look, and will be bought as soon as the price action allows.

—Bob Iaccino