February 1, 2022

VICTORIA Capital Management, Inc.

Market Musings

A newsletter brought to you by Victoria Capital Management, Inc.

VOL. 5, ISSUE 2

The January market decline is not unusual after a lengthy rally in stocks. Such declines not only shake out speculators but long-term investors who cannot stomach short-term gyrations. Often these investors will never get back into the market and never achieve their long-term goals. The chart displays the largest crashes in history over a 16-day period.

Event	Decline
Wall Street Crash of October 1929	-33.6%
Black Monday October 1987	-31.3%
End of Gold Standard October 1931	-26.7%
Lehman Crisis November 2008	-25.2%
World War II May 1940	-24.6%
COVID-19 Outbreak March 2020	-20.7%
Dot.com Bubble July 2002	-19.3%
Post-World War II Demand Shock September 1946	-16.9%
U.S. Debt Downgrade August 2011	-16.7%
Great Financial Crisis March 2009	-13.8%
Long-term Capital Management August 1998	-8.7%

A Negative Turn in Equity Markets

Equity markets got off to a rough start in January as speculators covered margin calls, hedge funds met redemption requests and several high-profile exchange-traded funds faced huge outflows – all requiring the fire sale of equities. We have written about the speculative risk for years and January was the beginning of this phenomenon. The boom in the stock market really started in mid-2020 with the flood of government disbursements to individuals that found their way into the stock market. With low interest rates, the financing of speculative stock investments flourished. Companies that were on the verge of extinction became stock market darlings in online chatrooms as novice traders challenged institutional investors.

Companies that are deemed to be “disruptors” and future dominant enterprises sold at prices that were measured as a multiple of sales not earnings. Many of these “disruptors” don’t even have any sales yet alone earnings! Traders climbed aboard the cryptocurrency train as these trendy exchanges became the modern-day equivalents of tulip bulbs. In 2021, the price decline of bitcoin, the most popular cryptocurrency, was greater than every bear market in stocks other than the crash of 1929. Yet, there remains a loyal following of this exchange. One unintended consequence of this situation is that many of these speculators who have been upended by the market selloff find themselves forced to sell anything—even the best companies—to satisfy the liquidity demands of their angry shareholders. The common question asked by these newbies is: “When will I get my money back?”

Financial markets are resilient. After the speculators leave by the nearest exit, some semblance of normality returns. The old reliable shorting of stocks or use of derivatives to speculate among stocks will become less attractive. The economic recovery that is slow in coming due to the reverberations from ongoing virus variants is likely to dissipate even if it means herd immunity becomes the solution to the pandemic. At last count, consumer sentiment was ebbing, and related spending was slowing—just as the supply channel was beginning to catch up. Recent reads on many measures of inflation seem to be heading in the right direction. Corporate earnings remain on a positive track for this year adding hope that equity markets will follow fundamentals in the aftermath of the most recent speculative meltdown.

Stocks may not rebound as quickly as they did in 2020 after the government shut down the economy and then funded a likely economic rebound. Without that government safety net, the speculators will remain at bay, but a less speculative market may move higher, slowly but surely, for the balance of 2022.

“If you don't know where you are going, you'll end up someplace else.“

Yogi Berra

Market Commentary

January was a tough month for stocks. After three years of double-digit returns, it was only a matter of time before a correction would occur. Such an inevitable pullback was needed to offset the speculation that characterized many sectors in the economy. Virtually all sectors and styles declined except for energy stocks that rallied on the back of rising oil and gas prices. Growth stocks got hit the hardest. The NASDAQ Composite finished down 9%, the S&P 500 down 5.3%, and both the S&P 400 (mid-cap) and the S&P 600 (small-cap) down 7.3%. Foreign stocks fell by 3.7% while emerging markets were lower by 1.9% as Latin American markets rallied from their lows of last year. Bonds declined as the yield on the 10-year Treasury rose to 1.77%.

In addition to stock “corrections,” the S&P 500 has suffered 7 “bears” in the last 50 years, i.e., declines of at least 20% from a previous closing high. The last S&P 500 “bear” was a 33.9% fall between 2/19/2020 and 3/23/2020, i.e., early during the global pandemic *(source: BTN Research)*