



## May 2023 Market Outlook

That '70s Show (Rerun)

Investors continue to look at the markets in black or white terms. Stocks, it seems, must be either soaring or plunging; there is no middle ground. Years of central bank easy money policy known as quantitative easing (QE) have conditioned investors to the flood of liquidity that has levitated stock prices, bonds and real estate. Long bullish runs, punctuated by short, sharp bear markets, became the norm. Bulls proclaim that with just a little loosening from the Fed, the next leg up is just around the corner.

Bears, on the other hand, see disaster with every jiggle in interest rates. With a market as sensitized to liquidity as this one is, the prevailing direction of interest rates is no small matter. Bears point to an inverted yield curve, predicting stocks will fall because of recession, and this fear haunts investors with every weak economic report. Mix in shrill financial media trying to boost audience share and it seems the market must either soar or plunge.

But there is a third outcome that most investors today have forgotten—or choose to ignore—a long sideways period for stock prices like we had in the 1970s.

The Wall Street generation that lived through the 1970s has long retired, and the institutional memory of that time is being slowly relegated to history books. Most investors today have only known the best of times—rising asset prices, falling interest rates, and low inflation. The decade of the 1970s was the mirror image of recent history, and that confluence of factors led to a “lost decade” for investors between 1966 and 1982. Over that 16-year span, the major stock indexes made no net progress, ending the period where they began.

Could investors be facing a rerun of the 1970s? Interesting parallels are starting to appear, making it instructive to look at the 1970s as a possible guide to the future.

The economic analogies of today's environment to the 1970s are multiplying, starting with inflation. The 1970s were a byword for the inflation experience in the United States, and anyone who lived through those years remembers the leap in energy prices, Nixon's attempt at wage and price controls, and Gerald Ford's WIN buttons (“Whip Inflation Now”). While it was the obvious supply-side costs (e.g. OPEC and higher oil prices) that are often accused of creating inflation, there is another parallel to today that has long been forgotten.

By the time the 1970s dawned the U.S. was trying to juggle two huge, and controversial, commitments. The first was Lyndon Johnson's Great Society program, which established Medicare and Medicaid, broadened educational access, and formalized civil rights legislation. The initiatives that comprised the Great Society have been compared to Roosevelt's

1100 East Hector Street, Suite 399, Conshohocken, PA, 19428 Tel: 800 220 2161  
355 S. Teller Street, Suite 200, Lakewood, CO, 80226 Tel: 303 458 5250  
[www.nstarfinco.com](http://www.nstarfinco.com)

Northstar Financial Companies Inc. is a Registered Investment Advisor. Advisory services are only offered to clients or prospective clients where Northstar and its representatives are properly registered or exempt from registration.

New Deal programs of the 1930s, and is considered one of the most extensive social reform plans in modern history.

This legislation ran headlong into the deepening American quagmire in Vietnam. This unpopular war, intended to block the spread of communism from China to its neighbors, quickly morphed from an advisory role to the South Vietnamese government to an all-out continental land war that ultimately took the lives of 58,000 soldiers and countless civilians.

The vast expense of these efforts required a large increase in federal debt, which was financed by very accommodative monetary policy and a commensurate growth in money supply. According to economist Robert Samuelson, U.S. money supply rose 23% in the 1950s, 44% in the 1960s, and 78% in the 1970s—an astounding growth rate for the decade. The result was historical inflation that peaked at 14.5% in 1980.

Today, we are coming off analogous events. Foreign wars engendered by the toppling of Iraq's Saddam Hussein and the 9/11 attacks led to long overseas military campaigns designed to stamp out terrorism, including a 20-year presence in Afghanistan. As in Vietnam, no clear-cut victory could be declared, despite trillions of dollars spent and thousands of lives lost.

The cold war between the old USSR and the US is being played out again, but now with China as the key foreign villain. Thirty years of wary cooperation have turned ice cold as economic and social stresses, along with overt threats to annex Taiwan, have led the Chinese to take a more aggressive foreign policy stance with America. As both nations juggle for global dominance, an international standoff prevails, consuming military spending, impacting commerce, and depressing consumer sentiment.

Social spending has also grown to an unprecedented scale as Medicare and Social Security costs have ballooned. The unwelcome covid pandemic spawned budget-busting federal deficits as economic shutdowns globally led to massive pandemic aid spending. US politicians, unable to come to grips with the idea of raising taxes to help pay our way, have taken the easy way out and pressured the Fed to "monetize" our debt by paying for T-Bond purchases, the linchpin of QE, with printed money. The result is what we believe to be a structural, not cyclical, type of inflation that will take time to control, with high(er) prices becoming a way of life.

Analogies to the 1970s extend beyond economics or politics. The social environment today is nothing if not strained, mirroring the pressures of the '70s era. Fifty years ago, the Vietnam war created huge tensions between the "establishment" and the rising liberal post-WW II generation, and the effect permeated society at the time. Free love, increased drug use, and the explosion of counter-culture rock music fed the schism between young and old, children and parents, and liberals and conservatives.

Given the passage of time, we've forgotten how radical the rise of feminism and the push of women into the workforce was. No longer satisfied with their traditional roles of raising

children and “homemaking,” women had to fight for their place at the economic table, which was not granted willingly by the male dominated society of the time.

Today, we have clear social pressures that are driving the cultural debate and polarizing society. Gun rights, the thorny quandary of immigration, challenges to traditional marriage, sexual preferences and even sexual identity are no less radical societal challenges than we faced in the '70s. In both eras, social pressures have created such profound questioning of the status quo as to change behaviors for generations to come.

Financial markets also show several similarities to the flower power decade. In addition to persistently rising inflation and interest rates, valuations were a problem then as they are now. The bull market of the late 1960s led to a major increase in stock valuations not seen since the late 1920s. We are even seeing a return to the complacent “Nifty Fifty” stock market of the early '70s, when about fifty high-growth darlings were so revered they were called “one decision” stocks because you only had to make one decision—to buy—and then hold them forever.

Attitudes toward today's growth favorites of Microsoft, Apple, Amazon, and Google would have fit right in at the time with Nifty Fifty favorites Kodak, JC Penney, and Polaroid. Their popularity led to high price/earnings ratios, low dividends, and inflated growth expectations that left investors unprepared for the inflation that was to come.

Our current financial world shares many of those same traits and has left investors similarly unprepared. More than a decade of QE has fed the belief that the Fed will always come to the rescue of Wall Street, fooling investors into thinking they can ignore the risks of valuation, unrealistic expectations for growth, and instead bank on the belief that technology and financial engineering will result in perpetually bullish trends.

It is tempting to draw the comparison to the 1970s too boldly, and make the classic forecasting error of relying on history to describe the future. But there are enough comparisons that investors should consider such a future conceivable.

How should investors cope with the possible repeat of the '70s experience? First and foremost, an emphasis on current income should be embraced. Price charts such as the one above mask the fact that the vast majority of investors' meagre returns during that decade came from dividends. This was easy to ignore in recent years as the Fed's QE tsunami has led to dramatic (but unsustainable) price appreciation. A portfolio of dividend paying stocks with, importantly, a history of dividend growth, can do much to blunt the effects of a long sideways market. And for retirees who are using their investments to augment their income, consistently growing dividends can prolong the life of their portfolios substantially.

Second, valuations should not be ignored in the naïve belief that the next bull market is just around the corner. The page 1 chart plots not only the price of the Dow index, but also the trail of broken hearts throughout the decade. Huge percentage rallies were followed by equally

huge declines as inflation, rising interest rates, and social schism shrunk valuations from the Nifty Fifty heights to the bargain basement lows of the early 1980s. From a then-stratospheric high of about 19x in April 1971, the S&P 500's price/earnings ratio relentlessly ground lower to below 8x earnings in August 1982. While 2022's bear market brought valuations down, stocks are still not "cheap," so investors should be discriminating buyers and seek good value.

Finally, at the risk of speaking heresy, investors should consider sharpening their market timing skills. Not to make 100% shifts into and out of the market, but to be more sensitive, for example, to investor psychology and swings from bullish to bearish moods. When bullishness predominates, take some profits, and when bearishness prevails, be a more aggressive buyer. There are numerous tools available to help investors identify these cycles, such as CNN's (free) Fear and Greed Index (<https://www.cnn.com/markets/fear-and-greed>).

With any luck, we won't be going back to the era of bell-bottom pants, tie dye dresses and disco music. What we do know, however, is that human behavior can reliably be counted upon to repeat itself. With the policy mistakes of the past clearly being echoed today, we should be mindful of a rerun of that '70s show.