Disciplined Wealth Management

03/31/2023 Quarterly Newsletter

Discipline is the key to success

With every approach to the stock market, bear in mind that there will always be periods of over-performance and periods of under-performance. Here at Disciplined Wealth Management (DWM), our goal is to concentrate your portfolio in the leading asset classes while avoiding the performance-sapping lagging asset classes; over the long term, our approach strives to provide you with better performance compared to the overall stock market average (the S&P 500) and with less risk. In summary – stay disciplined during times of under-performance; don't become emotional and abandon a proven long-term strategy during a usually short period of under-performance, but stick with it and let the strategy work for you. If someone says they are never wrong, they have just proven themselves otherwise.

General Commentary—

The collapse of Silicon Valley Bank, concerns over the health of less-regulated U.S. regional banks, and the Credit Suisse debacle begs the question, how have the recent stresses in U.S. banks spread to the rest of the world?

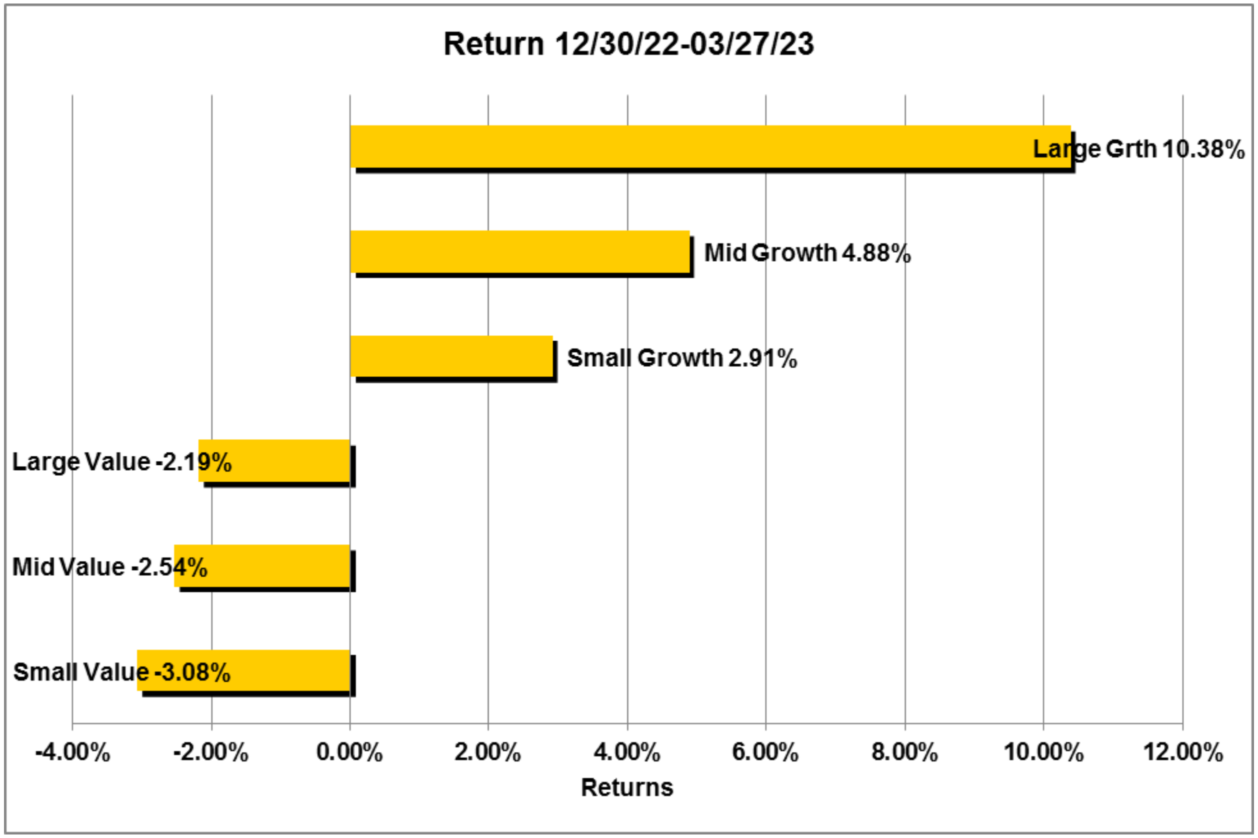
The data tells us that financial conditions have gotten worse but aren't entirely awful. Although European banks are generally better positioned than U.S. regional banks, Europe has historically been more sensitive to U.S. contagion risk and will likely see growth stifled through tighter lending standards. Comparatively, China has been more insulated. Even so, history suggests that if the U.S. financial system implodes, so goes the rest of the world.

Silicon Valley Bank was unique in the sense that it suffered from excessive duration risk, both from its long-term investments and Treasury holdings, and was vulnerable to the fact that it had an outsized share of large, and thus non-FDIC insured, depositors.

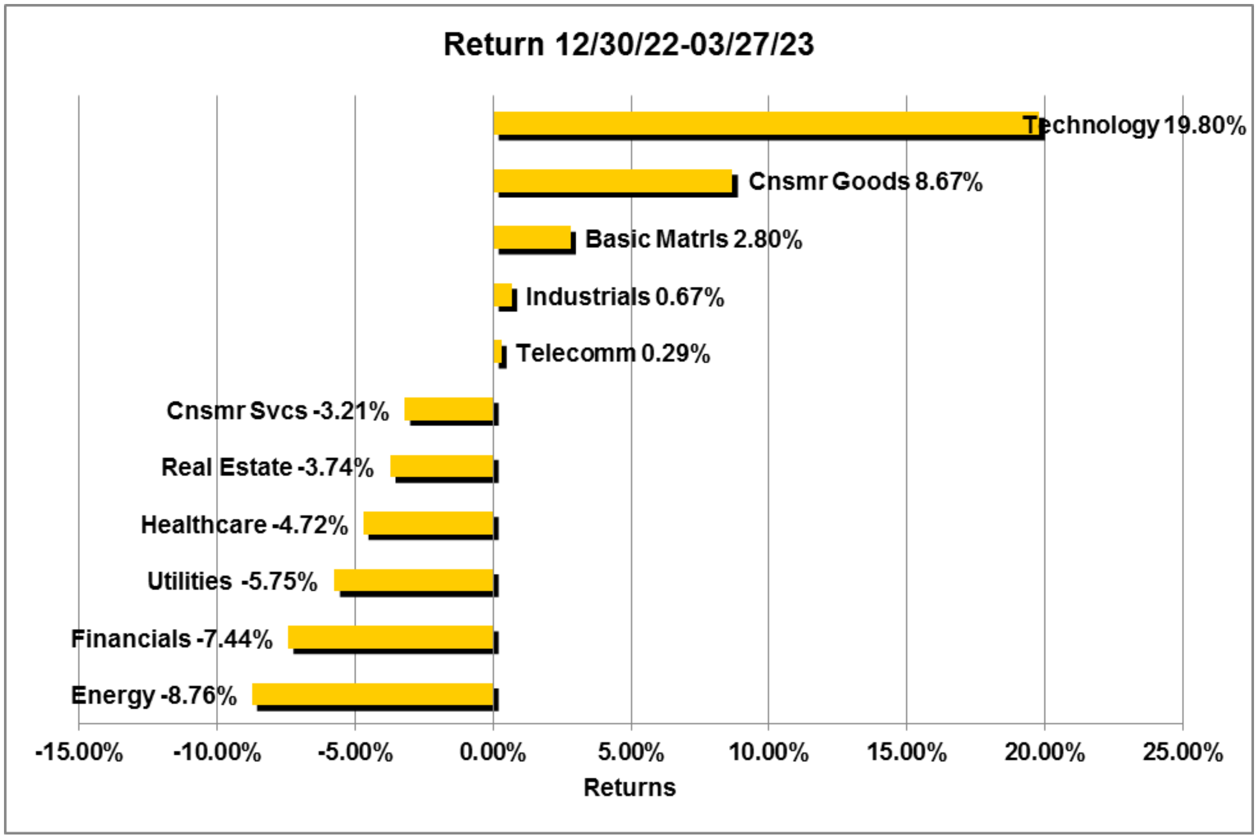
Even so, other U.S. banks have unrealized Treasury bond and other asset losses ($620 billion to be exact) and could also be susceptible to deposit outflows given the higher yield from money market accounts. As of now, the Bank Term Funding Program (BTFP) and some of the deposit guarantees have instilled confidence that another bank run is less likely.

As we go to press, the overall Market Environment Indicator (MEI) remains bearish, along with the Individual Fund Signals (IFS). We will continue to monitor these indicators and make the necessary adjustments. For an individual performance review, please call 303-471-5189. Please note that, in the following pages, the performance charts for certain asset classes showing year-to-date returns, are for illustration purposes only and do not reflect our Relative Strength Analysis (RSA) system.

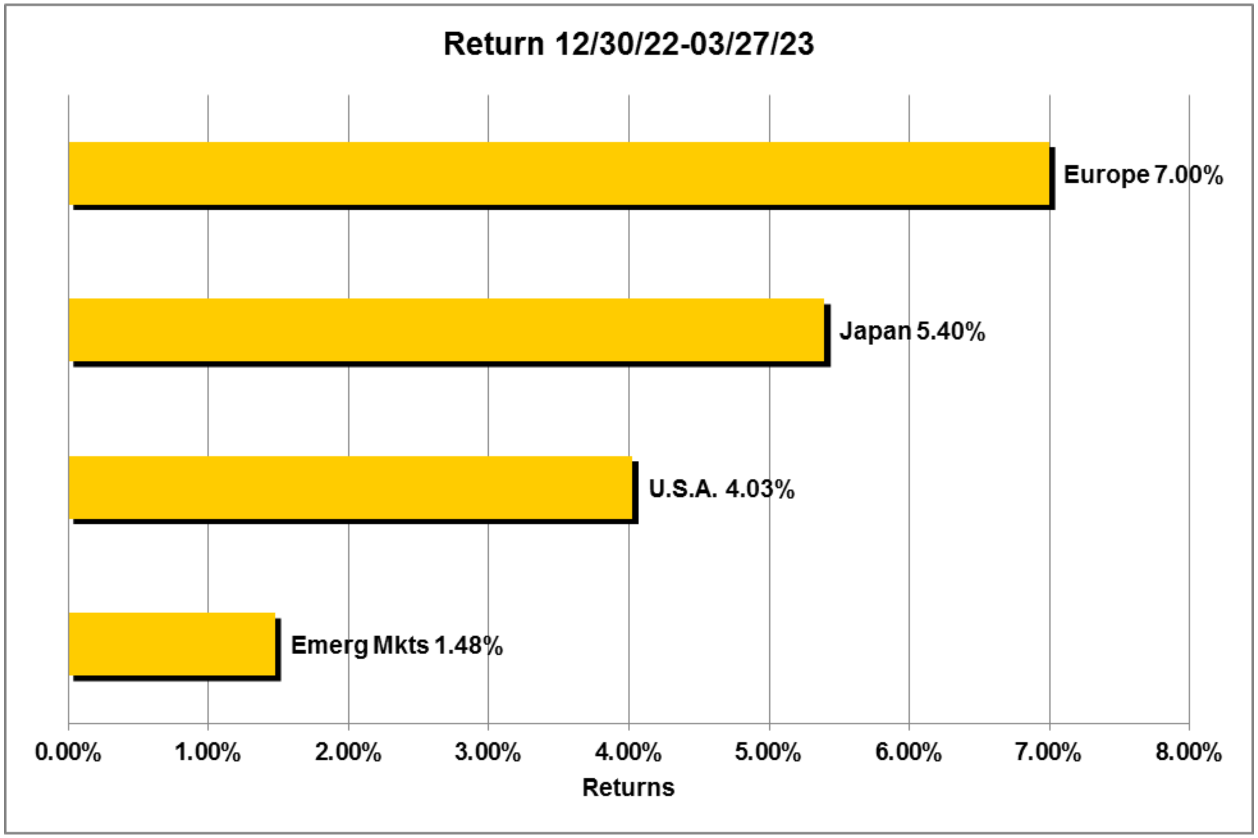
Style Boxes — As of March 27, 2023, Large Growth experienced the largest move up in my Relative Strength Analysis (RSA), jumping five spots to claim the number one position. Mid Growth fell one position to finish in second place. Large Value fell one position to finish in third, and Mid Value also fell one spot to round out the top four positions. As usual, we will continue to rely upon our time-tested RSA to guide our investments in Style Boxes.



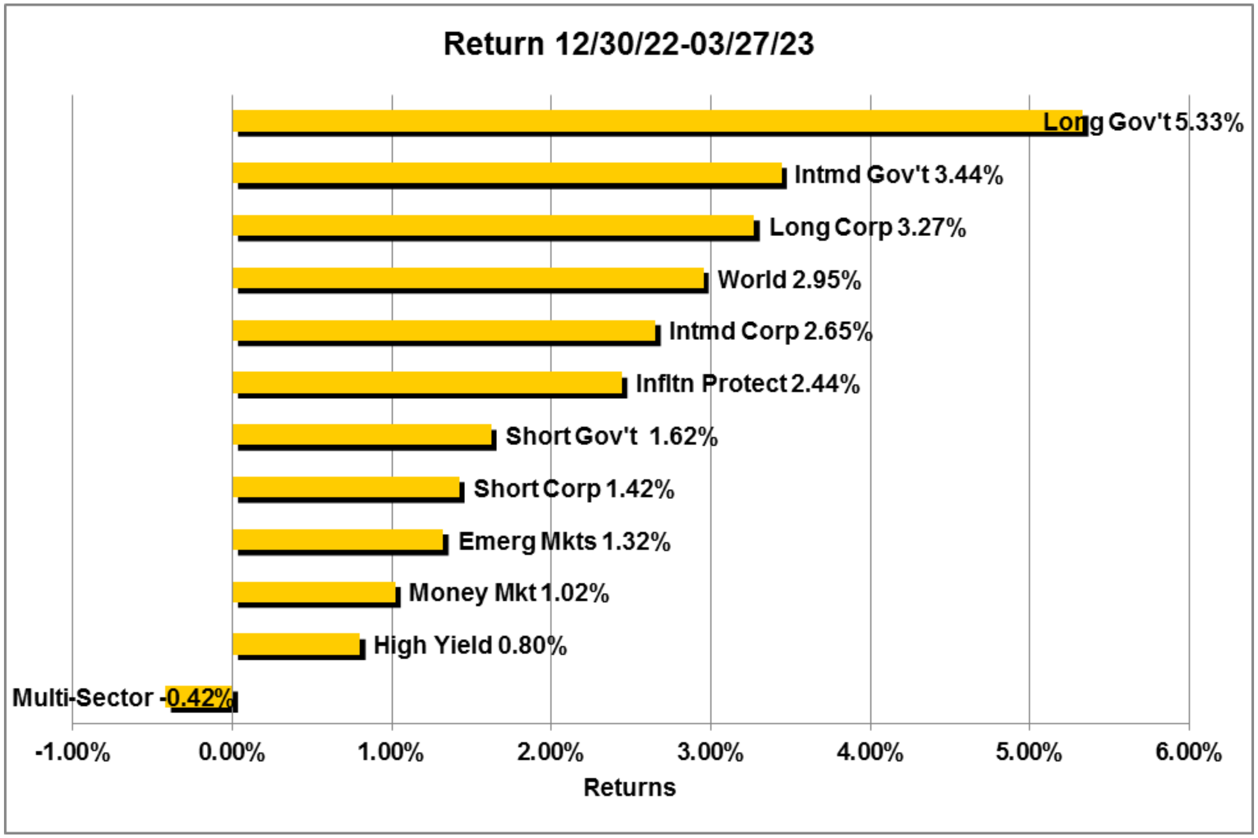
Sectors — As of March 27, 2023, Technology experienced the largest move up in my RSA, jumping eight spots to claim the number one position. Basic Materials moved up two positons to finish in second place. Industrials fell one spot to claim the third position. Consumer Staples jumped two spots to round out the top four positions. This should come as no surprise considering the banking crisis that is plaguing our financial system; Financial Services experienced the largest drop in my RSA falling six spots to finish in ninth place. As usual, we will continue to rely upon our time-tested RSA to guide our investments in Sectors.



Internationals — As of March 27, 2023, not much change in my RSA surrounding internationals from last quarter. Europe and Japan both maintained their stronghold on the number one position, and second place. Emerging Markets and the U.S.A. swapped positions from last quarter, as Emerging Markets moved up one and the U.S.A. fell one spot. The U.S.A. now sits in last place. As usual, we will continue to rely upon our time-tested RSA to guide our investments in Internationals.



Bonds — As of March 27, 2023, World Bond experienced the largest move up in my RSA, jumping seven positions to claim the number one seed. Emerging Markets maintained its stronghold on second place. Long Corporate jumped up four positions to finish in third, and High Yield fell three spots to round out the top four. Money Markets fell the most, dropping nine spots to take last place. As usual, we will continue to rely upon our time-tested RSA to guide our investments in Bonds.



Forecast —

S&P 500 at 5,200 in 2023?

Or the Dow hitting 43,000! Sounds outrageous considering the fundamental picture of rising interest rates, a looming recession, stagnant corporate earnings, government deficits growing by trillions, etc.

But thinking outside the box and looking at a little history, suggests things may not go the way of the current consensus. Consider the following headline and text within the Stock Trader's Almanac 2023.

"Why a 50% gain in the Dow is possible from its 2022 low to its 2023 High."

"Normally, major corrections occur sometime in the first or second years following presidential elections. Since 1914 the Dow has gained 46.8% on average from its midterm election year low to its subsequent high in the following pre-election year. A win of such magnitude is equivalent to a move from 30,000 to 45,000."

We converted the data from the Dow to the S&P 500, looking at the gain from the Midterm low to Pre-Election year high starting in 1930.

S&P 500				% Gain from Midterm Low to Pre-Election year High		
Midterm Year	Low	Pre-Election Year	High	No Bear Market Previous 24 months	Bear Market ended in Midterm	Bear Market previous year to Midterm
1930	14.44	1931	18.17		25.8%	
1934	8.36	1935	13.46		61.0%	
1938	8.5	1939	13.23		55.6%	
1942	7.47	1943	9.77		30.8%	
1946	13.21	1947	19.25	45.7%		
1950	16.65	1951	23.85			43.2%
1954	24.8	1955	46.41			87.1%
1958	40.33	1959	60.71			50.5%
1962	52.32	1963	75.02		43.4%	
1966	73.2	1967	97.59		33.3%	
1970	69.29	1971	104.77		51.2%	
1974	62.28	1975	95.61		53.5%	
1978	86.9	1979	111.27		28.0%	
1982	102.42	1983	172.63		68.6%	
1986	203.49	1987	336.77	65.5%		
1990	295.46	1991	417.09		41.2%	
1994	438.92	1995	621.69	41.6%		
1998	927.69	1999	1469.25		58.4%	
2002	776.76	2003	1111.92		43.1%	
2006	1223.69	2007	1565.15	27.9%		
2010	1022.58	2011	1363.361			33.3%
2014	1741.89	2015	2130.82	22.3%		
2018	2351.1	2019	3240.02		37.8%	
		Average		**40.6%**	**45.1%**	**53.6%**

A couple of observations:
1. Since 1930, the probability of a 20% decline occurs on average 1 out of every 4 years or 25% in any given year. Looking at the data above, 78% of the time, a bear market occurred either during the midterm year or the year prior.
2. Bear markets are followed by bull markets, possibly explaining the big returns from the lows of the midterm low to the pre-election year high.
3. Gains were 40.6% when a bear had not preceded the midterm low but jumped to 45% to 54% if a bear did occur. The 2022 S&P 500 fall of 25.3% meets the criteria of having a midterm election year bear market.

If history repeats or at least rhymes, a 45% to 54% gain off the 2022 bear market low of 3577 on the S&P 500 would lead to a 2023 high between 5,200 to 5,500!

Impossible? Consider the following:

- Investors and institutions are holding record levels of cash, matching levels last seen during the Pandemic. That is a lot of potential buying.
- A contrarian indicator is the percentage of newsletter writers bullish is at just 38% and has not been above 50% in over 60 weeks. In contrast, during 2020 and the onset of the pandemic, the bearish reading lasted only 13 weeks.
- The pending recession may be the most anticipated recession in history. Normally, recessions catch companies and investors by surprise and unprepared, making them very difficult. Today, companies and investors have had months to adjust and prepare for a recession. That anticipation might mitigate the potential damage of a potential recession. “An ounce of prevention is worth a pound of cure” highlights the wisdom of planning ahead to avoid problems.
- The market is forward looking, anticipating events and earnings 6 to 12 months in advance. The future may be brighter than current prices are reflecting.

The best course is to be prepared, to be flexible, and to be tactical. Don’t try to outguess the market, but simply follow the trends. The bears could be right, and the market retests last year’s lows or worse, or the market could just as easily “climb a wall of worry”, catching too many investors underinvested and producing a long wave of buying as they get back in.

Will this be the case? No one knows for sure and only time will tell. DWM, for one, will continue to rely upon its tactical tools to stay in line with the market’s fluctuations. Always remember: the key to investment success is to stay disciplined and flexible in an ever-changing market environment. The moment you start to second-guess your decisions is usually when you shouldn’t.

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Sources: Style box data = i-Shares Russell Indexes. Source: Investors FastTrack.Sector data = DJ US Sector Indexes via I-Shares. Source: Investors FastTrack. International data = i-Shares for Emerging Markets, Europe, pan, S&P 500 Index for U.S.A. Source: Investors FastTrack.
Bond data = various bond exchange traded funds (ETF). Source: Investors FastTrack.