Technology Stocks and the US Economy - Transcript

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Tom Mullooly: Welcome back to the podcast. This is episode number 348 of the Mullooly Asset Management podcast. I'm Tom Mullooly, and joining me today is Brendan Mullooly and Tim Mullooly. Hey, guys.

Brendan M: I think you have a little story you'd like to share with us to start us off.

Tom Mullooly: Yeah, I'd like to start with a story. I was not in, despite what you guys think, I was not in the stock market in 1966, but the economic backdrop in 1966 and in 1983 when I was working at EF Hutton was very similar to what we're seeing now. And so I want to start with a little story. In 1983, the economy had just emerged from a recession the year before in 1982, but still was having a little trouble getting off the ground. In 1983, the economy was still very sloppy, but things were happening. Pieces were starting to come together where a lot of folks started looking and say, "Wow, you know what? 1984 is going to be a blockbuster year for the economy." So people started buying stocks. And in 1983, the gross domestic product, I know this is going to sound like a crazy number, in 1983, the economy grew at about four and a half percent, which would be blockbuster now, but that was kind of so-so back then.

Brendan M: Inflation was high too.

Tom Mullooly: That's right. In anticipation of 1984 being such a good year, economically speaking, in 1983, the Dow Jones was up over 20%, was up about 20.2%. So fast forward now to 1984, what happened? Well, sure enough, the economy grew at almost 7%, which is terrific. What did stocks do? The Dow was actually down a little bit for the year. The Dow was down 3.8%. And so the market moved up in 1983 in anticipation that '84 would be a good year, but the market had to digest all of this. The market needed to … It got a little bit ahead of itself. I think the phrase that I've heard now like 19 times on Bloomberg this week is we're getting out a little over our skis with the economy. And so we have a rip roaring economy in 2021. It doesn't necessarily mean that stocks are going to do the same thing.

I mean, if you go back, as we've mentioned on the last couple of podcasts, from the depths of where the market was a year ago, some of the markets, some of these investments, OTC markets are up 50, 60, 70% just year over year, but up 75, 80%, 90% from the bottom of the market. These markets need time to digest these moves.

Tim Mullooly: Yeah, I think we mentioned a few times over the last year when the market was going up and things still looked pretty grim. And on Main Street and in the economy, people were questioning how the market could be moving up so much, and we would put out how the market tends to be forward-looking. And that's what happened in that example in the '80s. We could experience something like that here as well, where the market was looking forward to what's happening in the economy potentially this year with it continuing to recover. Stocks already made their move.

Tom Mullooly: So they say that markets don't repeat, but they often rhyme. And we've kind of seen this before now in the '60s, in the '80s. We may see this again now this year unfold, where the market moved up in anticipation of the economy reopening this year. And as the economy is reopening and people are starting to spend money and things are starting to happen again, the market may need time to digest. So it folds in nicely with the old saying to buy the rumor and sell on the news.

Brendan M: Yeah. I don't think I'd necessarily encourage people to be selling or anything, but I think it's tough to reconcile for folks sometimes that over shorter term periods, like one year or even two years, the stock market and the economy don't have to do the same thing. I think that that's tough to reconcile because we all understand that over the long term, five, 10, 15, 20 years, the stock market and the economy are going to reflect the same reality. They do measure a lot of the same things in different ways. But when you're looking over six months, 12 months, 24 months, they don't always have to line up. And it doesn't necessarily mean that anything is wrong or that you need to do something different because of what's happening. In fact, it can be a pretty good signal, like it was last year when the economic data was at its crummiest. Great time to put money into stocks.

Tim Mullooly: Yeah. I think people also used the term the market just as a blanket, and right now we're seeing certain areas of the market moving sideways or down, large cap growth tech stocks, but there are plenty of areas-

Brendan M: The market's doing fine this year. It's not like stocks are down on the year or anything.

Tim Mullooly: There are plenty of sectors and areas of the market that are working and are performing well. So if you see just like what the NASDAQ is doing on a daily or weekly basis, if you use that as your term for quote unquote "the market," yeah, it could be a little rocky right now.

Brendan M: But even that though is relative because we just said areas like the NASDAQ from the bottom of last year, even on a rolling one year basis, are up 80% or something like that. And since February-

Tom Mullooly: Without a break.

Brendan M: … and since February 12th when the NASDAQ hit its most recent high, it's down 7%. Like, come on. Over that time period, the S&P 500 is flat and the Dow's up 5%. So maybe that's skewing your opinion because it feels worse on a relative basis. Things like small caps are doing fine, value stocks are doing fine and NASDAQ is down 7%. So, there's a gap there, but you've had a gap above and beyond all those other areas in the reverse for years on end now. So to get bent out of shape over a little relative under performance from an area of leadership, I think, it's what you have to expect when you invest in that area of the market.

Tom Mullooly: As you guys just mentioned, it doesn't make them bad investments, the NASDAQ or technology stocks. I mean, technology is the future. That's where we're going to see a lot of the growth, but we may have a year where we go sideways.

Brendan M: I mean these things, the prices have gone up so much over the last several years, that the way these things catch up from being out over their skis, to use that term, is they can produce more earnings to catch up to the increase in their price or have a period of time where they go down a little bit. And that's all right. I mean, if you want to be an investor in these areas, we've talked about this plenty over the last several years too, is if you wanted to be in some of these biggest winners that everybody wants to be in, the FANG stocks and all similar names, I mean, these things all go through 50% plus draw downs. So if you think you're going to be a successful investor in them without having those two, then you're going to be in for a bad time.

Tim Mullooly: Yeah. And I think, you need to put into context, like we're saying, where they came from off the bottom and just what they did last year in general. I mean, we pose the question to people, if you could average 10% a year over the next three years in a certain investment, would that be okay with you? And everyone says, "Yeah, that's great." Here are the terms. It's going to go up 30% in the first year and then do absolutely nothing for two years. You still average 10%. So I mean, some of these funds that are down 7, 8%, I mean this year, put that into context of what they did last year and take the average and say, "Are you okay with that?"

Brendan M: Even the example from the '80s where you had the mismatch, where stock market and economy flipped roles in back-to-back years there, I mean, you had a two year stretch where economic data improved over the two year stretch. And I mean, you made 20% one year and then lost a couple the next. So maybe you're up like 16%. So you made 8% over a two year period with improving economic data. Not bad. And then by the way, the market-

Tom Mullooly: Look what happened after that. We had a year of basically sideways action in the market, and in 1985, the following year, the Dow was up over 27%. 1986, up over 22%. And in 1987, if you go from the beginning of the year, 1900 to 2700 in August of 1987, that's another 40% on top of those gains. So the market essentially doubled after doing nothing going sideways for a year. And we've even seen this recently where we had 2015, that stretched from 2015 to 2016, where market seemed to just go sideways to down, or at least the major averages.

Brendan M: Earnings recession. That was basically what was going on under the hood is that earnings were not keeping up with the growth we had seen in prior years. So we had a two year period or one and a half year period of consolidation and prices followed by two very good years in the market after that. And we had that in 2018 too. After that nice run, we had a year where the market was down a couple percent for the first time in a decade. No big deal. There were still two more years on the other end of that that were great.

Tom Mullooly: We all lived.

Brendan M: Had to be a little bit patient.

Tom Mullooly: Yeah. Like I had mentioned earlier, the stock market doesn't repeat, but it often rhymes. And so we can pick up clues from things that have happened in the past. And I think that's an important message to carry to our listeners, that we're not in the prediction business, but you want to just be cognizant of what's happened in the past because it may leave clues as to what to expect.

Tim Mullooly: Right. I was going to say, it can not tell you what to predict or black and white, here's what's going to happen, but I think it can just help you recalibrate your expectations and know that this has happened before in the past. Doesn't mean it's always going to happen that way in the future, but run through the different possibilities in your head and become okay with the fact that any of those could happen.

Brendan M: I think it's more helpful to do something like that than to listen to the talking heads, trying to make up reasons for what the market is doing on a daily basis, as if … I don't know. You hear all this commotion about what's going on with interest rates and how that's causing what's going on with the NASDAQ of late. And I think that that's going to be something that we laugh about in two or three years. We really thought people were selling their tech stocks because the 10 year yield went from half a percent to 1.7, that's what did it. That was the end of these giant tech companies. That was the end.

Tim Mullooly: Maybe they're just taking a break.

Brendan M: It's just going to be another bullet point on the chart that our friend Michael Batnick has put together, where it's reasons to sell. And all of these things look hilarious in hindsight, but in the moment they were things people were genuinely worried about. So rather than getting wrapped up in the talking points of the day, yeah, I think looking back to history to see that things like this have gone on before is a more useful way to spend your time.

Tom Mullooly: There is a lot of talk, as Brendan alluded to, about rates moving up. I think you need to look at some of the yardsticks that bond market mavens use to determine what's going on not only in the bond market, but what's happening in the economy. Eddie Elfenbein put out a chart that he actually got from the Federal Reserve of St. Louis the other day that showed a chart of what we call the 2-10 spread. And the way to describe that is the difference in yield between a two year treasury and a 10 year treasury. And the spread on the 2-10 chart has gone negative right before every recession that we've had going back over the last couple of decades. People get worried when they see the 2-10 spread narrowing, because they worry that it may eventually go negative, but that doesn't always necessarily mean that we're going into a recession.

When it goes negative, okay, that's a pretty good indicator. Not always perfect. At the moment, the 2-10 spread is going straight up like a rocket on its chart. And so it shows that there's a huge gap between the yield on the two year treasury and the 10 year treasury, and that points to economic expansion. So there's people worried, concerned, gee tech's selling off. I'm worried about this market. I don't know if the economy can continue. It may not come back. The indicators that we're looking at say something completely different. And as you had mentioned yesterday, Brendan, it's hard to be bearish.

Brendan M: Any measure you're looking at with risk-on risk-off assets in a relative sense, I'm not sure how you could look at any of those, like stocks versus bonds, stocks versus gold, copper versus gold people look at. None of these things would suggest being bearish at the moment. So it may feel worse than it is, but I don't really think that there's a lot of evidence to be overly concerned with the market action of late.

Tom Mullooly: Do you want to talk a little bit about the indicators that we use and where cash stands now and why we include that?

Brendan M: Yeah. I mean, we look at it compared to other areas of the market, just to see where it falls. I mean, we want to compare everything to all other available options. And right now, it's dead last. It's been there for several months. This was a measure that was towards the top half of the rankings while things were unfolding last year, and remain there through some of the recovery at somewhat elevated levels, pretty much until the fall, fourth quarter of last year, and into the first quarter of this year. Couldn't be lower. So again, another measure of risk on.

Tom Mullooly: So we have gotten calls from clients who have been concerned about seeing their technology investments selling off, going down. We're not as concerned. We expect this digestion period after a huge run-up like we've seen in the last 12 months. So we're okay with it, but we wanted to come on today and talk about this so people are in the loop and are aware of what's going on in the market. Seems pretty normal to us.

That's going to wrap up episode 348 of the Mullooly Asset Management podcast. Thanks again for tuning in, and we will catch up with you on the next episode.