Cornerstone Report

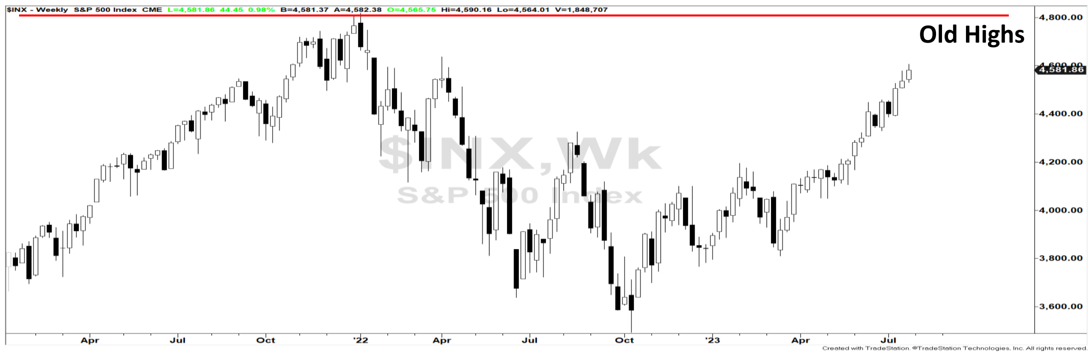
Special Report | **August 4, 2023** | **By: Jerry E. Tuma, MS, CFP®**

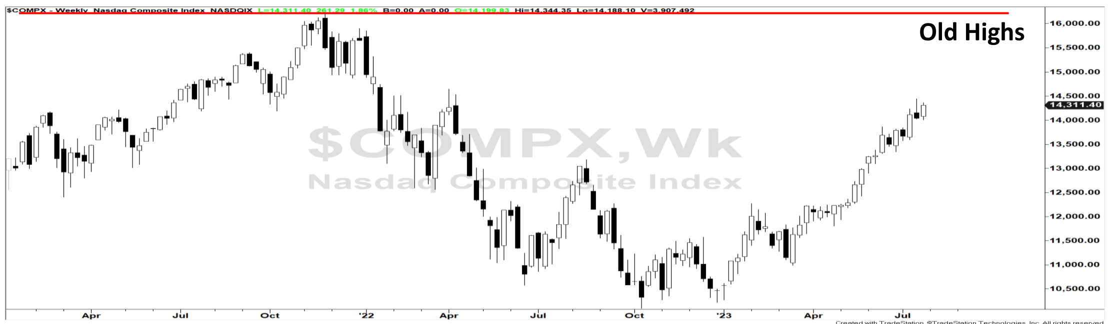
Topics:

- The Fed
- What Our Experts Say
- The Fed Is Still Tightening
- So What's *Really* Happening
- Stock Market

We're Out To Change The Way America Thinks About Investing.

Bull or Bear? You Decide.





Above you see the most recent charts of the stock market, and as you can see we've had a very strong bounce since April.

This is curious, since almost all of the ***leading*** indicators for the economy continue to decline, plus the vast majority of the recession "precursors" are ***flashing red warning signs.***

Despite this, the market marches on, as both the S&P 500 and NASDAQ are pushing toward the old 2021 market highs.

The question of the hour is, is "this time truly different" or are we headed for a major recession and bear market — is "this time just *longer*?"

We will attempt to answer these questions in this newsletter. At the end of it you will get to vote for yourself as to whether or not this is a new bull market, or just a resumption of the previous market followed by a recession. We will see.

Let's start with the economy.

On page 2, you see the latest table from *ITR Economics* showing their economic projections.

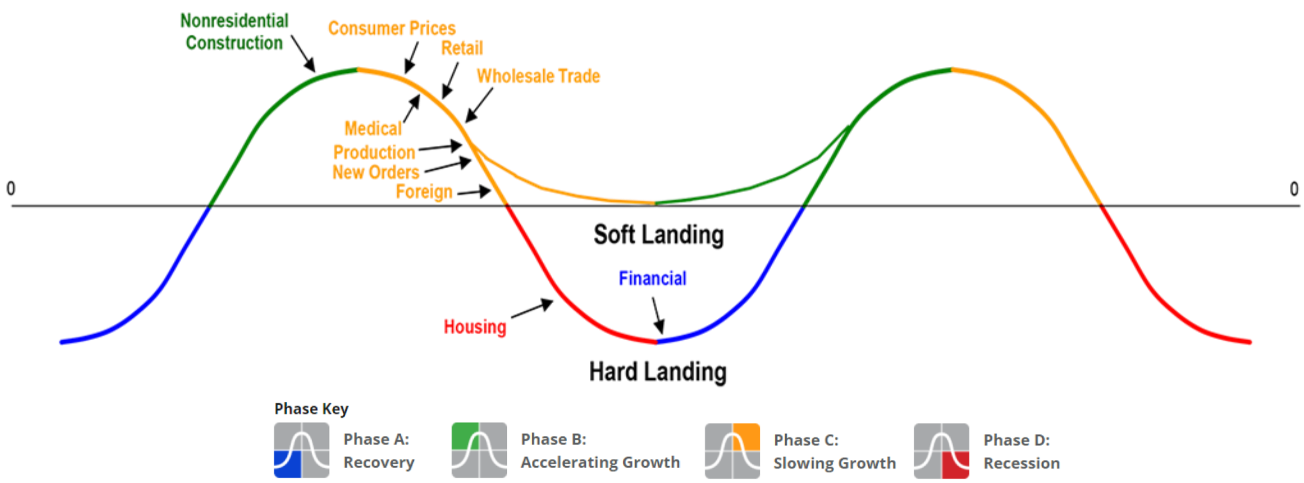
As we all know, past performance is never a guarantee of future results, but ITR has not only had the best forecasting track record in the country for ***15 consecutive years,*** but also is currently batting a mere 94.7% at one year out since 1985!

As you can see ITR is forecasting a recession for 2024, followed by recovery in 2025. The last time I interviewed CEO Brian Beaulieu, PhD, he stated that the recession, which he believes will last throughout 2024, could start as early as September.

Bull or Bear? You Decide.

	12/12	12MMT/A	Current 12/12	2023	2024	2025	Highlights
US Industrial Production			1.9	0.1	-2.3	2.7	Downside pressures are intensifying. Annual Production is expected to peak in the near term and then decline through 2024.
US Nondefense Capital Goods New Orders			4.2	0.3	-3.3	3.8	Business financials are not as strong as last year, and lending standards are tightening. New Orders will soon transition to decline.
US Private Sector Employment			3.8	2.4	-0.3	-0.7	Nonfarm Job Openings are declining. Employment will continue to slow in growth, then decline from mid-2024 to late 2025.
US Total Retail Sales			6.4	2.1	-0.7	4.4	Credit card debt and delinquencies are rising but not yet at red flag status. Retail Sales are expected to peak around the end of 2023.
US Wholesale Trade of Durable Goods			4.7	1.5	-2.6	3.8	US Imports From the World are declining. Wholesale Trade will slow in growth this year and contract in 2024.
US Wholesale Trade of Nondurable Goods			10.5	1.5	-2.1	5.0	Consumer demand for nondurables shows signs of waning. The 12MMT will rise mildly into late this year, then decline for most of 2024.

"'The Economy is Strong." No, it is NOT. Time to prepare for reality! Essentially the only primary gauge regarding the US economy that is strong is the labor market, and that is a ***lagging indicator***. If you look at the windshield instead of the rearview mirror, you see negative road signs. We expect recession and ***deflation*** for US Producer Prices into next year. 2025 will generally be a year of rise for the US economy. – *ITR Economics July 2023*



Please note that the colors for the table and chart above are color coordinated. Red stands for recession (or hard landing), yellow denotes slowing before recession, the blue and green colors denote recovery or growth.

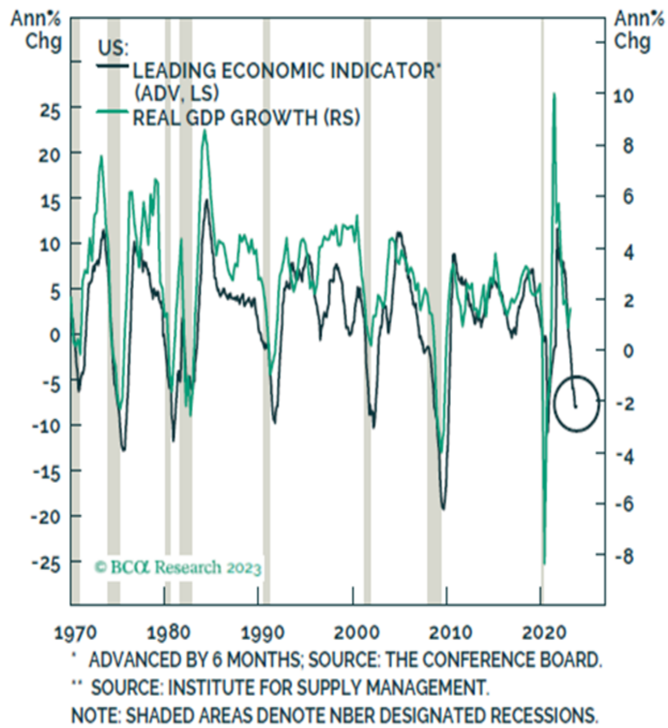
If you compare where we are in the economy today, with ITR's chart of where we were in January 2022 (see Special Report ***Fed Policy Mistakes*** January 2022 www.cornerstonereport.com) you will see that at that point only housing and financial were in the slowing growth phase while everything else was still accelerating. Now housing and financial are in a recession and everything else has rolled into slowing growth. Recession is likely on the way.

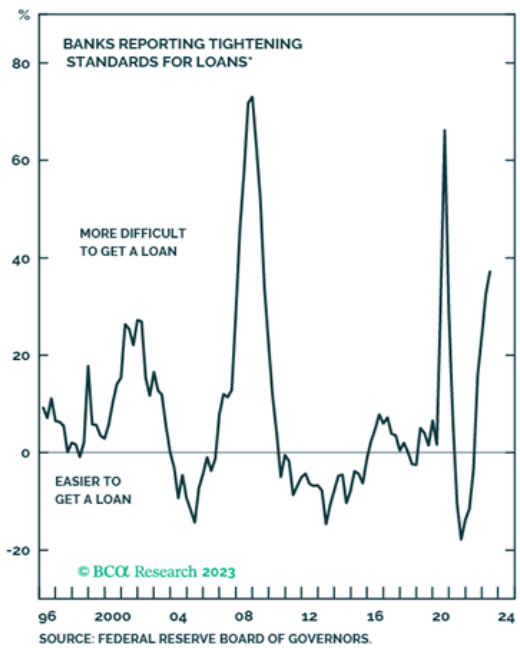
	• 2022 •		• 2021 •		• 2020 •				• 2019 •		• 2018 •	
	Duration	Accuracy	Duration	Accuracy	Data is Through	Date of Forecast	Duration	Accuracy	Duration	Accuracy	Duration	Accuracy
US GDP	18	98.9%	15	98.6%	Dec 2019	Mar 20	9	98.4%	18	98.1%	24	99.9%
US Industrial Production	18	98.9%	19	98.3%	Feb 2020	Mar 25	9	96.5%	16	99.7%	34	99.4%
Europe Industrial Production	23	99.6%	11	97.3%	Jan 2020	Mar 25	9	98.7%	16	97.4%	24	99.2%
Canada Industrial Production	24	99.5%	12	99.5%	Dec 2019	Mar 25	9	94.9%	18	99.7%	27	97.1%
China Industrial Production	16	98.5%	14	97.7%	Feb 2020	Mar 25	9	92.8%	13	99.5%	30	99.9%
Retail Sales	13	98.0%	11	90.6%	Jan 2020	Mar 21	9	98.7%	16	98.9%	28	99.6%
Housing	17	84.8%	12	93.1%	Jan 2020	Mar 26	9	99.6%	26	97.6%	26	99.2%
Employment	13	98.7%	18	99.2%	Feb 2020	Mar 28	9	93.7%	30	99.9%	30	99.4%

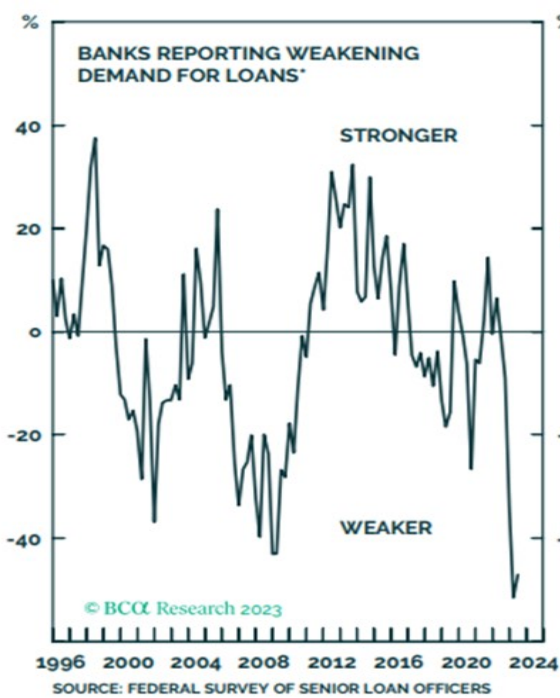
Duration is measured in months.

"Our overall forecast accuracy since 1985 is 94.7% at one year out. At ITR Economics, the length of time a forecast is in place is just as important as its accuracy." https://www.itreconomics.com/

In addition to the Beaulieu's projections, to the right you see the Conference Board's ***Leading Economic Indicator***. The Conference Board is generally regarded as the official "arbiter" of recessions, meaning they are generally accepted as the firm which officially declares recessions in the United States. As you can see, historically, the leading indicators drop ***prior*** to the economy (GDP).







As you can see it has fallen below the zero axis, indicating that a recession is likely coming. In this chart going back to 1970, their leading indicators have never fallen this far previously without an impending recession.

To the left you see lending standards for banks which are clearly tightening.

Historically, when banks significantly reduce access to credit (ala 2008 and 2020) this typically corresponds with a recession, as less new lending slows the economy.

The second chart shows that banks are also reporting lower ***demand*** for loans, at a weaker level than even 2008 — which is startling.

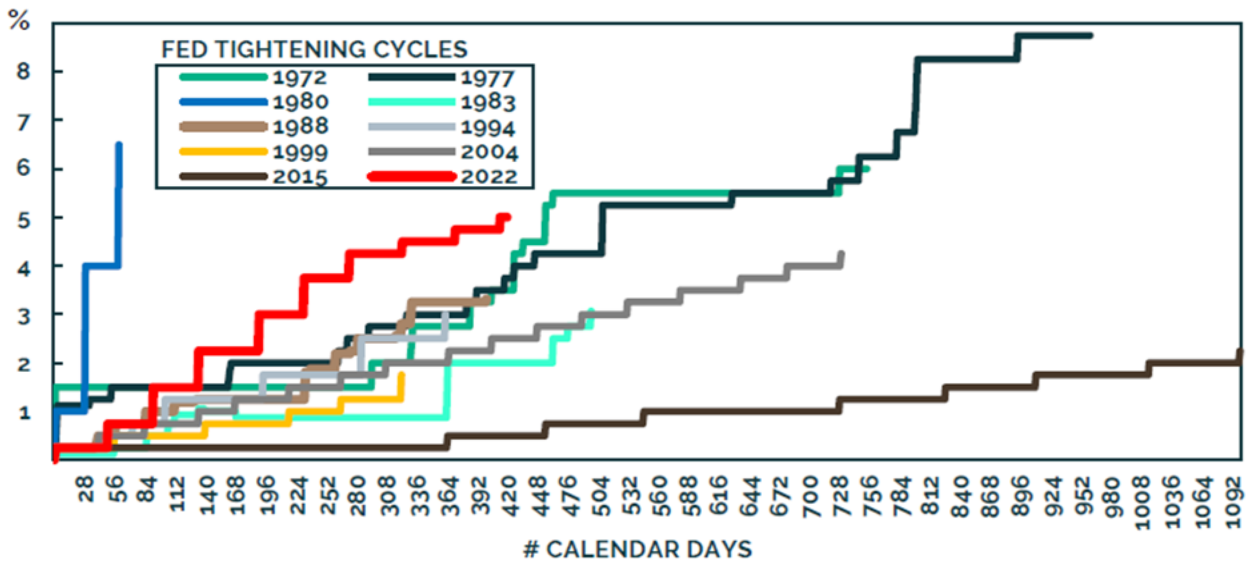
So, if the normal precursors to recession are all flashing red, yet the stock market is continuing to rise, the question remains, "**what gives?**"

Let's take a look under the hood at both what the Fed has been doing as well as the fiscal responses of the Biden Administration and I think we will find our answers.

Let's start with the Fed.

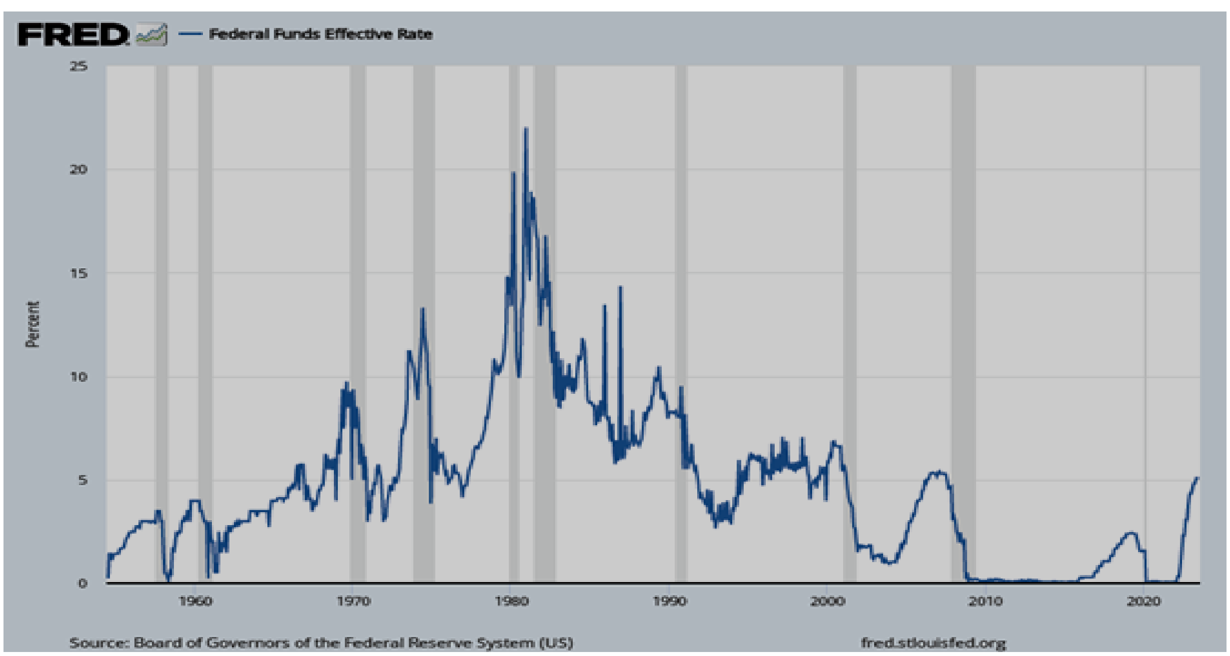
The Fed

Below you see a table showing the current rate of Fed tightening prior to this week's hike. As you can see from the chart, the pace of the Fed's tightening from 2022 on is the second ***fastest*** tightening cycle in the last 60 years, with only Paul Volker's 1980 surge, which was designed to drive a stake into inflation's heart for the last time in the 1970's cycle.



Below that you see the history of the Fed's tightening's since the 1950's. With only a couple of exceptions (1966 and 1987), every time the Fed raised rates significantly, a recession has followed.

Concerning those two exceptions — neither produced a recession — but 1966 marked the top of the Dow Jones Industrial Average prior to a bear market and 1987 marked the largest one day crash (the Crash of 1987) in history. This gives me no comfort about the current Fed's ability to pull off a "soft landing."



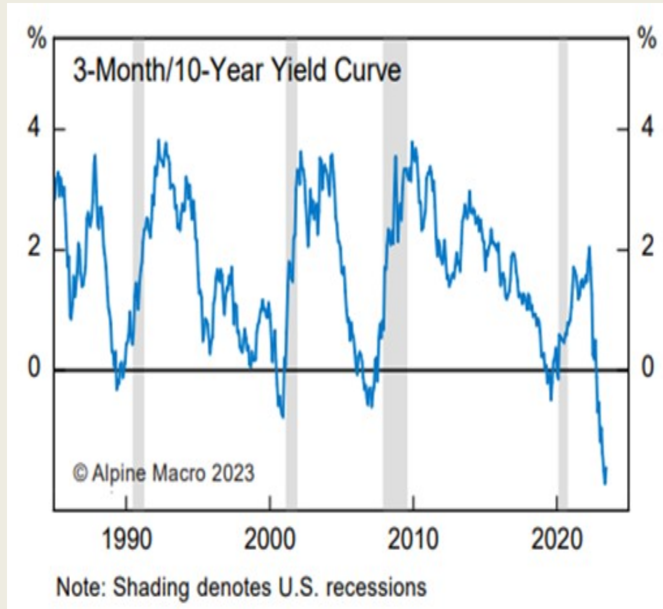
What Our Experts Say

There is still a monster in the closet…

The 10-year to 3-month Treasury yield curve remains inverted, a status that typically foreshadows macroeconomic weakness. With interest rates elevated and banks tightening their lending standards for both consumers and businesses, decline is coming for numerous sectors of the economy.

The inverse yield curve has not gone away. It will take the Federal Reserve reversing course and lowering interest rates for that to happen. Thus far, they exhibit no inclination to do so, because of the labor market. Their quest for wage price stability does not diminish the threat to the broader economic health posed by higher interest rates.

– ITR Economics July 2023



Historically, when the Fed raises short-term interest rates "too high" this results in short-term rates being higher than long-term rates, the famed inverted yield curve. While past performance is no guarantee of the future, historically when the Fed has inverted the yield curve (i.e. short-term rates are higher than long-term rates), it has been a precursor to a recession 11 out of the last 14 times. Note that interest rates are more inverted than they've been in almost 30 years. *Source: BCA 2023*

Having failed to anticipate the surge in inflation, the Fed is concerned about its credibility. To right that wrong and brandish its anti-inflationary credentials, the Fed feels that it must now err on the side of monetary overkill. In the extreme, this could lead to a deeper than needed recession and inflation undershooting the 2% target, perhaps even risking deflation. This would be two wrongs to make a right.

Monetary policy works with lags, which can range between 12-24 months. As the Fed's tightening cycle began 16 months ago, most of its impact is yet to be felt. Moreover, the Fed is saying that it is still not finished tightening. We continue to believe that the Fed's monetary overkill will usher a recession. The yield curve is deeply inverted, the Conference Board's leading indicator has declined for 15 consecutive months, and credit conditions are tightening. A recession will bring demand destruction and lower inflation.

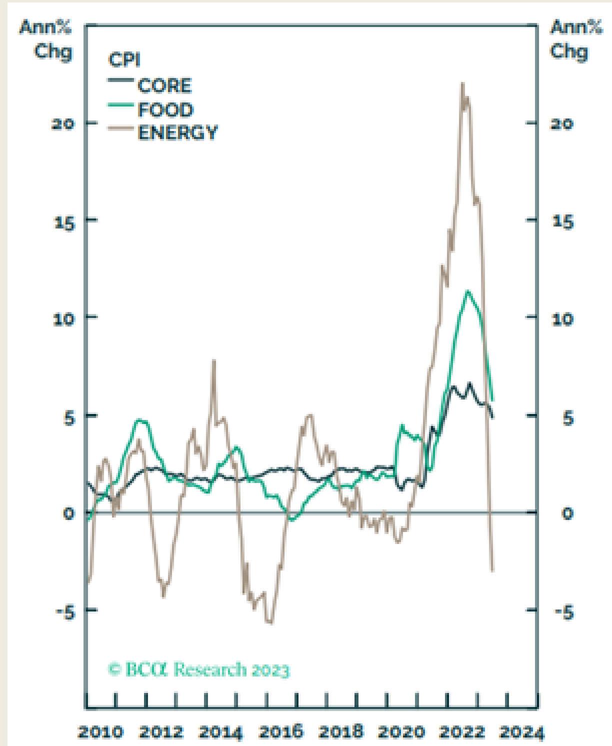
Instead, the Fed wants to keep financial conditions tight, and FOMC minutes have revealed that most policymakers are willing to err on the side of being too tight rather than too easy. This is troubling. History shows that it is the last few rate hikes in each cycle that usually spell trouble for the economy and markets. We are in this last stage of tightening. *– Alpine Macro July 2023*

At a central bankers forum in Portugal late in June, Powell sounded a more hawkish tone, saying Fed policymakers "believe there's more restrictions coming" – possibly rate hikes at consecutive policy meetings – and pointing to the "very strong" labor market as a reason for further tightening.

– Gary Shilling's Insight July 2023

More rate hikes may or may not be needed to push inflation to the Fed's long-term target of 2%. What is less debatable is that additional rate hikes raise the possibility of the Fed pushing the economy into recession in 2024. Jerome Powell has consistently said he is willing to cause a recession to keep inflation expectations in check.

At the latest Fed meeting, it was very clear that Jerome Powell and the Fed now want to see an inflation reading of 2% on core Personal Consumption Expenditures (PCE), which has a lower weighting on shelter costs and is a bit different than CPI. The current core PCE reading is 4.7% year-over-year. – *Mauldin Economics July 2023*



Source: Federal Reserve
Note: Core inflation excludes food and energy

The credit crunch is here, and this will take not quarters, but years to play out if the cost of capital remains high. Understand too that many small and medium sized businesses have to pay an interest rate on a loan that is above 10% if they can even get one. Things in the private economy worked ok at 3–4% interest rates, not so much at 10% as we're on a whole new economic playing field that I don't think is being fully appreciated.

The net effect of having this subjective committee make subjective decisions about a subjective goal will likely mean they once again act too late. Just as they let inflation get worse than it had to be, they will (potentially) keep policy "higher for longer" and perhaps even raise rates and let the next recession cut deeper than it otherwise would. – *Mauldin Economics July 2023*

Simply keeping rates steady at this higher level is itself further tightening. The effects spread more widely as time passes. Peter Boockvar described the process in one of his pre-FOMC letters. "Just keeping rates at high levels for longer is a continued form of monetary tightening as each day that passes someone's adjustable rate mortgage resets much higher, someone's commercial real estate debt is coming due at an interest rate on offer more than double on the loan that is maturing, some business debt needs to be refinanced also at a much steeper rate, and some project or business doesn't get started because more equity is needed because the cost of capital is too high to make the numbers work, each and every day from here.

And each time it happens, more cash is allocated to interest expense than something else or some business doesn't make it. Throw in the ever-growing needs of the US government who is now crowding out the private sector and this is a process of tighter money and less financing availability that will take years to play out, again assuming the Fed is committed to keeping rates higher for a while. – *Mauldin Economics July 2023*

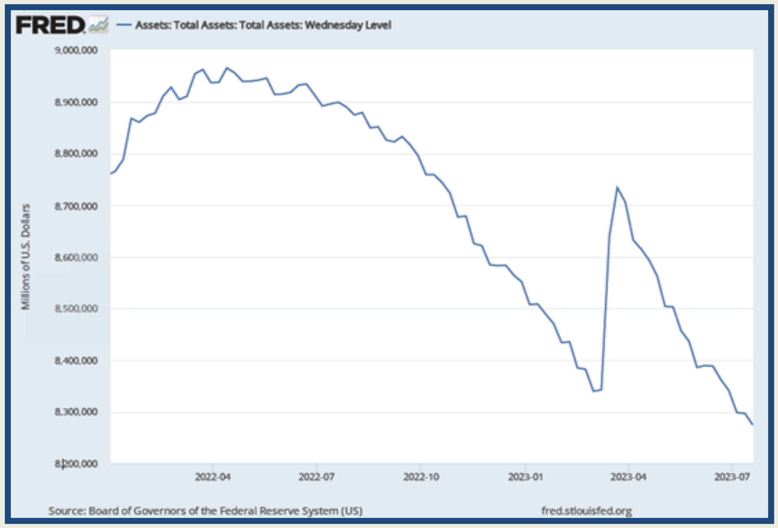
The Fed Is Still Tightening

As you can see below, the Fed is continuing to tighten, with no current end in sight.

The first chart shows the total assets on the books for the Fed. The bulk of these assets are made up of treasury and mortgage backed securities.

After the 2008 Great Financial Crisis and Covid, the Fed's balance sheet had risen to almost $9 trillion, as the Fed created money out of thin air - an electronic "printing press." They added massive liquidity to the system to combat the deflationary impact of the banking crisis in 2008 and Covid in 2020.

Post Covid, Jerome Powell's Fed decided that they need to reduce the balance sheet. You can see that a severe liquidity crunch had been building until April when the "bank crisis" erupted. The old saying is that the Fed tightens until "something breaks."



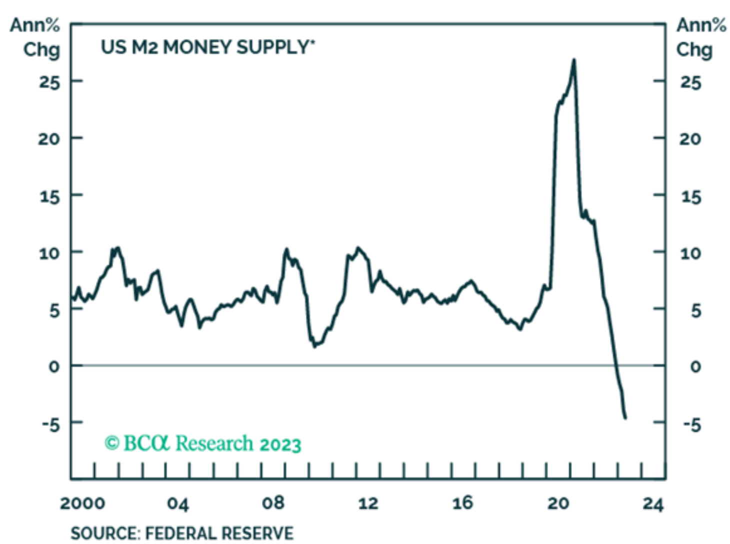
Note the straight up spike in liquidity that occurred during the "mini bank crisis." Is it a coincidence that the stock market surged after that, or maybe cause and effect?

While it is obvious that the banks that failed were certainly pushing the envelope risk-wise with their portfolios and had enormous uninsured deposits (over the $250,000 limit per account registration), I believe that liquidity constraints played a big role in the banking outbreak.

As you can see from the chart, liquidity on the Fed's books temporarily spiked upward during the bank crisis, but has subsequently not only gone away, but gotten worse. The Fed is simply on the warpath toward anything that it deems inflationary. While I do not agree with this tactic, it's what we have to deal with.

In fact, the money supply of the country as measured by M2* is currently ***contracting for only the second time in U.S. history!***

The only previous time that M2 actually contracted was during the Great Depression of the 1930's. I'm not predicting a repeat of the '30's, just pointing out that this is unprecedented and potentially very dangerous.



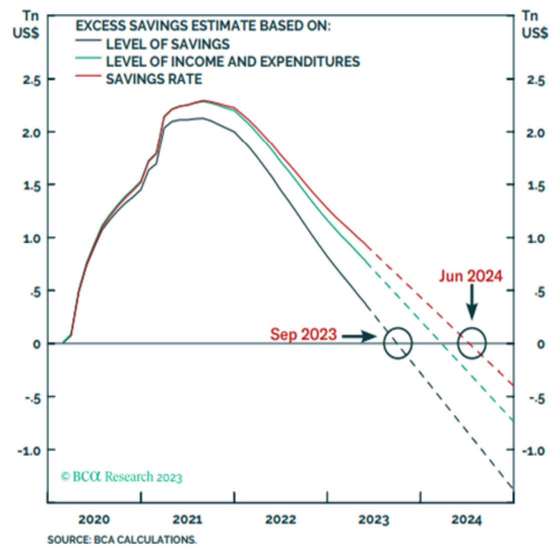
While its clear that the Fed "printed a lot of money" to push the economy up during Covid, in my opinion choking the economy liquidity-wise is a very bad strategy.

*M2 is a measure of the U.S. money stock that includes M1 (currency and coins held by the non-bank public, checkable deposits, and travelers' checks) plus savings deposits (including money market deposit accounts), small time deposits under $100,000, and shares in retail money market mutual funds i.e. the most liquid money.

So What's *Really* Happening?

Multiple factors appear to be at work here. With the Fed continuing on the inflation warpath and raising rates, bank lending standards very tight and getting tighter, plus shrinking liquidity, you would think that the economy would already be receding and the market would be worried. Yet, at least on the surface, this does not appear to be what is happening. GDP for the 2nd quarter actually rose to a 2% annual rate of growth.

Two major factors appear to be largely offsetting both the Fed's warpath, bank lending standards and shrinking liquidity, yet I do not believe these factors will continue to offset the negatives.



To the right you see a chart showing "excess savings" which consumers built into a huge mountain of liquidity during Covid. Remember not only were consumers largely confined to their homes, thus almost no travel, restaurants, etc. resulting in less consumer spending, but in addition the Federal Government handed out almost $2.5 trillion worth of "paycheck subsidies," which largely funneled into savings.

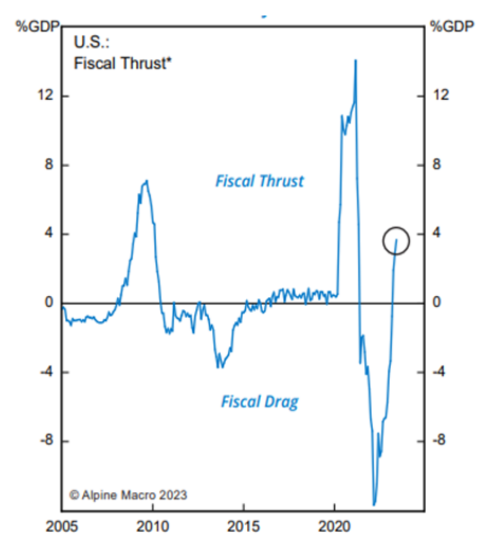
So you had greatly reduced consumer spending, combined with greatly increased savings, producing an ***excess*** level of savings, far beyond what is normal or what consumers were willing or able to spend. These were not normal times.

As you can see from the chart to the right, the best estimates are is that most consumers will have blown through their excess savings sometime in the next 6 months to a year.

Since consumer spending is close to 70% of the economy (GDP) this liquidity mountain has helped sustain consumer spending longer than might have normally been the case in past tightening cycles. Consumers, fed up with being locked down in their own homes had a lot of "pent up" demand, especially for travel, eating out and other forms of recreation once Covid subsided.

So in spite of the tight money environment, consumer spending has continued, but this clearly has its limits, in recent surveys are showing that delinquencies for student loans, credit cards and other forms of credit are now starting to climb. (*Source: Bank Credit Analyst July 2023)*

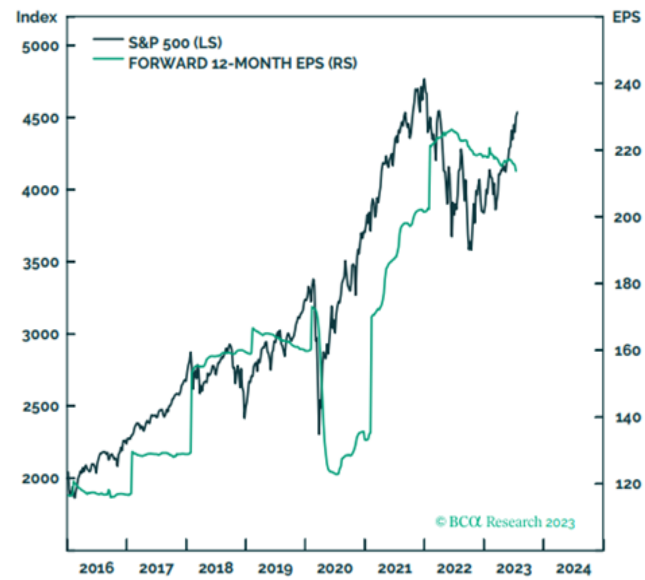
Secondly, as Covid receded, the Federal Government injected approximately $1.1 trillion into the economy through a combination of President Biden's *Infrastructure Investment and Jobs Act*, as well as the CHIPS Act, and the *Inflation Reduction Act*, passed in 2021 while the Democrats still had a majority in the House. Note that this is by far the largest fiscal stimulus ever performed outside of a recession.



*Annual change in primary budget deficit as % of GDP; Q2 2023 nominal GDP is estimated at a 1.2% quarterly growth

Thus enormous fiscal stimulus has been injected into the system. While some of this government spending will be spread out over years, a lot of it is frontloaded and has resulted in tax incentives for everything from clean electricity, loan guarantees, semiconductor manufacturing and transportation. This estimated $1.1 trillion in GDP has clearly been stimulating portions of the economy, in spite of rising interest rates. *(Source: Alpine Macro July 2023)*

Stock Market



To the right you see a chart showing the huge bounce we've seen in the S&P 500 since last October's lows, and you can clearly see that the market is approaching the all-time high. Curiously enough, you can also see that projected forward earnings are continuing to decline. So estimated future earnings and stocks are going in opposite directions. Since stocks tend to be an extrapolation of future expected earnings, the question is, ***what gives?***

We are also seeing unprecedented market concentration in a handful of big cap tech stocks. In fact, according to Ned Davis Research (7/20/23), "sentiment (positive market emotions) for several asset classes has reached excessive levels. One measure of excessive optimism shows the combined market cap of the ELITE 8* stocks has surpassed the ***combined market cap of the entire Energy, Materials, Industrials, Financials, and Real Estate sectors!"***

(*Note: ELITE 8 are Meta, Amazon, Netflix, Microsoft, Apple, Google, Tesla and Nvidia.)

It's possible that this could be a "new bull market," but from my perspective that is highly unlikely. Normally the start of a new bull market brings an entirely new set of winners. This appears to be a huge bounce in the previous bull market's winners, partially because these stocks have been viewed as "safe havens" in the event of another recession and now make up over 25% of the value of the entire S&P Index. Historically, these levels of market concentration normally occur at or near long-term market tops - *Ned Davis July 2023*

Historically, stocks can do quite well just prior to a recession. In the table to the right, you see both the 7-12 months prior and the 1-6 months prior to recession from *Bank Credit Analyst.*

Critically here, the question is how close are we to the next recession. If the next recession is 7-12 months away, which I consider to be very unlikely we could be still in for another significant run.

On the other hand, if we are 1-6 months away, the picture changes entirely.

Historically speaking the ***lag effect*** of the Fed's policies is notoriously difficult to time. However, from everything I'm seeing, we are likely living on borrowed time.

The 7-To-12 Months Before Recession Are Good For Stocks

ANNUALIZED REAL RETURNS (%) PRIOR TO RECESSIONS	MONTHS PRIOR TO RECESSION	
	7-TO-12 MONTHS	1-TO-6 MONTHS
Jul 1981 - Nov 1982*	32.2	-11.2
Jul 1990 - Mar 1991	22.2	1.6
Mar 2001 - Nov 2001	20.0	-40.6
Dec 2007 - Jun 2009	13.6	-6.3
Feb 2020 - Mar 2020	11.7	2.6

* FIRST 2 COLUMNS OMITTED DUE TO OVERLAP WITH PREVIOUS RECESSION PERIOD. NOTE: MONTHLY RETURNS ARE ANNUALIZED AND DEFLATED BY THE CONSUMER PRICE INDEX; CALCULATIONS ARE BASED ON TOTAL RETURN INDEX.
©BCA Research 2023

As we continue our discussion of ***what next?***, lets look at what the outlook for both the major brokerage houses and banks and investors has been for 2023, because I think it sheds a lot of light on the matter.

As you can see at the right, the majority of the banks expected a recession to begin in the first half of 2023. Clearly that has not occurred, and in my opinion the combination of President Biden's stimulus programs plus pent up excess savings have likely pushed the recession a little further out, but I do not believe it has postponed it indefinitely.

Major Banks - 2023 Recession Outlook

Bank	2023 Recession Forecast (As of January)
Bank of America	Mild recession, beginning 1st half
Barclays	Shallow recession, beginning in the spring
Citi	Recession
PNC	Mild recession, starting in the spring
Wells Fargo	Modest recession, beginning mid-2023
Goldman Sachs	Recession narrowly avoided
Morgan Stanley	No recession
Deutsche Bank	Recession in 2nd half of the year
JP Morgan	Mild recession, beginning late in the year

*Source: Investech January 2023

For a crystal clear look at what I believe has happened in the market this year, lets see what Bank Credit Analyst's Vice President and Chief Economist, Jonathan LeBerge has to say. He preceded these comments by stating that he felt that investors were "naïve" in their outlook pertaining to stocks.

> Many equity investors have taken this (GDP rebound), in conjunction with expectations of interest rate cuts over the coming year, as a sign that the worst is over for the stock market and that pro-risk positioning is warranted. This reasoning is flawed in a few respects.
>
> The first mistake made by investors was interpreting the decline in leading economic indicators (LEIs) last year as a sign of an ***imminent*** recession that should already have occurred by now. We noted in our August 2022 report that there were a few reasons to believe that the usual signal from commonly cited LEIs might be distorted (Ed Note: factors previously discussed, i.e. excess savings and fiscal stimulus).
>
> The second mistake that investors are making is to assume that core price disinflation will lead to meaningful interest rate cuts outside of the context of a recession (a "soft-landing"). We accept that this could occur, but it is the least likely of the three possible scenarios over the coming year.
>
> Finally, the third mistake investors are making is interpreting the near-term pickup in growth and the ongoing stability of ***coincident*** economic indicators as a sign not just that a recession will be avoided in the near future, but also that a recession is likely to be entirely avoided. In short, the fact that market participants jumped the gun last year on their expectation for the timing of a recession ***now has those investors believing that a recession is unlikely at all because it has failed to arrive.*** *– Bank Credit Analyst June 2023*

So, indeed if we do end up with a "soft landing" the markets enthusiasm will likely be justified.

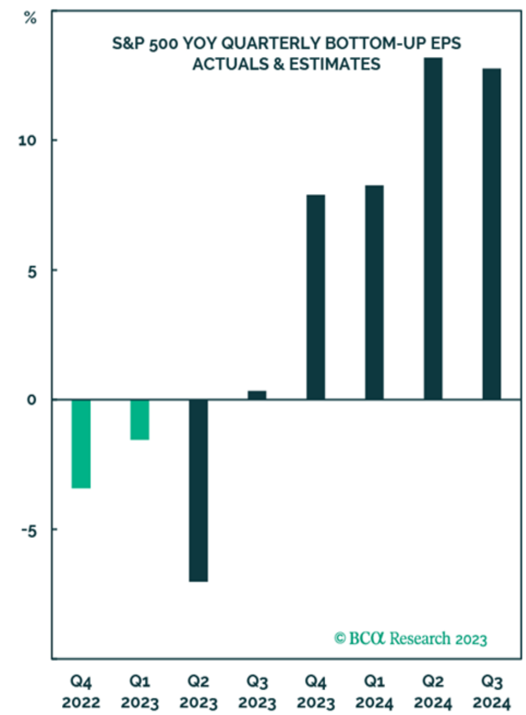
However, if we have a recession as we believe we will, stocks will almost certainly experience a major decline, as is typical in recessionary times. The next chart shows the history of recent declines in earnings per share for the market in recessions. Again, the key is timing!

RECESSION	MAX Y/Y % QUARTERLY EPS DRAWDOWN
2001	-39%
2008	-100%
2020	-49%

©BCA Research 2023

If we are near the apex of this current cycle and recession happens in the next few months, this is highly likely to produce a huge bear market, especially considering just how much the market has bounced this year, plus the ***radical emotional shift*** that is almost certain to take place once investors realize that they're wrong. I personally believe that last October lows will likely be taken out in the next bear. More on this to come.

Since the majority of firms expected a recession in the first half of the year, which has clearly been wrong, they followed that by projecting a massive surge in earnings starting in Q4 of 2023 as you can see in the chart on the right.



Keep in mind this reflects the collective thinking of Wall St. which is frequently subject to "groupthink," peer pressure, etc. as well as the contagion effect. In other words, ***if everyone believes the same thing it must be true!*** Not really.

So, the recent mega rally in stocks is partially reflective of a "mini" mania over any company remotely connected to Artificial Intelligence (which will likely be a boom industry in the future), plus a mega tech stock rally due to the perception that these mega tech growth stocks would be a potential shelter in a recessionary storm, plus expectations that earnings will again start to boom in 2024.

My question is, what if instead of a boom in 2024 we experience a recession. I originally thought the likely recession would be mild, and could still be, but with the Fed potentially overdoing it, maybe not so mild after all. We will see.

The next table shows the average length of time for the market peaking prior to recessions, and secondly prior to market bottoms.

Stock Market Peaks And Troughs Around Recessions

Recession Start	S&P500 peak	Stock Peak Vs. Recession Start (Months)	Recession End	S&P500 bottom	Stock Bottom Vs. Recession End (Months)
Jul/1981	Nov/1980	-8	Nov/1982	Jul/1982	-4
Jul/1990	Jun/1990	-1	Mar/1991	Oct/1990	-5
Mar/2001	Aug/2000	-7	Nov/2001	Sep/2002	10
Dec/2007	Oct/2007	-2	Jun/2009	Feb/2009	-4
Feb/2020	Jan/2020	-1	Apr/2020	Mar/2020	-1
Average past 43 years		-3.8			-0.8

©BCA Research 2023

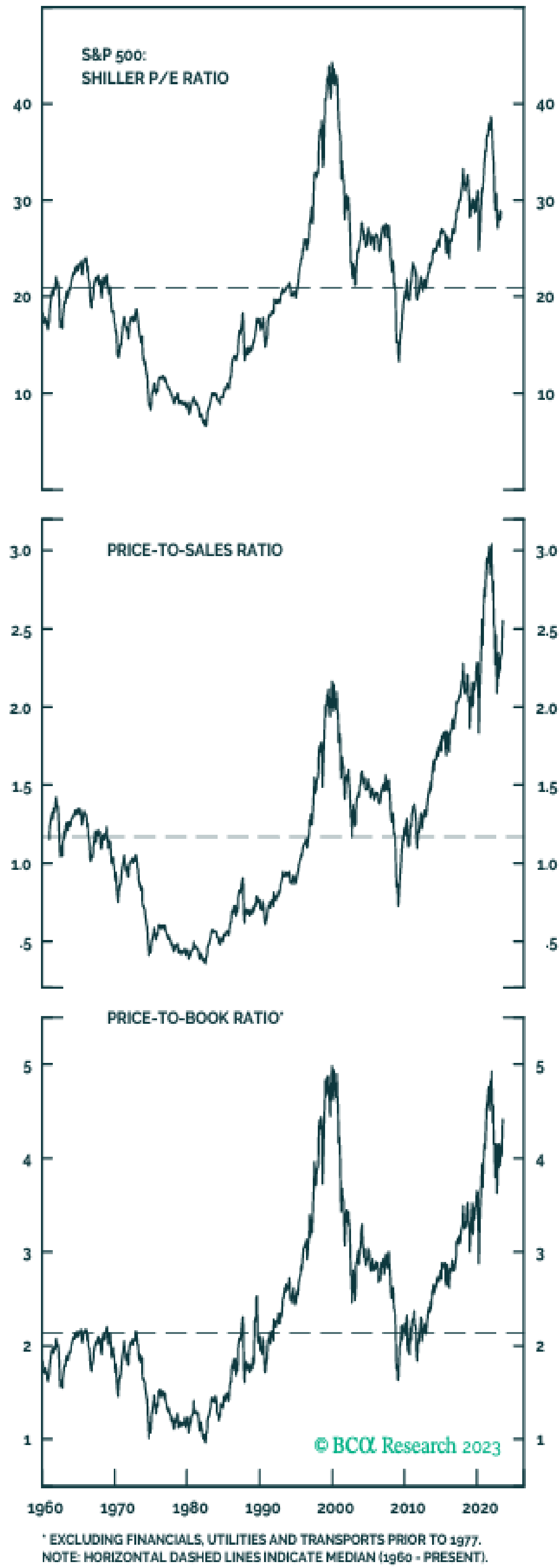
As you can see, over the past 43 years, stocks have tended to peak anywhere from 1-8 months prior to the recession "officially" starting. On average, it's been just under 4 months.

You can also see that stocks also tend to bottom, before the recession is over. With the exception of the unusually long bear in 2001-02, stocks have averaged bottoming about 3.5 months ***before*** the recession is over.

So again the issue is timing. If the recession starts soon, possibly this fall, the market might be putting in a top as we speak.

On the other hand, if the recession starts in 2024, it could be later.

From my perspective, we are in a high risk situation. The likelihood is high that the Fed is overdoing it again, which puts stocks in a peculiarly dangerous situation given that expectations have changed so radically from negative to positive, ***but now could change from extreme positive to extreme negative in a hurry.***



To the left you see several valuation benchmarks for the stock market, which are widely accepted. As you can see based upon the charts which go back to 1960, you would be hard pressed to make the case that stocks are cheap right now. In fact, by many measures, such as the price/earnings ratio and the price/book value ratio stocks are still near all time valuations, i.e. very expensive.

Thus if our scenario proves to be right there will likely be a radical shock to investors emotions precipitated by the recession. The fact that stocks are very expensive beforehand, and still highly leveraged (margin debt not shown) are typically ingredients that appear before Daddy Bear markets (see Special Report: ***Daddy Bear Market*** May 2022 www.cornerstonereport.com)

> Ned Davis Research recently did a study on the history of bear markets and concluded that typically the longest and deepest bears occur during recessions.—*Ned Davis Research July 2023*

So, in all we think the Fed is over doing it and raising interest rates too high (again) plus providing an extreme reduction in liquidity in this banking system. Given sufficient lag times we believe this will produce a recession within the next 12 months, but potentially as soon as September.

Should this scenario play out, all the necessary ingredients are with us for a potential major bear market, or a Daddy Bear.

Perhaps it's only a Mama Bear, there's simply no way to know ahead of time. But overvalued stocks, massive margin debt leverage, plus recession ingredients are unlikely to produce a mild bear. As Ned Davis recently documented, the longest and deepest bears normally accompany recessions.

Conclusion

If events play out as we expect, the likelihood is high that we will experience a major bear market within the next 12-18 months.

We are also concerned about potential geopolitical disruptions (i.e. Russia/Ukraine War acceleration) and potential conflict with Iran, likely affecting world oil supply. These geopolitical events, at this point, are being largely ignored by the market.

Investment luminary Sir John Templeton, in my opinion, one of the most important investment all-stars of the last century, stated it this way: ***this time is different are the four most expensive words in the English language.***

As we have demonstrated in this special report ***all of the major ingredients*** that we expect to see ***prior*** to a recession appear to be with us currently.

The market now appears to be largely ignoring the risks and ***hoping*** that everything works out.

We think its very dangerous here to ignore historical precedence. As we all know, past is performance is never a guarantee of future results, but the indications, in my opinion, are strong that a recession will soon breakout and a very overvalued market will likely lead to a major bear.

I do NOT believe that this time is truly different, but I do believe it is likely longer. Is this a new bull or a bear, you decide.

The Cornerstone Report is published by Cornerstone Financial Services, Inc., a Registered Investment Advisor.

The opinions and statements made within this newsletter should not be construed, directly or indirectly, as an offer to buy or sell any securities mentioned herein. Due to volatility within the markets mentioned, opinions are subject to change without notice. Statements and opinions are based upon sources of information believed to be reliable; however, accuracy and completeness cannot be guaranteed. No assurance can be made that recommendations contained herein will be profitable or will be equal to past results. Past performance is no guarantee of future results.

This newsletter is designed to provide general economic and market information and should not be construed to comprise individual or specific counsel concerning investment, tax or legal considerations. Material discussed herewith is meant for general illustration and/or informational purposes only, please note that individual situations can vary. Therefore, the information should be relied upon when coordinated with individual professional advice. Please consult your financial advisor(s) for specific advice pertaining to any and all areas of financial planning.

Please remember: Different types of investments involve varying degrees of risk, and there can be no assurance that the future performance of any specific investment, investment strategy, or product made reference to directly or indirectly in this newsletter (including the investments and/or investment strategies recommended or undertaken by Cornerstone Financial Services) will be profitable, equal any corresponding indicated historical performance level(s), or be suitable for your portfolio or individual situation or prove successful. Due to various factors, including changing market conditions, the content may no longer be reflective of current opinions or positions.

Moreover, you should not assume that any discussion or information contained in this newsletter serves as the receipt of, or as a substitute for, personalized investment advice from Cornerstone Financial Services, Inc. To the extent that a reader has any questions regarding the applicability of any specific issue discussed above to his/her individual situation, he/she is encouraged to consult with the professional advisor of his/her choosing. A copy of Cornerstone's current written disclosure statement discussing our advisory services and fees is available for review upon request. A complete history of Cornerstone's market calls is available at the Cornerstone office upon request.

All technical analysis and resulting conclusions and observations are based upon historical chart formations and patterns. Therefore, observations are a function of each analyst's interpretation of the charts—and also a function of mathematical probabilities. In effect, technical analysis is a study in probabilities. What happened x number of times in the past per a particular chart pattern does not mean it will always recur in the future. It logically follows that historical precedent does not guarantee future results.

In general, bond market is volatile, bond prices rise when interest rates fall and vice versa. This effect is usually pronounced for longer-term securities. Any fixed income security sold or redeemed prior to maturity may be subject to a substantial gain or loss. Fixed income investments are subject to various risks including changes in interest rates, credit quality, inflation risk, market valuations, prepayments, corporate events, tax ramifications and other factors.

Investing involves risk including the potential loss of principal. No investment process in the stock market is free of risk; no strategy or risk management technique can guarantee returns or eliminate all risks in any market environment. There is no guarantee that our investment processes will be profitable.

There is no assurance that any strategy will achieve its objectives.

The market indexes discussed are unmanaged and generally considered representative of their respective markets. Individuals cannot directly invest in unmanaged indexes.

Cornerstone Financial Services, Inc.
4851 LBJ Freeway, Suite 1175
Dallas, TX 75244

Jerry E. Tuma, MS, CFP®,
Senior Editor

David McCord, CMT,
Contributing Editor