Golden Eagle Strategies | Q3 Update

October 1, 2022

RAPIDLY CHANGING MARKET DYNAMICS

September proved to be a difficult month for the U.S. stock market as the three major indexes finished lower. Whereas the NASDAQ composite and Russell 2000 index had entered bear markets in June, the S&P 500 slipped into its own bear market during the last week of September. In our last commentary, we intimated that the stock market lows for the year were seen on June 16, as both the NASDAQ Composite Index and Russell 2000 Index rallied 23% from their June lows by August. Typically, moves of 20% or more signal that a new bull market has begun. Both indexes have since retraced their recovery gains and are now hovering near their prior lows.

The economic and financial landscapes have changed dramatically in the past month. The Federal Reserve has shifted policy and adopted a more hawkish stance on interest rates which sent the markets into a decline. Previous targets for the discount rate were set at 3.5% for 2022 and 3.75% for 2023. However, the Fed raised its 2022 target at its last meeting from 3.75% to 4.6%. Rates in 2023 will likely go higher, increasing the probability of a recession, if one has not already taken hold.

KEY POINTS

- **All three major indexes continued to drop in Q3 amidst a background of sustained high inflation and the announcement of more aggressive monetary policy by the Federal Reserve**
- **Increased probability of recession with Federal Express, a bellwether of economic activity, reporting an 11% drop in August deliveries**
- **Darkening outlook for economy affected stock market, however, bull markets are born from bear markets and typically aggressive growth stocks lead the way. We remain convinced that this is an unparalleled buying opportunity for aggressive growth stocks.**

Federal Express, a bellwether of economic activity, reported that August deliveries plummeted 11%. Skyrocketing inflation in food and utility costs, along with rapid rent inflation have caused a massive loss of purchasing power for the general public. Each one of these costs has risen between 13% and 20% during the past year.

Inflation Threat to Economic Growth

We think it will be difficult to reduce inflation to 2%, which is the Fed objective over the next couple of years. High food inflation will persist for years to come given worldwide drought conditions and the green movement which seeks to eliminate fertilizer use in crop production. Sri Lanka banned the use of fertilizers in farming two years ago. Their rice crop this year dropped by 40%[1]

causing food to become scarce, resulting in skyrocketing prices and civil unrest. The phasing out of coal and oil in electricity generation comes at a high cost because wind and solar power are more expensive energy sources. This phase out also goes hand in hand with rising utility costs. Further, the Realtor.Com June Rental Report shows that rent grew by 14.1% in the latest year[2]. Food, utility, and rent account for more than 50% of the CPI index.

What is equally threatening to economic growth, besides high interest rates, is the use of "moral suasion" by the Fed, a non-metric tool used to darken the outlook for both the economy and stock market. Statements made by the Fed such as "we will take any action to break the back of inflation" tend to have a dampening effect on both the economy and stock market, compounding the effect of the projected rate increases.

Fed Still Behind the Curve

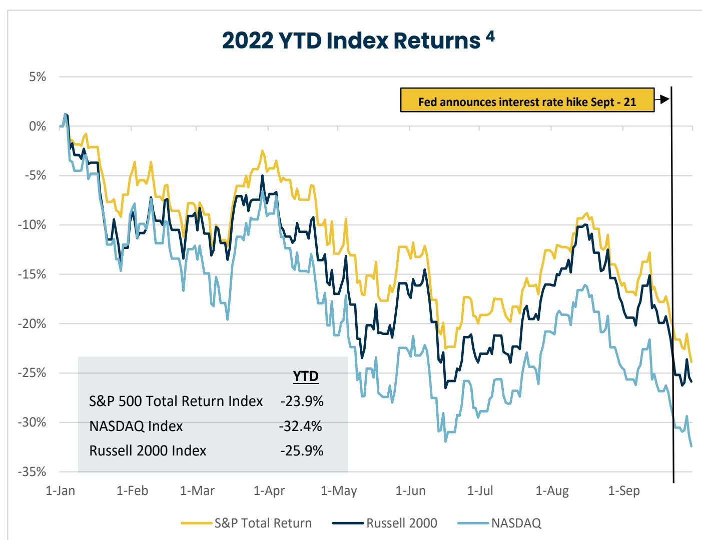
Golden Eagle was early in sounding the alarm on accelerating inflation after observing a gargantuan increase in the M2 Money Supply Aggregate, which expanded from $15 trillion to $22 trillion over 15 months. It took the Fed nearly a year to realize that inflation had become a significant problem, largely owing to the rapid expansion of the money supply.

Currently, the Fed seems comfortable in raising the discount rate in sizable increments underpinned by a healthy jobs market. It was reported that for August 315,000 new jobs were created, accompanied by an unemployment rate of 3.7%. However, the unemployment rate tends to be a lagging indicator, meaning that the unemployment rate turns down after the economy enters into recession. We regard the FedEx report of a dramatic decline in deliveries as being the canary in the coal mine, implying that the economy is weaker than assumed by the Fed. In turn, we think that the Fed could find itself again behind the curve by applying too much pressure on interest rates to slow the rate of inflation, causing the economy to go in reverse.

Many job cuts are already in the works. Golden Eagle Strategies would not be surprised to see aggregate job destruction by the end of the year. Announcements of new job cuts are starting to flow like water, with 51% of corporate executives reporting that they have implemented or plan to implement job cuts, according to a PricewaterhouseCoopers survey[3]. Some announcements are noted as follows:

Wage Force Cuts by Sector[3]

Consumer Cyclicals	Gap (GPS)	5%	Wayfair (W)	5%	Ford Motor (F)	1%
Finance	Credit Suisse (CS)	10%	Robinhood (HOOD)	9%	Coinbase Global (COIN)	18%
Real Estate	Compass (COMP)	10%	Re-Max (RMAX)	17%	Redfin (RDFN)	8%
Technology	Shopify (SHOP)	10%	Meta Platforms (META)	10%	Snap (SNAP)	20%



Impact on Stock Market

What does this all portend for the stock market? While we thought the lows seen in June represented a potential market bottom based on the strong recoveries by the NASDAQ and Russell 2000, the S&P has touched new lows subsequent to the Fed's retraction of their previous guidance as indicated in the chart to the left. What is perhaps a more relevant perspective when considering a market bottom is looking at the risk-to-reward ratio for the stock market.

There have been 13 bull and 13 bear markets since World War II excepting the current cycle. Our research shows that bear markets go down 33% on average over a 13-month period while bull markets go up on average 150% over four and one-half years. With the S&P 500 now down 23% from its all-time peak on January 3rd, further downside might amount to a possible 10% using history as a guide. Thus, the risk to reward ratio for stocks would be potentially a 10% decline on the negative side with a subsequent 150% gain on the positive side. These are very good odds going forward. While the economic outlook may be bleak, the stock market typically leads the economy and turns up when it appears most bleak. Bear markets serve an important function; downturns force increases in productivity and efficiency that carry the economy into the next bull market.

Maintaining Perspective

Investors tend to become more bullish toward the end of bull markets and more bearish towards the end of bear markets. Bank of America just reported that 284 major advisory firms were holding their highest cash positions for this year at the end of August. The media also exacerbates bearish sentiment by publishing articles such as, "Will this be another lost decade in a stock market?". When grounded by a broader historical view, however, the outlook can be perceived in a positive light.

The US stock market origins date back to 1792. *How Wall Street Reshaped America's Destiny*, a book written by CIO Robert Zuccaro, chronicles 14 periods of innovation. During this 200-year stretch the stock market routinely went higher and established a countless number of record highs ending with January 3 of this year. At Golden Eagle, we hold to the credo that "bear markets are temporary, but the bull market is permanent". As in the past, it is almost certain that the economy will start to grow again and that the stock market will follow suit by rising to new record highs (copies of the book are available upon request).

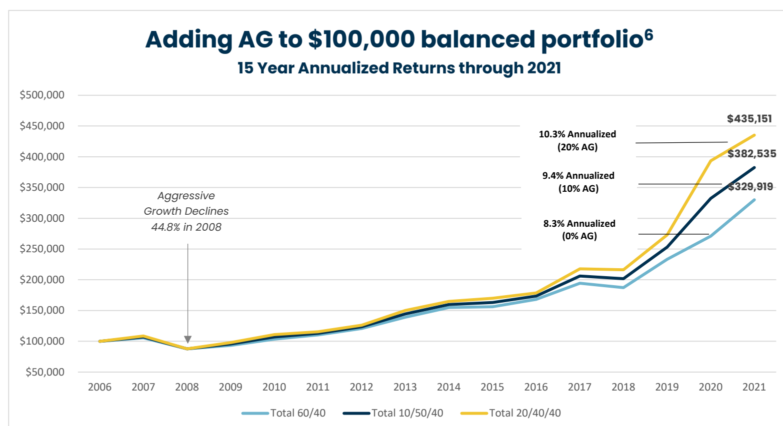
Outlook for Golden Eagle

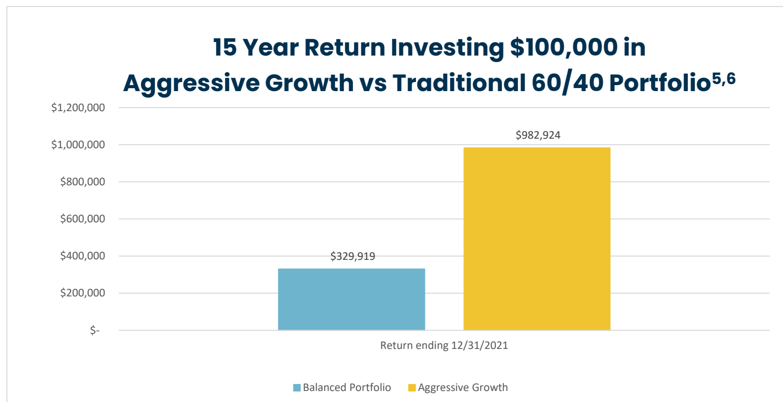
As we have consistently stated, we expect aggressive growth stocks to again lead the way into the next bull market. Golden Eagles Strategies has constructed a history on investment styles dating back to 1958. By far, the aggressive growth style has outdistanced both the growth and value styles. In addition to demonstrating superior performance on an absolute and relative basis, this style has

proven to be one leading indicator of the stock market in recent years. During the bear market of 2007 to 2008 our Aggressive Growth Fund Index (AGF Index)[5] turned up in November, four months prior to the S&P 500 which bottomed on March 9, 2009. During the brief bear market of 2020, the shortest on record lasting five weeks, the AGF Index preceded the stock market turn by one week. It should be noted that even though the S&P 500 touched bottom in the past week, the AGF Index still trades above its June low and is up 6% from that point. Thus, it is possible that the overall stock market is close to a bottom.

Golden Eagle is set to fly in the next bull market. Golden Eagle's decision-making process is much different than its peers because we focus on companies that exhibit *current rapid profits growth*, while most managers invest in companies with an eye pointed towards *potential future growth*. Further, because we are agnostic to sector and size, we can find growth no matter where it is occurring in the stock market.

As growth specialists who have studied the market for 40+ years, we seek companies which are growing their profits by 100%+ or more. 'Price follows earnings' is a widely held tenet in the investment business, however our research has proven that the highest profits growth leads to the highest returns over time. And 'over time' should be kept in mind because aggressive growth stocks are more volatile than the overall stock market. While many people look at volatility as risk, volatility is also the source of profit over time. In the stock market, risk dissipates over time.





Consider that since 1926, the S&P has produced positive returns 98% of the time over all 10-year periods. Further, consider the long-term impact of adding hyper-growth stocks to your portfolio.

- If an investor allocated 20% of the typical 60/40 portfolio to aggressive growth stocks 15 years ago, it would have increased annualized returns by 2.0% (despite aggressive growth funds declining 44.8% in 2008).
- If an investor allocated 100% of their wealth to the aggressive growth style, the return over the past 15 years would have been close to triple that of a traditional 60/40 portfolio.

While aggressive growth stocks do tend to be more volatile, again, that volatility also serves as a source of alpha.

Conclusion

The outlook for the economy has darkened as the Fed has adopted a more aggressive stance after failing to respond in a timely manner to inflationary pressures. The stock market has been affected by the worsening outlook, however, bull markets are born from bear markets. Typically, aggressive growth stocks lead the way out of a bear market; we remain convinced that this is an unparalleled buying opportunity for aggressive growth stocks.

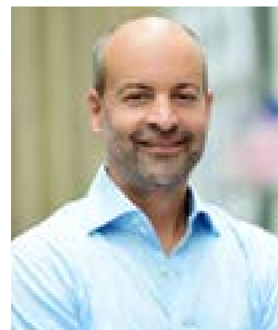
As stated before, the first six months of 2022 have been the worst for the aggressive growth style in more than 60 years as aggressive growth funds declined almost 50%. Golden Eagle was also a casualty in this market rout (fact sheet). Prior to this period, Golden Eagle earned a rarefied standing amongst some 9,000 funds in first two years of existence with a 121% cumulative net return.

While we are clearly disappointed in how this year has unfolded so far, we are not discouraged. Our research proves that the aggressive growth style consistently outperforms other asset classes over time. The style also demonstrated powerful recoveries after recent downturns – rebounding 68% off the bottom in 2008 and 122% off the bottom in 2020 over the following 12 months. As such, we believe that the future remains bright.

Robert

Robert Zuccaro, Founder & CIO

Marc



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[1] *https://www.reuters.com/world/asia-pacific/sri-lanka-paddy-crop-slated-drop-after-chemical-fertiliser-ban-2021-11-10/*
[2] *https://www.realtor.com/research/june-2022-rent/*
[3] *https://www.forbes.com/sites/brianbushard/2022/09/28/docusign-plans-staff-reductions-here-are-the-major-us-layoffs-this-year/?sh=172b4ef41d41>*
[4] *Yahoo! Finance*
[5] *The GES Aggressive Growth Index includes 12 strategies of top performing publicly traded aggressive growth funds (ETFs and Mutual Funds) similar to investment objective of Golden Eagle Strategies. Additional details can be provided upon request.*
[6] *The 60/40 portfolio represents 60% return of the S&P and 40% return of a fixed income portfolio consisting of their Shares 7-10 Year Treasury Bond ETF. The 20/40/40 portfolio consisted of 20 of the Aggressive Growth Index, the S&P and the fixed income portfolio previously outlined, and the 10/50/40 is the same items outlined previously.*

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