Nine Reasons Reprise - The Economy Remains Strong For Now

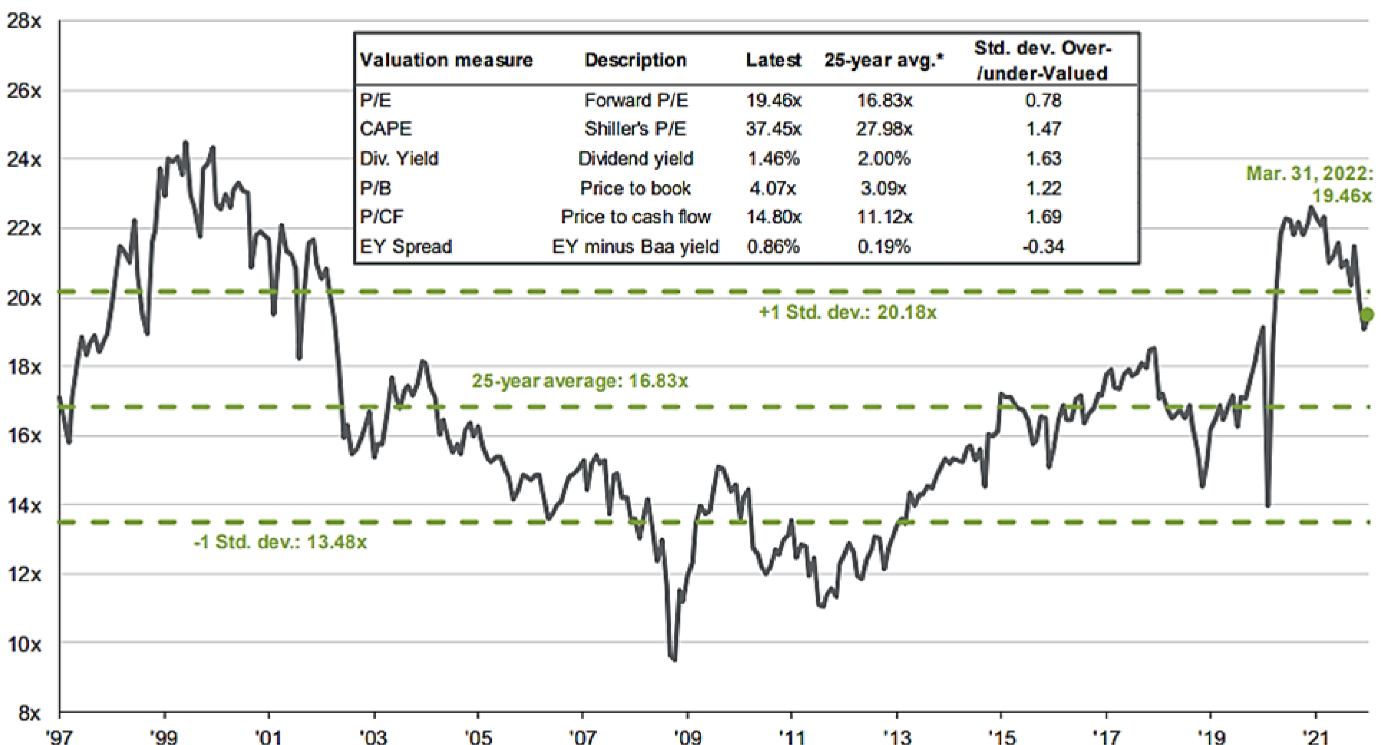
Last year we wrote a prescient note on markets entitled "Nine Reasons to Expect a Market Pullback – And One Not to Worry." Given the significant uptick in market volatility since the new year, we thought it would be timely to update our views now that the major indices have formally entered correction territory. To begin at the ending, although a variety of concerns remain, the economy continues to plug along quite nicely despite a recent topline contraction in Gross Domestic Product (GDP), which could help contain downside risks in the near term.

First, How Did We Get Here?

If you have not noticed at the grocery store or at the pump, inflation is on the rise. This past March, the US Bureau of Labor Statistics reported annualized inflation at +8.5%, the highest level since 1981. Not only was significant stimulus, equivalent to half of US GDP, pumped into the economy during the COVID pandemic, but global supply chains remain disrupted, and now Eastern Europe finds itself at war with the tragic invasion of Ukraine. A desire to extend economic support left the Federal Reserve flat-footed in responding to these price increases, which they initially predicted to be "transitory" in nature. With the jobs market fully recovered, the Federal Reserve turned its full attention to battling inflation coming into the new year. A speedily increasing hawkish tone caught markets off-guard, precipitating a bear market in bonds and extreme choppiness in equities featuring a rotation out of last year's growth winners into late-cycle value plays.

Stock Valuations Have Retreated & Stock Fever Has Abated

Extreme valuation levels at the end of 2021 focused into a narrowing set of growth stocks set the stage for potential market volatility, and that is exactly how it has played out.



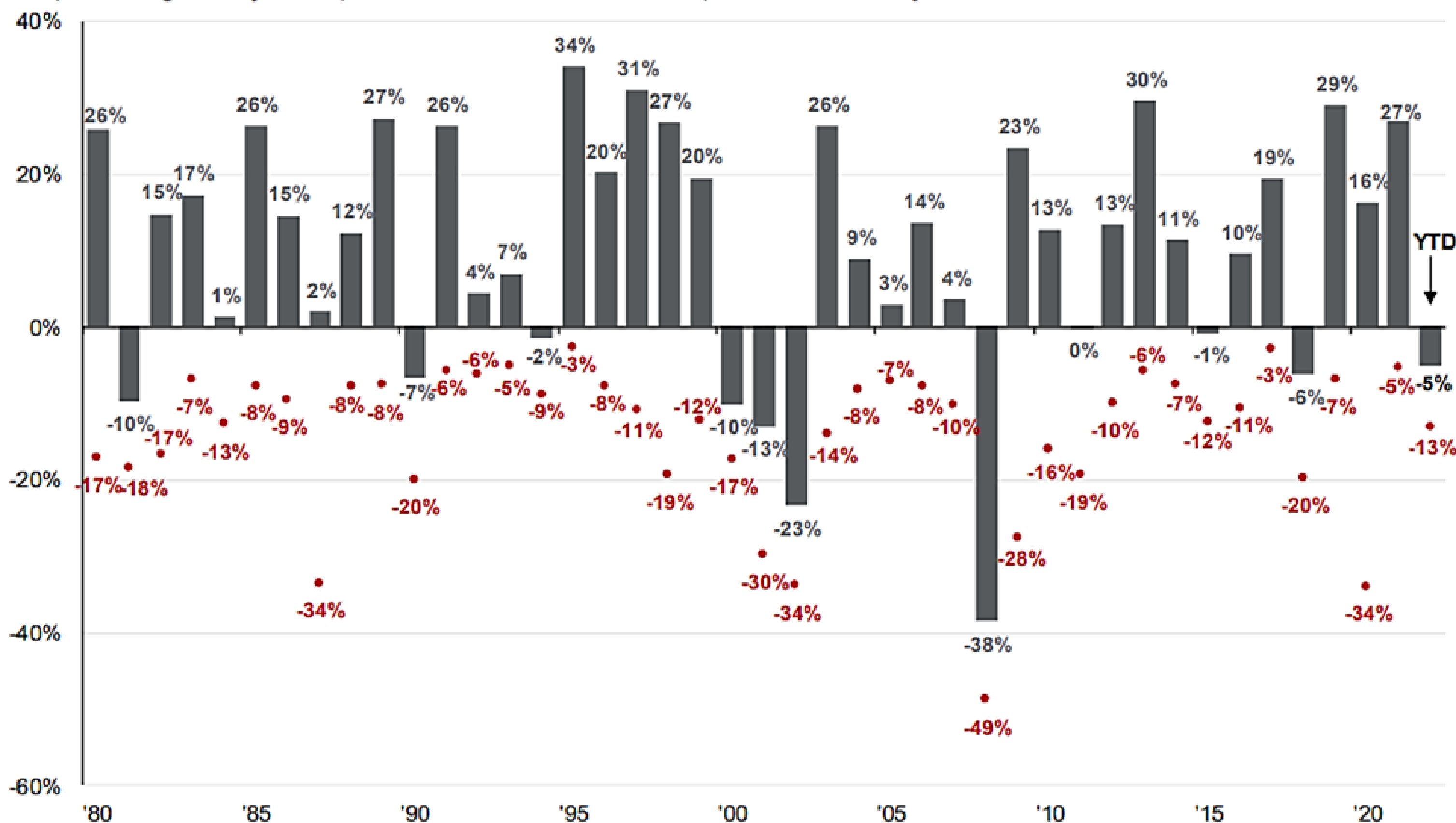
Valuation measure	Description	Latest	25-year avg.*	Std. dev. Over-/under-Valued
P/E	Forward P/E	19.46x	16.83x	0.78
CAPE	Shiller's P/E	37.45x	27.98x	1.47
Div. Yield	Dividend yield	1.46%	2.00%	1.63
P/B	Price to book	4.07x	3.09x	1.22
P/CF	Price to cash flow	14.80x	11.12x	1.69
EY Spread	EY minus Baa yield	0.86%	0.19%	-0.34

Source: JP Morgan Asset **Management,** "Guide to the Markets," March 31, 2022.

As shown above, the good news is that forward Price/Earnings ratios have come back into a more normal range even though they remain above long-term averages. Throughout last year, the investing conversation surrounded heady Meme-Stocks, Special Purpose Acquisition Companies (“SPACs”), and Initial Public Offering (“IPO”) volume. With the growth sector having come back down to earth, investors are now more reasonably sanguine about future earnings prospects.

We’ve Seen a Typical Correction

Last year investors bought every “dip” in the market, allowing only a short-lived -5% peak-to-trough fall. This year has been a different story, with the S&P 500 US Large-Cap index twice falling into a mid-teen correction level. Although this has “felt” quite negative, the reality is that the three-year low volatility power ramp higher in the indices spoiled investors to a degree; the fact is that the average intra-year retrace back through 1980 has been about -14%. In other words, this is very normal market behavior, and one view is that it is quite positive to have finally cleared the deck so that markets may resume their long-term rise at a healthier pace.



Source: JP Morgan Asset Management, “**Guide** to the Markets,” March 31, 2022.

Inflation May Be Peaking, But Could Persist

While it is still reasonable to believe inflation will abate as supply chains slowly come back on-line, residual waves of COVID shutdowns in China have caused them to last longer than expected. This, coupled with a tight labor market, has promoted transmission of higher prices into labor and housing costs, which tend to be “sticker” and longer lasting. The war in Europe is not helping, since a third of global grain production comes from Ukraine, and significant energy supplies face restrictions from Russia to Europe. All this makes the Federal Reserve’s mission to reduce inflation especially difficult since these factors go beyond our borders and their direct control. This exacerbates market fears that the Feds will make a policy error, over tightening monetary policy and creating a recession rather than the “soft landing” they wish to achieve.

Growth Is Leveling Off, But Remains Robust

Despite rising costs, corporate America continues to grow its bottom-line. With 20% of the S&P 500 having reported first-quarter earnings, we are seeing +6.6% average growth. Although this is the lowest rate since late-2020, it is nicely positive and well above expectations (Factset, "S&P 500 Earnings Season Update," 4/22/22). We could make similar comments at a macro level. While Q1 GDP posted a surprisingly negative -1.4% first read, this was largely due to trade and inventory effects, with consumer spending and corporate investment levels remaining strong (Reuters, "US Economy Shrinks in First Quarter…," 4/28/22). The US jobs market is particularly strong, with unemployment recently reported at 3.6% by the US Bureau of Labor Statistics.

We Remain Optimistic Despite Headwinds

With all the current economic and geopolitical headwinds markets are facing, it is no wonder markets have been so challenging in 2022. That said, with the economy holding tight and much of the damage occurring vis-à-vis rotational effects among sectors rather than a wholesale sell-off, we have reason to believe drawdowns may remain contained to set up a better second-half to the year. Granted, it may take an unknown catalyst to get us there, but time is often the best medicine and markets have a way of eventually finding a path higher. Whichever direction markets may trade, the factors we have described above suggest the time is now to employ a more active, risk-managed, or "Tactical" approach to portfolio management. This is an approach that incorporates risk mitigation elements and strives to "lose less" or minimally reduce volatility during times when the bears come to call at the corner of Broad & Wall.

Tactical Fund Advisors Provides a Suite of Tactical Solutions

One of the key assumptions we make at Tactical Fund Advisors ("TFA") is that, given a choice, few investors would intentionally remain fully invested during severely negative market environments such as those seen in 2000-2002, 2008, again during the COVID Crash last spring, and certainly during this new year in the bond market.

It for this reason that we are proponents of a tactical, risk-managed approach to portfolio management. In short, the primary goals of our tactically managed mutual funds: Tactical Income Fund ('TFAZX'), Tactical Moderate Allocation Fund ('TFAUX'), Tactical Growth Allocation Fund ('TFAFX'), Tactical Quantitative Fund ('TFAQX'), and Tactical Multi-Dimensional Fund '(TFADX'), are to (a) preserve hard-earned capital during periods of market distress, while (b) seeking opportunities for growth in the long run.

In closing, employing a risk-managed approach to at least a portion of one's portfolio provides investors a particularly good reason not to worry about corrections in the stock market. Investors should consider the investment objectives, risks, charges, and expenses of the Funds carefully before investing. The prospectus contains this and other information about the Funds.

You may obtain a prospectus at www.tfafunds.com or by calling the transfer agent at 888-838-9488. Read the respective prospectuses carefully before investing. As with all mutual funds, there is the risk that you could lose all or part of your investment in the Funds. The Funds may not achieve their investment objective and are not intended to be a complete investment program. Many factors affect the Funds' net asset values and performances.

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