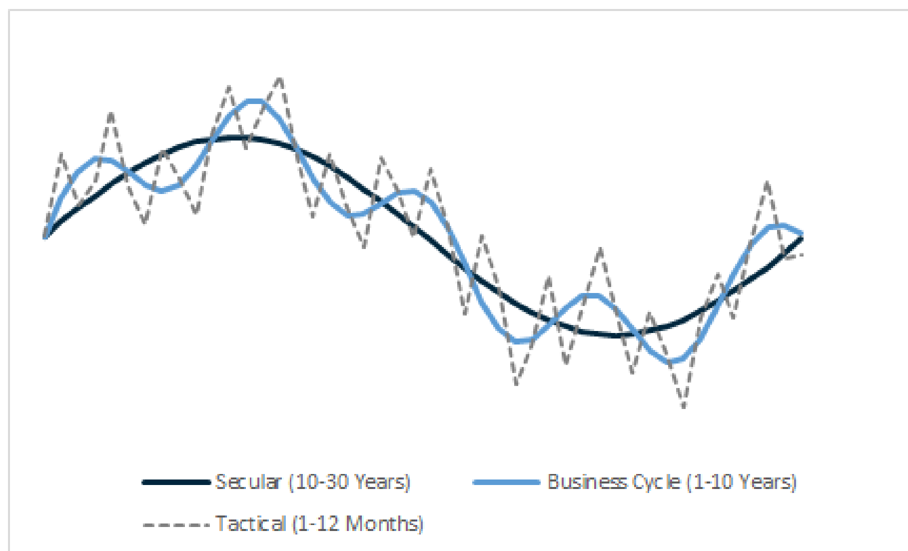
Seventy2 Capital
Wealth Management

Market Commentary: Structural Shifts

October 5, 2023

Financial ecosystems are dynamic, everchanging by policy shifts, technological innovation, and consumer trends. Short-term market behavior (less than a year), is erratic, driven mostly by noise, reacting quickly to news headlines and financial/economic metrics. In portfolios, we make tactical changes in response. Intermediate-term market behavior (1-10 years) is defined by longer-lasting cyclical changes, such as changes in consumer spending (needs/wants), inflation (costs), employment (supply of capital), and policy (restrictions and/or incentives). We structure our portfolio based on a business-cycle approach. Long-term market behavior is driven by slow-developing and semi-permanent structural changes. Our portfolios are structed based on our secular views over this time horizon. For the baby boomer generation, housing and education was affordable, but for the most part, the excess wealth which leads to discretionary spending and credit availability was not. Over the last few decades, technological innovation has enabled US consumers to have more for less, and the expansion of financial markets and instruments has allowed them to leverage credit to have something now rather than later. We believe US consumers may be around the tipping point of longer-term structural changes.

Investment performance is driven by short-, intermediate-, and long-term factors:



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Short Term

We expect that restrictive monetary policy and a global slowdown in growth will cause market volatility and downward revisions on corporate profits (and therefore valuations on US equities). We expect the Federal Reserve will stay restrictive until something breaks, whether that is in liquidity, credit, government debt service, the labor market, or something else. In the short term, savers will benefit from higher rates of interest. Spenders, however, will need to pay more on a relative basis for the same goods due to the high cost of having something today versus tomorrow. We believe that equities that exhibit high quality characteristics such as strong cash flow metrics, sound balance sheets, and consistent top-line growth will do well. Within fixed income, we see downward pressure on below investment grade securities that currently exhibit higher yields.

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Market Commentary, Continued: **Structural Shifts**

Intermediate Term

We expect the rise in geopolitical tensions will disrupt trade policy and supply chains, leading to higher costs for consumers and an above-average level of inflation. Heightened government spending through the pandemic increased both the national deficit and the cost of its service payments, so we expect these factors will pressure the government to reduce spending and/or increase taxes, leading to further decline in discretionary spending power for US consumers. Higher rates limit the potential for consumers and businesses to leverage growth through financing, signaling the end of “easy money” (see our previous commentary, “The End of Easy Money”). However, we believe that US productivity metrics, a free trade system, and a culture around innovation allows greater corporate profitability in the US versus overseas. We recommend this exposure in portfolios.

Long Term

We see one negative, one positive, and one unknown structural shift for the US consumer. Given our view that interest rates will remain elevated, if all other factors are unchanged, we expect higher costs and lower discretionary spending power will be imposed on consumers. Furthermore, we believe the average household will be able to buy/consume less over the next 20 years than the last 20 years. However, one positive catalyst may remediate this circumstance: technology. We believe that we are on the verge of a technological revolution, and the rate of change of improvements to productivity and standard of living far outweigh the negative effects of lower discretionary spending power, which leverage has enabled consumers in the recent past. Whether we look at computing power, transportation, manufacturing, or medical breakthroughs, we expect to see more progress in the next 20 years than we have seen in the last 100. With that, we will see new industries, new revenue streams, and new opportunities to capture profits for our investors. The largest unknowns will depend on the influence of social policy and the health of our environment. We do not know which direction policy will shift around these topics, but we will continue to monitor and react accordingly for the benefit of our clients.

Overall, it is important to understand as investors that you cannot change the investment environment that you are given, and that the best plan of action is to control what you can. Make sure to work with your financial advisor to align your portfolio with your long-term goals and values. Make sure that you are investing prudently, and not emotionally.

As always, if you have any questions or concerns, please do not hesitate to reach out to your financial advisor.

-The Seventy2 Capital Team
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