Partying Like It's 1982

By Jonathan Caplan

Earlier this month the U.S. Bureau of Labor Statistics reported that the consumer price index registered a 7.5% increase in January 2022 over one year ago. Inflation is back and perhaps is proving more nettlesome than some top economists and Federal Reserve officials had believed. We have not seen a similar inflation reading in the U.S. since 1982. This begs the question of whether we can use an historical analog to shed light on how the present situation will evolve.

Some financial professionals and market historians will recall that 1982 turned out to be an inflection point and the dawn of a new major bull market for both stocks and bonds. In retrospect, it was one of the best points in the past half century to deploy cash into both the stock and bond markets. I recall the precise moment in time when the investment climate began to turn dramatically.

In August 1982, I was on an airplane headed to Seattle, Washington, to get married to my wife and future business partner, Lori. On my flight to Seattle, I brought along that day's Wall Street Journal. I began to read the breaking news of that week when sentiment toward interest rates began shifting drastically. That week, two prominent Wall Street economists and bond market bears, Henry Kaufman of Salomon Brothers and Albert Wojnilower of First Boston, both called the peak in interest rates. And the financial markets, both stocks and bonds, were off to the races.

To be sure, sentiment on Wall Street was much different back then than it is today. Many experts posited that the stock market was uninvestable, that inflation was intractable and that stubbornly high unemployment was to be a permanent feature of the U.S. economy. What the pessimists did not see was that many of the political and economic headwinds at the time were beginning to turn for the better. Geopolitical tensions were abating, monetary policy under the leadership of Federal Reserve Chairman Paul Volcker was beginning to show signs of restoring price stability and the economic benefits of "Reaganomics" were beginning to take hold. The inflation rate was at 7.5% in early 1982, but it was heading in the right direction.

This Is Not Your Father's Bull Market

One of the stark differences between 1982 and 2022 is the level of interest rates. According to a New York Times account of the Kaufman/Wojinlower capitulation event, long-term Treasury bonds were yielding about 12.75% and the Federal funds rate (overnight bank to bank lending rate) was at 10%. As I explained in my November 2021 column, "real" interest rates (interest rates less inflation rates) were positive. In other words, one's loss of buying power on one's bond investment was more than compensated for by the interest rate earned. If one owned a long-term Treasury bond yielding 12.75%, one's buying power would not have been completely lost by the 7.5% inflation rate. That margin of safety is no longer available today. In fact, 30-year Treasury bonds are yielding about 2.25%, well below the current inflation rate. Thus, bonds currently offer no margin of safety. And even if the inflation rate abates over time, it may take many years before that margin of safety returns.

Taking Stock

While the bond market dynamics in 2022 are not favorable compared to 1982, what about the stock market dynamics? On the surface, equities are not as attractive an asset class as they were back in 1982 either. By a number of valuation metrics, equities on average are significantly more highly valued than they were back then. Just to highlight one measure that I believe sheds light on the attractiveness of stocks, the Cyclically Adjusted PE Ratio (CAPE Ratio) was at a cyclical low of 7.39 at the beginning of 1982 versus 37.47 at the beginning of 2022. This could imply that either stocks were incredibly cheap back then or that they are overvalued today, or perhaps both. In any case, I believe that this is one indication that equity investing could have its challenges in coming years.

Investment Implications

While investors have benefited from investing in just about any financial asset class over the past 40 years, and healthy returns seemed like a fait accompli, I feel that the road ahead could be full of potential financial speedbumps and potholes. In contrast to those halcyon days of 1982, I believe that the markets today are considerably more fraught. Despite the fact that major stock market indices are trading about 10% below all-time highs, we have witnessed utter devastation in a number of formerly highflying stocks. And I believe that the fallout could spread and be more prolonged. Many investors have been conditioned to believe that the secret to healthy returns is buying and holding index funds. But even index funds have their drawbacks. The most glaring problem with index funds is that they are now heavily weighted in a small group of mega technology stocks. As we saw recently with the stock of Meta Platforms (the stock formerly known as Facebook), these "tech titans" are not immune to risk and competitive pressures.

One of the defining aspects of our investment process at Caplan Capital Management is our disciplined approach to equity selection and portfolio construction. We remain staunch advocates of equity investing, as we see stocks as one of the best investment vehicles for generating healthy long-term returns. But, as always, we caution individual investors not to be cavalier regarding risk management, especially when there are increasing signs that the investment climate has turned less friendly. Stay invested. But be sure to appreciate and understand the risks.

The views presented are those of the authors and should not be construed as personal investment advice or a solicitation to purchase or sell securities referenced in this market commentary. The authors or clients may own stock or sectors discussed. All economic and performance information is historical and not indicative of future results. Any investment involves risk. You should not assume that any discussion or information provided here serves as the receipt of, or as a substitute for, personalized investment advice. All information is obtained from sources believed to be reliable. However, we do not guarantee the accuracy, adequacy or completeness of any information and are not responsible for any errors or omissions or from the results obtained from the use of such information.

Jonathan D. Caplan, a former Wall Street executive, is president and founder of wealth management firm Caplan Capital Management, Inc., with offices in Highland Park and Hackensack. He holds a BA from Yeshiva University and an MBA in finance from New York University Stern School of Business. You can find other recent investment articles by Jonathan at www.caplancapital.com/blog.

VIRTUAL

THE IMPACTFUL BUSINESS LEADERSHIP MASTERMIND

1 GOAL CLARITY
2 ACCOUNTABILITY
3 FRESH IDEAS
4 REAL SUPPORT

Hosted by Naphtali Hoff, PsyD
President, Impactful Coaching and Consulting

"Naphtali Hoff is an excellent coach and a superb listener... I was intrigued by Naphtali's professionalism and his process, taking his clients' own ideas and portraying a mirror image to gain clarity."
— Chaim Desser, CEO, Poel Group

THE IMPACTFUL BUSINESS LEADERSHIP MASTERMIND (BLM)

The BLM brings together business owners and professionals to develop their business and leadership skills, network and have their toughest problems solved on the "hot seat." Topics include branding, marketing, sales, time management, productivity and more.

- If you would like to scale your business...
- If you want to lead from a position of clarity and confidence...
- If the thought of learning, networking, and growing with like-minded peers appeals to you...

Then the BLM may be the solution you've been looking for!

impactful COACHING & CONSULTING

Visit ImpactfulCoaching.com/BLM to learn more!

מעינות MA'AYANOT Yeshiva High School for Girls

Ma'ayanot Yeshiva High School is looking for an experienced, innovative, and dynamic **Executive Director** who will bring professionalism and creativity to the school's business operations, logistics, and educational operations.

This leader will direct, supervise, and support the school's finance and business operations, security, IT, HR, and partner closely with the Head of School, the Board of Trustees, and the Senior Leadership Team. Reporting to the Head of School, the Executive Director will draw upon leadership/educational best practices and a robust body of past experience to build effective and efficient systems to support the full Ma'ayanot mission. The ideal candidate will demonstrate warmth and a collaborative spirit in addition to a dedication to our mission.

Application Instructions:

Please submit a resume and a cover letter to executivedirector@maayanot.org
A more detailed job description will be provided to qualified candidates.