NOTTINGHAM ADVISORS
ASSET MANAGEMENT

A View From the TOP

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"In real life, things fluctuate between pretty good and not so hot, but in the market, things go from flawless to hopeless. Nothing is ever flawless and nothing is ever hopeless, but when people reach those extremes, it's a good opportunity for the contrarian."

- *Howard Marks, Oaktree Capital*

In a recent interview with the *Financial Times*, renowned investor Howards Marks shared the above observation. Later in the interview he remarked, "The short run is by far the least important thing." These two pearls of wisdom, no doubt honed over his extraordinary 50-year career, are not only accurate in our opinion, but also very timely as we exit what was a generationally bad year in capital markets. Sentiment overall is dour and many estimates are for a recession in 2023, ranging from a "soft-landing" to a full-blown collapse in GDP. As Marks observes the truth likely lies somewhere in between.

As we look back to YE 2021, the S&P 500 had just returned +28%, the Federal Funds rate was 0% while the yield on the 10-yr Treasury note was 1.50%, Unemployment was 4%, WTI oil was at $68/barrel and the Consumer Price Index had risen +7.1% during the year, all the while the Federal Reserve insisting inflation was "transitory" (a term forever after banished from my lexicon). While not exactly flawless, things were seemingly pretty darn good.

Fast forward one year to YE 2022: the S&P 500 fell -18%, the Federal Funds rate is 4.50%, the 10-yr Treasury yields 3.56% (the US Aggregate Bond index fell a staggering -15%), Unemployment is 3.5%(!), WTI is $77/barrel and the latest CPI report showed inflation softening, but still running at a +6.5% YoY clip. Russia is still tormenting Ukraine, China is still saber rattling over Taiwan, US political dysfunction is reaching new heights, and analysts everywhere are debating the scope and depth of the pending recession. While not necessarily hopeless, things don't appear too auspicious.

Nottingham Advisors has survived (and prospered) since 1981, largely by ignoring the so-called "madness of crowds", all the while adhering to a disciplined strategy, which for the past 20 years has been laser-focused on asset-allocation, largely utilizing cost-effective, liquid and tax-efficient equity index funds. Married with a sophisticated and customizable fixed income allocation, Nottingham's strategies are designed to benefit from the "flawless" scenarios, and also weather the "hopeless" ones.

Today's environment, like many times throughout recent history, is full of uncertainty. Will the Fed keep raising interest rates? If so, by how much? Are stock markets overvalued? If so, by how much? Will corporate earnings meet expectations? If not, how much will they miss by? Will Congress extend the debt ceiling? Will the US default on its debt if they don't? The list goes on.

Fortunately, Nottingham is busy doing the work required to, at the very least, have an informed opinion on these topics (and many others). In the FT interview referenced above, Mr. Marks suggested we're currently in the "zone of reasonableness". We agree. In our view, some things are over-priced; others not so much. There is value to be found, although one must do the work to find it. There is no obvious fat pitch worth swinging at presently, and likely no easy way to make a quick buck. As always when investing, resolve and discipline play key roles in investment success.

A summary look at valuations suggests US large-cap stocks are reasonably valued IF current earnings estimates are met. These estimates appear a little aggressive in our eyes, but time will tell. US Small and Mid-cap continue to look attractive and are worth investing in today. Value has only begun outperforming growth, and could for a while. It isn't terribly expensive either. Technology stocks have taken it on the chin, and while many of these high-growth companies have seen 50% to 75% declines in their prices, there may be more room to the downside if interest rates continue to move higher. Be cautious here.

International markets have been on a tear the past few months, aided by a falling US Dollar and valuations that left little room to the downside. Since the beginning of the 4th quarter through now, international developed stocks have gained +23%, while emerging market stocks are up +18% (compared to a +10% gain in the S&P 500). During this period the Dollar has fallen nearly -8%. With international developed equities trading at 12x forward earnings, and EM equities at 10x forward, any further erosion of the US Dollar could add fuel to an explosive rally in these under-owned and increasingly loathed markets. But again, caution is warranted.

For us "bond nerds", 2022 was an excruciating year, although one wrapped in shiny paper with a bow. Once through the pain of an historic -10% to -15% decline in bond prices, the rise in interest rates left us with an opportunity set we haven't seen in a decade. Painful getting there, but worth the price of admission. Going forward, Nottingham's clients will be the beneficiaries of the Fed's overdue end to QE, and will be able to own quality fixed income while clipping 4%, 5% and 6% coupons. One New Year's resolution to rally around will be for the Fed to return its QE playbook back to the academic library and let it collect dust for a while. Mr. Market is eager to regain pricing authority over the bond market.

One area of caution for investors here in 2023 is the private investment space. Whether it be private equity, debt or real estate, our foray into this illiquid and murky realm has revealed stale pricing, an abundance of misplaced optimism (characterized by the belief that private companies aren't subject to the same "laws of physics" as public companies), and a deficiency of capital in support of liquidity. In other words, BE CAREFUL. When public asset prices fall -20% to -40%, and private asset prices are flat to up +10%, questions need to be asked.

What 2023 ultimately has in store for us in anyone's guess. Optimism might be deemed the ultimate contrarian play here, as pessimism appears the base case. Mindful of the "zone of reasonableness", Nottingham's team will continue to mine for investment gold, manage risk while embracing opportunity, and as always, keep our clients' interests first and foremost in mind. From all of us at Nottingham, we thank you again for your trust in us, and wish you all a happy, prosperous and peace-filled New Year.

Larry Whistler, CFA
President
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