BILLS ASSET MANAGEMENT

BAM MARKET NOTE

FEBRUARY 18, 2022

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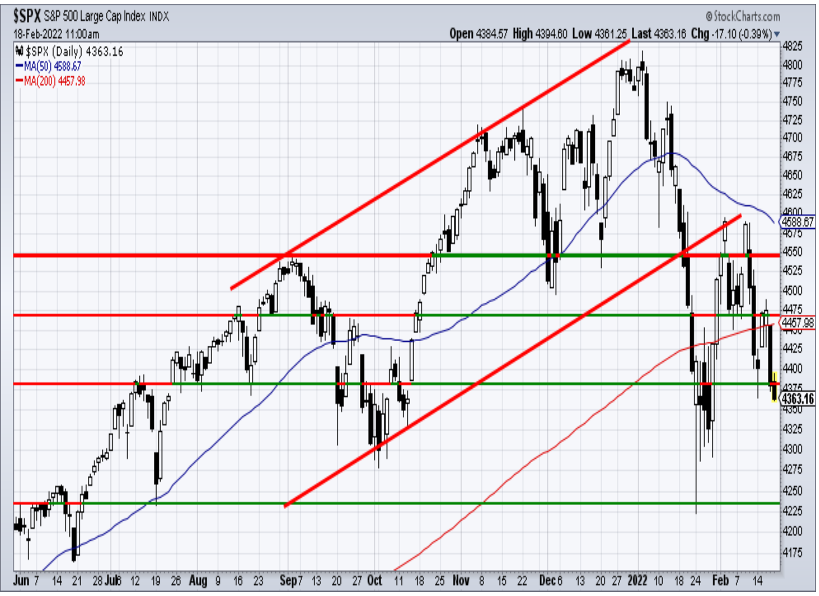
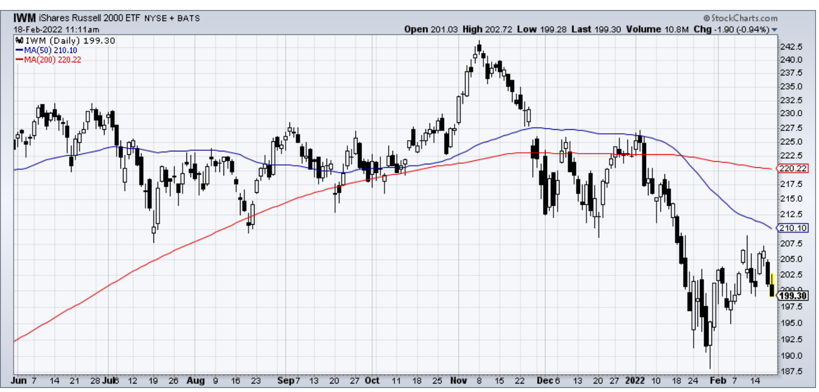


Weakness continued this week as the early week rally failed at resistance (4475 level) after eclipsing the important 200-day moving average for a couple of days. The S&P is now back below the 200-day moving average and is nearing the January closing low. The index is in a well-defined short-term downtrend with lower highs and lower lows. We continue to believe that the lows of January will be revisited over the coming days/weeks. The S&P is off 9% from its recent highs. Meanwhile, the NASDAQ and Russell 2000 are down 15% and 17% respectively. While the markets could find a bottom at any time, the risks to the downside far outweigh the upside potential at this point. Investors would be wise to tread carefully. With markets weak and traders in a mood to sell, any extraneous event/news could send the market tumbling.



Small-caps had provided a sliver of hope over the last couple of weeks that the selling might be short-lived. While the Russell had lost more than the other indices it had established a weak uptrend off of the late January lows. Yesterday's carnage and today's continued selling put a stop to that (for now). We will be watching the Russell for signs that a bottom is forming. However, at this point it appears the rally in small caps has failed.

Our Point

While Russia and Ukraine are getting the headlines and blame for the recent sell-off, inflation and the Fed are the real drivers. Short-term weakness can be attributed to the headlines out of Eastern Europe but, any war in Ukraine will have little effect on the US economy and the earnings of US companies. Should Russia actually invade Ukraine, the markets will likely react, but the effects will not be long-lasting. The markets are much more concerned with the continuing inflation problem and how the Fed may try to combat it. Charlie Munger (legendary investor and long-time partner of Warren Buffett) went so far as to say, "we're flirting with serious trouble" and "inflation is a very serious subject, you could argue it's the way democracies die. It's a huge danger. So, it's the biggest long-range danger we have, probably, apart from nuclear war." We don't disagree and it's why the Fed is in such a precarious position. Raising rates will mute the effects of inflation but will also be a negative for the markets and reduce corporate profits. Additionally, any rate increase will further exacerbate the US debt issues as interest payments on that debt will increase. While every Fed meeting holds great importance for the markets, the next several meetings will be even more important. The next scheduled meeting is March 15th and 16th. The markets will be closed on Monday for President's Day. With the long weekend and the tensions in Russia/Ukraine, it is likely that today's losses will remain if not accelerate further to the downside. In any event, there is little reason for the markets to rally today but we could see a relief rally of some sort next Tuesday assuming nothing newsworthy happens over the weekend. Our portfolios remain very defensively positioned. We did buy a hedged position in our aggressive accounts that shows some promise for some gains in all market environments. We will likely add a similar position in our other portfolios next week. The unpredictable Tennessee weather continues with 70's one day and 30's the next! Much like the market, it is hard to know what is coming next. Have a great weekend.