Hello Everyone and Happy New Year,

"Profit or perish. There are only two ways to make money: increase sales and decrease costs."

Frank DeLuca, American Mobster 1898-1967

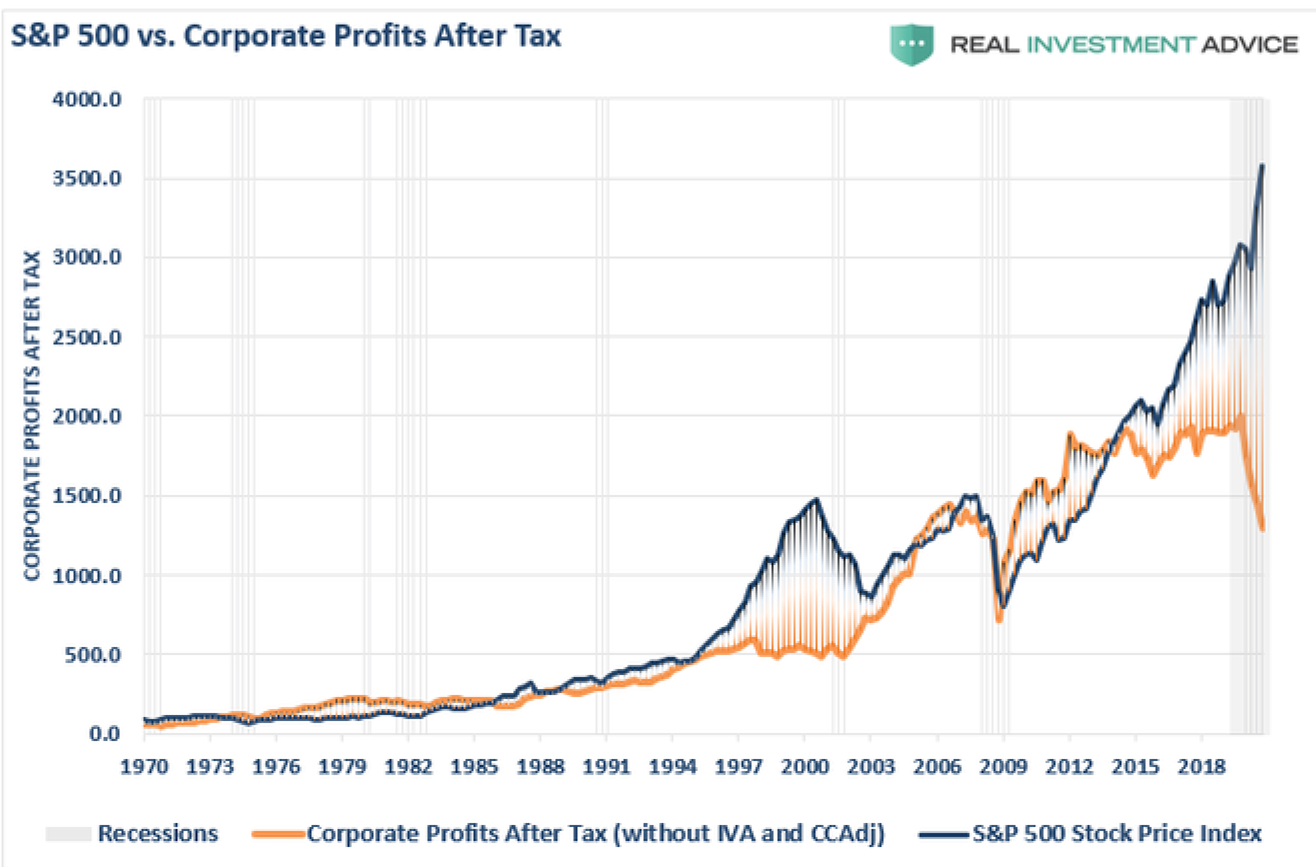
I don't usually quote mobsters, but I believe Mr. DeLuca would be dumbfounded at how modern American finance works today. Profits do not seem to matter much to Wall Street.

And if you don't believe me, look at the chart below. It is the chart Bob and I will go over in today's missive.

I hope this helps you see why 2021 could be the reverse of 2020. We could see the economy recover but the markets correct.

Signed, Your 2020-Proved-Americans-Are-Exceptionally-Adaptable Financial Advisor,

Greg



KKOB 2021.01.04 Be Careful What You Wish For

Bob: So, Greg, Happy New Year. And, in your world, 2020 was a weird one. The stock market did well. But because of Covid ---- the economy didn't fare as well.

Greg: I know. The Dow started 2020 just shy of 28,600. And we closed last week just over 30,600. So, the Dow was up 7% for the year. Not bad considering Covid. But here are some things that might make your intrepid listeners go, hmmmm.

As you said, the 2020 Covid economy was not exactly robust. In fact, corporate profits fell to 2005 levels. But the stock market is now 300% higher than it was in 2005.

So, corporate profits are where they were 15 years ago, but the market has tripled.

And I know what some of your listeners are thinking. *"Yeah, Greg, that may be true, but last year was a one-off event. Once things return to normal, the economy will quickly rebound. And that will bring stocks and the economy back into balance."*

And, Bob, I guess my response to that would be, *"I don't believe we are going back to normal."*

Bob: I'm not even sure what "normal" is anymore. Politically, things aren't normal. The economy sure isn't normal. And I don't even think the society and the culture can be categorized as normal.

Greg: I agree. And I'll take it a little further and say normal ways to evaluate stocks (and stock markets) went out the window years ago.

Let me explain.

In the old days, analysts used metrics like price-to-earnings ratios, cash flow, and debt levels to make judgments about a company. But ultimately it always came back to the bottom line. How much money was a company making? You know…profits. But that's not true anymore.

And, Bob, to make my point, before the show I emailed a chart to you that has two lines on it. Do you have that chart in front of you?

Bob: I do. The blue line on the chart is the S & P 500 Index. That is the one that keeps going up. The orange line is corporate profits. That's a more subdued line.

Greg: Good. So, Bob, looking at that orange line, when did profits begin to stall?

Bob: I don't know. That line took a big dive in 2009. So, that must have been when the housing bubble popped. Then the line goes up nicely until around 2012. Then it just squiggles sideways until 2020 when it dives again. That's obviously Covid.

So, what this is showing me is corporate profits capped out in 2012. Then they essentially ran in place until Covid hit.

Then in 2020… down they went….back to 2005 levels.

Greg: Right. Meanwhile, the stock market has been marching upward apparently not caring about profits. And now the divergence has become one for the record books.

Bob: I know. I can see it. The blue line of stocks is pointing straight up. And the orange line of corporate profits is pointing straight down. That doesn't make sense. In fact, it doesn't even make sense that the orange line went sideways for seven or eight years, while the blue line kept rising.

Greg: Right. So something else is driving the markets. Something that isn't profits related. And what you'll find is the lines started diverging about 9 years ago, when the printing press went into overdrive and we dropped interest rates to almost zero. Stock traders loved both those moves. Thus, profits no longer mattered much to Wall Street.

Bob: But that seems so artificial. That means if interest rates were to rise---or if we stopped printing money-- then that would be tough for stocks.

Greg: Agreed. My take is millions of stock investors are really just betting on a continuation of current Federal Reserve and Government policies. I get that. But that's not normal.

So, when people say*, "I just want things to get back to normal"* ---be careful. Normal means profits will matter. And the current corporate profits picture doesn't support today's stock prices.

Bob: Unless you think profits will zoom higher. But my guess is, recovering from 2020 may take some time. How do people reach you?

Greg: I agree again. My number is 250-3754. Or go to my website at zanettifinancial.com.