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COACH K AND THE HEELS: THE RIVALRY THAT MOVES MARKETS

by Adam J. Morgan, CFA, CMT

As I was preparing to watch the Final Four, a setting befitting the best rivalry in all of college basketball and the 100th game between Coach K and UNC, suddenly, out of nowhere it hit me like an Oscars slap! What if the Tobacco Road rivalry is even bigger than we all realize? Walk with me here…

Mike Krzyzewski became the head coach at Duke in 1980, during a recession. The yield on the US 10 Yr. Treasury was 12.85% when the Tarheels handed him his first loss later that year on December 5th. Interest rates have been coming down ever since, until recently of course, when Coach K announced his retirement. A couple of years later Michael Jordan's Tarheels would sweep Duke and go on to win the National Championship, also during a recession. The country wouldn't endure another recession until the one that ended in March of '91, the same month Coach K won his first National Championship. Everyone knows that the stock market went gangbusters throughout the 90's, except for 1994 when the S&P 500 and Coach K took a year off. The next US recession occurred in 2001. The National Champion that

> "What if the Tobacco Road rivalry is even bigger than we all realize?"

year? Yup, Duke. The recession of '01 kicked off a painful bear market that lasted until early March 2003, reversing almost on the very day that Carolina broke a three-year slump against Duke with a win at the Dean Dome. That year the Tarheels were coming off their worst season ever where they went 8-20 and lost to Duke by 29 points at home. Most UNC faithful blame Coach Matt Doherty for those years, but maybe they should've blamed the bear market.

A few years later during the financial crisis, President Obama was credited with famously calling the market bottom when in a press conference on March 3, 2009, he said, "What you're now seeing is profit and earnings ratios are starting to get to the point where buying stocks is a potentially good deal." The market turned around six days later on March 9, 2009. But what all of America completely overlooked is that Tyler Hansbrough scored 17 points in his last home game and beat Duke to win the ACC the day prior, on March 8th. The worst recession since the Great Depression was finally over and wouldn't you know it, Carolina would win the National Championship a month later. Coincidence? Well actually… Yes. Unfortunately, sports fans, any correlation between economic or market outcomes and the UNC/Duke rivalry are spurious. But you already knew that.

So, what really makes the market do what it does? In the near term, uncertainty, or a lack thereof, is a driver of markets. Fear about inflation or resulting Federal Reserve policy can create uncertainty. So, too, can a maniac overseas who starts a war for no good

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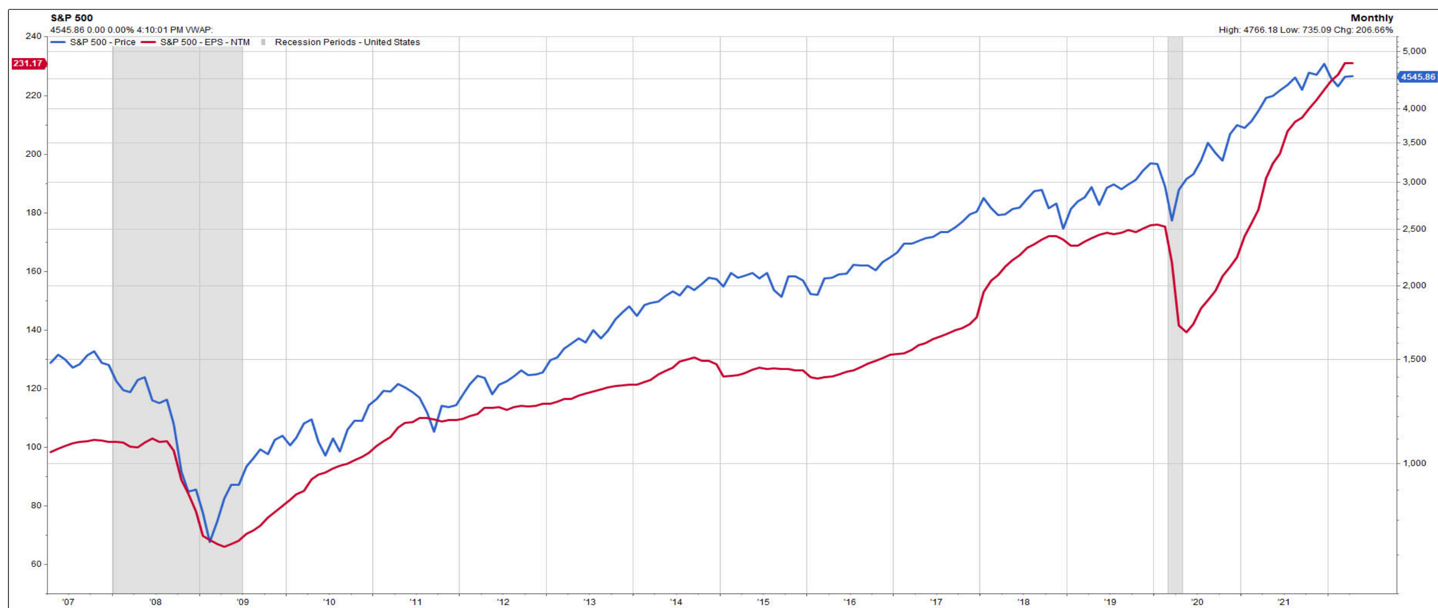
reason. But in the intermediate to longer-term, markets are more correlated to the growth of corporate earnings. When you own a share of a stock you own a share of that company's earnings. The value of that share can be volatile when there is reason to be uncertain about the eventual realization of the future earnings already baked into the current share price. The recent pivot in Fed policy has investors worried about whether or not the future economic environment will allow for companies to realize the same earnings growth that was priced into stock values in the last rally that ended in late 2021.

After all, investors know that it wasn't actually Coach K that caused the dramatic turn in interest rates in the early 80's, but rather the aggressive monetary policy spearheaded by then Fed Chair, Paul Volcker. And we did experience two recessions in the three years following Volcker's shift in policy. (By the way, Volcker was 6'7 and played basketball at Princeton.) So, should we be worried now? Let's look to corporate earnings for some guidance.

Below is a chart of the S&P 500 dating back to 2007, and the growth of the underlying corporate earnings of those same 500 companies. The blue line represents the S&P 500, and the red line represents the consensus forward-looking next-twelve-months estimate of corporate earnings. The shaded areas are recessions. The first thing to note is the long upward trend of both. My eye is then drawn to the steep drops during recessions and the strong recovery coming out of them. Most people agree that it felt odd to see the market recover the way that it did in 2020, in the midst of a global pandemic. But even more aggressive was the recovery in corporate earnings. Companies did a phenomenal job adjusting business models and popularizing concepts like "work from home," "curbside pick-up" and "contactless delivery" in order to continue to do business under extreme conditions. Capitalism prevailed once again.

Now it's true that those forecasted estimates of corporate earnings could prove to be too optimistic. But with a labor market hiring at a rapid pace and a population itching to get back outside to enjoy life, it doesn't appear to be the environment where corporate earnings contract, at least not yet. There are challenges facing our economy that we're monitoring closely and there are always reasons to worry but don't let the recent drop in the stock market convince you to change your long-term investment plan. In fact, dating back to the first time Carolina and Coach K faced off in 1980, the average intra-year decline in the S&P 500 is 14%, and yet the annual returns have been positive in 32 of those 42 years. Furthermore, in almost all of the ten years where the market didn't yield a positive result by year-end, corporate earnings were actually down instead of being up less than analysts had forecasted. I know of no one currently forecasting negative S&P 500 earnings growth for 2022. Then again, anything is possible now that Coach K just ended his career with a loss to the Tarheels.—*A. Morgan*



S&P 500 Price (blue) & S&P 500 Earnings per Share (red) Source: FactSet

(Please see disclosures on page 4.)

CHANGING JOBS? WHAT TO THINK ABOUT

by Graham Shepherd, CFP®

Among everything else to think about when changing jobs—meeting new coworkers, learning new software, figuring out the commute, etc.—it can be challenging to fully consider the many financial ramifications of your transition that have nothing to do with your new compensation. Retirement plans, equity awards, flex spending account balances, insurance coverage, tax liabilities, and more can be impacted by a job change. It is critical to include these considerations in your decision-making process when offered a new opportunity.

One critical consideration is determining what to do with the assets in your **401(k) or similar retirement plan**. Here you have several options:

- **Roll over to your new employer plan.** This approach can be beneficial if you have a higher income and wish to make backdoor Roth conversions of non-deductible contributions.
- **Leave in the prior employer plan.** If your previous employer's plan has better investment options or lower fees when compared with that of your new employer, it may be of benefit to leave the assets where they are.
- **Roll over to an IRA.** An IRA provides a broad investment selection and can allow you to streamline your retirement assets. Additionally, IRAs allow for professional management.
- **Take a withdrawal.** With few exceptions, withdrawals taken before age 59.5 are subject to a 10% penalty, in addition to income tax.

If you received **equity awards** from your previous employer such as restricted stock or stock options, it is important to know how much of the award remains unvested, as this portion is usually lost after employment ceases. Also, the expiration dates of granted options are occasionally accelerated after termination, which can either lead to a lost opportunity or, if exercised, an increased tax liability.

If you elected to contribute to a **Healthcare Flexible Spending Account** with your former employer, you have access to the full amount of your election for the current year regardless of how much you have contributed so far. Additionally, if you leave your job in the middle of the year but have unused funds left in your Healthcare FSA, you can still use the full amount of the election even if you will not be making future contributions. **Dependent Care Flexible Spending Accounts** are a bit different, however, as you can only be reimbursed for the amount you contributed as of the time you leave employment.

You typically have several options for continuing your **health insurance coverage**, even if your new employer does not offer it. If your spouse is employed and their company offers health coverage to non-employee spouses and families, you may be able to join their plan. However, it is always worth doing an objective comparison of costs and coverage against your other options. COBRA lets you keep the coverage you had through your previous employer, albeit without the employer-paid portion of any premiums. Most people can elect to continue coverage for up to 18 months under COBRA. Of course, you may also be able to obtain coverage on Healthcare.gov or—if you are at least age 65—via Medicare.

If there will be a gap in employment or your new position will pay less than the one you left, having a lower tax rate for the year opens some **tax planning possibilities**. With a lower tax bracket, strategies such as accelerating realized gains or converting pre-tax assets into a Roth IRA may yield a significant long-term benefit.

These are just a few of the many factors to keep in mind as you consider making a job change. Your Armor team stands ready to help if you or someone you know would benefit from a holistic review of the impacts of making a transition. Please always feel free to reach out for a meeting!—*G. Shepherd*

ARMOR GIVES BACK

Join us this quarter for our Armor Volunteer Day as we help build safe, affordable, and energy-efficient homes for low-income families through Habitat for Humanity of Wake County on Friday, May 13, 2022.

We extend an invitation for all to join us, as well as welcome any suggestions for volunteer initiatives you are passionate about.

Reach out to Allison at amiller@armorinvestmentadvisors.com with suggestions for future events, requests to participate, or if you would like to donate towards this cause.

(Please see disclosures on page 4.)

FROM THE CROW'S NEST: ACCELERATION ANXIETY

by Jeffrey R. Miller, CFA

My drive to the office appears more treacherous by the day. Whether it is a small compact car or a semi-sized SUV, drivers are exceeding all limits and often appear in anger mode. In my own defense, I have not become the doddering old guy, I maintain a fair 3-8 MPH over the limit.

I think our driving habits are a reflection of increasing angst in a world seemingly gone crazy at times. As the pace of change accelerates, human construct remains relatively static. Call it stress, cognitive dissonance, or information overload, it just seems to grate on our nerves, resulting in a scary commute.

There is a lot to consider. The war in Ukraine is an immediate concern, with inflation, the erosion of standards of living, pandemics, all following close behind. These are all symptoms of the great technological and geopolitical shifts which impact how we must look to the future, and not objects in the rear-view mirror.

An emerging trend more frequently discussed in the financial media is deglobalization. When Nixon went to China it accelerated a process where whole industries were relocated to lower cost-of-production regions. For nearly 50 years the industrialized world grew at a

steady pace, while the developing and emerging world worked hard to catch up. With some hiccups it was a remarkably stable trend in one direction.

> **"Our efforts stay focused on the forward view..."**

This process is in reverse as we move from a US-dominated monopolar world to a multi-polar world of US, China, Russia, and Europe. Dependence on traditional alliances are weakening, while our greatest rivals each seek dominance in their own way. As for Russia and China now being BFF's, let us not kid ourselves. They are both out for themselves.

This has great implications for how we invest going forward. Scarce resources will be more aggressively competed for, regional self-interest will grow, and global trade will likely moderate. In the US, manufacturing is being repatriated and technology will be more aggressively protected. Electrification of transport and production is creating whole new industries. This is neither good or bad—it is the reality of a changing world. The increase in competitive friction only serves the common angst.

Our efforts stay focused on the forward view to identify the appropriate investment opportunities for our clients and seek to profit from them. Labeling an investment as either US, Asia, or European is less relevant now than considering all investments as either domestic or multinational. According to Goldman Sachs, 29% of S&P 500 profits were derived internationally as recently as 2019.

When balancing risk versus return in today's world, we see non-US risks increasing. This explains a continued flow of funds toward the US. It was announced two weeks ago that a Vietnam-based auto company will be building a US $4.0 Billion electric vehicle battery plant a few miles south of Raleigh. I didn't even know there was a Vietnamese auto company, but they must think the US is a worthwhile place to expand.—*J. Miller*

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