Moe Ansari: Let me go to another break. I'll come back, and David Ellison and I are going to talk about the market. He always has a very calm, realistic view of the markets. That's what I like with David. He doesn't sugarcoat it. You're not going to get the "rah rah rah" from David. He'll tell you the way it is. And he's going to join me on the other side of the break. Again, if you want to join us, if you need help with your portfolio, call me now, #250 on the cell phone. Talk to Moe. Dial #250 on the cell phone. Say, "Talk to Moe." Stay tuned. I will take a short break, and I will be right back.

Speaker 2: How much risk are you willing to take in your portfolio? And does that match how much risk is actually in your portfolio? Find out now so you can make any necessary changes before it's too late. Just go to www.marketwrapwithmoe.com and click on the What's Your Risk Number? button to get your free risk analysis. That's www.marketwrapwithmoe.com and click on What's Your Risk Number? Now here's Moe with more on Market Wrap.

Moe Ansari: Welcome back, everyone, to Market Wrap. I'm Moe Ansari, and you're tuned in, as you've been doing so for over 34 years now. And as always, wherever you are across the nation, send me an email, and I will be more than happy to share my opinions, my experience with you, anything you want to know financial.

Moe Ansari: For the next few minutes, hold the emails. I'm going to go to our guest line, someone you've heard, and I respect a lot, that gives us great insight you've heard for the last decade and a half right here on Market Wrap. And that is Mr. Dave Ellison. He is portfolio manager at Hennessy Funds. Mr. Ellison brings over three decades of investment management experience to Hennessy Funds, and has been recognized by Morningstar as the most tenured mutual fund portfolio manager in the financial services sector. Prior to joining Hennessy Funds in 2012, he served as president and chief investment officer of FBR Funds, where he launched and oversaw the lineup of FBR Funds. Mr. Ellison began his career at Fidelity, where he managed the Select Home Finance Fund and developed his investment discipline and strategy under the tutelage of famed value investor Peter Lynch. Dave, welcome back to Market Wrap.

David Ellison: It's good to be back, Moe. It's been about, what, a couple months?

Moe Ansari: It has been a couple of months. And it's been a wild couple of-

David Ellison: And a lot's changed.

Moe Ansari: It's a wild couple of months.

David Ellison: A lot's changed. So-

Moe Ansari: Yes. A lot of change. So let's talk about the change. Let's talk about, first, the Fed. Let's start with that and go from there. The Fed is expected to raise rates half a percentage in the meeting next week. And then they're expected, now the market is saying, another two more half-point increases, 50 basis point increases, in the two following meetings, after the one next week. And they're going to start bringing the balance sheet down, or reducing the balance sheet, as they say. Let's talk about that. Has the market overreacting, or has it got it just right? And if they do... I'll ask you the next question in a bit... does that put us in a recession? Let's start with the Fed. What do you think they're going to do?

David Ellison: Well, I think the Fed's been pretty good about telegraphing what they're going to do. They haven't surprised us. They haven't pulled a Paul Volcker and raised rates over the weekend like he did that one time. So I think they're going to stick. I mean, they're talking about 50. Maybe they do 25. I think the market wants them to get on with the rate hikes and not delay it. I think the balance sheet shrinkage, or the quantitative tighten, is the more important factor that could be troublesome for the market like it was back in 2018. But I think the market is going to do a lot of nothing until the Fed is done and we can see a clearer path forward without the Fed disrupting it.

David Ellison: So again, if you go back to 2008 and then supercharged into the pandemic, the Fed was behind a lot of why the market was going up. People were convinced that the Fed was going to keep pushing, and keep rates low, and buy stuff. And so that made the market move up. And then the pandemic kind of put that on overdrive. And now that's reversing. And so I think you have to respect the big macro trend, which is, basically, don't fight the Fed.

Moe Ansari: So you don't fight the Fed at this point. We go back and forth. Where do you go and hide in the meantime?

David Ellison: It's hard to talk about that, because it's like any good analyst. So, "I didn't tell you to sell a 10, but you can make money now that the stock's gone to 5."

Moe Ansari: Right.

David Ellison: It's the old adage, "You can make money from here." It's like, "Well, wait a minute. Why didn't you tell me to sell over there?" But I think that what's happening with the market lately is, my view is that it's losing its multiple. The financials, as a group, lost their multiple in 2008, '09, '10, and they really haven't gotten it back. And now the tech sector is losing its multiple because they're missing on numbers. Their growth rate is slowing. Netflix had a net negative growth rate in subscribers. Google had a pretty big slowdown in YouTube this last quarter. So that's why I think the market is going down. And tech is a big part of the market, and it's not being able to get offset by natural resources like oil.

David Ellison: So I think you hide. As I always say, I said on this program many times, if you go to bed at night, and you're lying in bed, and you're worried about losing money and worried about the market, sell more stuff until you're comfortable with it. And that's what you should be doing now, is don't lie in bed worrying about losing money in the stock market.

Moe Ansari: You sell, and the market turns around in three days. It's gone down 8%. Then it goes up 8% three days later, and you go, "Why did I sell?" When do you buy back in?

David Ellison: My feeling is that... whatever, I'm just picking numbers... if the stock's at 8, I'd rather buy it at 10, knowing what I've got, than buying at 8 and not knowing what's going to happen. I think I'd rather miss the bottom, because the market can be pretty relentless on the downside, and it can take a long time for these things to recover or, at least, even come back to where they were. So I think you're in a cycle now where if you know what you own, and you're comfortable with it, you can stay with it. But if you're just buying equities and really can't afford to lose the money, and the Fed's not on your side, and there's a war, and there's inflation, it's just a riskier place to be. And the higher the multiple on the company, meaning the higher P/E you have, the more risk you have. And you're seeing that now in a lot of these companies.

Moe Ansari: Do we go into a recession? And when?

David Ellison: The recessions that we've had in my lifetime... This goes back to the early '80s... have all been driven by the financial sector getting into trouble on the credit side. And then they stop lending, and that creates liquidity problems, and the economy goes into recession. I don't think we're going to have that. The financial side of the system now is very liquid. Yes, they've got credit issues, but they've got plenty of profitability. The debt-to-equity, or the debt-to-value, or the loan-to-value on a lot of loans out there is just too low. And you tack on even a price increase in housing and everything else. It's just hard to see a traditional recession as we understand it, which is basically, banks get in trouble. They stop lending. Car sales fall. Home sales fall. People start getting laid off, and we have a recession. I don't think that's going to happen.

David Ellison: I think we're going to be in a situation where the market is going to struggle with where rates are, where inflation is, where margins are, meaning that the cost of goods sold in a lot of these companies is just unknown. You've seen GE reported yesterday and basically said... I'm putting it in a nutshell... that their cost of goods sold is very uncertain now. They just don't know what their costs are going to be, and so their margins are getting crunched. And the stock went down 10%. And GM and Ford reported, and they're kind of saying the same thing, that, "The outlook for profitability is tough because we don't know what our cost of goods are going to be." So we'll see. It's different. We just don't have the problems, and the leverage, and the financial system that we typically have at these junctures.

Moe Ansari: So we don't have the structural problems that we had with tech bubble, or the housing bubble, or anything like that. And unemployment is very, very low, so people are not worried about their jobs. It's, "Look, if I lose this job, I'll get another one there because there's so many jobs available." Do we watch the unemployment number as an indicator to tell us when the economy is getting into trouble?

David Ellison: Well, certainly the Fed has been watching that. And the Fed is more concerned about employment as I've ever seen it. But I think that the unemployment numbers are going to stay strong. The question now is whether the wages are going to keep going up. As I view it, the bottom half of the income, wage earners of this country are... The wages are just too low relative to any sort of logical long-term structure, in terms of being able to make a living, save for retirement, buy a house, get an apartment, and have a family. It's just very, very difficult. Now, it may have been that way for many, many years, but I think it's gotten very acute. That's where the wage pressures are going to be on these companies. And I think that's going to be a push on inflation for a while, which then gets back to the Fed having to normalize rates or go above that.

David Ellison: I think all of these things are good, in a sense that I'd rather be here, where we are now, Moe, talking about inflation, and rates, and the Fed, and a strong economy, and a very low unemployment rate, than talking about where Japan has been for the last 20 years.

Moe Ansari: So you don't think we're becoming a Japan.

David Ellison: Well, I've told people that that was the big concern of mine for many years, is that we were going to end up like Japan. Low rates, low growth, and just a dead economy.

Moe Ansari: Mm-hmm (affirmative).

David Ellison: I guess maybe the pandemic was a blessing because it forced a tremendous amount of spending, or a tremendous amount of money, directly given to people as opposed to corporations, and that's allowed them to go out and spend money. And then, for a lot of reasons, it's starting to put pressure on wages. We need wages to go up at the lower end to generate the kind of growth, and productivity, and activity in the economy that we need long term. You can't have 10 people have all the money and have an economy. It's a good thing that's what's happening now.

David Ellison: The market doesn't have to go up because of that. I think the market has lived on low inflation, low wages, moving all the production to China and wherever else they've been going. And the Fed's been pushing. And this has been going on pretty much my whole career, after the rates started to come down, when Volcker did his thing and inflation started to come down. The Fed has been aiding and abetting this market, and that's been the big thematic reason to own the market. And now that that's turning, it doesn't mean it's bad for wages. It's not bad for unemployment. It's not bad for the economy but may be bad for the market.

Moe Ansari: So you think we going into a more-

David Ellison: So it's like, well, the market [crosstalk 00:13:41].

Moe Ansari: Do you think we get into a more normal market, where we go up and down, and up and down, and the easy money has been made, and now it's going to be a rough slogging going forward?

David Ellison: It could be. I mean, I think everybody's looking for it to go back to the way it was. And of course, as you know, we never do that. In a sense, when high school ends, it ends. I mean, you never go back there. You never go back to the prom. You never go back to your wedding day. I mean, it doesn't work that way.

Moe Ansari: But the college is fun.

David Ellison: Yeah, right. [inaudible 00:14:17].

Moe Ansari: On the other hand-

David Ellison: So I think you're at a point now where the system is continuing to evolve. I think the market could do a lot of nothing, and the economy could do fine. You look at Japan. The market went down for many years. The economy did fine. They had zero inflation. They did fine. You look at in the '60s and '70s in this country, especially the '70s, people had jobs. The market didn't do anything. The market doesn't necessarily have to go up. The other thing I will mention is that as each sort of event happens, especially going back to 2008 and then the pandemic, the market is more and more index. There's just so much more money in index funds or ETFs, whichever you want.

Moe Ansari: You have to pick and choose. David, if you could stay through the break, I'd appreciate it. I'm going to take a short break. Everyone stay right where you are, and I will be right back with Mr. David Ellison.

Speaker 2: Listen to Market Wrap at your convenience. Just go to marketwrapwithmoe.com for a list of stations and times to hear the show live. You can also download the apps to listen to the podcast on iTunes, Spotify, or Google Play. And we've got archives of all the shows available at marketwrapwithmoe.com. We appreciate your support and invite you to keep listening, when and where it's most convenient for you.

Moe Ansari: Welcome back, everyone, to Market Wrap. I'm Moe Ansari, and we're talking to Mr. David Ellison. He's a portfolio manager at Hennessy Funds. Dave, thank you so much for staying with us through the break.

David Ellison: Yep.

Moe Ansari: Let's-

David Ellison: Good to be back again.

Moe Ansari: Yep. You're back again. And I appreciate that. Let's talk a little bit about, where do you see value? You don't see a problem with the financial sector. And remember in 2000, when the tech bubble burst, financials did well. That was one of the areas where the financials did very well. What do you see with the financial sector right now?

David Ellison: Well, I think the financial sector is going to be hinged on whether the Fed can get rates up enough, and they can stay there. And we don't need rates to go up a lot, but the risk is that the Fed goes up to, let's say, 2, 2.5% in fed funds, and then we have a recession, and they go right back down, and they have to lower rates again back to zero. That, to me, would not be good for the sector. But the sector is doing well. They're positioned to take advantage of a better economy. The hope is that the Fed will move rates up a little bit here over the next year or so, and then we can stay there, and the Fed won't feel a necessity to bring rates down again when the next recession hits, or the next downturn, or the next liquidity problem happens.

David Ellison: So again, rates are a critical part of their cost of goods sold, but I think financials are becoming more of a safe haven. Their earnings are more predictable. They don't have international problems with trying to raise money. Their cost of goods sold is much more understandable. I think the housing market is very strong, so whatever loans they're making are probably going to be okay. But the market is fearful of credit, and they're fearful of a recession. And 2008, in a lot of people's mind, still happened yesterday, because anytime there's a credit problem in this sector, whatever the individual stock just gets annihilated. It's amazing how quickly that happens.

Moe Ansari: But you don't see that problem right now. There's no structural problem in the financial sector. And that usually causes major recessions because the banks just stop lending money, and there's a liquidity crunch in the market. You don't see that.

David Ellison: Right.

Moe Ansari: Let's talk a little bit about the Russian-Ukrainian war. It has pushed up oil prices. It's a very uncertain situation. No one knows how it's going to end, when it's going to end. Or this could be a long-term grind on both sides until one of them is exhausted and say, "Okay, let's talk." Where do you see that going? And how does that impact inflation? I mean, it's pulled up oil prices a lot, and we are at $100 a barrel in oil, plus or minus. What do you think that does to inflation? And does that become more entrenched because of this?

David Ellison: Well, it's disappointing to have whatever is happening happening there. I'm not a politician. I'm not going to try to sort of predict these things. I think you've got to assume that it's going to go on. And so, in a sense, what is it impacting? Well, it's impacting supply. So as an investor, I got to say, "Well, if that continues, what's going to happen?" Because again, there's a lot of triggers that could really make things a lot better. Right? The war's over. The Fed stops raising rates. There's partisanship in... or bipartisanship in Washington, and spring comes, and the Red Sox win the World Series. I mean, it could get really good, real fast. Right?

Moe Ansari: Right.

David Ellison: But you sort of got to assume that what's happening now is going to continue, and that's going to put pressure on inflation and pressure on trade. Again, it gets back to, who does it impact the most? Well, it impacts companies that source goods and source products from other countries around the world. And that's primarily most of the companies. Right? So you got to assume there's going to be impacts. They're not necessarily going to be good. And so the question is, can the companies adapt to it? But it all is sort of pushing the idea that prices are rising. Mean, I don't see anything that's deflationary in what's happening around the world these days. And that, to me, is the big, overriding theme that we've developed here in the last year or so.

Moe Ansari: Mr. Ellison, as always, it's a pleasure talking to you. And thank you for your insights. Always give us great, straight talk on exactly what you think is happening and how to look at these markets. Thank you again for spending this time with us.

David Ellison: You're welcome, Moe.

Moe Ansari: That's Mr. David Ellison. He's portfolio manager at Hennessy Funds. Go and check out his funds if you want information on the small-cap or large-cap financial funds that Mr. Ellison runs. He's got more experience in the financial sector than anybody that I know. So get some information. Or just dial #250 on the cell phone and say, "Talk to Moe." #250 on the cell phone, "Talk to Moe." Or just go to hennessy.com, and you can see all the information on what Dave does, and especially his small-cap and large-cap financial funds. If you're looking at the financials, that might be a place for you to consider. As-