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3rd Quarter 2022 **Newsletter #5**

	Q3	YTD
S&P 500 TOTAL RETURN	-4.9%	-23.9%
US AGGREGATE BOND TICKER: AGG	-5.3%	-15.6%

"94% of the time, your portfolio is below its all-time high"

3rd Quarter's No Charm

Before we get into the 2022 numbers, we think it's important to remember that the S&P 500 gained 31% in 2019, 18% in 2020, and 28% in 2021… just for a little perspective.

(Cracks knuckles… here goes nothing)

Through the end of the 3rd quarter, the 60/40[1] portfolio is having one of the worst performing years in history (-20.2%). The market has certainly had worse years than 2022, but combined with the weakness in bonds, portfolios have endured a historically bad year.

It has been a forest fire across the board. Of the 11 major US industrial sectors, only Energy is positive on the year. Healthcare has lost *17%*, Financials *25%*, Industrials *27%,* and Technology *39%.*

The bond side has been arguably worse because nobody has ever expected to buy US Government Bonds and lose ***30%*** which is what happened to 20-year Treasuries this year. *Quick reminder that the US Treasury offers Series I Savings bonds that pay out 9.62% for purchases made before the end of October. Visit TreasuryDirect.gov for more.*

History Repeats

"The vast majority of the U.S. stock market's life (about 94% of the time) has been spent in a drawdown from the prior peak…[2]" *To put it another way, 94% of the time, your portfolio is below its all-time high.*

[1] The standard portfolio comprised of 60% stocks and 40% bonds.
[2] https://www.northerntrust.com/united-states/insights-research/2022/wealth-management/a-history-of-drawdowns

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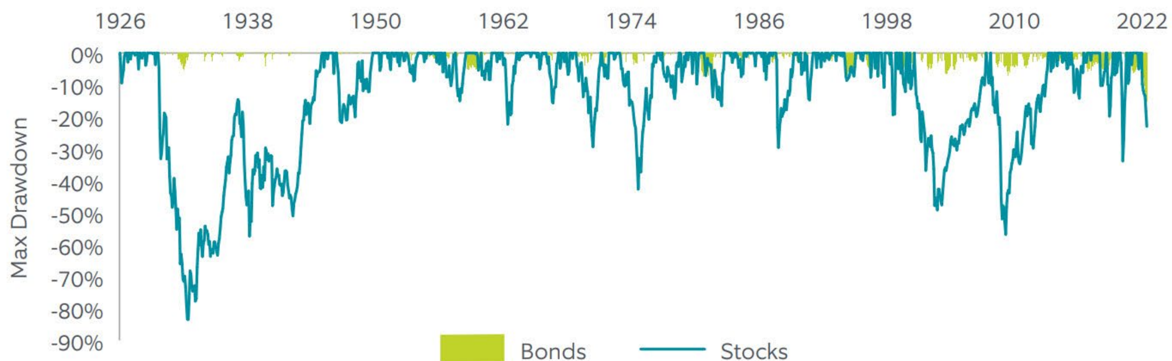
Large corrections have historically had above-average market returns in the years following. In an analysis put together by JP Morgan, the market returns an average of 83% in the 5 years following a correction of at least 25%.

Below is a chart from Northern Trust showing the amount of time the stock and bond markets spend below all-time highs.[3]



Prophecy & Positivity

We've been optimistic that the economy can continue to plod along despite the Fed rate hikes, and we continue to hold that opinion. However, our belief that the Federal Reserve will guide us to a "soft landing" has tamed a bit. The Fed Governors have publicly stated they will keep raising rates until inflation begins to come down, and the current indication from the Fed is that they are aiming to over 4% by the end of this year.

In our view, this is a mistake. Rates were increased from 0% to 3% from March to September, and the effect of those increases has not yet been borne out in the economy. Adding additional rate hikes without knowing the economic fallout from the previous hikes seems like a miscalculation.

We'll revisit this in 12 months to see if this was prophetic.

[3] https://www.northerntrust.com/united-states/insights-research/2022/wealth-management/a-history-of-drawdowns

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The Federal Reserve

Instead of slowly raising rates in the decade since the financial crisis in 2008-2009, the Fed kept the interest rates at 0% until 2016, when it began increasing the rate only to drop it straight back to zero when Covid hit in 2020.

Since March of this year, the Fed has raised the rate from 0% to 3.25%, *which is more than they did in* ***four years*** *from 2016 until Covid in 2020.* The "free" government money we needed to get through Covid combined with low interest rates created this situation with high inflation and the Fed now attempting to do a decade worth of rate hikes in just one year.

To the surprise of absolutely nobody, this is having some adverse consequences.

(Below: Historical Fed Funds Rate via TradingEconomics)

Note the sharp increase in 2022 at the far right.

Interest Rate Shock & Consequences: A Breakdown

Investments: Higher rates decrease the value of your existing bond holdings. Secondly, debt that companies carry will become more expensive as they issue more debt to fuel

investment. Thirdly, higher rates typically mean slower economic growth, and the value of your equity investments has reflected that with lower values.

Real Estate: One realtor we spoke with recently said there were regularly 50+ people at open houses in the spring. At one more recently, nobody had showed up at all. She double checked that the open house details were posted correctly online. They were.

Stronger Dollar: As interest rates rise and yields become attractive, foreign investors buy dollars to invest in our bonds. This makes the dollar stronger, which makes it cheaper for Americans to purchase goods overseas, and on the flip side makes it more expensive for everyone else to buy American goods. This has the intended effect of *lowering* domestic inflation, and the unintended effect of *increasing* foreign inflation.

Oil Prices: Oil on the international stage is priced in dollars, which is fine for the United States, because the price is the price. However, because the dollar has appreciated considerably, it has become far more expensive for other countries to purchase it. This is especially poignant in the European countries who are enduring crushing natural gas prices due to the war between Ukraine and Russia, and the political fallout that continues.

Expectations

What does that mean for your investments? Jamie Dimon, CEO of JP Morgan was recently asked where he thinks the bottom of the stock market will be.

"Well, I don't know."

While nobody can forecast the future, we think it would be safe to say that one day in the future, the market will reach new all-time highs. That day may be next year, or in 10 years, but we *will* be there for it. In the meantime, we are well-positioned with allocations to companies that will continue to operate successfully and provide value to you, the owners, and we think that part is very important to remember.

We'll see you soon,

Patrick and Joe