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2022 Third Quarter Review
"Turning Off the Spigot, Turning Up the Heat"

After a spate of bad news in the last week of the quarter, the volatile financial markets ended with stock *and* bond indexes making new lows for the year. Stocks have recorded one of their worst starts to the year in history with the Dow Jones Industrial, the S&P 500, and the NASDAQ indexes falling 21%, 25%, and 33% respectively, year-to-date. Bonds have suffered their worst losses since 1949. Long-term US Treasury Bonds, as represented by the iShares 20+ Year Treasury Bond ETF, have lost almost 30% of their value since the beginning of the year. Bonds have traditionally been viewed as a "safe haven" and a counterbalance to stock holdings. This year those following traditional models of asset allocation have been buffeted by declines in both asset classes simultaneously.

For the first time in years, financial assets are beset by an array of problems on many fronts including monetary, economic, systemic, and geopolitical. The Federal Reserve Board (the "Fed"), after having kept interest rates too low for too long, is now raising rates at an historically rapid rate. The interest rate on a 1-year Treasury Bill rose from 0.39% last year to 4.16% recently, with the possibility of going still higher by the end of this year. The spigot of easy money has been turned off. Accordingly, mortgage rates have more than doubled to 6.75% in a year's time. Higher energy costs and supply chain issues continue to plague certain sectors of the economy and raise the possibility of economic recession. The strong dollar curbs the profits of multinational corporations. Fear of financial defaults has increased as rates rise and disruptions persist. Finally, the war in Ukraine has created or exacerbated a host of problems that include the threat of escalation and broader destruction. The Russians and Ukrainians are turning up the heat. However, the concern closest to home appears to be the actions of the Fed.

"This is gonna hurt." In effect, that is what Chairman Jay Powell said when recently announcing the Fed's plan to raise interest rates at the fastest pace in modern history. The Fed has a dual mandate of maintaining price stability and maximizing employment. With employment looking strong, the Fed is concentrating on its goal of price stability after having let inflation get out of control with a decade of easy money and record low interest rates. Unfortunately, the Fed has a very blunt instrument that also has a considerable lag time to be effective. After Mr. Powell's announcement of the new aggressive plans for rate hikes, stocks promptly fell 15% in the next 2 ½ weeks. By the end of September, the indexes had made new lows undercutting the levels last seen at the end of June's sell-off.

We have largely been "playing defense" in most portfolios unless instructed to do otherwise by more aggressive clients. By that we mean that we have avoided most speculative investments, reduced fixed income investments well below traditional norms, concentrated on high quality equities with better valuation and dividend characteristics than average, and kept individual positions small enough to reduce risk to negative surprises in either individual securities or sectors. Where appropriate, we have purchased short-term US Treasury securities as rates have risen to more reasonable levels into the 3% to

4% range. These are probably the safest investments in the financial world, and they now pay enough to warrant investment. Speculators have been chastised and investors have been reminded of the wisdom of having reasonable criteria for valuation. As Warren Buffet says, “Price is what you pay. Value is what you get.” And good values are beginning to emerge as this market has retreated.

We should not lose sight of the fact that lower prices are the friend of the rational investor. Everyone feels better when prices are high and rising, but that is usually not when the best long-term investments are made. It is more in times like these that we can make new investments that are more likely to prove profitable in the years to come. We also should not lose sight of the fact that bull markets are usually born in times of pessimism and bad news before the headlines turn positive. Some surprises that may support an improving market include a moderating/declining rate of inflation (early signs are already accumulating) or a Fed “pivot” to a less aggressive monetary policy. We have developed a shopping list of high-quality companies whose stocks we would like to buy as lower prices are available. If the market continues to trend lower, we intend to have enough cash reserves to add those investments incrementally as we build positions for the next bull market. An important part of maintaining patience is having the right allocation of assets to weather the storm.

If you would like to discuss your portfolio allocation in detail, we would welcome the opportunity. Please review your reports and statements at your convenience and give us a call to discuss any changes or adjustments you would like to make as well as any tax considerations you may have going into the end of the year.

In the meantime, we will continue to monitor our investment positions, take actions to preserve capital, and make changes as the market provides us with opportunities.

Best regards,

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