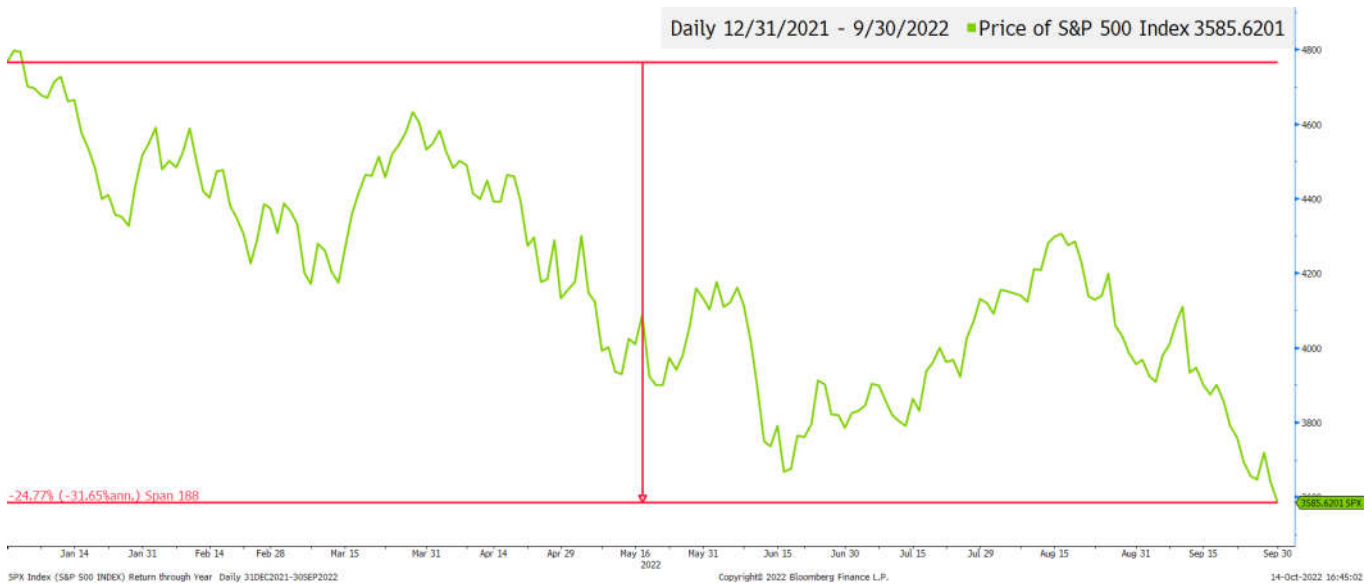




**Battered Bull, but Animal Spirits are Strong**  
Third Quarter of 2022

To say that 2022 has been challenging so far is an understatement. Fortunately, there is not much more bad news that can hit the market at least at the moment. We cannot remember the last time when both stocks and bonds sold off during the same period. Normally, when stocks sell off, investors shift to bonds which then drives down the yield, but not this year. This year the rout has been historic as bonds have also sold-off. This year, the yield for a 10-year bond has increased from 1.51% to 3.83% through September, resulting in a roughly -15.5% decline in price. Meanwhile the S&P 500 has declined -24.77% during the same period.



As we have discussed in the past, inflation had not been reflected by current bond yields. The Federal Reserve has decided to play catchup with aggressive rate increases in order to tamp down inflation.



Fortunately, the FOMC interest rate hiking cycle should wind down in the next few months. The current fed-funds rate is 3.75% and it is expected to top out at 4.60% in 2023.

Looking for the silver lining from this year's risk asset sell-off helps us think about what the future might look like. Typically, when the market is the most bearish, it is time to get bullish for the long run. Below is a current list of reasons to be bearish.

- The Fed is raising short term rates
- Mortgage rates have increased, slowing the housing market
- Inflation year over year is still fairly high
- The dollar is very strong
- Fossil fuels are in short supply, wait until winter
- The global economy is on the brink of a recession

Since 1950, the S&P 500 has been down more than 25% nine different times including this year's sell off. Fortunately, during those periods when you look ahead to one, three, five and ten year period returns, the S&P has been up 21.6%, 36.9%, 83.3% and 213.7% on average, respectively. Being out of the market increases the risk of missing the market recovery thereby offsetting the cost of being early.

Consider the following quote,

*"This is the one thing I can never understand. To refer to a personal taste of mine, I'm going to buy hamburgers the rest of my life. When hamburgers go down in price, we sing "Hallelujah Chorus" in the Buffett household. When hamburgers go up, we weep. For most people, it's the same way with everything in life they will be buying – except stocks. When stocks go down and you can get more for your money, people don't like them anymore."* Warren Buffet

Buying stocks when prices are low is by and large a great way to get into the market. The markets have been very volatile this year without a doubt and can still fall further before they recover but expected returns should be higher when prices are lower. Like real estate, it is not where you sell your property but is the price at which you purchase the real estate that really matters.

Market volatility may persist as inflation continues and the risk of the Fed pushing rates higher longer than necessary, resulting in a recession is still a concern. However, the fundamental backdrop remains supportive:

- Positive GDP growth, albeit slower
- The Fed is nearing the end of its interest rate increases
- Earnings growth is still positive
- Strong consumer wealth
- A strong banking system with liquidity and capital
- Stability in the corporate sector

Finally, the midterm elections are less than a month away. Since 1962, stocks in midterm election years typically decline -19% intra-year but have historically bottomed out in October and been positive in the year by an average of 32% after every midterm election since 1942.

This year has been anything but typical but we remain cautiously optimistic going forward. We will continue to tax loss harvest where we sell positions at a loss and take the loss for tax purposes for both stocks and bonds as well as adding stocks and bonds to the portfolios as appropriate.

