Forward Focus

October 2022

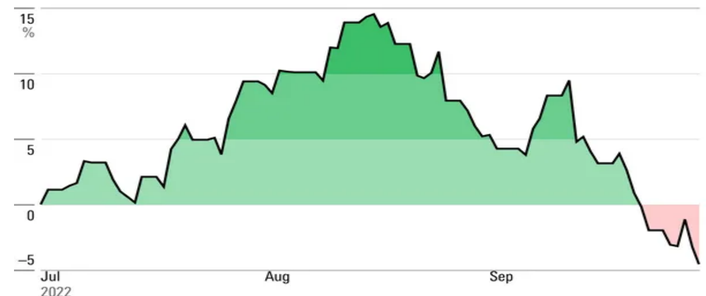
Inside this issue:

Page 1
- Quarterly Market Review
- Market Boxscore

Page 2
- Bonds: Beaten, Battered & Bruised
- 60/40 Portfolio

Quarterly Market Review

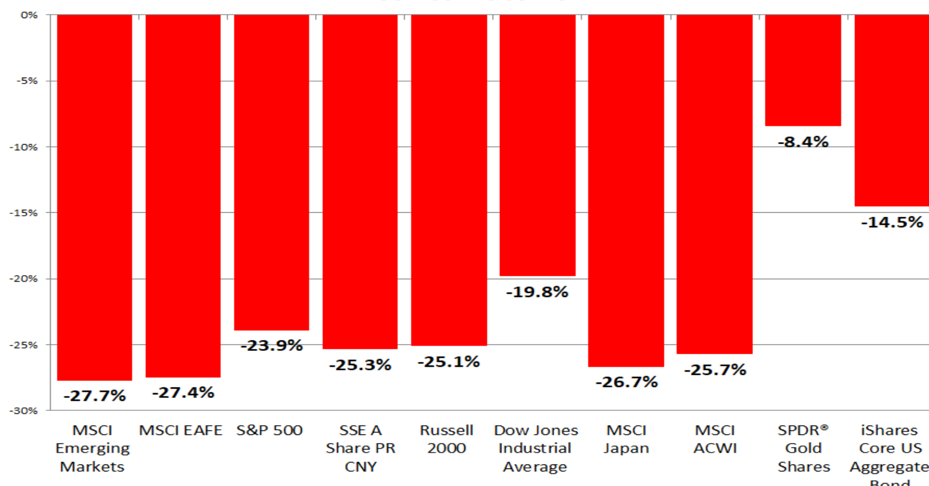
All major stock and bond market averages hit fresh yearly lows at the end of the quarter. The S&P 500 is down 25%, The Tech-heavy Nasdaq is down 32%, and the U.S. Bloomberg Aggregate Bond Index is down 14%. While this news is not anything we want to write about, no less experience and live through, a bit of perspective is important. The best chart I can find to explain this is listed below.



In July and August, the market rallied 15%+ before faltering in mid-August and September.

While big drops and new lows are scary, it is important to note that we are simply a few percentage points below where we were 3 months ago. In fact, the first two trading days of October erased ALL the losses over the past 3 months, as the S&P 500 index rallied almost 6%. As I stated last quarter, markets are likely to remain choppy, however, there are tremendous buying opportunities emerging. Yes, it might be tempting to sell. Selling right now will prevent future losses, but it also will prevent future gains and create no opportunity for recovery.

For the quarter, the U.S. dollar ended at $112.10, Oil (WTI Crude) closed at $79.49/bbl, and the 10-year Treasury yielded 3.83%. Unemployment is at 3.7% and year over year wage growth is 6.1%. Global supply chains are improving and shipping rates have dropped significantly. The Forward P/E ratio for the S&P 500 index is now 15.1 (for reference, it began the year at 21.4 and the 25-year average is 16.84) Consumer confidence has risen over the last three months to 58.6%. The best performing sectors were Consumer Discretionary, Financials and Energy, while the worst performing sectors were Consumer Services, Real Estate and Materials.



The year to date performance of most of the major indicies are listed on the left. A lot of red, I know. As you can see it is a similar story around the globe. Even the much-touted Gold index is down 8.4% year to date.

As the Market Boxscore along the bottom indicates, most U.S. markets did not decline significantly from last quarters levels. In fact, ALL the quarterly market losses occurred in the last two weeks of September.

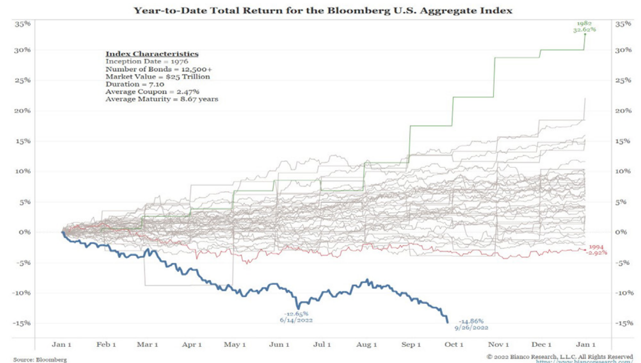
Third Quarter 2022

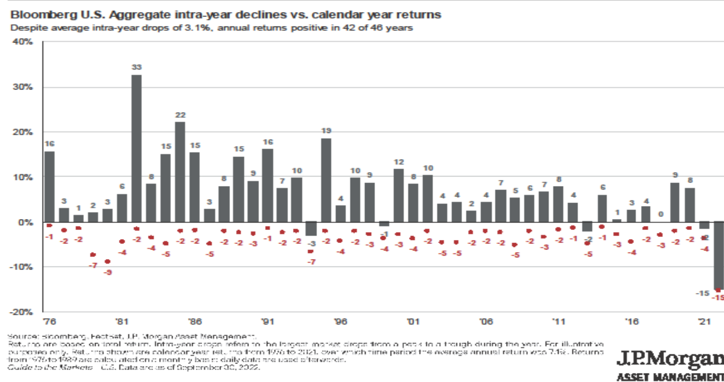
Dow Jones Industrial Average -6.2% • S&P 500 -4.9% • MSCI EAFE (International) -10.4%
Russell 2000 (Small Cap) -2.2% • MSCI EMI (Emerging) -12.5% • Barclays Capital Aggregate Bond -4.7%

Bonds: Beaten, Battered and Bruised

Bonds are loans to government or corporate borrowers. The terms of the loans (amount, time frame, interest rates, dates payments are due, etc.) are determined at the time of issue. It is basically an IOU from one entity (corporation or government) to another entity (investor). A person buys a bond in order to earn a stream of income over time. Think of it like a car loan, but in reverse. YOU are loaning the money and then receiving the interest payments.

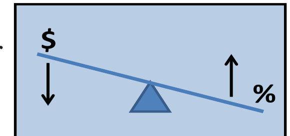
The chart on the right is from **Bianco Research,** showing the annual return for the U.S. Bond Market over the last 46 years (1976-2022). The **dark blue line** shows the year-to-date return for the U.S. Bond Market Index. Yes, it's the worst bond return going back to close to the 1930s. The second chart shows the same information in a bar chart (source: **J.P. Morgan Asset Management**). Both of these charts show you the unprecedented behavior of the bond market this year.





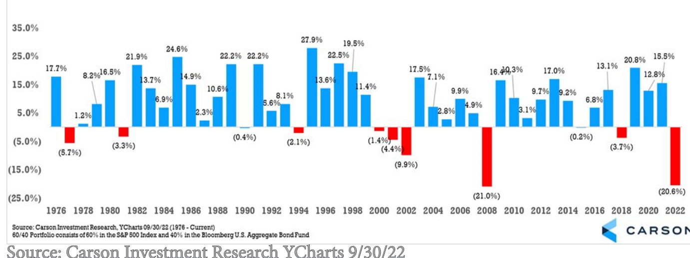
The reason for this sharp decline was a perfect storm of low interest rates, aggressive Fed hikes, Quantitative Tightening, and high inflation. The Federal Reserve has hiked rates 5 times since March. They have raised rates 3.0%, the most aggressive set of hikes since 1980's. This has caused interest rates on things like home mortgages to more than double and has wreaked havoc in the bond market. The combination of starting at such a low level (Fed rates were at 0.25%) and hiking rates to 3.25% in just 6 months at a time of spiking inflation (near 10%) was just too much for the bond market to handle.

Bond prices and Interest rates have an inverse relationship. Think of it as a teeter-totter (for anyone that still remembers what that is). When yields go up, bond prices go down.



In 1981, a 30-year mortgage was above 18%! Those sky-high interest rates of the early 1980s have slowly been declining over the past 40 years. Over the past decade, Quantitative Easing by the Fed has pushed rates down to near zero. As inflation began to spike and the economy began to overheat, the Federal Reserve found themselves needing to slow things down quickly. Thus, they raised the Fed Funds Rate. This has sparked a massive reversal in the bond market. While the moves were swift and severe, long-term holders of bonds will recoup their losses. A year ago, if you purchased a 10-Year Treasury note you would have earned 1.35% a year for 10 years. Today, if you purchase a 10-Year Treasury note you will earn 3.81% a year for 10 years. That is almost 3X greater return. Thus, long-term bond holders are now receiving better income and also have the potential for additional gain should interest rates decline a bit.

60/40 Portfolio: 60% Stocks and 40% Bonds



Source: Carson Investment Research YCharts 9/30/22

The 60% stock portion is down 25% year-to-date. The 40% bond portion is down 14.1% (See above article). Thus, an overall 60%/40% bond portfolio is down about 20.6%. The worst year for a 60/40 portfolio since 2008. Not fun at all. However, there is reason for optimism. Notice the annual returns following a down year for the 60/40. History has rewarded those who stay invested.