Third Quarter 2022 Commentary

July 2022 seems like such a distant memory now. We can still vaguely recall the brief period of happiness the stock market enjoyed. After the brutal second quarter, which pummeled stocks down by a drastic 16%, it seemed like we were seeing some economic signs of hope. The corporate earnings cycle was not as bad as was feared, there were signs of a possible peaking of inflation, gas pump prices were marching steadily lower, and the Fed hinted that its rate hiking may not last as long as some had been predicting. The Dow Jones Industrial Average and S&P 500 index bounced up 7% and 9%, respectively.

Then came August. At the yearly Jackson Hole Economic Symposium, Fed Chair Jerome Powell indicated that the rate hiking may need to last longer, which led him to predict that the U.S. economy will probably feel some "pain" in the near term. Then in the Fed's regular September meeting, it raised short-term interest rates by 0.75%, as was expected, but signaled that future rate increases could be higher than current expectations. The stock market did not react kindly to these developments.

In the second half of August and September, all of the July gains were wiped out and then some. The S&P 500 index fell 4.9% for the quarter, bringing its total loss for the year so far to 24%, and the Dow fell 6.2%, though its total loss through the end of September was "only" 20%.

Bobby McFerrin Was at Least Half Right

Almost exactly 34 years ago, the number one song in America was an *a cappella* tune called "Don't Worry, Be Happy." Singer-songwriter Bobby McFerrin encouraged his listeners not to worry if, for instance, they didn't have a place to lay their head because someone had come and taken their bed. We are no philosophers, but we tend to think that we would indeed worry in that circumstance. At the very least, we would not be particularly happy.

We are not advising you to be happy about the current state of the American stock market. But we do advise you not to worry. That may sound like a Herculean task, given the state and trajectory of various economic indicators, so please let us spell out our reasoning behind it. (We have actually arrived at this advice through a careful examination of the historical record, and not out of an unthinking, Panglossian view of the future.)

If you are a client of ours, you fall into one of two categories. The first category is a client who is actively drawing upon their portfolio to provide regular cash deposits into their bank accounts. Typically, this would be a person in retirement who needs to tap their investment portfolio to provide funds for their living expenses. These withdrawals are usually automated to occur either monthly, quarterly, or annually, but they may also occur on-demand from time to time. The second category is a client who does not plan to make any withdrawals from their portfolio over at least the next five years.

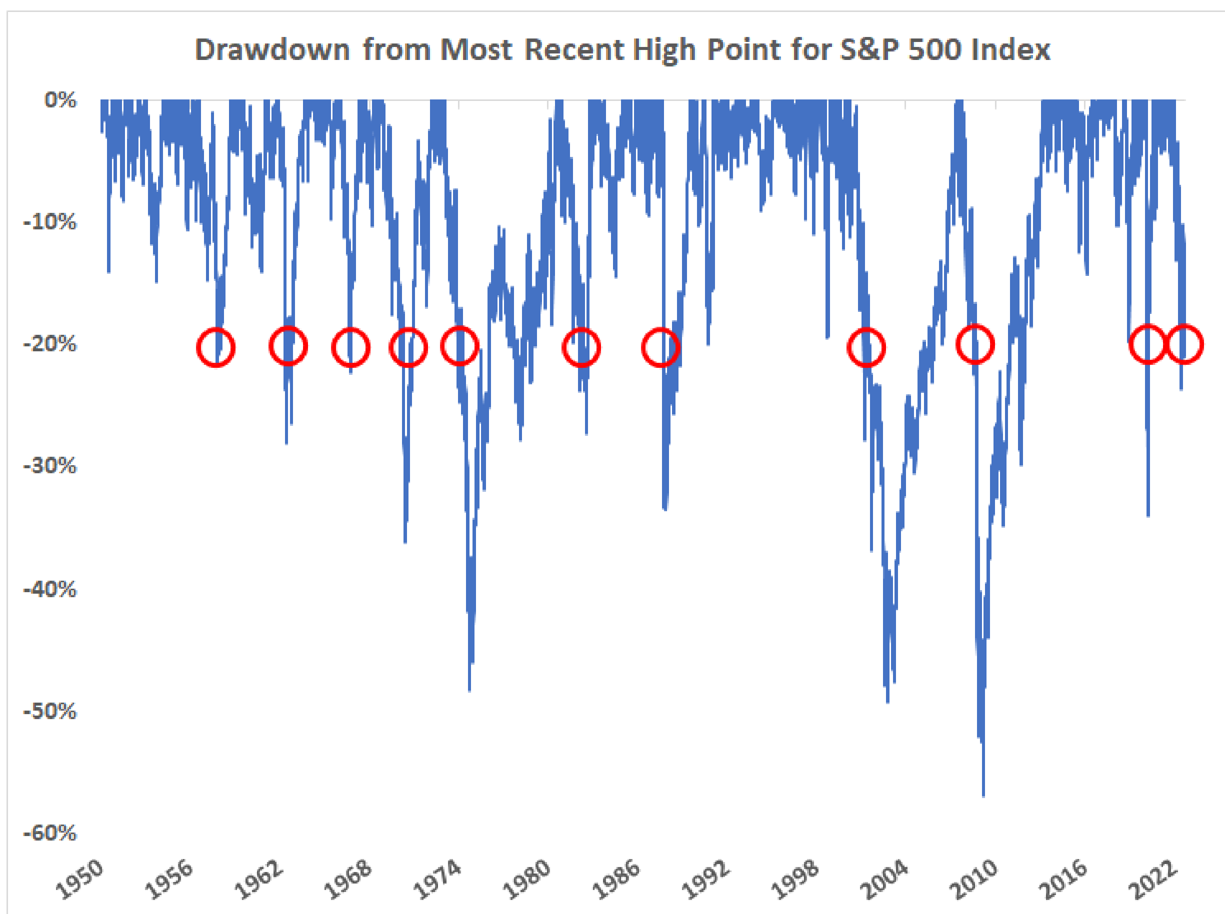
For the first category of clients, the majority of your portfolio is invested in the stock market. However, a significant portion is also held in cash, cash-like instruments, and bonds. In fact, each of these types of clients has at least 15% of their portfolio value in individual bonds and/or

cash. If we include bond mutual funds as well, the proportion is more like 25%. Any anticipated withdrawals over the next five years will be taken from these sources. That is, we will not have to sell stocks at the current depressed prices in order to fund your planned cash needs.

For the second category of clients, we also will not have to sell stocks at the current depressed prices, because you do not have any near-term anticipated withdrawals. So the question then becomes, what will happen to the stocks in your portfolio over the next five years? That answer is not knowable, but we can look at history as a sort of guide for what we might reasonably expect.

Ten For Ten, So Far

Good data for the S&P 500 index goes back to 1950. Since then, that broad stock market index has declined at least 20% from its most recent high point on 11 separate occasions. The latest of these 11 times was just a few weeks ago in late September 2022:



source: Yahoo! Finance, Robert Shiller, Inkwell analysis

Here is what happened in the five years following each of the ten prior instances. Well, actually, we have five years' worth of data for nine of the instances. For the tenth, which occurred in March 2020 at the beginning of the coronavirus pandemic, we are only halfway through the ensuing five-year stretch.

Date	Subsequent Five-Year Total Return for S&P 500
Oct 1957	68%
May 1962	92%
Oct 1966	56%
Jan 1970	7%
Nov 1973	25%
May 1982	219%
Oct 1987	118%
Mar 2001	18%
Jul 2008	48%
Mar 2020	53% (so far)
Sep 2022	??

source: Yahoo! Finance, Robert Shiller, Inkwell analysis

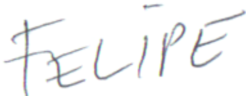
Before we savor the good news from that table, let's take a second to digest the difficult news from the graph above. In 5 of the 10 instances in which the S&P 500 fell at least 20%, it then fell at least another 10% from there. And in three of those (1973, 2001, and 2008), it fell a further 30%. Will this time be like one of those three? Or do we only have another 10% downside from here? Or will we bounce around at these levels before turning back up again? There is simply no good way to tell the answers to those questions ahead of time.

However, there is good news: the average subsequent 5-year return in the prior ten instances was 70%, the median was 55%, and the minimum return was still a positive 7%. Will the next five years from now be as good as that? We have no way of knowing precisely, but these historical figures give us enough confidence to say that we should not be worrying too much about it.

What About "Be Happy"?

OK, so that takes care of the "don't worry" part of the song. As for being happy, we think it's best to look to other sources for that, rather than in our portfolios. Spend time with family, get out and enjoy some sunshine, travel a bit, catch up with an old friend. If you can try to do some of those things, then you can leave the worrying about your portfolio to us. We hope you enjoy the rest of 2022, and we look forward to reporting to you again early next year.

Sincerely,



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