StrategicInsights
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The Cross-Eyed Bear

Here it is. After 14 years of stock and bond market growth (punctuated by a 5-week drop in 2020), we have entered a bear market. This is the first major decline many investors remember, the last protracted downturn having occurred back in 2008.

Yet, it's not a surprise. A few clients asked recently if I am concerned about the decline. I understand the meaning behind their question, and it's reasonable to feel discomfort. At the same time, I was more concerned last year when markets were expanding to immoderate valuations. Recessions and down-market cycles are necessary, and healthy.

Economic contractions separate strong, efficient, well-run companies from those which aren't. They re-position resources, allowing employers to attract talent for less cost, build inventory and stretch their investments further. Down cycles magnify the areas firms should improve. Recessions bring consumer prices back in line and curb inflation. My enduring belief remains that the best time to prepare for a bear market is before the bear market, not during. Reacting midstream, particularly emotionally, can be harmful financially, even though it may feel better in the moment.

Summary

- Global equity markets are down double-digits as of this writing.
- Pullbacks, including this one, are a healthy part of the cycle.
- We expect this and prepare ahead of time.
- Market cycles create opportunities if you know where to look.
- I consistently review client plans and execute as appropriate to harvest opportunities.
- If there are changes in your situation which merit discussion, please let me know.

> "The market is the most efficient mechanism anywhere in the world for transferring wealth from impatient people to patient people."
>
> — Warren Buffett"

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THE CROSS-EYED BEAR

I was a financial planner in 2000 at Merrill Lynch during the bear market. I remember attending office meetings with investment fund representatives saying, "This time it's different. The internet has changed the paradigm, many "Dot.coms" don't make money and never will, and all of this has altered the dynamics of the markets and economy going forward." Even back then, that didn't sound right to me. Everything has changed? Really? Is it unusual that subsets of public companies have extremely overvalued stock prices? Or that people buy unstable assets hoping for immediate gains from others willing to pay more? Have stock prices over time ceased corresponding to company earnings and are now tied to, say, the weather? Have market dynamics and human nature fundamentally changed? Or - is it the same game but different players?

Overview

Year-to-date returns in both global equities and fixed income are negative. There is no one particular reason for the volatility. The backdrop is that the US dollar is strong, and the Federal Reserve is aggressively raising interest rates to control inflation, with world economies following suit. We may be entering a profits recession, (although this, of course, depends on the sector.) It's worth remembering that short-term market prices reflect investors' collective expectations for the future. But long-term market prices reflect company profits.

2022 Index Returns[1]

Equities	Level	1 week	QTD	YTD	1 year
			Index Returns (%)		
S&P 500	3693	-4.63	-2.06	-21.61	-15.71
Dow Jones 30	29590	-4.00	-3.34	-17.30	-13.15
Russell 2000	4174	-6.58	-1.38	-24.48	-24.70
Russell 1000 Growth	1441	-4.57	-0.77	-28.63	-23.83
Russell 1000 Value	849.50	-5.20	-3.14	-15.59	-10.81
MSCI EAFE	1688	-5.59	-8.09	-25.78	-25.91
MSCI EM	905.84	-4.02	-8.44	-24.44	-26.47
NASDAQ	10868	-5.06	-1.27	-30.13	-27.26

A TWO-STEP PLAN

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Step One: *Be Prepared*

Collectively, we are not robots making purely analytic decisions; rather we are organic creatures who run when fearful. Evolutionarily this is an advantage. But the problem is that in our fright we sometimes bolt from noise in the shrubs we think is a lion (but is actually a ground squirrel) and plunge in our panic off a nearby cliff. Prudence is knowing when to be wary, and arming yourself ahead of time. In planning we accomplish this by:

1. **Retaining liquidity** for upcoming cash flow needs, knowing you may forgo longer-term growth in those savings
2. **Keeping an allocation in cash and/or fixed income** to weather bear markets
3. **Aiming for short and high-quality fixed income** portfolio duration as appropriate
4. **Diversifying** equities amongst geographies, capitalization and industries
5. **Selectively decreasing overvalued classes** and increasing those which are undervalued

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Step Two: *Seize Opportunities*

Shrewd strategies exist in any market environment. In fact, many financial planning strategies work best in a down cycle. Constructive tactics we are evaluating and executing these days include:

1. **"Pre-paying income tax"** (e.g., Roth conversions, i.e., effectively paying income taxes now at a depressed price, which allows future appreciation to expand inside the Roth tax-free)
2. **Increasing contributions to tax-free accounts** (529s, HSAs)
3. **Lowering future taxes** through tax-loss selling
4. **Selectively rotating fixed income or cash to equities**
5. **Adding cash to CDs as the Fed raises interest rates.** Last weeks' rate increases have made CD yields more attractive. The current yield as of the date of this letter for CD rates of 6 to 12 months in maturity can be found between 3% and 4%, depending on the offeror.
   - *For clients: I am reviewing your bank and brokerage cash positions and will contact you this coming week if it is advantageous to replace a portion of cash with CDs.*

Setting Expectations

I don't know how long this bear market will last. The average length of an S&P 500 bear market is 14 months and since 1949 there have been nine periods of 20%+ declines, the average of which is 33%.[2] We build buffers of safety into your plan with the objective of holding sufficient savings outside equity markets to outlast downturns.

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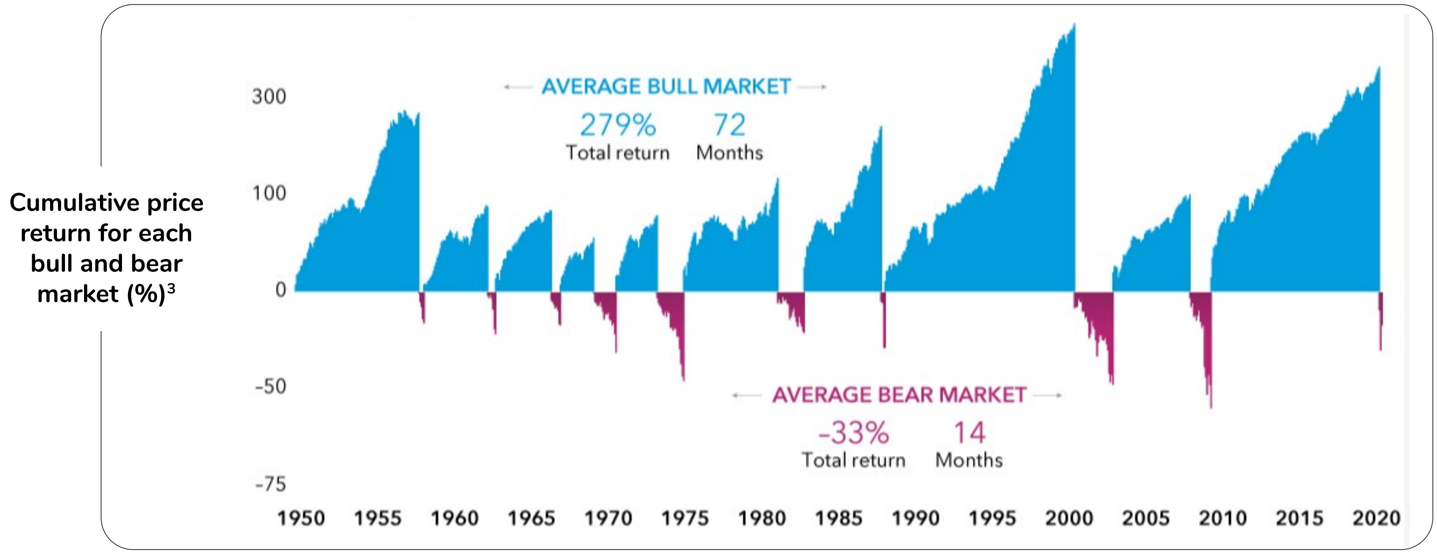

I frequently ask Clients: "What are your largest upcoming expenses in the next 6 to 12 months?" Why? Because funds you need soon (for extensive home renovations, grad school tuition, a large charitable donation) should likely not be kept in equities.

Bearing the Pain

The best risk reduction tool is time. That doesn't make it more comfortable.

Why go through this? The average bull market offers 279%.[4]

The reward for pain is growth.

As always, I am here.

—Adrianne

September 30, 2022

1 Index Returns: JP Morgan Asset Management, Market Insights Weekly Market Recap, 9/26/22
2 Cumulative Price Return: "Guide to Market Recoveries", Capital Group, 2020. https://www.capitalgroup.com/advisor/insights/articles/guide-market-recoveries.html
3 Bull & Bear Markets: Bear markets represent peak-to-trough declines of 20% or more in the S&P 500 index. Returns are show on logarithmic scale through 2/14/18. Sources: Capital Group, RIMES and Standard & Poor's.
4 Cumulative Price Return: "Guide to Market Recoveries", Capital Group, 2020. https://www.capitalgroup.com/advisor/insights/articles/guide-market-recoveries.html

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