

Raymond Capital Advisors, LLC

October 23, 2022

Stock & Bond Benchmark Total Returns (%) For Periods Ending September 30, 2022					
	QTR	1-Year	3-Years	5-Years	10-Years
Dow Jones Industrial Average	-6.17	-13.40	4.36	7.42	10.45
Standard & Poor's 500	-4.88	-15.47	8.16	9.24	11.70
Bloomberg Barclays U.S. Aggregate Bond	-4.75	-14.61	-3.26	-0.27	0.89
60% Stocks / 40% Bonds TAA Composite Index	-4.75	-14.85	3.85	5.70	7.51
3-month Treasury Bills	0.63	0.97	0.57	1.11	0.66
Returns (%) include capital gains, dividends and interest, and are annualized for periods greater than one year. <i>60% Stocks / 40% Bonds TAA Composite Index is rebalanced monthly. Sources: S&P Dow Jones Indices, Morningstar, Federal Reserve.</i>					

Market Review: Fed Turns Up the Heat

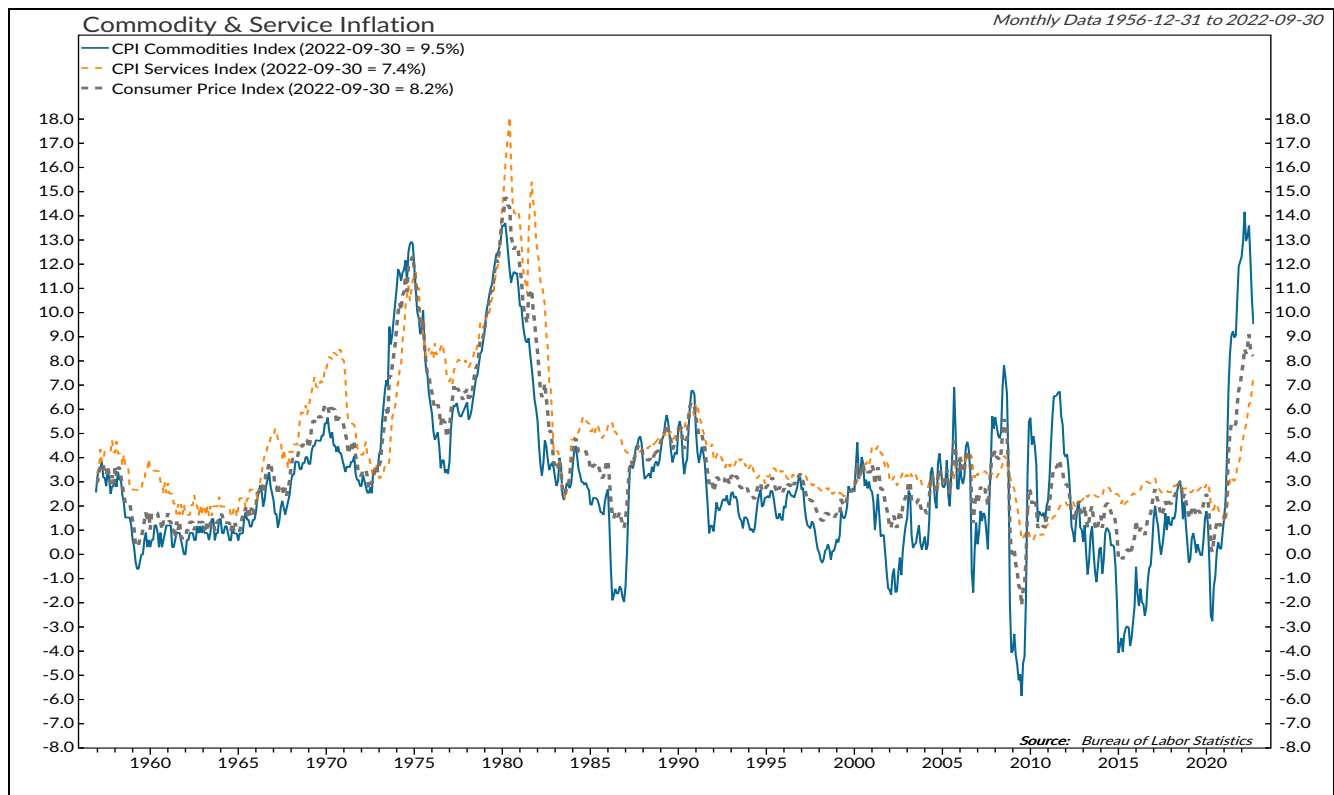
The third quarter of 2022 started out strong, but ultimately faltered as the Federal Reserve became increasingly hawkish. From oversold levels, stock prices rallied 18.9% from mid-June to mid-August on hopes the Fed would soon pause and reverse course from their rising interest rate policy. But those hopes were dashed as the Fed declared inflation as public enemy number one, and signaled that interest rates would likely need to be held at a higher level for a longer period of time in order to kill the current inflation and also keep future inflation expectations well anchored at low levels. With the Fed's increased hawkishness, investor sentiment shifted... Pushing the economy into recession was no longer viewed as a potential consequence of interest rate policy, but might even become necessary for killing inflation. As a result, stock and bond prices reversed their earlier gains and then some, both ending the quarter down a little shy of 5%.

During the quarter, RCA increased its defensive posturing. Within equity portfolios, exposure to the Energy sector was added via an Exchange Traded Fund. And within the fixed income portion of balanced portfolios, an Exchange Traded Fund that invests in Treasury Bills was added, while exposure to inflation protected bonds was increased.

Outlook: Focus on the Long-Term View

To be sure, inflation is the crux of the Fed's angst for raising interest rates. The problem is also global as many countries pursued easy monetary policies for too long following the pandemic. But here in the U.S. inflation has both cyclical and structural underpinnings. On one hand, commodity-based inflation has been coming down at a respectable pace as supply chains untangle. While this progress has been in the right direction, service inflation (e.g., wages, rents, medical) remains on a stubbornly persistent trajectory and appears poised to remain so awhile longer. **The Fed does not have the surgical tools to address these problems directly, and can only raise interest rates to slow the overall economy in their goal to kill inflation. Consequently, there is a risk that the Fed will overtighten and push us into a recession more than is necessary.**

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Raising interest rates is problematic for stock prices on two fronts. First, the rapid rise in interest rates means that **stocks are now facing increasing competition from fixed income yields**. Ten-year Treasuries are now yielding 4.12%, while 2-year CDs are yielding 4.80%! These yields are much higher than when we started the year (respectively 1.63%, and 0.54%). Second, with a slowing economy comes declines in earnings. But here one can also see some “silver linings”:

1. Thus far, earnings growth expectations have declined only modestly and are still positive, currently showing +7.0% for 2022, and +7.6% for 2023. Given that unemployment is a very low 3.5%, and consumer and business balance sheets are in good shape, it's possible we are in for only a mild slowdown. If so, stock prices have already overshot to the downside. However, we will need to see how far these estimates come down as the economy bows to the Fed's interest rate pressure.

2. Much may already be priced in. Since 1946, the S&P 500 has declined an average of 33.8% when a recession has been involved. But the Fed has already widely telegraphed its intent, and stock prices have already declined -27.5% (S&P 500 intraday high to low: 1/3/22 to 10/13/22). **Stock prices appear to have already priced in at least a mild recession.**

In all, significant both bullish and bearish influences remain in the short-run. Much depends on inflation and the future course of action the Fed takes. The inflation problem for services appears to have some underlying structural persistence. But just how much interest rates should be increased is a source of much debate. The Fed Funds target rate range has already been raised at a record pace from 0% to .25% (February) to 3.0% to 3.25% (September), with another .75% likely in November. Many

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economists believe a pause after November would be prudent, but thus far the Fed has been maintaining its “tough love stance”. Monetary policy has also typically worked with a 12 to 18 month lag.

What’s different this cycle is the both magnitude and speed that the Fed and fiscal authorities have acted, and the extent that new information is being priced in. Record amounts of liquidity were pumped into the economy to cushion the effects of the pandemic, and the Fed is now rapidly mopping up those excesses. And, as we have noted in previous letters, the speed by which markets have adjusted to new information is extremely rapid and appears to have increased in recent years. This cycle, the Fed has widely telegraphed its intent, record amounts of liquidity are being moved in and out of the economy and markets, while algorithmic trading has contributed to making the markets’ up and down movements high velocity events. (As we saw this past quarter, mini bull markets can be traversed in just two short months).

In a longer-term multi-year context, however, this is all part of a “healing process” as the Fed attempts to find the balance between its mandates of full employment and low inflation. Recovery, however, is not always a straight line and can include setbacks, periods of time that must sometimes be waited out. The “silver lining” is that markets appear to have priced in at least a mild recession. This is not to say that we shouldn’t rule out further downside in the short-run, but that over longer multi-year holding periods, we believe there is likely more upside potential than downside risks. Further, once markets are down, reducing exposure or rapidly trading in and out of today’s high velocity markets subjects an investor to the possibility that they could miss a significant part of the market’s recovery. Notice in the table below that **the historical probability of ending up with a profitable portfolio has increased as an investors’ time horizon has lengthened.** We therefore advocate taking a long-term multi-year view in the management of investment portfolios.

S&P 500 Total Return Historical Probabilities of a Profit December 1925 to September 2022 (Monthly Data)	
Percentage up all 1-Year Periods	74%
Percentage up all 5-Year Periods	87%
Percentage up all 10-Year Periods	97%
Percentage up all 20-Year Periods	100%
Percentage up all 30-Year Periods	100%
<i>Concept Courtesy: Ned Davis Research, Inc.</i>	

All the best,

Geoff & Lance

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