GARDECAPITAL

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Market Monitor: October 2022

Bad news is good news! As the challenging environment of 2022 persists, market watchers find themselves in a strange new place. The Federal Reserve is attempting to cool the economy with a series of interest rate increases. While the prices of many commodities have come down dramatically from their highs early in the year, job growth and spending have remained quite resilient. This puts capital markets at odds with the labor markets to some degree. Increases in the value of securities could actually now be correlated with reductions in available jobs and the size of the labor force. This will be a trend worth watching as a volatile 2022 winds down.

Here we provide some updates on the most recent quarter and add some perspective that you may find useful.

3rd Quarter Highlights

- As interest rates have increased, risky securities around the world continue to be devalued in the face of anticipated slowing in the broader economy. Whether the market has correctly predicted a sharp economic downturn though remains to be seen.
- U.S. stocks, as measured by the S&P 500 Index, finished September down 25.0% for the first nine months of the year.
- Non-U.S. stocks followed a similar pattern. The MSCI EAFE Index of developed markets was down 27.1% for the first nine months while the Emerging Markets Index declined 23.8%.
- Bonds, while not down nearly as much as stocks, are in the midst of one of the worst performance periods on record. The Bloomberg US Aggregate Bond Index was down 14.6% for the first nine months.
- The Federal Reserve has put itself front and center in the conversation as investors eagerly await

the results of the steady rate rising campaign. Since beginning the tightening campaign in March of this year, the Fed Funds Effective Rate has gone from near zero to 3% in September. Longer term rates for borrowing such as mortgage rates have followed suit, increasing the costs for borrowers and dampening loan demand. This is by design, as the Fed attempts to slow the economy to combat persistently high inflation.

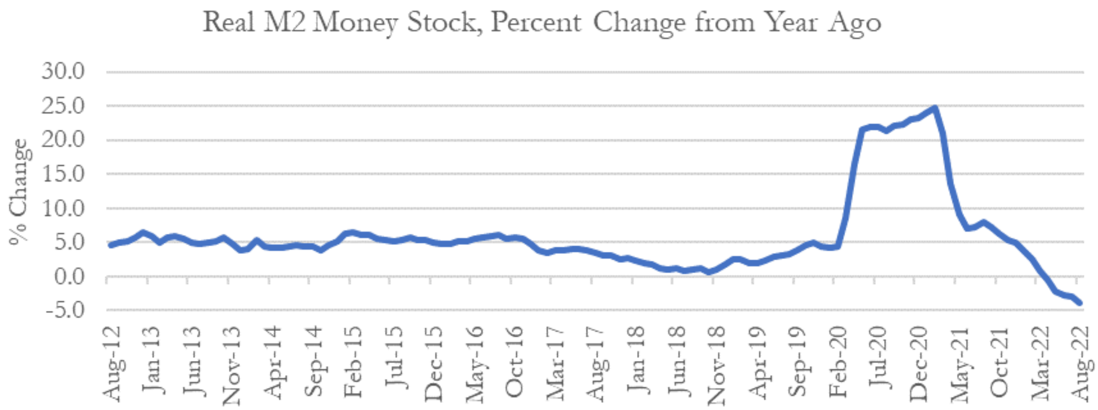
- While cooling slightly in August, inflation remained elevated at 8.3% for the Consumer Price Index (CPI) relative to the same period a year ago.
- Interestingly, while stocks have declined by 25% on numerous occasions over time, those declines are usually accompanied by a boost in returns from the bond market. This year, that has not been the case as yields continue to rise and bond investors worry about inflation.
- On the positive side, the economy appears to be slowing and the prices of many commodities have declined rapidly, many reverting to levels last seen in late 2021.
- Markets continue to be hard for investors to beat. The Vanguard Value Index, while down 14.6% for the YTD period, is outperforming the vast majority of all value funds in the peer group. It has performed better than 74% of all funds for the last 5 years and 88% of all funds for the last 10 years! Low costs and diversification matter in the long run.

Three Big Things

Here we look at some emerging trends that may be important for investors and their portfolios. We look at the change in money supply (available money in circulation), the power of indexing, and a note of optimism for investors who can look beyond 2022.

Money Supply

The Money Supply is the total amount of money in circulation. In general, the higher the money supply, the more stimulative the conditions for growth. The chart below shows the historical expansion and recent downward trend in the money supply. The Fed is indeed in the midst of tightening.



Source: Federal Reserve Bank of St. Louis, Real M2 Money Stock [M2REAL], retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/M2REAL, October 8, 2022.

The Power of Indexing

The table below depicts the performance of the Vanguard Value Index Fund compared to its underlying index and the average performance of the peer group of all U.S. large value funds. While the index is often in the top quartile among all funds, this nine-month period has not been kind to the active managers (market timers and stock pickers). On a ten-year basis, this fund has outperformed 88% of all other funds in the group, up from 84% as of December 2021.

Vanguard Value ETF vs. Peer Group and Benchmark (Annualized % Returns)

	YTD	1 Year	3 Years	5 Years	10 Years
Vanguard Value ETF	-14.58	-6.61	6.14	7.06	10.49
US Fund Large Value Peer Group	-16.67	-9.65	5.02	5.48	8.66
CRSP US Large Cap Value Benchmark	-14.56	-6.59	6.17	7.08	10.51

Source: Morningstar Direct

Looking Forward

The table below shows the performance of stocks and cash after the S&P 500 Index declined 25% during past downturns. During these periods, stocks still had farther to drop before they got better, yet patient investors were rewarded as is often the case. Anytime markets drop, long term investors should be focused on future opportunities.

5-Year Forward Cumulative Return after 25% Decline in Stocks

	S&P 500 Index	Cash (30-Day T-Bills)
Credit Crisis (2008)	68.5%	0.4%
Tech Bubble (2001)	28.7%	11.7%
Oil Embargo (1973)	53.0%	37.5%

Source: Morningstar Direct

As always, we encourage investors to continue to focus on the core principles of sound wealth management: Address near term cash flow needs, revisit the financial plan, rebalance the portfolio, and tax loss harvest where appropriate.

We are fond of the old axiom, “Smooth Seas Do Not Make Skillful Sailors.” These are challenging times, and there are always lessons to be learned at this point in the cycle. We look forward to connecting with you to review your wealth management plan in the coming months, and please do not hesitate to reach out to us at any time.

Please find this newsletter and others on our website at [www.gardecapital.com.](http://www.gardecapital.com)