Glen Eagle

Faith Family Firm®

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Investment Commentary

As we begin the fall season, let us remember to reflect upon the beauty of life and our gifts while acknowledging that this year is shaping up to be one that most investors would like to forget…and we are only in October. The S&P 500 has now fallen for three straight quarters and has suffered its worst performance at this point in a year since 1931. [(1)] To make matters worse, there seems to be little to no haven as other asset classes, such as gold and bonds, have fallen with the stock market, and the value of idle cash has been reduced by inflation.

As discussed in our recent webinar, we believe this painful environment has primarily been the result of the Federal Reserve's tactic of aggressively raising interest rates to combat inflation. The pace at which the fed has been raising rates has been astounding and is even faster than its rate hike back in 1994, which up until now had been the fastest hike cycle in recent history. Needless to say, the impact has been intense, particularly in interest-rate-sensitive sectors like real estate. Last year the 30-year mortgage was 2.98%. Today it is over 6.7%, leading to an 82% drop in refinances and a 29% drop in new mortgage applications. [(2)]

This data implies that Europe is heading toward a painful recession as the War in Ukraine drags on and Russia continues to take steps to cut off energy supplies to the continent. European industrial production is shutting down due to this energy crisis, with 50% of the EU's aluminum and zinc capacity already offline. [(3)] With the winter coming, many European households could see their energy bills rise 3x, leading them to cut their spending elsewhere. While we may feel like these economic troubles are an ocean away, the reality is that there will be ripple effects felt here in the US. This is because 20%-25% of revenue from companies in the S&P 500 comes from Europe. [(4)]

So, the logical question that comes from the above summary of the environment we now find ourselves in is, "are we also heading towards a painful recession?" In answering this question, we think it is safe to say that the risk of a recession (assuming we are not already in one) is exponentially higher than it was a year ago. However, the pain of any recession, while more intense for those that may become unemployed, will likely not be as deep or impactful as the Great Financial Crisis (2008) or the Dot-Com Bubble (2000). This is because corporations and households have stronger financials today than they did back then. Ultimately, we believe the Federal Reserve will be forced to decide whether it is more important to fight against inflation by continuing to aggressively raise interest rates or to mitigate the rise in unemployment which their current interest rate policy will ultimately cause.

During times like these, when there seems to be bad news all around us and media outlets continuously inform us that the worst is yet to come, we like to think of the simple parable of the mule and farmer. According to the story, there was a mule that fell into a well one day. When the farmer came to try to rescue the mule, he realized that the situation was hopeless and neither the mule nor the well could be saved. As a result, he began shoveling dirt into the well to ultimately put the mule out of its misery. Initially, the mule was understandably hysterical. Yet, as each pile of dirt hit his back, he realized he could shake it off into the bottom of the well and step up.

In sticking with the parable, we, as investors, like the mule, are stuck in an undesirable situation that will take time to recover from. Yet, controlling our emotions and focusing on the three below themes may help us to slowly climb higher:

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1) **Keep Perspective:** Over the 50 years from 1970-2019, there were 7 recessions, 10 bear markets, and 4 legitimate market crashes with losses of over 30% for the U.S. stock market. [5] And yet, the S&P 500 has provided an average total return of 11.89% over that same time.
    - Market Implication: Investors who can consistently maintain their investment strategy throughout these volatile times are likely to be rewarded over the next several years. The historical average annual return of the stock market one-year after a recession is 24.5%. Additionally, the growth tends to continue further into the future. The historical average annual return for the three years following a recession is still an astounding 14.7%. [7]

2) **Look For Opportunities:** Often, during times of panic, both good and bad investments fall together. For example, during the dot-com crash of 2000, both Amazon and Pets.com fell by over 80%. Pets.com went on to go bankrupt and became a notorious example of irrational investor exuberance while Amazon went on to become…well Amazon. [6]
    - Market Implication: For the investor that has a lower risk tolerance or shorter timeframe, this continues to be a time to focus on dividend stocks. These stocks tend to be less volatile in these recessionary environments, and they pay you "rent" (i.e., dividend income) for the opportunity to live in your portfolio. Yet, for the investors with a higher risk tolerance or longer time frame, the next several months may provide an opportunity to purchase quality companies at a discount. The average recession lasts roughly 13 months, with a market drop of around 36%. [5] That would indicate that we still have more downside to go, but a smart long-term investor may use this as an opportunity to invest more money each time there is a significant drop.

3) **Don't Hoard Cash:** Last year, if you bought a 2-year US Treasury bond, you would have received an annual yield of 0.11%. Today (thanks to the Federal Reserve's interest rate increases), the same 2-year treasury bond will give you an annual yield of over 4.0%.
    - Market Implication: Typically, when the yield on treasuries rises, so does the yield you receive on the cash in your bank checking and savings accounts. However, banks still have such a high level of cash deposits from the pandemic that they don't want to incentivize people to give them more. As a result, many of our investors have worked with our team to take advantage of the unique environment we are in. They can take the cash that they do not need for their everyday expenses or emergency fund and invest it in US treasuries where they can get above a 4% yield without taking market risk since treasuries are backed by the US government.

As an investor, it often pays to be an optimist, and history tells us that, although we do not know when, good times will return. Until then, however, we understand that this can be a challenging time whether you are retired, running a business, or raising your family. Please know that our Glen Eagle team is always here to help you in any way we can.

Wishing you a happy, healthy, and blessed holiday season,

The Glen Eagle Investment Team

1) Bloomberg: "Runaway Bear Market Blows Past Everything Meant to Slow It Down" 2) Los Angeles Daily News: "30-year mortgage rates soar to 6.7%, highest in 15 years" 3) BofA Global Research: "The RIC Report – The Turn of the Screw" 4) Barrons- "Pay Attention to Europe's Unfolding Crises. They Could Impact U.S Stocks" 5) A Wealth of Common Sense- "Navigating the Pain of Your First Bear Market" 6) The Capital Group: "Braving bear markets: 5 lessons from seasoned investors" 7) Blackstone "Student of the Market"

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