MARSHALL & SULLIVAN
WEALTH MANAGEMENT

viewpoint

Summer 2022 newsletter

Be Careful What You Wish For!!

As the 'Great Recession' unfolded back in 2007, the Federal Reserve aggressively lowered rates from 5.25% to nearly zero. The unprecedented drop was extreme, taking nearly 12-months to complete. At the time, we expected rates would gradually drift back to prior levels as the financial/housing crisis waned. Instead, we saw historically low rates for the next 14 years.

During this 14-year period, we expected interest rates to rise. For our balanced accounts, fixed income purchases were primarily in short-term bonds as we expected to take advantage of increasing rates as our bonds matured. For years we sounded like a broken record, telling clients that rates would go back up and we would again see rates above 1% on our fixed income purchases.

Now, in an effort to control inflation, the Federal Reserve is raising rates. And, as rates rise, we are reminded of the old saying: "*be careful what you wish for*."

Instead of the gradual rate increases we anticipated, the Federal Reserve is raising rates more rapidly than ever before. Over the past 6 months, the Federal Funds rate has gone from around zero to 3% and the Federal Reserve has signaled more increases will follow in the coming months. This has quickly taken money market rates from near zero to over 2% and has enabled us to invest our client's maturing bond proceeds in the 4% range. Both rates are below inflation, but much better than recent history.

Normally, this kind of inflationary environment would send hard assets like precious metals and real estate up in value. However, with interest rates increasing at such a rapid pace, a unique set of circumstances have conspired to push nearly every traditional investment class down in value, even as inflation pushes higher than it has been in years. Seemingly, there is no place to hide causing many investors [and, investment managers] to fear everything.

Declining asset values may feel a lot like 2008, but actually it is very different. In 2008, consumer borrowing was at an all-time high – today, it is at an all-time low. Unemployment was 5% on its way to 10% – today, we are at an historic low and going lower. In 2008, we were in the midst of the deepest recession since the great depression – today, the economy is growing.

The only thing similar to 2008 is that we don't know what the near future holds. How high will the Federal Reserve raise rates? When will inflation come down? Will the Fed's actions push us into a recession and if so, will it be short and shallow or long and deep? All of which has investors wondering "what is next?"

We obviously can't answer that question, but we can say with confidence that sticking to a well-defined investment discipline is the most proven path to success during difficult markets. By keeping emotion out of the investment process, we avoid the common mistake of selling when markets are down and buying back when they are up again. Remember, when you sell, you need to be correct twice - you need to pick the right time to sell and then get back in before the market recovers. Markets are forward-looking, and most turnarounds occur swiftly and without warning. This is why most investors sell, but never get back in fast enough.

So, as the market flutters, Marshall & Sullivan continues to carefully monitor the companies we own, making sure they can continue to grow their earnings in this environment and beyond. You will notice we sold an old friend this past quarter, Church & Dwight. This company couldn't continue to grow its earnings and the proceeds of the sales are sitting in cash until we find a suitable replacement at a reasonable price. A few companies on our radar are getting close but we have not added a new name yet.

If you are adding new funds to your accounts on a regular basis or thinking about it, we recommend you continue. With the market down more than 20% and bond yields over 4%, it is an opportune time to add funds.

One thing we know is that in the future, stocks will be worth more than today and market highs are likely to eclipse the all-time highs set earlier this year. Just like 2008, the markets will recover. During the Great Recession, the S&P500 dropped over 50% from its high and no investor was happy. Many wondered if the market would ever recover, but it did so in less than 22 months. Today it is almost 100% higher than the 2008 high. Patience pays dividends!

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