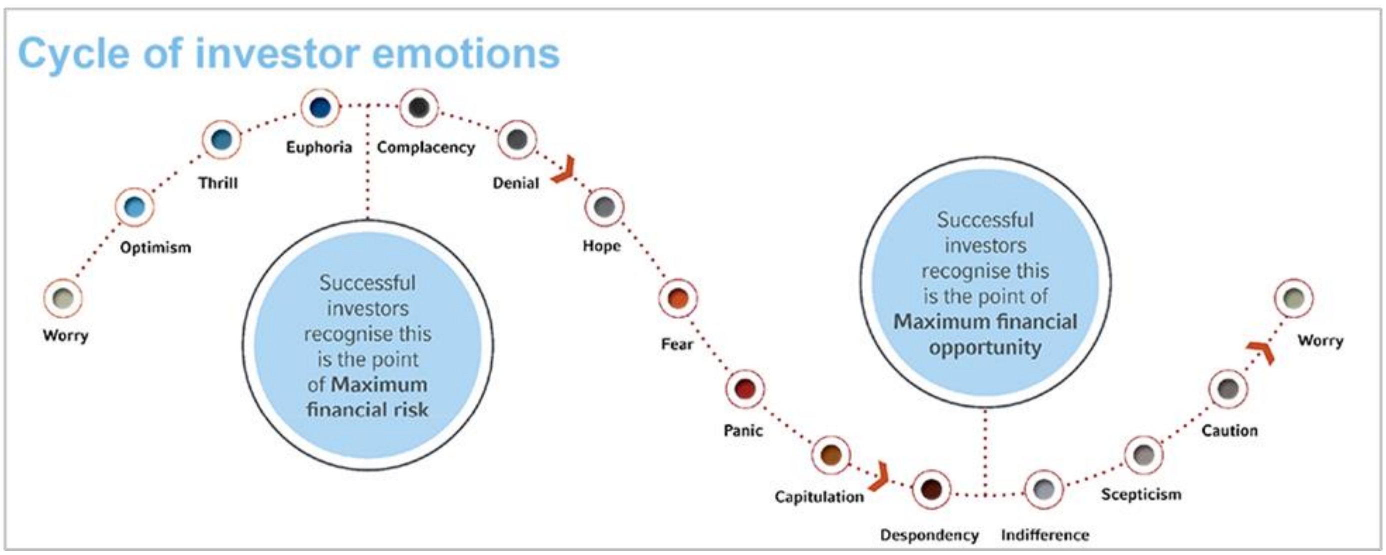
Flash Commentary | October 4, 2022

Thoughts on Recent Market Volatility

"I'm keeping the faith / Yes I am / You know I'm keeping the faith, oh yes I am" ***Billy Joel, "Keeping The Faith"***

The rollercoaster market behavior this year has led the financial media to consult a thesaurus to find the right terms to accurately describe this environment. We think a great description was offered by The Financial Times' Martin Wolf, who, with classic British understatement, described the situation both in the U.K. and the world as 'profoundly tumultuous.' Tumult implies confusion and turbulence, and often promotes emotional swings to investors' collective psyche that can ultimately cause imprudent behavior. We often emphasize that successful investing is dependent on (among other things) sound emotional behavior with respect to portfolio management. We have found that the best way to illustrate how market results and emotions are linked is by using the graph below:



Of particular note this year is the very rapid emotional descent investors have experienced from euphoria / complacency (green arrow) to capitulation / despondency (red arrow). The markets have been barraged with conflicting data and policy shifts that have been difficult to digest. This means rational forward-looking decisions have been very challenging to execute, and we expect this uncertainty to continue for at least the next few quarters.

We see the major issues confounding investors as follows on next page.

ISSUES AFFECTING MARKETS and THE GLOBAL ECONOMY		
Issue	**Result**	**Effect**
Inflation	High consumer, input and wage inflation has negatively affected consumer prices and corporate earnings	• Costs have spiraled for food, housing and energy • Central banks have aggressively raised interest rates to combat inflation
Interest Rates	Higher rates have hurt bond owners, all borrowers and the stock market	• Bonds prices have declined sharply thus far this year as rates have risen • Financing costs for houses, credit and corporate finance have risen markedly this year • Discount rates for future earnings have hurt stock prices, especially for tech and consumer stocks and foreign names
Currencies	High interest rates have helped a strong U.S. dollar and mildly tamped down inflation	• Companies with large amounts of offshore earnings will have repatriation issues • U.S. exports are declining, though this is offset by falling import prices • Emerging markets economies are hit hard in markets and financing • Dollar-denominated financing is more expensive
Stocks	Markets have declined sharply as the global finance environment has changed	• Margins are under pressure from several sources • Near-term earnings forecasts should be correcting downward • Growth stocks are in severe corrections
Growth	Global growth forecasts are being revised downward in expectation of slowing economies due to inflation pressures	• Rate increases are intended to slow demand and increase unemployment • High rates and declining stock markets will force companies to re-evaluate growth and hiring plans • Fed Chair Jay Powell has indicated that a recession may result from the Fed's rate-hiking program
Other Issues	Other situations and events will have a bearing on our forecast	• WAR in Europe will affect global food and energy supplies and potentially escalate to involve NATO • CHINA's economy is slowing, and the increasingly hardline Xi Jinping may be named 'leader for life' • WEATHER events are becoming more severe, harder to predict and more costly • FOOD insecurity is rising globally • COVID is still present • GLOBAL ELECTIONS are moving to more autocratic governments

For more comments and details on these issues, please refer to our previous three newsletters: Q2 2022 Market Summary, Q1 2022 Market Summary, and Q4 2021 Market Summary.

As perpetual optimists (which is *not* the same as perpetual bulls), we still see positive things about the markets and the economy.

- First, the markets as we understand them are functioning well. During the Global Financial Crisis of 2008-09 and the COVID pandemic in 2020, there were systemic issues with global financial institutions that necessitated intervention. Regulatory and behavioral changes have occurred since both of those events, and we're not currently operating under any restrictive issues despite unhappiness with equity prices and bond yields.
- The global economy was profoundly shocked by the COVID-19 pandemic, and the book is not yet closed on the disease. Many economic and behavioral changes occurred / are occurring, some large and visible, others small and largely unnoticed. Almost three years on, we have thankfully returned to a strong resemblance of pre-pandemic normal in the U.S. and other developed nations. As we work through these changes, however, we expect there to be further disruptions in various markets and economies, especially with respect to work and compensation.
- The U.S. economy and most other major economies—despite dire predictions and negative thinking—are not *yet* in recession. There does seem to be one on the horizon, but the robust job market and consumer behavior are keeping things afloat for the time being. We are often reminded that just because we think we're in a recession does not make it so, especially without substantial headline job losses. The job market, at least in the U.S., still appears robust and U.S. inflation appears to be at a near-term (if not absolute peak).

So where does this leave investors? It seems evident that there is further turbulence ahead, and, as we noted above, the likelihood of rolling regional recessions. As we often note to our clients, we should always focus on things we *can* control (which include our emotions) and focus much less on things we *can't* control (markets and policy). Referring back to our chart on the market-emotion cycle, we are clearly closer to capitulation and a period of capturing opportunity than we are to market-top euphoria. Much of the analysis we currently see projects financial re-calibration for the next nine-to-fifteen months, with expectations that the Fed may pause but not end its rate hikes given economic and markets conditions. This implies a number of entry points for investors over this period; the key is to take advantage of them.

Keeping these comments in mind, some of our recent conversations with and questions from clients have been very focused on this emotional disquiet. As always, we encourage everyone to *remain invested*, as market bottoms never announce themselves in the financial media, and to instead focus on things that we can control. Specifically, these include:

- Re-examining goals and time horizons as appropriate.
- Maximizing tax-loss harvesting opportunities.
- Prudently deploy long-term capital into equity markets by dollar-cost averaging.
- Reconsidering and possibly delaying any debt financings.
- Consider possible changes to allocations with respect to the ratio of stocks to bonds in portfolios.
- Reevaluate cash positions to ensure adequate reserves for the next 12 to 18 months.

We continue to look for places to reallocate capital, take losses and rebalance portfolios. Given that stocks and bonds have declined in tandem and almost to the same level, rebalancing is not as robust a tool thus far in the cycle, but changes in policy will likely provide excellent future opportunities.

Finally, we appreciate that these are trying times for investors and it is very easy to get caught up in the daily emotions of the market and lose sight of the bigger picture. Concentrating on the near-term level of the S&P 500 or the Dow Jones Industrial Average is not a prudent investment strategy. Also, drawing a “line in the sand” for your portfolio value and saying that “I am selling if it drops below that line” is not a sound philosophy, either. Your JJB team has weathered a number of these downturns over the decades, and focusing on the value inherent in financial planning and not deviating from our process has served our clients well during these time periods. Market drops are common, and can at times be steep, because emotions take hold causing investor to rethink their entire strategy. Once the emotions have settled, investors then turn their focus to earnings and valuations of companies and a market bottom is formed. It is important to note that once the selling has subsided, expectations are lowered and uncertainties have been resolved, and the market has always grown to new highs.

Please contact us with any questions or concerns you may have, and thank you for the trust you place in us.

—Your Wealth Management Team at JJ Burns & Company

The Russell 1000 Index measures the performance of the large-cap segment of the U.S. equity universe. It includes approximately 1000 of the largest securities based on a combination of their market cap and current index membership. The Russell 2000 Index measures the performance of the small-cap segment of the U.S. equity universe. It includes approximately 2000 of the smallest securities based on a combination of their market cap and current index membership.

The Barclays U.S. Corporate High-Yield Index covers the USD-denominated, non-investment grade, fixed-rate, taxable corporate bond market. The Barclays U.S. Aggregate Index covers the USD-denominated, investment-grade, fixed-rate, taxable bond market of SEC-registered securities.

The Citi World Government Bond Index (WGBI) provides a broad benchmark for the global sovereign fixed income market. It measures the performance of fixed-rate, local currency, investment grade sovereign bonds, currently includes sovereign debt from over 20 countries denominated in a variety of currencies.

The Morningstar® US Real Asset Index is a diversified portfolio of four different asset classes that have historically displayed high sensitivity to inflation. Real assets are defined as TIPS, commodity futures-based strategies, real estate investment trusts, and inflation-sensitive equities such as upstream commodity stocks and master limited partnerships

The S&P U.S. REIT Index defines and measures the investable universe of publicly traded real estate investment trusts domiciled in the United States. The S&P Global REITis a comprehensive benchmark of publicly traded equity REITs listed in both developed and emerging markets. The S&P 500® index includes 500 leading companies and captures approximately 80% coverage of available market capitalization.

The MSCI ACWI index captures large and mid-cap representation across 23 Developed Markets (DM) and 23 Emerging Markets (EM) countries. The MSCI EAFE Index is an equity index which captures large and mid-cap representation across Developed Markets countries around the world, excluding the US and Canada. The MSCI Emerging Markets Index captures large and mid-cap representation across 23 Emerging Markets (EM) countries.

The Bloomberg Commodity Total Return index is composed of futures contracts and reflects the returns on a fully collateralized investment in the BCOM. The index currently represents 20 commodities, which are weighted to account for economic significance and market liquidity.