MAY 2023

MARKET NEWSLETTER

The latest news from Gasaway Investment Advisors

"Helping you navigate your financial course."

What's New

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A WORD FROM JIM GASAWAY

As many of us experience in the winter, driving on snowy roads can be tricky. Once you start slipping and sliding one way, your gut reaction is to jerk the steering wheel the opposite way. Unfortunately, sometimes you overcorrect and may end up in the ditch.

Unfortunately, this seems to be similar to the path the Federal Reserve is on. They have flip-flopped from 'inflation is transitory' to 'interest rates should stay above 5% throughout 2023 to tame inflation'. This sudden turnaround and commitment to higher rates for longer has many investors fearing an overcorrection which could unnecessarily stunt the economy. This indecisiveness from the Fed led to a highly volatile 2022 as Wall Street hung on their every word and interest rate decision. This trend has continued into 2023.

WHAT HAVE WE BEEN DOING?

- Early last year, we shifted quite a bit of money from Large Growth companies to more Value oriented companies. In the last couple of months, we have trimmed the holdings and taken some profits on those Value stocks and reinvested that money back into more Growth oriented stocks again. So far we haven't made huge moves, I'd call them more adjustments. The reason for this is that Value stocks tend to be safer and tend to outperform when the market goes down, and this was the case in 2022, but the tide looks to possibly be turning in 2023. Growth stocks have started to outperform again in the short-term. We've shifted some money back into Growth and will see if this trend continues. If so, we'll continue adjusting into it.

- In the fourth quarter of last year, we moved some money to International investments, which have started looking better for the first time in years. We didn't bet the farm on it. Instead, we shifted some money into this area, and as we saw this trend continue. We continued adjusting into it.

- As we've written before, we have moved a lot of your 'safe money' from bond funds to CD's and laddered them somewhat. Because interest rates continued up after we bought them, your statements are showing a temporary loss. However, the great thing about CD's is that you will get the entire principal back at the maturity date **and** a guaranteed rate of interest. So, we expect to be seeing improvement there as we approach maturity dates and anticipate being able to reinvest at even higher rates than when we purchased the current CD's. Just a note on this… With all that is going on in the banking world, we have been investing for the most part in very large banks that we believe will provide the most stability while paying what seems to be fairly good rates of interest. We regularly compare the CD's that we are able to purchase to those of local banks and credit unions and see that we have generally been able to purchase CD's with higher interest rates than are available locally, even including most of the bank's "special offer" rates.

SO, WHAT IS MY SUGGESTION??

I believe that the best thing to do right now is to "Hold on." While I certainly don't know the future or what the next piece of news to come out will be, I truly believe that we're through the worst of the storm and that things are already starting to look a little better. Fears of recession domestically and abroad seem to be subsiding, at least somewhat, and inflation is moving lower, though very slowly.

While the market has continued to be more up and down than we like, so far the year has started off positive, giving us further reason to be hopeful.

We appreciate the trust that you have placed in us. We are diligently watching your investments and have made and will continue to make the moves that we feel need to be done. If you have any questions, please reach out to us.

CONTINUOUS INVESTING:

INVESTING IN DOWN MARKETS

by: Caleb Schoon, Financial Advisor

When the market drops, investor sentiment drops right with it. Nobody likes seeing their account drop over 20% in a calendar year. We have seen in the past that the market has always rebounded; however, no one ever knows how long that will take. What should you do while the market is down?

When we are in a bear market, it is the best time to implement a continuous investment strategy and incorporate dollar cost averaging methods. “Buy low and sell high” is a common phrase in the investment community, and bear markets are the ideal opportunity for investors to buy low. During a bear market, most investments trade at a much lower price and can often be extremely undervalued. This can be compared to when things go on sale at a grocery store: it could mean it is a time to buy. There are a few things to be conscious of when considering this strategy.

What have we seen in the past?

What should I be conscious of with this strategy?

1. You should always have an emergency fund. Making sure you have three to six months of accessible savings in the case of an emergency is crucial. This money can prove vital in the event of an emergency such as damage to your home, loss of a job, or any other uncontrollable event.
2. Ideally, you would be prepared to not touch your equity portfolio for at least seven years, as the longest time a major U.S. Stock Index has taken to recover after a recession or bear market over the last 80 years has been roughly seven years. If you are near or in retirement, it is important to be prepared for this possibility with relatively safe, less volatile investments. This would include things like bonds, CDs, and money market accounts. Being invested in these in retirement allows you to withstand bear markets by only pulling from these safer investments during those years, which in turn allows for your investments to recover and you to minimize the loss you may experience in your account.
3. Don't obsess over the status of your portfolio. It is understandable how, when a market is down, it can be stressful and discouraging; however, constantly worrying about your account will not do anything except keep you up at night. If you have enough money in emergency funds and "safe" investments, do your best to not panic when you see a major market drop. When individuals see their balance drop significantly during a year, the natural response is to panic and want to sell out of their investments. This forces you to realize the losses instead of allowing the investments to recover to where they were prior to the down cycle.

HOW DO YOU INVEST YOUR MONEY DURING A BEAR MARKET?

When a market is down and in a time of high volatility, the worst thing you can do is try to time the market to perfection. In times of extreme unpredictability in the market, such as times we have seen occur during bear markets, trying to time the market is nearly impossible. What should be done then?

Dollar cost averaging (DCA) is a method that is most useful in times of high market volatility. This is a method, used by investors in the accumulation phase of their life, where an individual invests a set dollar amount on a consistent basis (whether it be weekly, biweekly, or once a month).

The benefit of dollar cost averaging is that it allows you to purchase more of an investment when the market is down (which results in lower average share prices), and it minimizes emotional investing.

In addition, dollar cost averaging can be a useful strategy to encourage continuous investing during bear markets, and even recessions. During the Great Recession, we saw the market lose nearly half of it's value in about a year, as shown in the graph below. In times like these, investors tend to sell out of their investments, thus experiencing intense losses.

These two examples both utilize a dollar cost averaging approach; however, one has the negative annual returns experienced in the Great Recession while the other showed steadily increasing share prices. Both examples have a $100,000 starting account value and they both invest $500 a month. The only difference is the returns they experience.

How could this be turned to benefit the accumulating investor? Let's look at some examples:

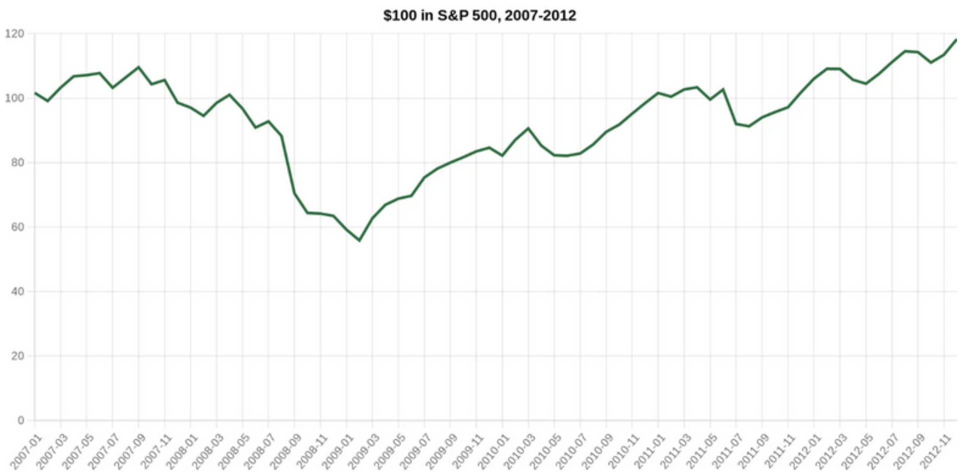


Figure 1

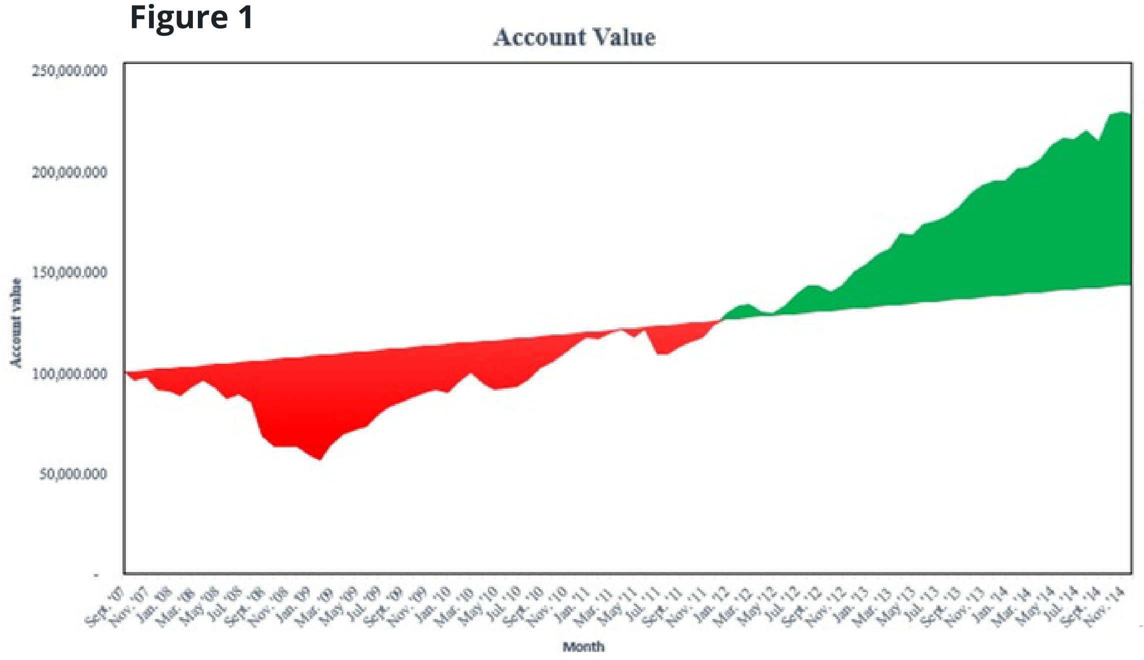


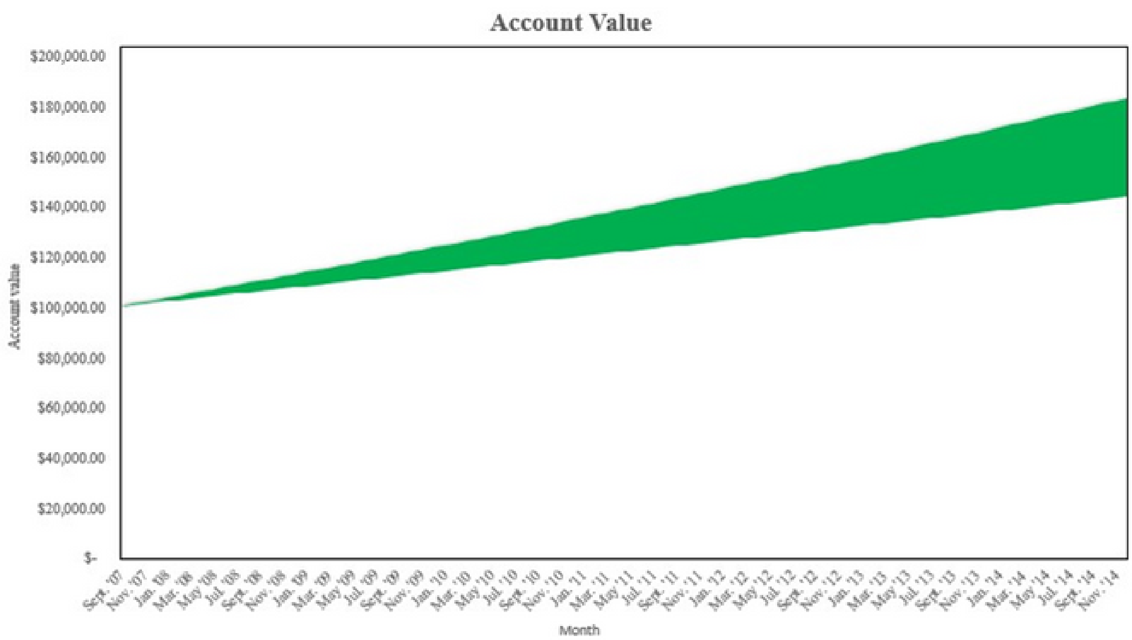
Figure 1 shows roughly a seven-year period starting at the beginning of the Great Recession. Throughout, dollar cost averaging is used by the investor. Around February of 2009, this investor would have lost nearly half of their overall account value, yet there are some advantages to a declining market, if investing in the stock market. Initially, let's say the investor was purchasing shares for $10 a share; however, at the market's lowest point, those shares were purchased at $5.10, while the investor was still investing $500. Therefore, when the market price drops significantly, you can purchase more shares while still investing the same dollar amount. How can this be helpful?

Answer: When the market got back to even, you would have owned X number of shares, compared to Y number of shares if the market had stayed level.

Now let's look at what would happen if you invested only in "sale" investments. Figure 2 shows an example of what an account value would be had there been consistently increasing share prices throughout this same period. This shows an account as if it were invested in a consistent investment such as a CD. The largest difference to note is that when Figure 1 bottomed, Figure 2 showed increasing share prices, meaning the $500 monthly investment purchased fewer shares than in a bear market (Figure 1). How large of an effect can this truly make?

How large of an effect can this truly make?

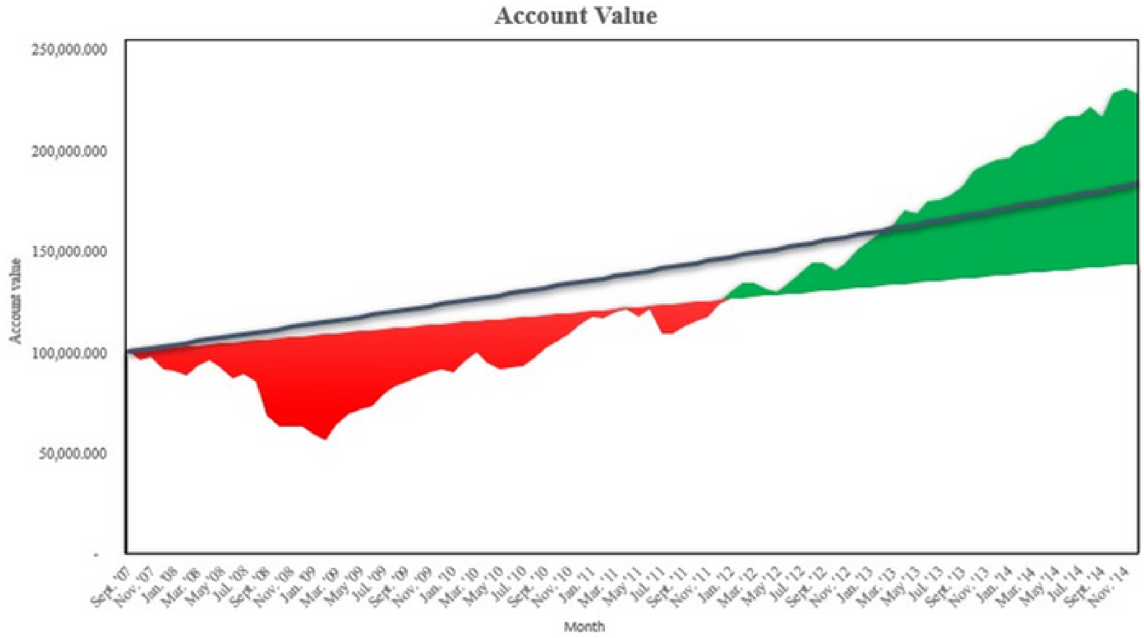
Figure 2



By overlapping Figures 1 and 2, as we have in Figure 3, it shows that in a volatile market, an investor can use dollar cost averaging to take advantage of fluctuating prices. In these scenarios, the fluctuating market example has a final account balance of $228,305, while the "safer" fixed income example has a final account balance of $144,141. An investor utilizing a dollar cost averaging approach would have ended with roughly $84,000 more if they were investing in the stock market during this recession (as opposed to a "safer" fixed income account).

Dollar cost averaging is a method that can be easily applied to mitigate emotional investing by consistently buying during down markets. It is important to remember how to view investing during bear markets and always remember that although the market is down, it could be the perfect opportunity to invest money and experience the growth of those investments when the market recovers. To do this, you must have proper savings and emergency funds in place, and be able to prevent yourself from panicking about the state of the market and pulling out of your investments. If you apply these methods and remember these key things, you will best prepare yourself for the long-run growth that you need to meet your financial goals.

Figure 3



(1) This article referenced data from the Fidelity Learning Center

MARKET ANALYSIS

by: Ethan Thies, Financial Analyst

The first quarter of 2023 continued 2022's trend of high volatility in the markets, stubbornly high inflation, rising interest rates, and then a miniature banking crisis instead of a pandemic. January, February, and March saw mixed (but overall positive) market returns and economic data and led to another quarter with much to unpack.

MONTHLY HIGHLIGHTS FOR Q1

January:

The stock market, measured by the S&P 500 index, rose 6.2% in January, providing some much-needed relief after a deeply negative 2022 (1). The economy added a significant number of jobs, far surpassing expectations, while unemployment fell slightly to 3.4% (2). Inflation rose 6.4% from last January (4).

February:

The market then fell 2.6% in February, mostly due to a higher-than-expected inflation number that came out in the middle of the month (1). The economy once again added more jobs than expected as the unemployment rate rose to 3.6%, though still remaining at historic lows. (2) On February 1st, the Federal Reserve delivered an expected 25-basis-point rate hike, raising the federal funds rate to 4.50%-4.75% (3). Inflation rose 6.0% from last February (4).

March:

The market bounced back from the negative February and rose 3.5% in March, ending the quarter up just over 7% (1). The Federal Reserve raised interest rates again to our current level of 4.75%-5%, the highest level in 15 years (3). Once again, more jobs were added than expected, while unemployment fell to 3.5% (2). Inflation rose 5.0% from last March (4).

The first quarter saw positive market returns during another period of high volatility and mixed economic data.

Inflation

Inflation, as measured by the Consumer Price Index (CPI), has proven to be very sticky. Throughout 2022, it remained much higher than economists, the Federal Reserve, or anyone would have predicted at the beginning of the year. Unfortunately, it looks like this trend has continued into 2023. After what looks to be the peak in June at 9.1%, inflation has dropped to 5.0% on the March reading (4). This is a year-over-year number, meaning that prices are 5% higher now than they were a year ago, significantly higher than the Federal Reserve's 2% goal. Energy prices remained volatile while other categories like food and shelter, the largest contributor to CPI, remained elevated. Even with the decrease in inflation since June, it remains a major issue for the consumer, and the Fed is focused on bringing it down at all costs.

Rising Interest Rates

In order to combat inflation, the Federal Reserve, in March of 2022, began raising interest rates from 0% to slow spending and economic growth and encourage saving. The federal funds rate now sits at a range of 4.75% to 5%, an unprecedented rise for one year (3). This has been noticed most glaringly by the average consumer in mortgage rates, with the 30-year fixed rate climbing from under 3% in late 2021 to over 7% in March and now sitting around 6.5% (5). Consumers will also notice these rate hikes in auto loans and every other form of financing.

Another result of these rate hikes is that fixed income investments such as Certificate of Deposits (CDs) and Treasury securities have looked increasingly attractive during this past year. Currently, we can get investors a 5.10% return for CDs that mature in 6 months or 1 year, and a 5.20% return for CDs that mature in 3 months (these rates are subject to change). These and the yields on treasuries are the highest since 2007. (6)

The Federal Reserve has promised that it will not stop raising rates until it sees inflation significantly and consistently coming down, though there is some talk recently that they may pause rate hikes soon (7). This will likely lead to slower job growth, higher unemployment, and slower economic growth, but it is a price the Fed is willing to pay for easing prices for the consumer.

Banking Issues

Typically, rate changes take around 12 months to affect the economy; however, they usually have an immediate effect on the stock market. (8) This is exactly how this past year has played out. Stocks moved lower throughout 2022 in anticipation of the

What has made the market uncertain this quarter?

economy being in a high interest rate environment, while in March of 2023, 12 months after the first rate hike, a few smaller poorly-managed banks have failed and economic conditions have tightened significantly.

These banks failures, most notably Silicon Valley (which also spurred the failure of Signature Bank) and Europe's Credit Suisse, were largely caused by the Fed's rate hikes. In the case of Silicon Valley Bank (SVB), they did not adequately hedge for interest rate risk. As rates rose and the economic outlook soured, many of the startups that SVB funded started to withdraw funds. This forced SVB to sell many of the mostly short-term government bonds they bought (which are generally very safe investments). However, since interest rates rose drastically after these bonds were bought, the bonds lost significant value – billions of dollars in total. After SVB announced this huge loss, panicked investors withdrew even more funds, and the bank was forced to close. Thankfully, all non-FDIC insured deposits were covered by the government, because this helped stop the contagion of bank runs on other healthier banks (9).

Is this risk the same for the bigger banks, and are we in for another 2008-style crisis? Highly unlikely. Big banks are stress-tested regularly (10) to ensure they have enough capital to absorb such losses while still being able to lend to businesses and households. Because of Silicon Valley Bank's size, they were not subject to these stress tests, and their business of lending to mostly startups and venture capitalists made them specifically vulnerable. When buying CD's in client accounts, we make sure to never put more than $250k (the FDIC-insured limit) worth of a client's funds into one bank and are steering clear of the riskier banks akin to Silicon Valley, just to be extra cautious.

Conclusion and Outlook

The failure of these banks has led most to believe that the Fed will not raise rates as much or keep them elevated for as long as previously predicted, which is good news for the economy (11). Still, recession remains top of mind for many investors. One historical precursor to recessions, an inverted yield curve (which has preceded all 10 recessions since 1955), has been inverted since July of 2022. (12) However, the definition of recession is subjective. A good rule of thumb is two consecutive quarters of negative GDP, but we already experienced that in 2022 without it being called a recession. Most assume that, if there is a recession, it will be defined by lower corporate earnings, higher unemployment, and potentially negative GDP growth.

So, what is the good news out of all this data?

- Investors have known about the Federal Reserve's rate-hiking plans for a while now, so much of that negative impact is priced into the market. Once interest rates stop rising, sentiment towards the economy and equity markets will likely grow more positive.
- Should we enter a recession, history tells us that stocks usually bottom around 5-10 months before the worst of the recession. The forward-looking stock market does not wait for the economic turnaround, but instead sees the trends and invests accordingly (as can be seen now with high interest rates priced into the stock market before really affecting the economy). (13)
- Finally, with the market (measured by the S&P 500) still down over 15% from its peak, this is a buying opportunity, especially for those with a longer time frame. The length of this downturn also provides a great opportunity for anyone to dollar cost average and lower the cost bases in your positions. (14)

We will continue to watch the stock and bond markets, global factors, corporate earnings, inflation, interest rates, and the overall economy and manage and invest your money prudently. As always, feel free to reach out to us with any questions, comments, or concerns about your investments or the markets in general.

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Article 2

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Article 3

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