# BRIAN D. LOWDER, INC.

QUARTERLY NEWSLETTER

Volume 25, Issue 3 October 2022


## Inside This Issue



## Financial Market Overview

By the end of the third quarter, all three major U.S. stock indexes were down between 21% and 25% over the first 9 months of this year. The overall U.S. stock market finished the **third quarter** down nearly 5% and down 25% year-to-date ending September 30th.

Large-company ***growth*** and ***tech*** stocks declined about 4% during the third quarter – a negative return, but still better compared to a 6% decline in large-company ***value*** stocks. However, ***growth*** and ***tech*** stocks are down 31% and 33% while large ***value*** stocks were down just over 18% during the first nine months of 2022.

Likewise, the performance of both small and mid-size ***growth*** stocks was worse than small and mid-size ***value*** stock during the third quarter. However, year-to-date, ***value*** stocks are down about 21% compared to a loss of 30% for mid and small-company ***growth*** stocks. Small and mid-size ***value*** stocks only lost about 2% during the third quarter. During uncertain economic times and a declining stock market, value (older and well-established companies) stocks generally perform better than growth stocks - it does not take much time to see the transition away from growth stocks to safer and higher quality value stocks.

International stocks fell over 10% during the third quarter and are down over 27% year-to-date. Europe and Asia have the same or higher inflation and interest rates but their currencies are falling in value compared to the soaring U.S. Dollar. In uncertain times, the U.S. Dollar is still a preferred place to hold investments especially for foreign investors suffering from declining domestic currencies.

Emerging markets (smaller-country international stock indexes) continued to post the worst equity (stock) performance both last year and this year. Emerging markets are down 13% during the third quarter and 28% year-to-date.

Investment real estate prices continue fall – down 12% during the third quarter and down 30% year-to-date compared to posting a 40% return for the 2021 calendar year.

Water utility stocks were up over 25% during the 2021 calendar year, however water stocks have given up all last year's 25% gain. Drought conditions across the U.S. – especially California, have hurt the bottom-line profits of water utilities– less product to sell, the smaller the revenue and falling profit.

Energy stocks were up more than 50% during the 2021 calendar year and are up over 20% for 2022 year-to-date despite the recent drop in gas prices during the third quarter.

Even the price of gold was down over 8% during the third quarter and down 10% for the 2022 year-to-date. *Gold - mining stocks* were down 24% during the first quarter of 2022. The second asset class, commodities (which includes many items from livestock, rare minerals to gold) lost 10% during the third quarter, but still have a modest positive return year-to-date through September.

Fixed income or bond prices for short-term maturities were down 2% during the third quarter and down 5% year-to-date. Intermediate maturity bonds were down over 6% during the third quarter and down 16% year-to-date. Even guaranteed bonds are losing value as interest rates continue to rise. As interest rates rise, bond values fall. We are reminding conservative investors again: Interest rates will continue to rise into 2023. Expect negative returns for fixed income/bonds for at least another year.

*Continued on page 2*

*Continued from page 1*

The following chart displays sample returns of various asset categories during the third quarter of 2022:

| Year-To-Date 2022 | 3rd Qtr. 2022 | Index Return (*includes dividends reinvested*) |
|---|---|---|
| - 20.95% | - 6.66% | **Dow Jones Industrial Average (^DJI)** |
| - 24.24% | - 5.32% | **Standard & Poor's 500 Index (^GSPC)** |
| - 25.14% | - 4.85% | **DJ U.S. Total Stock Market (VTI)** |
| - 30.93% | - 3.80% | **Large-company stock-Growth (IWF)** |
| - 18.34% | - 6.19% | **Large-company stock-Value (IWD)** |
| - 31.76% | - 1.00% | **Mid-Size Stocks – Growth (IWP)** |
| - 20.94% | - 5.43% | **Mid-Size Stocks – Value (IWS)** |
| - 29.38% | + 0.14% | **Small-company stock- Growth (IWO)** |
| - 21.81% | - 5.30% | **Small-company stock- Value (IWN)** |
| - 27.24% | -10.37% | **International (EFA)** |
| - 27.99% | -13.02% | **Emerging Markets (EEM)** |
| - 30.07% | -12.01% | **Real Estate Investment Trusts (VNQ)** |
| | | *Fixed Income (includes appreciation)* |
| - 4.84% | - 1.91% | **Short-term U.S. Treasury (SHY)** |
| - 16.07% | - 6.17% | **Intermediate U.S. Treasury (IEF)** |
| | | *Alternative Investment Category* |
| - 9.53% | - 8.19% | **Gold (GLD)** |

**All returns calculated using adjusted historical quotes from finance.yahoo.com*

## FINANCIAL MARKET OUTLOOK

The reality of our current economic circumstances should finally be apparent to everyone, not only in the financial markets, but also with consumers and investors. The argument whether we are definitionally in a recession or not is now meaningless …. we are in a recession of sorts. Excluding the potential impact of an escalating military conflict, the worldwide recession will likely be mild and a shorter duration compared to past recessions. However, progress may be painfully slow and could easily continue into late 2023.

By the end of the third quarter, all stock categories or sectors were down between 20% and 30% year-to-date. Last year's positive 24% stock market return vanished in nine months.
Gross Domestic Product (GDP) is declining – currently about half the 5.7% GDP rate in 2021. Last year's growth was easy to beat the lockdown conditions of 2020. At the end of the first two quarters of 2022, GDP growth was 2.2% and the estimate for the 3rd quarter 2022 is about 0.3%. It is very likely that 2023 GDP will be near 2.5%-3% range or about one-half of 2022 GDP.

The "oldest recession indicator" - Dow Jones Transportation Index is an index of the 20 largest airline, railroad, parcel delivery and trucking companies - is **down 26%** so far in 2022 with 12% of that decline coming in the month of September alone. When shipping, trucking, airlines, and railway business growth is declining, we are not near a recovery – we are in a recession.

A continuation of tight monetary policy means interest rates will continue to rise. Initially, the Federal Reserve moved too slowly in raising interest rates in order to slow the rate of inflation. Now, the Federal Reserve projects that the federal funds rate (the rate banks pay for borrowing) is expected to reach 4.4% by year-end and rise to at least 4.6% by the end of 2023. The current target Federal Funds rate is 3.25%; therefore, expect interest rates to rise at least another 1.5% -2% later this year and into 2023. All other interest rates (mortgage, auto loans, credit cards, etc.) follow as they are based on the Federal Funds rate.

Home Mortgage rates have more than doubled since the end of 2021. Last year, home mortgage rates were below 3% on conventional loans. Today, the average conventional loan rate is 6.7% or more than double last year's rates in just nine months and the highest rate since 2007.

In practical terms, this increased interest cost means for the same priced home and mortgage amount the monthly payments will be double what they were at the end of 2021. Yes, that does imply home prices will fall in the years ahead. Low interest rates were directly responsible for the 2-year wild run-up in personal residence values.

Now, the pendulum will begin to move in the other direction. The number of existing home sales have dropped for seven straight months through August, escrow cancellations are rising, and applications to refinance an existing home loan have dropped 85% from a year ago. The downward price adjustment will be reasonable. The time required to reach a new and lower fair valuation for personal residences will progress much slower and take more time compared to the stock market.

The biggest surprise factor that emerged in 2022 was the U.S. Dollar's strength. On the surface, an average person would think a "strong U.S. Dollar" is a positive attribute at any time or under any circumstance. Over the first three quarters of 2022, the U.S. Dollar was surging upward – more than 14% against a basket of

*Continued on page 3*

*Continued from page 2*

other world currencies.

The Dollar's role as the primary currency used in global trade means any fluctuations have widespread impact. First, many other country's economic prospects are worse than the U.S. and the impact is our goods become more expensive and less price competitive around the world the stronger our currency becomes. Smaller nations, whose currencies have declined relative to the Dollar, find their crucial imports of food and fuel that are priced in Dollar terms more expensive. For U.S. businesses and citizens, a stronger Dollar means cheaper imports from clothing to computer chips resulting in more purchasing power.

Second, in this uncertain world, the strong U.S. Dollar encourages global investors to pull money out of other financial markets to invest in higher interest-paying U.S. assets that offer greater protection and more security. The high safety perception and higher interest rates is attracting capital.

Third, many international and emerging market countries hold Dollar denominated debt. As the Dollar becomes stronger, these countries spend more to service that debt. Expect some near-term pain in international and emerging markets. For example, turmoil in Sri Lanka and the UK highlight this phenomenon.

Lastly, the soaring U.S. Dollar caused our firm to abandon and sell a recently purchased asset class – gold metal and gold stocks. The stage seemed to be perfectly set for adding gold and gold mining stocks because our inflation rate was rising and soon after making the purchases, Russia had just invaded Ukraine. High inflation and uncertainty (such as world conflict, falling economy and currency values, residual COVID effects) favors Gold as "store of value."

Suddenly, the Federal Reserve had to "catch up" to curb rising inflation that clearly was not "transitory." The Fed reversed course and rapidly raised U.S. interest rates that were as low as 1% to a much higher 4% for a two-year U.S. Treasury Note.

Higher interest offered on safe U.S. Treasuries is a big negative for gold and gold mining stocks. As interest rates were increased, gold prices fell. We sold out and moved on. Gold prices have dropped even further since we removed the metal from client accounts.

In summary, the economic and financial market outlook is still under pressure and will likely decline further – previously we suggested we are heading either into Recession or Stagflation. My guess is slightly lower economic growth and continued inflationary pressure (Stagflation).

The best analogy for our near-term expectations on how our financial markets will perform would be taking an elevator down from a 20-story building. Once inside and selecting ground floor, the elevator starts moving down quickly. As you near the bottom – say the fourth floor, the elevator starts to slow its decent until it finally reaches the bottom floor and stops. We have passed the mid-point (tenth floor), but we will be approaching the $4^{th}$ floor by the end of 2022.

As stated last quarter, it is a matter of timing – how long will it take for a clear vision, actions, and the necessary changes to be implemented? Problems are not solved until admission that the problems exist. Second, steps need to be taken to solve the problem whether difficult or easy or whether planned or not. Presently, there is no leadership or agreement. Congress is equally divided and the White House is what it is for the next two years. Under these circumstances, there is more adjustment coming, but the floor could be reached by the end of 2023.

## INVESTMENT OUTLOOK AND RECOMMENDATIONS

Given the current domestic and global economic environment and the likelihood of more downward adjustment in company valuations to come, there is plenty of time to make strategic decisions and specific investment selections.

Over the past decade, the economic environment was different and that environment favored specific industries and stocks. The economic growth rate was slow and relatively consistent. We had low inflation and the lowest interest rates in my adult lifetime. That environment favored big mega-growth industries, primarily technology and large consumer-discretionary companies (such as Amazon, Nike, Home Depot, Target etc.). Just about any company with a growth story performed well regardless of profitability. The S&P 500 stock index was up an average 16% annualized return from 2009 through 2021. We are no longer in that type of environment.

Over the next few years, cash-generating and profitable

*Continued on Page 4*

*Continued from page 3*

companies will likely be the best sectors to start with. **Value stocks** and businesses that generate the most cash with higher shareholder returns will likely be the top performing sector. Reliable, consistent, and dividend-paying stocks are likely to be the best stock category to begin building positions.

Beginning in November 2020, February 2022 and again in early summer, we made reductions of stock holdings (sold stocks), and sold gold and gold mining stocks in client portfolios. The sale proceeds were invested in guaranteed and short-term U.S. Treasury Notes with maturities of 1 year or less and we held much larger cash/money market balances. We will continue with this conservative allocation until sometime next year.

It is likely that the stock market will have short periods of positive performance – just as we saw in April and August of 2022. For example, the mid-term Fall elections are coming up, and short-term traders may be happy with a slight change in the balance of power in Congress. However, we expect a Fall rally to be short-lived as a stalemate in Congress and same White House will be in place for another two years.

The bottom line is we already implemented changes to our managed accounts. *Presently, we are not making any additional or significant changes to the investment holdings in our client accounts. We have already made meaningful changes throughout 2021 and early 2022.*
We are now focused on preparing a mix of BUY recommendations – primarily value-oriented and income-paying stocks.

It's going to take more time before investors' confidence is restored through progress and accomplishments or further weakened to the point where more investors may continue making sell changes to their portfolios. If progress is **not** restored, yes, the financial markets will continue to be subject to *waves of selling*.

## ANNOUNCEMENTS

We have a few milestone birthdays this month. Congratulations to Jenn Finley who just celebrated her 60th birthday! Congratulations to Rebecca Dodge who just celebrated her 30th birthday!

## Contact Us

***Brian D. Lowder, Inc.***

Brian D. Lowder, CFP®, CFA
Michael Kinnear, CFP®, CFA
Rebecca Dodge, CFP®, CFA
Jennifer Finley
Pamela Priest

**Address**
12780 High Bluff Drive Suite 100
San Diego, CA 92130

**Telephone**
(858) 794-6800

**Fax**
(858) 794-6906

**Website**
www.bdlowder.com

**Email**
brian@bdlowder.com
mike@bdlowder.com
rebecca@bdlowder.com
jenn@bdlowder.com
pam@bdlowder.com

Brian D. Lowder, Inc., a California Corporation, is a fee-only wealth advisory firm specializing in comprehensive financial planning and investment management. Brian D. Lowder, Inc. is registered with the Securities and Exchange Commission and licensed by the State of California Department of Corporations as an Investment Advisor.