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2022 Third Quarter Review

Greetings Clients:

In the first three quarters of this year, U.S. stocks declined 23.9%, world stocks were down 25.6%, and bonds declined 14.6%, as represented by the S&P 500 Index, the MSCI All Country World Index, and the Bloomberg Barclays Aggregate Bond Index.

We had quite a ride over the last three months: stocks started July down 20% from the beginning of the year, then we regained about half of the losses only to fall even farther over the last month. The most recent declines were triggered a few weeks ago by another negative inflation report and some very tough talk by Federal Reserve Chair Jerome Powell as he announced the third big rate increase at the last meeting of the Federal Open Market Committee.

Investors are trying to solve a very difficult puzzle: how much must the economy slow before inflation ebbs? And have the markets priced in the worst case scenario? So far, consumer spending and employment have been remarkably resilient. This is good news for the economy, but bad news for inflation and the markets. The Fed is promising to continue raising rates until enough consumers lose their jobs and stop spending money. Ironically, rising unemployment could be accompanied by rising investment prices if inflation moderates.

Will the central bank know when to stop raising rates, or will we be pushed into a painful recession? Wall Street banks and brokerage firms have varying opinions; some analysts believe the Fed will go too far and have to cut interest rates to stimulate the economy early next year. Which might lead to markets recovering sooner. Case in point: the S&P 500 Index of large US company stocks rallied over 3% yesterday after the morning JOLTS Report from the Bureau of Labor Statistics (Job Openings and Labor Turnover

Survey) showed job openings plunging more than 10% in August. Normally the elimination of over 1 million job openings would not be good news.

Given all this uncertainly, how has Ridley Cove positioned our holdings?

You will not be surprised to hear that we started preparing for rising interest rates years ago; we shortened duration and avoided the worst of this year's bond losses. Our quality stocks and value stocks have avoided 1/3 to 1/2 of the deep losses of growth companies due to inflation this year. Most recently, we trimmed our international targets in recognition of the superior economic and geopolitical position of U.S. companies. (That is, the US is the world's largest exporter of natural gas and Russia is not a neighbor.) Finally, we have shifted half of our short-term Treasuries to intermediate-term in case the Fed reverses the rate increases. We will continue to assess multiple scenarios.

Usually investors are too pessimistic. By design, the Ridley Cove discipline does not require us to predict the future; eventually markets correct, and we have nearly 100 years of data, including this unpleasant year, demonstrating that stocks and bonds continue to average annual returns of 10% and 5% respectively. We are happy trying to do just modestly better while helping our clients avoid the big mistakes of selling low and buying high.

However, our success is predicated on knowing and preparing for your spending needs. Should we raise extra cash? Absolutely, if your cash (and short bond) cushion is inadequate. For most clients, our 30% allocation is more than enough; don't hesitate to contact me any time to talk this through.

Please contact me if you have any questions about your investments, our strategy, or your financial goals. Our money is invested right alongside yours.

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