# MOULTON WEALTH MANAGEMENT INC.

# ***MOLTEN HOT NEWS!***

*SPECIALIZING IN RETIREMENT AND TAX PLANNING*

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## SECOND QUARTER 2022

The first half of 2022 has been a nightmare for even the most seasoned investor. When looking back, from the March 2020 lows until January 2022, investors were treated to a 21-month bull market. Since then, the S&P 500 has dropped 20.6%, its worst first six months of a year since 1970. The Dow Jones Industrial Average's 15.3% first-half drop is its worst since 1962, while declines of 29.5% from the NASDAQ Composite and 23.9% from the Russell 2000 are both indexes' worst first halves on record. The Bloomberg U.S. Aggregate, a broad index of fixed-income securities, fell 10.7% since the start of 2022. That's also its worst first half on record, based on data going back to 1975.

Although equity markets are higher than they were during pandemic lows, we're concerned that we may still only be in the early innings of this bear market.

On June 13, when the S&P 500 closed nearly 22% below its record high on January 3, it officially put it into a bear market. A "bear market" is defined as a decline of 20% or more from an index's recent high. This marks the

**S&P 500** Q2/2022 - 16.4%


**DJIA** Q2/2022 - 11.3%

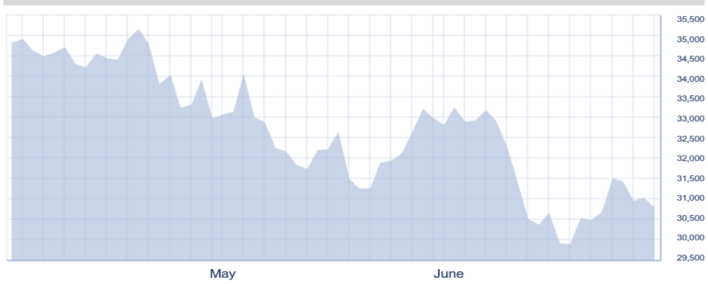



*Chart Source: www.bigcharts.com*

### MONEY RATES

*(as posted in Barron's 7/4/2022)*

| | LATEST WEEK | YR AGO |
|---|---|---|
| **Fed Funds Rate** (Avg. weekly auction)[c] | 1.58% | 0.10% |
| **Bank Money Market**[z] | 0.09% | 0.07% |
| **12-month CD**[z] | 0.39% | 0.17% |

*c- Annualized yields, adjusted for constant maturity, reported by the Fed Reserve on a weekly average basis. z – Bankrate.com (Source: Barron's; bankrate.com)* first bear market for this index in over two years, the last one triggered by the selloff in early 2020 due to the pandemic-driven lockdowns that stunted economic activity. *(Source: wsj.com; 6/13/22)*

The S&P 500 ended the quarter down 16.4% while the DJIA was only down 11.3%. The NASDAQ and Russell 2000 small caps were the biggest losers, down 22.4% and 17.5% respectively. The second quarter continued this year's theme of heavy volatility: high inflation rates; rising interest rates and forewarnings of more rate hikes in the near future; elevated gas prices; and continued global unrest.

The annual inflation rate for the U.S. was 9.1% for the 12 months that ended in June. According to the U.S. Labor Department, this was the largest increase in over 40 years. Food, energy, and shelter, the three areas that make up about 54% of the consumer price index (CPI), continue to be high priced items, and many forecasters do not expect these main staples to simmer down any time soon.

Fuel oil was up 98.5% over the past year, and shelter costs rose at the fastest rates in over 31 years. With these increases, the average worker lost over 3% income over the last 12 months. *(Source: cnbc.om)*

In this current economic environment, discussions of a recession are at the forefront of financial news headlines. Despite assurances to the contrary by brokerage firms and the media, we are almost certainly headed into a recession and in fact, may already be in one. Although it's true recessions are an ordinary part of the business cycle, they usually coincide with the deepest market declines. The last three recessions - March 2001 to November 2001, December 2007 to June 2009 and the Covid February 2020 to April 2020 – all were accompanied by S&P-500 declines that *averaged* 46.4%. These declines were in spite of a Federal Reserve *cutting* interest rates into and during the recessions and bear markets in an attempt to prop them up. Unless inflation recedes surprisingly quickly, it's unlikely the Fed will cut rates any

## KEY TAKEAWAYS

- **The S&P 500 is officially in a bear market.**
- **The Fed raised the interest rates 0.75% in June, the biggest rate hike since 1994.**
- **Inflation is still an issue for consumers.**
- **Consumer Price Index (CPI) had its highest increase since December 1981.**
- **The Fed is positioned to raise interest rates again at their July meeting.**
- **Volatility looks like it will be here for a while.**
- **Staying the course, by buying and holding has historically served investors well in bull markets but can result in huge drawdowns in bear markets.**
- **Understanding the cycle of investing emotions can be helpful.**
- ***We are here for you to discuss any concerns you have.***

time soon, and in fact will more likely keep raising them. This is not supportive of a shallow bear market or a quick recovery.

***BEWARE!***

## Inflation & Interest Rates

The last decade has offered historically low interest rates. Now, interest rates hovering near zero are a thing of the past. Although increased rates were much anticipated, the pace at which the Feds are raising them is sending shock waves through Wall Street and the general U.S. public.

Standing by its commitment to fight inflation, on June 15, the Federal Reserve again raised interest rates, this time by 75 basis points, or 0.75%, the biggest single rate hike since 1994. Add that to the 0.75% increase already implemented this year, it brings the Federal Funds Rate to a target range of 1.50 – 1.75%. Wall Street responded with selloffs, taking the S&P 500 officially into a bear market. In late June, the DJIA dropped below 30,000 for the first time since January 2021.

Most analysts are expecting another 0.75% interest rate increase in July and economic projections are suggesting that 2022 will end with the Fed funds rate near 3.4%.

The Fed is making these moves in an effort to quell inflation for Americans. "At the Fed, we understand the hardship high inflation is causing. We are strongly committed to bringing inflation back down, and we are moving expeditiously to do so," Fed Chairman Powell stated in the Senate Banking Committee meeting. *(Source: cnbc.om 6/22/22)*

A growing group of analysts fear that aggressive interest rate hikes could trigger a recession. Fed Chairman Powell stated at his Senate Banking Committee in June that while, "it is not our intended outcome at all, it's certainly a possibility." He continued, "We are not trying to provoke and do not think we will need to provoke a recession to bring down inflation." *(Source: fortune.com 6/22/22)*

The Federal Reserve's goal is to create a soft landing for the U.S. economy but it is finding this task challenging. "Frankly, the events of the last few months around the world have made it more difficult for us to achieve what we want, which is 2% inflation and a strong labor market." Fed Chairman Powell stated. *(Source: cnbc.com 6/22/22)*

The Fed will need to see strong evidence that the inflation rate is slowing down to assess how quickly and at what rate they will adjust interest rates. "Over coming months, we will be looking for compelling evidence that inflation is moving down, consistent with inflation returning to 2%," Powell said. "We anticipate that ongoing rate increases will be appropriate; the pace of those changes will continue to depend on the incoming data and the evolving outlook for the economy." *(Source: cnbc.om 6/22/22)*

What does this mean for you? Don't plan on rate increases slowing in the near future. With continued expectations of more rate increases, we suggest you proactively pay off all non-essential interest-bearing debt (especially if it doesn't have a fixed interest rate), maintain liquidity for any short-term purchases, and if you have a mortgage and haven't already done so, consider locking in your rate. If you have bonds in your portfolio, understand their duration and credit quality. Also, for clients we are reviewing all income-producing investments.

As your financial professional, we are committed to keeping a vigilant eye on all aspects of financial planning that may affect you. Interest rates will continue to be near the top of our watchlist.

## The Bond Market and Treasury Yields

It's been a while since investors have seen bonds paying decent yields. Bond prices and interest rates move in the opposite direction. The historically low interest rates we saw since the pandemic-driven global crisis did not make bonds very favorable. Now, with the Fed raising interest rates this past quarter, bond prices were lowered and yields rose. For many investors, bonds are starting to look more attractive than they have in the past few years.

Investors seeking a safer alternative to equities amidst market volatility, rising interest rates, and tightening financial conditions, often look at bonds. At the opening of the week after the Fed announced the interest rate increase, the benchmark 10-year Treasury note yield was 3.3% and the 30-year Treasury note yield was 3.37%. These yields are helping bonds become more favorable as key components to a diversified portfolio. Please remember, while diversification in your portfolio can help you reach your goals, it does not ensure a profit or guarantee against loss.

*Should a recession happen, the Fed may feel they will need to cut interest rates to stimulate the economy and get us back out of that recession. If this happens, the opportunity to take advantage of favorable bond yields could be brief. In short, bond investing can be tricky. If you'd like to explore how bonds could fit into your retirement income strategy, please contact us. We are monitoring how the Fed's movements and rising interest rates are affecting bond yields.*

## Investor's Outlook

The current economic environment is most certainly testing the discipline of even the savviest investor. Without a tested, mathematical defense as part of your investing plan, these times leave many not knowing where to turn. When emotions finally take hold, they often make the wrong decision at the wrong time.

The cycle of emotional investing is a theory every investor should understand. Preparing a plan with a mathematically based defensive component helps keep emotions in check and allows investors to make the best, long term decisions.

Unfortunately for those who listen, Wall Street is more than happy to throw out a multitude of misleading statistics in an effort to keep you invested regardless of current risks. Some of these are…

- **Bear markets are normal.** We would mention so is high blood pressure, getting out of shape, eating poorly and sickness. Yet we would never ignore them or hope them away because of it.

- **The long-term average frequency between bear markets is 3.6 years and they last less time than bull markets.** The Great Financial Crisis bear market in the S&P-500 took roughly 13 months from top to bottom, yet it took about 56 months to regain those losses. The fact that the bull market was longer did little good for your portfolio and retirement.


- **You haven't lost unless you sell.** Sadly, yes you have. If you don't think so ask your broker for the balance in your account as of December 31, 2021. At the very least you've lost months or even years.
- **A bear market doesn't mean a recession is coming.** The implication (or hope) here is that it will be a shallow and brief bear market. Yet we've had two consecutive quarters of negative GDP, which is a technical recession. Despite Wall Street trying to convince you this isn't the same as a "real recession", ***we've never had two consecutive quarters of negative GDP outside of a real recession.***


We're told not to worry about it because it's been a good run. In fact that's even more reason to worry. Years and even decades of irresponsible monetary policy by both politicians and the Federal Reserve has stretched the economic rubber band much farther than is normal. When it snaps back we're concerned it could be vicious.

Some tell us to "stay the course" and "ride out the bear market" rather than protecting ourselves. This may make sense if you have no plan or tested methodology and are just shooting from the hip. However, realize that it's possible there is a lot more downside in our future.

***When the S&P-500 was down 20% from its peak during the Dot.com bear market, it still fell another 37.5% to the ultimate bottom. When it was down 20% during the Housing bubble bear market, it still fell another 46.3% to the ultimate bottom.***

While being diversified is important, it's unlikely to mitigate these drawdowns significantly, especially if bonds keep behaving poorly.

Investors have yet to see if the Fed's attempts to fight inflation will work effectively, and how long it might take. We are still not near the Fed's long term target inflation rate of 2%.

***To be clear, as long as inflation remains elevated, the Fed will be actively working to slow the economy and bring down asset prices. This is a real – and very big – risk.***

Many other variables could affect the speed and direction of the economy. The last few years have reminded us that "anything can happen." COVID is still an issue, especially when it comes to commodities that are manufactured in China, the second largest world economy that is still committed to a "ZERO-COVID" policy that enforces mass quarantine and closures. Additionally, we are experiencing geopolitical unrest, particularly the war in Ukraine; and, who knows what the upcoming months will present to us. That is why we always abide by our mantra of ***"proceed with caution."***



While it's not possible to perfectly time equity market tops and bottoms, we feel it is possible to sidestep much of the damage in bigger declines. By doing so investors can help avoid the panic that can lead to poor decisions, as well as the months or even years spent trying to regain losses.

***There will be a time to return to a full equity allocation. But we think it will be from much lower levels.***

***After all, you can't buy low if you don't sell high.***

Please call our office to discuss any concerns or ideas you have or bring them up at your next scheduled meeting. Prior to making any financial decisions, we highly recommend you contact us so we can help determine the best strategy. There are often other factors to consider, including tax ramifications, increased risk, and time horizon fluctuations when changing anything in your financial plan.

As always, please feel free to connect with us with any concerns or questions you may have.

Although investing should be thought of as a long term commitment, the benefits of a defensive strategy should be thought of in the same light.

While we cannot control financial markets, inflation, or interest rates, we keep a watchful eye on them and adjust portfolios accordingly. We can discuss your specific situation at our next meeting or you can call to schedule an appointment. As always, we appreciate the opportunity to assist you and your financial matters.

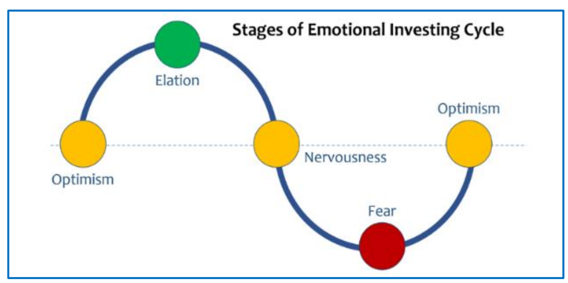
These and any other economic factors could complicate equity market performance in 2022, so investors need to be prepared.

Regardless of how equities are performing, investors should always focus on their personal objectives and long-term goals.

Four factors that investors should focus on are:

1. **Your risk tolerance or appetite.** How much risk are you willing to take, or better yet, how much can you afford to take? Of course a well-designed, defensive strategy can help with downside risk but whenever investing, losses are possible.

2. **Your time horizon.** The amount of time you want to be invested in any particular situation can help you determine your entry and exit points. Longer-term horizons provide more flexibility than shorter-term horizons.




3. **Your behavior.** How well can you emotionally endure the potential ups and downs of your investments? Market volatility is part of the investment experience and can create panic and anxiety. Making rational decisions during this mindset can be more difficult. Again, two factors can help moderate destructive behavior: ***first, relying on data over news stories and second, having a mathematically based, defensive strategy in place to keep "normal" losses from becoming catastrophic.***

4. **Your overall strategy, especially how you plan to mitigate losses.** Are you employing a strategy that doesn't fit you fiscally or emotionally? Perhaps you think of yourself as a "buy and hold investor", but admit you have sold at inopportune times in the past when losses were too severe to tolerate. We always say that it's nice if markets come back, but will your portfolio in a time that

aligns with your retirement? This is especially critical if you're relying on those funds for living expenses.

***We believe employing a sell discipline to protect your retirement is critical to your investment success.***

A skilled financial professional can help make your journey easier.  Our goal is to understand our clients' needs and then try to create a plan to address those needs.

Investing is a marathon, not a sprint…

***But even in a marathon, it's important to manage risk with an eye towards limiting losses. After the last two bear markets, the first 100% (or more) gains in the S&P-500, over multiple years, were required just to get back to break even. Using years of gains simply to recoup past losses does not further your retirement goals.***

Please listen to our radio show as we cover many of these topics, and we have a bit of fun too.

For more information, call the office and sign up for our weekly email newsletter. You can also sign up for a free Financial Physical.

Yours truly,

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