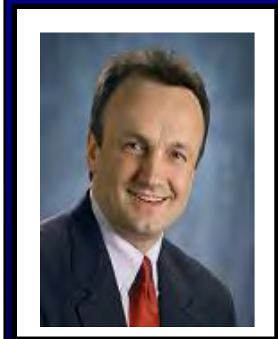

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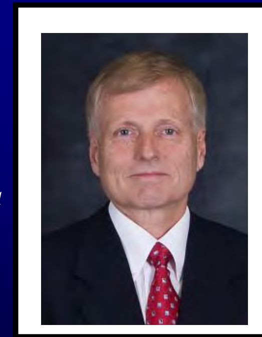
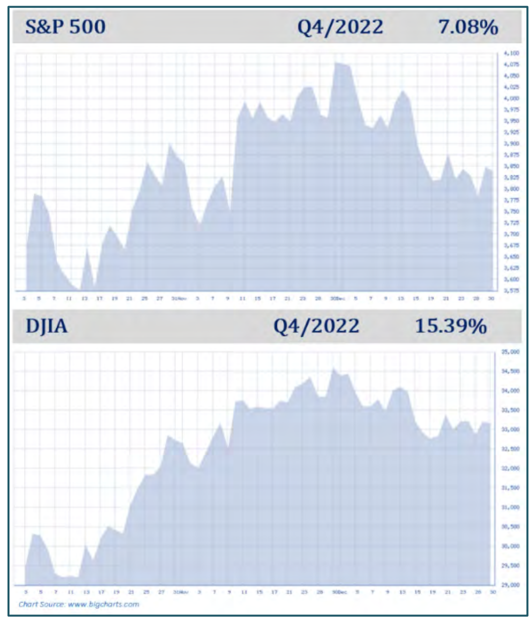


FOURTH QUARTER 2022



It's probably a fair assumption to say that most investors are happy 2022 is in the books. After enjoying the longest bull market in history, from the end of the financial crisis in 2009 to the beginning of the COVID-19 pandemic, the bear finally officially rose from its slumber and dominated Wall Street. There's no sugar-coating the fact that if you had money invested in the financial markets in 2022 it was an unpleasant year, perhaps even one of the worst you will experience as an investor. 2022's equity market loss was the 7th worst loss since the 1920s and the bond market also had one of its worst years in history. It was the worst year since 2008 for all three major indexes. Hopefully you followed our advice and got more defensive. Regardless, as a new year begins, all that matters is what happens from here, not what happened in the past. And for that, keep reading.

Although the yearly results were discouraging, the fourth quarter of 2022, despite its volatility and uncertainty, brought slight improvements in the U.S. equity markets. The Dow Jones Industrial Average (DJIA) closed out at 33,147.25, ending the year down -8.8%, the S&P 500, closed at 3,839.50, ending the year down -19.4%, and the technology heavy Nasdaq closed at 10,466.48, ending the year down -33.1%. *(Source: cnbc.com 12/29/22)*

MONEY RATES

(as posted in Barron's 12/26/2022)

	LATEST WEEK	YR AGO
Fed Funds Rate*	4.34%	0.08%
Bank Money Market[z]	0.25%	0.07%
12-month Certif[z]	1.35%	0.14%

z – Bankrate.com (Source: Barron's; bankrate.com)
** - Average Effective Offer*

During 2022, inflation, rising interest rates, slowing economic growth, the weakening of fiscal and monetary stimulus all packed a bear paw-sized punch to investor's portfolios. Recession fears also played a key role in the direction of the market. All these major factors allowed volatility to prevail, and investors rode a steady downward trend throughout the year. 2022 was a solid practice in emotional resilience and trust in your process which hopefully included a defensive component.

On a positive front, the Fed's efforts to slow down the rate of inflation finally began to show quantifiable results. The U.S. annual inflation rate experienced a slowing down and was 6.5% for the 12-months ending December 2022 (again, read further for more in depth analysis).

As we look toward a new year, multiple factors remain key for the direction of equity markets. Most particularly, the continuation of rising interest rates and how long and how deep a recession the U.S. and global economy could see in 2023 and beyond. Uncertainty remains, and wise investors should have a sufficiently diversified portfolio that looks for balance in times of volatility, but they should also have a defensive system. It can be difficult remaining defensive over an extended period, but if history is a guide, bear markets start slowly and then can pick up speed very quickly.

As we close out what was undoubtedly a rough year for equity markets, brace yourself for another potentially mercurial year. **As your financial professional, we are committed to keeping you apprised of any changes and activity that could directly affect you and your unique situation, and more importantly to take action.**

KEY TAKEAWAYS

- The Fed raised interest rates twice in the fourth quarter, to a range of 4.25 – 4.50% for a 4.25% total rate increase in 2022, the fastest upward cycle in history.
- The Fed is positioned to further increase federal interest rates in 2023.
- Inflation showed slowing signs, with a rate of 7.1% for the 12-month period ending November.
- Recession concerns are on the rise.
- Treasury yields are providing favorable returns.
- Volatility remains an investor fear in 2023.
- Staying the course and maintaining a well-devised, long-term focused plan has historically served investors well.

Inflation & Interest Rates

During 2022, Americans saw seven federal interest rate increases. In their efforts to use interest rate increases to lower inflation, the Fed ended a decade of historically low interest rates. In November, rates increased 0.75% for a target rate range of 3.75 – 4.00%. Then, as planned, the Fed again raised rates at the December meeting. However, because inflation started to show signs of slowing in the months prior, the Fed raised it by only 0.5%, to a range of 4.25 – 4.50%. This marked a 4.25% total rate increase in 2022, *the fastest upward cycle of interest rates in history*.

The labor market remains a key factor in how the Fed will adjust its attack on inflation, and when and how fast it will change policy. Employment remained strong in December with the unemployment rate announced as 3.5%. *(Source: Bureau of Labor statistics)*

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Fed Chair Jerome Powell suggested that in 2023 we may not see as sharp a rate of increase as in 2022, but he cautioned that *"It's very premature in my view to think about or be talking about pausing our rate hikes."* At their December meeting, the FOMC shared their economic projections that pointed to a possible interest rate range of 4.75 – 5.75% in 2023. *"It's not as important how fast we go,"* Powell stated, "*Our focus right now is really on moving our policy stance to one that is restrictive enough to ensure a return of inflation to our 2% goal over time."* *(Source: reuters.com, 12/14/22)*

Due to the continued rise of interest rates, here are some key areas we like to remind clients of:

- The cost of borrowing is up, therefore, proactively pay off all non-essential higher interest-bearing debt and maintain liquidity for short-term purchases.
- If you have a mortgage, we would be happy to review your rates.
- If you have bonds in your portfolio, understand their duration.
- Review all income-producing investments. As of this writing we are getting short term CD and Treasury bonds yielding over 4%.

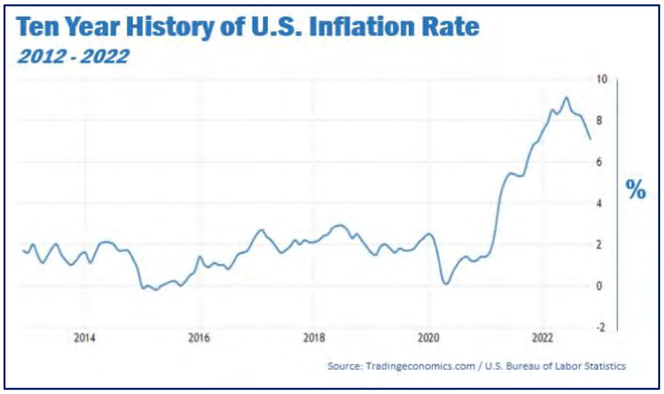
We will keep a vigilant eye on the federal interest rate movements and inflation. When rates will stagnate and for how long they will remain there is yet to be seen.

The Bond Market and Treasury Yields

Simply put, the bond market had one of its worst years ever. The total return of the Bloomberg Aggregate Bond Market Index (which dates back to 1976) of -13% in 2022 was far and away the worst loss ever for this total bond market index. For those with S&P U.S. Treasury Bonds, the return was -10.7% or worse, depending on their duration. *(Source: cnn.com, 12/30/22)*

Now that rates have risen, treasury yields in this environment can be a viable asset class for a diversified portfolio. As of December 30, 2022, 5-year notes yielded 3.99%, 20-year notes yielded 4.14%, and the 1-year treasury rate closed at 4.73%. *(Source: ycharts.com)*

Bonds are often a good diversification option for a conservative, balanced portfolio, as they are typically considered more stable than stocks. However, bond investing, particularly when considering individual bonds, can be tricky. The window of opportunity to get lower-risk, higher yielding bonds could be short-live if the Fed's feel the need to cut rates to prevent a recession. Keep in mind, bond prices and interest rates move in the opposite direction. If the Fed decides to change course and cut rates (again, more on this later), it will reduce yields but also likely raise the value of the bonds. Please remember, while diversification in your portfolio can help you reach your goals, it does not ensure a profit or guarantee against loss.



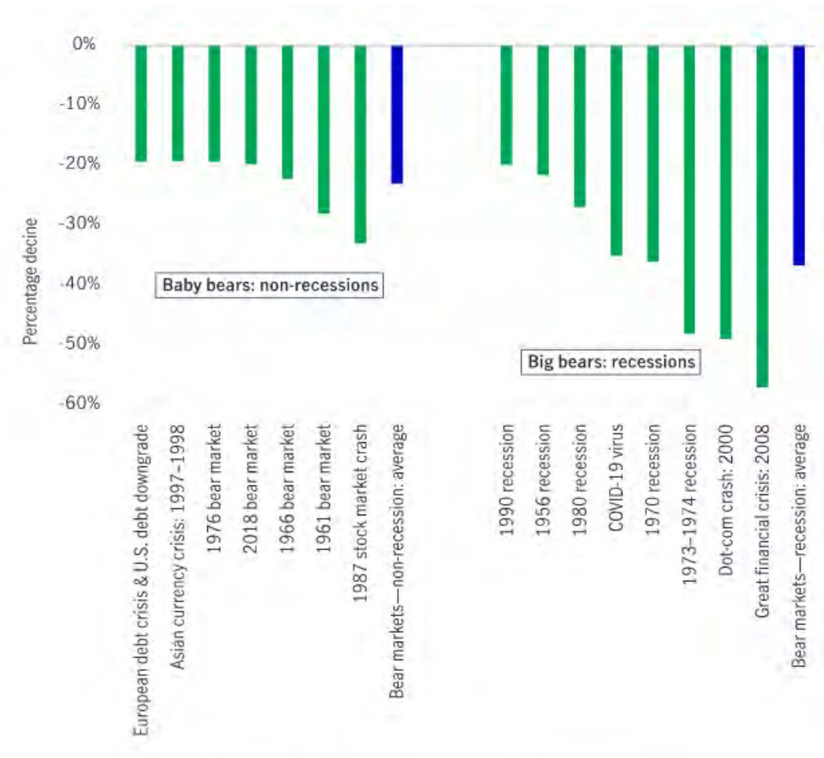
We will continue to monitor how the Fed's movements and rising interest rates are affecting bond yields. As your financial professional, we are committed to keeping a vigilant eye on all aspects of financial planning that may affect you, including interest rates and inflation. If you are concerned about how these may affect your portfolio, please contact us to discuss any strategies that may help combat the effect on your personal situation.

NOW IS NOT THE TIME TO DO NOTHING!

It's tempting to do nothing at all, in an effort to avoid doing something wrong. We understand. But we also suggest that would be a mistake if you are still invested in essentially the same portfolio you had entering 2022. Remember, the advice you received to hold the course in 2022, while likely well intended, was wrong. Yet most financial professionals are simply reiterating the same advice entering 2023. How much thought and research goes into simply repeating the same lines over and over?

Read on and consider the facts vs the talking points.

First are we in or headed into a recession, and does it even matter? Yes and yes. Bear markets in recessions are much deeper and last much longer than bear markets outside of recessions. See the Bloomberg chart to the right. Even if we are just entering an average recession (and with inflation and Fed rate hikes, we think this will be worse than average)…



Source: Capital Markets Strategy, Bloomberg, as of July 25, 2022

…you should expect the S&P-500 to fall ANOTHER -22% from the 2022 close.

If so, we're ***not half way*** to the bottom.

But how likely is a recession? The Wall Street narrative has gone from *"there will be no recession"* and *"we'll get a soft landing"* to *"there could be a mild and short recession, but it's not certain"* to *"there*

In the last two Bear Markets, the real declines started from here.

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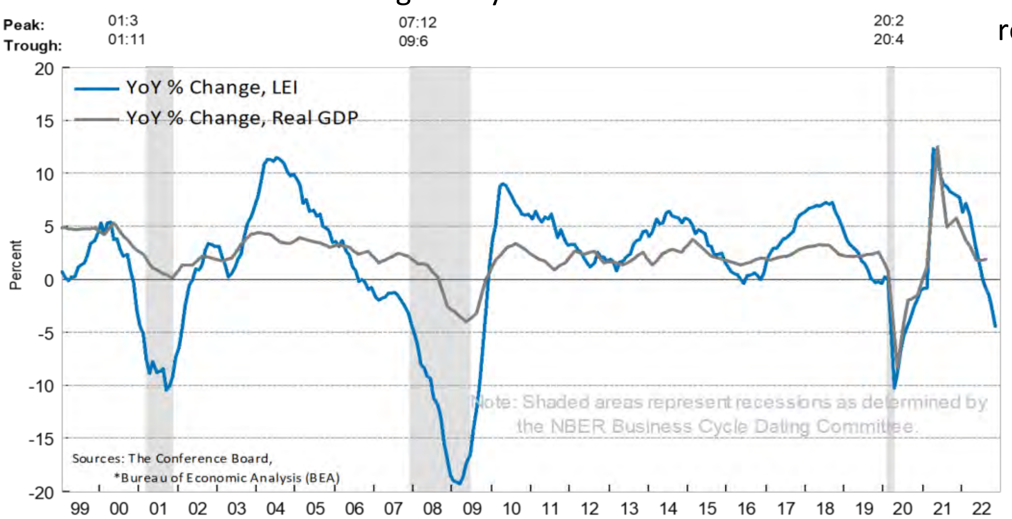
likely will be a mild recession sometime in late 2023 or 2024". The translation is, *"You just keep buying and holding so we can keep getting our fees, and once the market really craters we'll all agree that no one could have seen it come."*

It's coming.

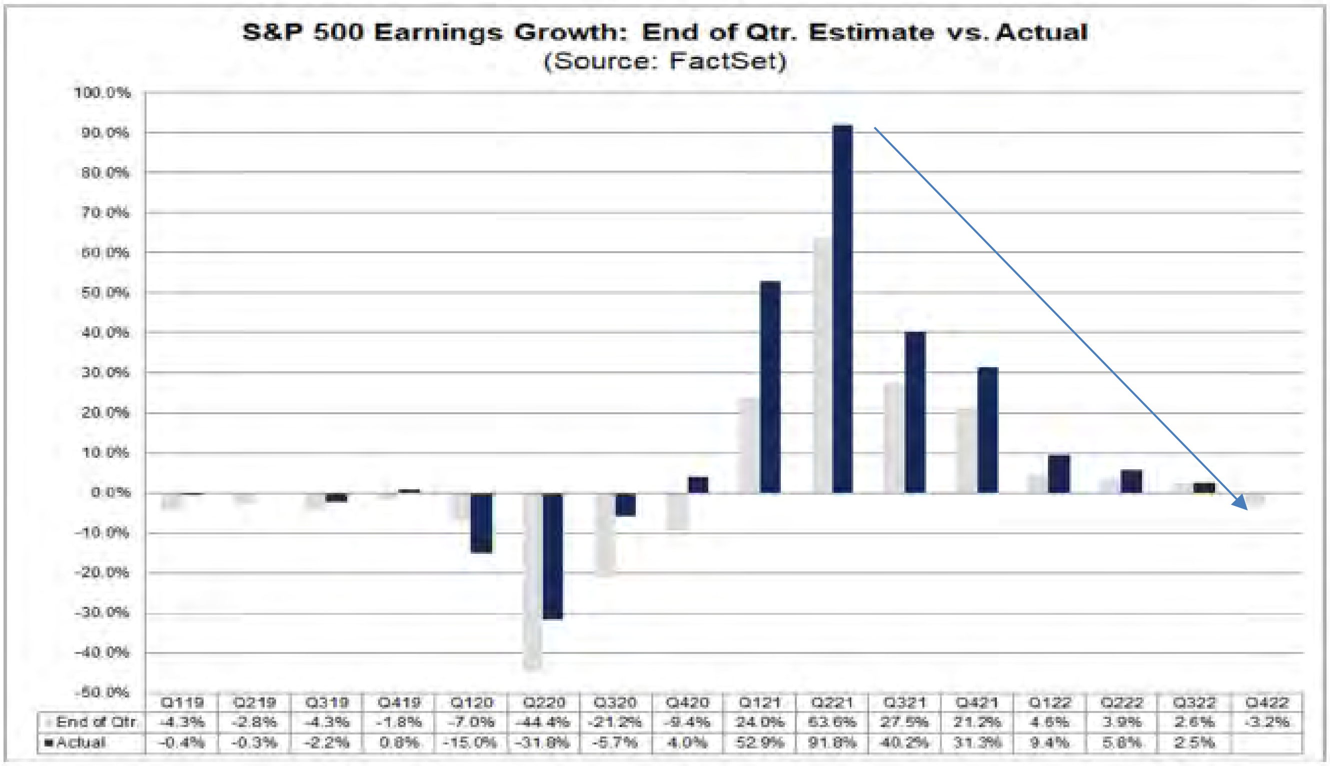
The following two charts are from The Conference Board of Leading Economic Indicators. They are considered the gurus of recession foresight. Their indicator is comprised of 10 forward looking measurements, all with good track records of seeing on-coming recessions, rolled into one. Each uses a different methodology to interpret the data. Keeping in mind that the vertical grey bars are recessions, and that each interpretation covers over two decades, they both tell the same story. What their measurements are showing today has ALWAYS indicated that we were either in or headed into a recession since at least the year 2000. It's NEVER been wrong over that period.



What about profits? Ultimately, the price of a share of stock, as an ownership unit of a real business, is driven by the profitability of that business. So where are corporate profits headed?

The chart on the next page is from FACTSET, one of the preeminent firms in analyzing and tracking corporate profits. This shows the S&P-500 earnings from Quarter 1 of 2019 through Quarter 4 of 2022 (keep in mind, reporting for Quarter 4 of 2022 has just begun so these can change). The light bars are what analysts expected and the dark bars are the actual earnings reported. As you can see, year over year earnings for the S&P-500 have been declining since the second Quarter of 2021. And what's important to investors is not whether they "beat Wall Street (manufactured) estimates" but ***whether they are improving or getting worse in rate of change***. The last dark bar (actual earnings) on the far right has not been included because as of this writing only 40 of the S&P-500 companies have reported. But those 40 show earnings to be down

-5.18%. This would be the first negative print since Quarter 3 of 2020 when Congress and the Fed were still printing $trillions.



But inflation is falling – is it likely the Fed will pivot (i.e. stop raising rates and start cutting rates), like they've done repeatedly since 2000, to help prop up the economy and the stock market? Wall Street wants us to believe such. In fact many are claiming you don't want to be out of stocks when this magical pivot happens because the markets will immediately skyrocket and you'll be left behind.

We'll consider this argument in two pieces. First let's consider how much inflation has fallen and then let's consider what has historically happened when the Fed has pivoted.

The most recent Consumer Price Inflation (CPI) was announced on January 12, 2023 and the Bureau of Labor Statistics tells us it was up +6.5% in December 2022 vs December 2021. The good news is that it is down from the peak in June of 2022 at +9.1%. Inflation is falling. But remember, CPI is an average across a basket of goods. And we always encourage investors to *consider the particulars, not the averages*. Some things in the basket are more important to families and some things are less important. Let's look at the particulars.

- Food was still up +10.7% from a year ago. Outside of 2022, this is the highest annual food inflation since 1981.
- Shelter was up +7.5% from a year ago. That's the highest annual shelter inflation since 1982 and it's still not peaked.
- The inflation on just services (about 75% of our economy) was up +7.5% from a year ago and is the highest since 1982. It has not peaked.

- Other notables.
    - Electricity was up +14.3% vs a year ago.
    - Utility gas service was up +19.3% vs a year ago.
    - Fuel oil was up +41.5% vs a year ago.
- From our research partner, Hedgeye, a basket of essentials including food at home, shelter, medical care, utilities and wireless service was up +7.9% vs a year ago and is at an all-time high.

So how could inflation be +6.5% with all of the numbers above? A couple of the offsetting numbers were used cars which fell -8.8% from a year ago and gas which fell -1.5% from last year. Now certainly we all welcome falling gas prices but I don't think most of us feel an -8.8% decline in used cars helps offset a +10.7% jump in food prices.

Do you think the Fed, and particularly the Fed Chairman, who has repeatedly said that inflation disproportionately hurts the poor, is likely to pivot from the numbers above so that your portfolio losses will be mitigated?

Next let's consider ***WHY*** the Fed might pivot. Historically the Fed stops raising rates and begins cutting, not just for the heck of it, but instead because the economy, and stock market, are falling dramatically. When they have done so, had it marked the end of any bear market as Wall Street keeps insisting? On the following double decker chart we show the Fed's funds rate on top and the S&P-500 on the bottom over the same time series. On the top chart, notice when the thin line stops going up (i.e. Fed stops raising rates), plateaus (i.e. Fed keeps rates stable) and then declines (i.e. Fed pivots to cutting rates). The vertical lines traversing both charts help you line up where that happened in terms of the S&P-500.

As should be apparent, the vaunted Fed pivot is when the real market declines begin. And logically this should make sense. The Fed doesn't pivot because things are going well. The Fed pivots because things are falling apart.

We encourage you to go to our website www.MoultonWealth.com where you can find podcasts of our radio show as well as all of our past newsletters. Particularly pay attention to January 2023 monthly newsletter titled *"Corporate Earnings are Beginning to Fall Which Marks the Start of the Biggest Bear Market Leg Down".* We've often said that bear markets play out in three stages. Stage one is multiple compression. Stage two is a relief rally. And stage three is when earnings begin to fall. The newsletter explains each stage and the math behind the third stage when the biggest declines occur.

"We are likely entering the third stage of this bear market."

Finally let's discuss income taxes. One of the reasons investors sometimes mistakenly ride bear markets down is their aversion to paying income taxes. We get it, no one wants to pay taxes. But remember, we consider paying taxes on gains a high class problem when compared to getting a deduction for losses.

Let's hypothetically consider two investors, John and Susan. Both have $1,000,000 portfolios that track the S&P-500. And both have the same embedded long term gains of $500,000 as of January 1, 2022.

Susan took our advice and sold in January of 2022 when the market was down 5%. That means she was down to $950,000 and had to pay tax on $450,000. The maximum long term capital gains tax rate for most people is 15% so let's assume it cost her $67,500 in taxes. All net she ended up with $882,500 after taxes.

John was more worried about taxes and decided to hang in there. In 2022 his portfolio fell -19.8% (just as the S&P-500) and he ended the year with a portfolio of $802,000. He's already $80,000 behind Susan. But in reality he's further behind because he still has embedded profits of $302,000 that he owes taxes on. In reality his after tax portfolio is worth $756,700 or $125,800 behind Susan. Worse, if it continues falling, which we think likely, he will continue to fall further behind.

"Taxes only reduce profits. Market losses reduce both profits and principal."

Of course this is all hypothetical and intended as a math exercise but don't let the tax tail wag your investment dog.

Remember…

"You can't buy low if you don't sell high!"

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Yours truly,

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