MOULTON WEALTH MANAGEMENT INC.

MOULTON HOT MINUTES

SPECIALIZING IN RETIREMENT AND TAX PLANNING

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Week of August 21, 2023

Last week's newsletter discussed tax receipts as a recession indicator. It should make sense that tax receipts are derived from income; both corporate and personal. Higher incomes mean higher receipts and lower incomes mean lower receipts. If tax receipts are falling – even as inflation makes them look greater than they are – what does it say about the economy? You can read it here: Newsletter - Moulton Wealth.

ATTEND OUR…

RISK MANAGEMENT

SEMINAR

BRING A GUEST

- **SEPTEMBER 20TH @ 9:30 AM – SPOKANE**
- **SEPTEMBER 27TH @ 11:00 AM – RICHLAND**

(LATE BREAKFAST)

CALL **509-922-3110** TO RESERVE A SEAT *OR IF YOU WANT A SECOND OPINION ON YOUR PORTFOLIO!*

Please see our new website www.MoultonWealth.com. Of the many improvements, the most important is we now host podcasts of past radio shows, allowing you to listen at your convenience. You can also read all the past newsletters and take the test to find your Risk Number.

Last Saturday's radio show also discussed tax receipts along with retail sales and China. Regardless of what Wall Street media tells you, the consumer is not strong. You can listen here: [Your Money Matters – Moulton Wealth](#).

The 10 year yield on U.S. government bonds hit 4.33% this week before backing off to close the week at 4.25%. This ties the high from October of last year and before that, it was last this high in 2008. Dramatically higher rates have real world implications.

Let's first consider home ownership. St. Louis Fed tells us the average home in the U.S. sold for $384,600 in the fourth quarter of 2019 pre-pandemic. At the time, 30 year mortgages were about 3.75%. As such buying the average home at the time required (an assumed 20%) down payment of $76,920 and a monthly payment of $1,425 before taxes and insurance.

Today the average home in the U.S. sells for $495,100 from the same source and the 30 year mortgage rate is 7.09%. As such buying the average home today assumes a down payment of $99,020 and a monthly payment of $2,659 before taxes and insurance.

Commercial properties are harder to quantify, simply because they are so diverse. An apartment building in Spokane is different from an office building in Manhattan. Also the loans are usually 3 – 10 years, amortized over a 30 year time frame with a balloon due. As such the borrower has to refinance every 3-10 years.

Let's assume a reasonable rate for a commercial loan is prime + 3%. If a property owner has to refinance a $5,000,000 loan he took out five years ago, amortized over a 30 year period, his payment will increase from $36,688 / month to $48,715 / month. As such his payments will be 33% greater and his interest expense balloons by $144,324 per year. This, of course, assumes the property's cash flow will qualify for the new payments and its value will hold up as collateral.

And it's not just the borrower who could have troubles, it's also the lender. If your bank loaned the $5,000,000 and the borrower can't refinance because the cash flow doesn't support the new payments, you're out the $5,000,000. Of course you can sue the borrower but that also is problematic. Many of the commercial loans made in the heady days of Covid related government handouts were non-recourse, meaning as the lender, you can only take back the

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EVERY SATURDAY MORNING AT

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property. You can't go after the borrower. If the borrower is willing to hand back the property, by definition it is no longer worth $5,000,000.

Is that significant? Last week a 47 story office building in Chicago was "handed back" to the lender. Previously a loan of $85,000,000 was given on the property against its valuation of $142,400,000. As the lender you were likely comfortable with a $57,400,000 buffer of loan to value. It now had to be refinanced, and the new value was assessed as $37,000,000. This particular building's value didn't decline by 25% or 30%, either of which would have still made the lender whole. Instead it fell by almost 75%.

But this has nothing to do with the stock market, right?

Before reading on, what rate of return do you expect to get from the stock portion of your investments over the next 10 years? Most people we ask either guess ~6% (the thought being that it should be lower than the long term average due to how expensive stocks are today) or they are closer to ~10% citing the 100 year approximate average.

MIT wrote a fascinating research paper in September 1999, months before the Dot.com bubble burst. In it they argued that pensions' long held assumptions of 7% real returns (i.e. after inflation) over the long haul were misguided due to how expensive stocks were at the time. They used the dividend yield of stocks to calculate that to attain a 7% real return rate for stocks at a time their dividend yield was 2%, prices would first have to fall 55%. In fact over the next 3 years the S&P-500 did fall ~ 50%, and after 10 years it averaged a return of -1.81% per year.

We're told you can't "time the market" so you need to stay 100% invested at all times and just keep the blinders in place. Was this timing the market? Was it luck? Or was it simply math. Few would argue with a person who waits for prices to decline before making a purchase, except when it comes to stocks.

By the way, today the dividend yield on the S&P-500 isn't even 2%, it's 1.51%.

But what does this have to do with interest rates? A lot actually. Think of interest rates as your alternative. You can buy a 10 year U.S. government treasury bond that yields ~ 4.25% per year. And it's commonly considered "risk free" because the U.S. government owns the printing presses. You can buy a two year U.S. treasury bond that yields ~ 4.9%, and a 3 month that yields ~ 5.5%.

Oh but inflation, you say? Inflation impacts every U.S. dollar exactly the same whether invested in bonds, stocks or under your bed.

Regardless of what you think about stocks' returns from these levels, or bonds as an alternative…

How many investment dollars do you think are beginning to leave stocks to migrate to these "riskless" alternatives?

After all, the price of anything, including stocks, is derived by supply and demand. What happens as the demand begins to look elsewhere?

Having said all of that, you still need to be careful "how" you buy bonds. Bonds held in funds – ETFs or mutual funds – can decline in value, even after their interest payments, if rates keep rising. Only individual bonds have an "end date" when you get back the face value. Also, especially for bonds not called U.S. Government, there's the chance of default. Of course, nothing in these newsletters is ever a recommendation to buy or sell anything.

There will come a time when those who choose to ignore the data will be "blindsided" by the market finally starting to pay attention. And then they will assure you that no one could have seen it coming.

The warnings keep piling up. Sooner or later, we will reach the proverbial snowflake that starts the avalanche.

As an investor, you can choose to adjust portfolio risk up or down, thoughtfully, based on the data. Whether you do so is up to you.

If your goal is to make as much money as quickly as possible, you're likely holding on to your positions and/or buying the dip.

If your goal is to protect what you have during economic market contractions so you can more fully participate in the next expansion and bull market, you should reduce risk in your investments now rather than continue holding the same portfolio you've had the last 10 years.

We strongly suggest that investors who are retired or close to retirement should be the latter.

If you're positioned to protect against the downside, then the extent of such is not so much a concern.

And the extent could be significant.

The Great Financial Crisis was triggered by the popping of a bubble in real-estate. ***The bubble in real-estate today is bigger by most measures.***

The Dot.com bear market was triggered by the popping of a bubble in equity valuations. ***The equity bubble is bigger today by most measures.***

Neither the Dot.com nor the Great Financial Crisis bear markets had inflation, or nearly as much debt across consumers and businesses as we have today.

If the Dot.com bubble resulted in the S&P-500 falling ~ -50% and the NASDAQ falling over ~ -80%...

If the Great Financial Crisis saw the S&P-500 fall ~ -57% and the NASDAQ falling over ~ -50%...

How much might a market fall with levels exceeding both of those along with inflation and higher leverage?

You don't have to remain locked into the same approach as you had when these risks didn't exist. You are allowed to protect yourself. You can step away and then come back when the risks decline. Call us to find out how.

It's time to focus on return of your money rather than return on your money.

If you still have the same portfolio allocation you had during the bull market, we would ask "why"? The risk profile of the economy and market has changed

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dramatically and will likely continue to rise. Wouldn't it make sense to adjust your portfolio to what is actually happening?

To be clear, we'll have a great buying opportunity at some point in the future. Usually that happens with the market crashing and most investors disgusted with the thought of investing. If you lose much of your net worth, participating will be difficult.

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

Patience and asset protection will be key.

Don't wait until you have suffered unrecoverable losses before taking action.

In the Great Financial Crisis, the S&P-500 fell 24% from the start on October 9, 2007 until the Lehman bankruptcy on September 15, 2008. That was close to a year, and not that far off from what we've lived through so far.

Then in just over a month from September 15, 2008 to October 27, 2008 the S&P-500 fell ***ANOTHER*** 28.8%. And from September 15, 2008 to the ultimate bottom, about 5 months later, it fell ***ANOTHER*** 43%.

Not only do bear markets normally unfold in three stages with the last being the most virulent, it also demonstrates that risk happens slowly and then all at once.

What is your defensive plan?

There's still time.

Call or attend a seminar to hear about ours.

Remember, we have a feature on our website: www.MoultonWealth.com to help you measure your risk tolerance. The problem with trying to decide how much risk to take is we all want to be aggressive when the market is going up, but conservative when it's going down. That's why a sell discipline is important. However, the first line of defense is always our allocation. This approach to measuring risk gives a number by making investors trade off gains and losses. Just click the button to see where you stand.

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Get a physical! We invite you to attend a seminar and come in for a "financial physical", even if you think your current approach is fine. Much like going to the doctor for a physical despite feeling great, you want to make sure any negative issues you may not be aware of are caught early and addressed. For example…

- Do you need a process to help manage losses during the next bear market?
- Have you addressed your investment process and adjusted it for what is going on in the world?
- If not, what are you waiting for?

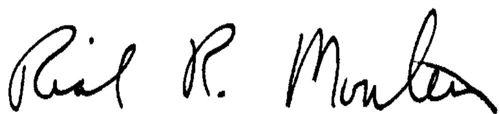
At the bottom of the 2007 - 2009 bear market the S&P-500 index returned to levels last seen in 1996.
The drop didn't retrace only a few months or even a couple years.

We discuss many of these issues and more on the weekly radio show and invite you to listen.

WEEKLY FOCUS – THINK ABOUT IT

How many investment dollars do you think might begin to leave stocks and migrate to these "riskless" alternatives?

Yours truly,



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P.S. Please feel free to forward this commentary to family, friends, or colleagues. If you would like us to add them to the list, please reply to this e-mail with their e-mail address and we will ask for their permission to be added.

Investment services offered through Moulton Wealth Management, Inc., an independent Registered Investment Advisor. The Standard & Poor's 500 (S&P 500) is an unmanaged group of securities considered to be representative of the stock market in general. The Dow Jones Industrial Average is a price-weighted index of 30 actively traded blue-chip stocks. The NASDAQ

Composite Index is an unmanaged, market-weighted index of all over-the-counter common stocks traded on the National Association of Securities Dealers Automated Quotation System. Yahoo! Finance is the source for any reference to the performance of an index between two specific periods. Opinions expressed are subject to change without notice and are not intended as investment advice or to predict future performance. Consult your financial professional before making any investment decision. You cannot invest directly in an index. Past performance does not guarantee future results. Investments in securities do not offer a fixed rate of return. Principal, yield and / or share price will fluctuate with changes in market conditions and, when sold or redeemed, you may receive more or less than originally invested. No system or financial planning strategy can guarantee future results.

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The Barclays Global Aggregate Bond Index *(formerly Lehman Brothers Global Aggregate Index), is an unmanaged market-capitalization-weighted benchmark, and tracks the performance of investment-grade fixed income securities denominated in 13 currencies. The index reflects reinvestment of all distributions and changes in market prices.*

The Barclays U.S. 1-10 Year TIPS Index *is an unmanaged index composed of inflation-protected public obligations of the U.S. Treasury that have a remaining maturity of one to ten years.*

The Barclays U.S. Aggregate Bond Index *is an unmanaged benchmark index composed of U.S. securities in Treasury, Government-Related, Corporate, and Securitized sectors. It includes securities that are of investment-grade quality or better, have at least one year to maturity, and have an outstanding par value of at least $250 million.*

The Barclays U.S. TIPS Index *is an unmanaged index composed of all U.S. Treasury Inflation- Protected Securities rated investment grade, have at least one year to final maturity, and at least $250 million par amount outstanding.*

The Barclays U.S. Treasury Index *is an unmanaged index composed of U.S. Treasuries.*

The CDX IG 12 *is a benchmark high-grade derivatives index, which measures the cost of insuring a basket of U.S. investment-grade corporate debt against defaults.*

The Chicago Board Options Exchange Volatility Index (VIX) *tracks the expected volatility in the S&P 500 over the next 30 days. A higher number indicates greater expected volatility. Common usage: The Chicago Board Options Exchange Volatility Index (VIX), a barometer of market volatility.*

The Dow Jones Industrial Average *is a widely followed market indicator based on a price-weighted average of 30 blue-chip stocks that trade on the New York Stock Exchange which are selected by editors of The Wall Street Journal.*

The Dow Jones Wilshire Real Estate Securities Index (RESI) *is used to measure the U.S. real estate market and includes both real estate investment trusts (REITs) and real estate operating companies (REOCs). It is weighted by float-adjusted market capitalization.*

The JP Morgan Emerging Market Bond Index *is a total-return, unmanaged trade-weighted index for U.S. dollar-denominated emerging-market bonds, including sovereign debt, quasi-sovereign debt, Brady bonds, loans, and Eurobonds.*

The JP Morgan EMBI Global Diversified Index *tracks the performance of external debt instruments (including U.S.-dollar-denominated and other external-currency-denominated Brady bonds, loans, Eurobonds and local market instruments) in the emerging markets.*

The JP Morgan GBI-EM Global Diversified Index *tracks the performance of local-currency bonds issued by emerging market governments.*

The MSCI World Index *is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of developed markets. The MSCI World Index represents 23 developed market countries.*

The MSCI All Country World Index *is a market-capitalization-weighted index composed of over 2,400 companies, and is representative of the market structure of 46 developed and emerging market countries. The index is calculated with net dividends reinvested in U.S. dollars.*

The MSCI EAFE Index *is an unmanaged, market-capitalization-weighted equity index that represents the developed world outside North America.*

The MSCI Emerging Markets Index *is a free float-adjusted market-capitalization-weighted index designed to measure the performance of global emerging market equities.*

The NASDAQ Composite Index *is a market-value-weighted index of all common stocks listed on the National Association of Securities Dealers Automated Quotations (NASDAQ) system.*

The Russell 1000 Index *includes 1000 of the largest U.S. equity securities based on market cap and current index membership; it is used to measure the activity of the U.S. large-cap equity market.*

The Russell 2000 Index *includes 2000 small-cap U.S. equity names and is used to measure the activity of the U.S. small-cap equity market.*

The S&P 500 Index *is a capitalization-weighted index made up of 500 widely held large-cap U.S. stocks in the Industrials, Transportation, Utilities and Financials sectors.*

Investing Terminology

Alpha *is a measure of a portfolio's return above a certain benchmarked return.*

Alternative Investments *are investments that are not one of the three traditional asset types (stocks, bonds and cash). Alternative investments include hedge funds, managed futures, real estate, commodities, and derivatives contracts.*

Asset-Backed Securities (ABS) *are bonds backed by a pool of loans or accounts receivable and commonly include payments from credit cards, auto loans and mortgage loans.*

Austerity *refers to measures taken by a country's government in an effort to reduce expenditures and a budget deficit.*

Beta *is a measure of the volatility or systematic risk of a security or a portfolio in comparison to the market as a whole.*

Book-to-Price Ratio *is the inverse of the price-to-book ratio, which is calculated as the market value of a security divided by its book value. A lower the price-to-book ratio for a security may mean the security is undervalued, and vice versa (the higher the book-to-price ratio, the better the value).*

Commercial Mortgage-Backed Securities (CMBS) *are pools of commercial mortgage loans that are packaged together and sold to the public. They are usually structured in tranches, or classes of risk, so that investors can determine how much risk they want to take on. In general, CMBS carry less prepayment risk than loans backed by residential mortgages.*

Corporate Bonds *are debt securities issued by corporations to raise money; these bonds usually pay higher coupon rates than government or municipal bonds.*

Correlation Risk *refers to the change in the marked to market value of an asset when the correlation between the underlying assets changes over time.*

Credit Ratings *are an assessment of the risk of default of a company or country. The higher the credit quality (or rating), the lower the perceived risk of default.*

Cyclical Sectors or Stocks *are those whose performance is closely tied to the economic environment and business cycle. Managers with a pro-cyclical market view tend to favor stocks that are more sensitive to movements in the broad market and therefore tend to have more volatile performance.*

Debt-to-Equity Ratio *is calculated as long-term debt divided by common shareholders' equity, and measures the amount of a firm's leverage, or debt.*

Donor Advised Funds *are private funds administered by a third party and created for the purpose of managing charitable donations on behalf of an organization, family, or individual.*

Duration *is a measure of a security's price sensitivity to changes in interest rates. Specifically, duration measures the potential change in value of a bond that would result from a 1% change in interest rates. The shorter the duration of a bond, the less its price will potentially change as interest rates go up or down; conversely, the longer the duration of a bond, the more its price will potentially change.*

Excess Returns *are investment returns from a security or portfolio that exceed a benchmark or index with a similar level of risk.*

Grantor Retained Annuity Trust *is an estate planning technique that minimizes the tax liability existing when intergenerational transfers of estate assets occur. An irrevocable trust is created for a certain term or period of time. The individual establishing the trust pays a tax when the trust is established. Assets are placed under the trust and then an annuity is paid out every year. When the trust expires, the beneficiary receives the assets estate and gift tax free.*

High Yield Debt *is rated below investment grade and is considered to be riskier.*

Managed Futures *strategies use futures contracts as part of their overall investment strategy. They provide portfolio diversification among various types of investment styles and asset classes to help mitigate portfolio risk in a way that is not possible in direct equity investments.*

Market Capitalization *is calculated as the number of companies shares outstanding multiplied by the share price, and is used to determine the total market value of a company.*

Momentum *is the rate of acceleration for an economic, price or volume movement; it is used to locate trends within the market.*

Mortgage-Backed Securities (MBS) *are pools of mortgage loans that are packaged together and sold to the public. They are usually structured in tranches, or classes of risk, so that investors can determine how much risk they want to take on.*

Option-adjusted spreads *estimate the difference in yield between a security or collection of securities and comparable Treasuries after removing the effects of any special features, such as provisions that allow an issuer to call a security before maturity.*

Peripheral Eurozone Countries *are those countries in the Eurozone with the smallest economies.*

Price-to-Book Ratio *is calculated as the market value of a security divided by its book value. A lower the price-to-book ratio for a security may mean the security is undervalued.*

Private Foundations *are charitable organizations that do not qualify as public charities by government standards. A private foundation is a nonprofit organization which is usually created via a single primary donation from an individual or a business and whose funds and programs are managed by its own trustees or directors.*

Quantitative Easing *refers to expansionary efforts by central banks to help increase the supply of money in the economy.*

Recapitalized/recapitalization *refers to injecting fresh equity into a company or a bank, which can be used to absorb future losses. This generally takes place through the company issuing new shares. In the case of a government or organization recapitalizing a bank, it usually results in the government or organization owning a stake in the bank.*

Spreads*: Yield spreads represents the difference in yields offered between corporate and government bonds. If they tighten, this means that the difference has decreased. If they widen, this means the difference has increased.*

Standard Deviation*: Statistical measure of historical volatility. A statistical measure of the distance a quantity is likely to lie from its average value. It is applied to the annual rate of return of an investment, to measure the investment's volatility (risk). Standard deviation is synonymous with volatility, in that the greater the standard deviation the more volatile an investment's return will be. A standard deviation of zero would mean an investment has a return rate that never varies.*

Treasuries *are U.S. government debt obligations that are backed by the full faith and credit of the government. Often, they are used as a proxy for a risk-free asset when comparing other risky assets.*

Yield Curves *illustrate the relationship between the interest rate, or cost of borrowing, and the time to maturity. Yields move inversely to prices. The Barclays Capital 1-10 Year US TIPS Index: Barclays Capital 1-10 Year US TIPS Index measures the performance of inflation-protected public obligations of the U.S. Treasury that have a remaining maturity of one to ten years.*