PATIENCE & MONEY

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"Whoever wishes to win in this game must have both patience and money" – Josef De La Vega, Dutch Trader, 1688

SUMMER 2022 EDITION

EQUITY UPDATE: Half of the Story ● FIXED INCOME UPDATE: Survive and Advance ● EVERYDAY ECONOMY: How much?

HALF OF THE STORY

Equities

Ryan Culpepper, Senior Vice President, Investment Officer | PIM Portfolio Manager

Well…The first half of 2022 was one we would all like to forget. Even after a strong rally on the last week of the quarter, the S&P 500 is still managed to have its worst start in over 50 years and the fourth worst start ever. And now that the S&P 500 has fallen more than 20% from its January 3 high, we do classify this decline as a bear market.

Some market strategists use definitions of bear markets and incorporate a time element into their definition… We have always preferred to use what we believe is the conventional definition, a 20% decline from a high. By our account, this is the 12th bear market since 1960 and the fourth in the past 22 years.

You can't go far without hearing how bad the start to the year has been for the S&P 500. In fact, as I am typing this I am watching a financial television market strategist talk about how this is the worst start in 50+ years and he is piling it on. If I didn't know what the total return of the S&P 500 was in 1970, I'd be ready to jump off the roof of my building. It's funny, with our publication being called Patience and Money…That's exactly what we need right now; and how we believe one can stay successful over time. Nobody that I have seen on the television has decided to tell you what the total return of the S&P 500 was in 1970 after a 21% decline to start the year. Are you surprised to hear that the S&P 500 actually finished a +4% in 1970. That is a huge swing from the first half of the year to the second. We feel history has a great chance to repeat itself, or at least rhyme with 1970.

As we enter the second half of the year there is no change in our view that the market will remain challenging. That said, we do see value in these stock prices today. Despite the S&P 500 recent advance, the index remains in a down trend with the bottom of the trading range around 3850. We will not insult you and claim to know where the eventual bottom is or if the market has already made its low. There are already enough 'experts' embarrassing themselves with such claims. This stock market selloff has certainly surprised me many times over. That said, as a stock investor, look at this as an opportunity and not something to run from. After all… We all need to have some patience and money.

Why am I not overly concerned? Because stocks are long-term investments. If you have your portfolio properly constructed with cash, bonds, and income, you should consider taking advantage of these stock prices. 'Buy low

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sell high' is one of the most commonly used narratives in my business. Yet when the opportunity arises so few take advantage of it. Now we could certainly see it go lower, but there are a number of great companies down over 50% from their highs. At some point there will be buyers and we will be one of them.

Embrace the market volatility… The sell-offs, no matter how uncomfortable they are, can reap great rewards over the longer run. All you need is a little patience and money and the stock market can help you achieve your investment goals.

Remember… The 1970 stock market decline was the worst in 52 years but finished the year in the green. Maybe we should; "Buy Low".

Stay Bullish. ●

Stocks offer long-term growth potential, but may fluctuate more and provide less current income than other investments. Index returns are not fund returns. An index is unmanaged and not available for direct investment.

The S&P 500 [Standard & Poor's 500] is a market-cap weighted index composed of the common stocks of 500 leading companies in leading industries of the U.S. economy.

SURVIVE & ADVANCE

Fixed Income

Sam Pennell, First Vice President, Investment Officer | PIM Portfolio Manager

As a graduate of NC State I cannot help but have Jim Valvano come to mind in a moment like this. Jimmy V was a charismatic personality and head basketball coach during NC State's improbable run to win 1983's National Championship. During their championship season Valvano is credited with coining the motto, "survive and advance". A nod to the mindset that you may be an underdog, the game may be ugly, but you need to simply survive to advance to continue playing. In our view we are in the same place in the fixed income markets. It is not pretty right now, and with the Fed's plan to continue to raise rates and taper its balance sheet, there could be more of the same with bond returns over the next couple quarters.

We've made it to the midpoint of the year and done so in epic fashion. This is the worst 6 month start to a year in the markets since 1970. Equity and bond markets have reacquainted us with "risk tolerance". We are living through history.

There's good news and bad news. The good news: Yields are up and make for a more attractive entry point. We are seeing some of the best opportunities in years in a couple sectors of the fixed income market. First, investment-grade, short term corporate bonds (maturities less than 5 years) have yields where surplus cash and maturing bonds can find a home to collect an attractive yield. We would encourage you to think of an allocation to bonds like this as a step out of a cash position; not a long term investment idea.

Our group has been excited about $1000 par Preferred Stocks, also known as Institutional Preferreds. These are usually issued by the best known and best ran financial companies on the planet. These Preferreds now have a Yield-to-Call in the 7-9% range…meaning they are keeping up with raging inflation.

The bad news: The Bloomberg US Aggregate Index (the most widely covered index in the bond market) is down double digits YTD along with most other bond sectors.

As of writing this the morning of July 1st the Atlanta Federal Reserve's GDPNow Forecasting model has GDP contracting by -2.1% for 2nd Quarter of this year. This makes two quarters of contraction in a row; meaning we are in a textbook definition of a recession. This puts the Fed on track for what it set out to do to combat inflation. By raising interest rates, reducing their balance sheet, and reducing money supply, the hope is demand significantly slows; borrowing costs increase and more companies have to adjust production, investment and labor downward. This obviously affects consumer sentiment and buying habits, too.

The goal of policy makers has never been to avoid recession, but how can we navigate a "soft landing". How to quell consumer demand and prices a la 1981 or 1994. Unlike the hard landings of credit fueled excesses like the Tech Wreck of the early 2000s or the Great Recession of 2008. As bad as this sounds, you survived. Time to advance.

We would assert that the rate hiking cycle may be shorter lived than many first thought. As the Fed can show inflation is going down and recession is here, they can then turn right back around and begin cutting rates. This would push bond prices higher. Many in the bond market are suggesting this could happen as soon as next year. Stay invested and stay tuned.

We understand it has been difficult to know when and where to put new cash to work this year. A question we often hear is what do we do with bond allocations? If we already are in a recession this is not the time to overreach for yield or attempt gain a better return on your bond allocation. The mindset for the second half of the year in bonds should be the return <u>of your money</u>, not the return <u>on your money</u>. For money earmarked for preservation, we believe staying invested in high quality and short term maturities will alleviate some of the pain.

For money earmarked for income purposes we are most excited about Institutional Preferreds and certain other niche investments. Buying low quality bonds, even bond funds, can be detrimental to your portfolio. Remember "High Yield" and "High Income" is another way to say "Junk Bond". We would contend most investors reading this need limited exposure to those sectors of the bond market especially in a recession as liquidity will come into greater focus. Liquidity is defined as the ability to get in and out of an investment at an agreeable price range within a reasonable amount of time. Typically, higher quality investments are more liquid.

When Jimmy V was hired at NC State, one of the first practices the team had, there were no basketballs. The practice did have a ladder and a pair of golden scissors. He wanted the team to practice cutting down the nets…the way teams celebrate a championship in basketball. He wanted the team to visualize their collective goal and see themselves winning. They each took turns climbing the ladder, cutting the nets with the golden scissors and celebrating. Two seasons later, after winning the championship, officials handed a pair of scissors to the first player to cut the nets. Jimmy V shrugged them off and pulled the golden scissors out of his coat pocket. They used the same pair of scissors to cut down the real championship nets as they did for their practice nets. The players knew how much he believed in them. What a gratifying moment.

Point is, prepare your portfolio for the market we are in (survive and advance). By doing so you will be ready to achieve your investment goals of preservation, income and growth in the future (cutting down the nets). I believe that. You should too. The golden scissors at my home office agree, too. ●

Investments in fixed-income securities are subject to market, interest rate, credit and other risks. Bond prices fluctuate inversely to changes in interest rates. Therefore, a general rise in interest rates can cause a bond's price to fall. Credit risk is the risk that an issuer will default on payments of interest and/or principal. This risk is heightened in lower rated bonds. If sold prior to maturity, fixed income securities are subject to market risk. All fixed income investments may be worth less than their original cost upon redemption or maturity.

Bloomberg U.S. Aggregate Bond Index: Bloomberg U.S. Aggregate Bond Index is a broad-based measure of the investment grade, US dollar-denominated, fixed-rate taxable bond market.

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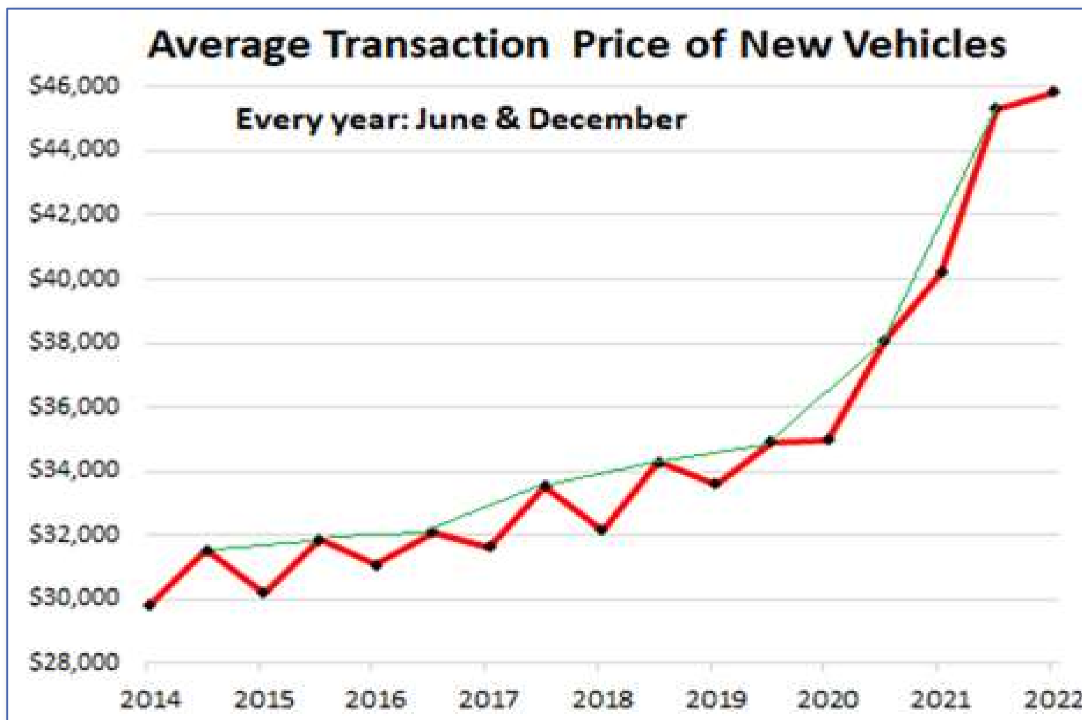
HOW MUCH?

New vehicle transaction prices are through the roof

It's not just housing—the average transaction price of new vehicles sold in June hit a new stratospheric record high of $45,844, up 14% from a year ago. As automakers continue to struggle with shortages of key parts and semiconductors in particular, inventories remain near historic lows. Dealers handled the shortages by charging more than list price and filling their lots with only the most expensive vehicles loaded with as many options as possible—and that's how the ATP (average transaction price) jumped to a new record. Since June 2019, the ATP has spiked by 36%, or by over ten grand per vehicle! (Chart by wolfstreet.com, data by JD Power).[1]



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