NEWSLETTER – OCTOBER 2022

MARKET TRENDS 9.30.22

Asset Class	3 Mo	YTD
Global Stocks		
MSCI World	-6.5%	-25.4%
US Stocks		
S&P 500	-4.9%	-23.9%
Large Cap Value	-5.7%	-17.9%
Large Cap Growth	-3.6%	-30.7%
Mid Cap	-2.5%	-21.5%
Small Cap	-2.2%	-25.1%
International Stocks		
Developed Markets	-10.4%	-27.4%
Emerging Markets	-12.5%	-27.7%
Fixed Income		
Taxable Bonds	-4.7%	-14.5%
Municipal Bonds	-3.1%	-10.8%
Alternatives		
EM Bonds	-5.1%	-24.3%
Floating Rate	0.8%	0.1%
Preferred	-2.0%	-16.8%
Gold	-8.1%	-8.4%
Real Estate	-10.5%	-28.6%

Source: Factset

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Shorepoint Capital Partners

"This is the bad time."

—*Goodfellas*

There is no way to sugarcoat the performance of the stock AND bond markets during the third quarter of 2022. There was almost nowhere to hide except for cash. Stocks were down ~5% for the quarter, with Bonds down roughly the same. It is a similar pattern for all of 2022, with the S&P 500 Index down 23.9% and bonds down 14.5%.

It's not usual that the correlation between these asset classes is so strong WHILE the returns are so poor *simultaneously*. In the past, when stocks have suffered a downturn, bonds have remained stable or even rallied (see chart below). Over the last 42 years, a balanced portfolio of 60% stocks and 40% bonds has produced a positive return 83% of the time, but not so this year! Why did this happen?

…enter inflation and the Federal Reserve ("Fed") raising rates in a way we haven't seen in decades.

60/40 Portfolio: Despite average intra-year drops of -7.7%, annual returns were positive in 35 of 42 years

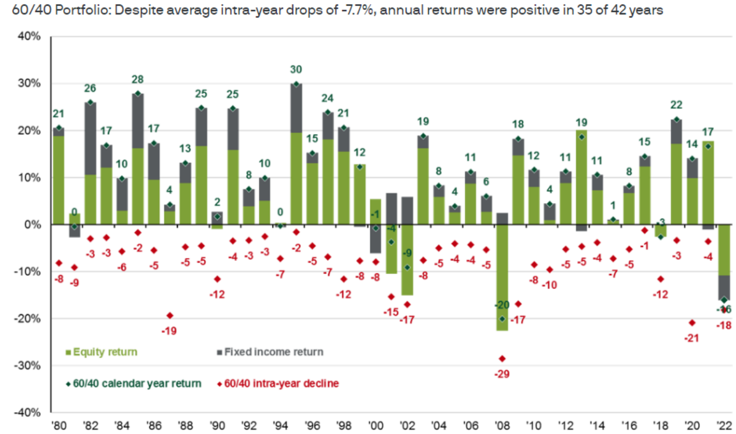


Figure 1- Source: JP Morgan Asset Management – data as of June 30th, 2022

IT'S ALL ABOUT INFLATION

Due to persistently high inflation (about 8%!), the Fed is using the tools at its disposal to combat the problem. Specifically, the Fed is decreasing the size of its balance sheet and raising rates assiduously, with two rate hikes for a total of 1.5% in the third quarter. For all of 2022, we have had five rate hikes for a total of 3%, with more expected to come.

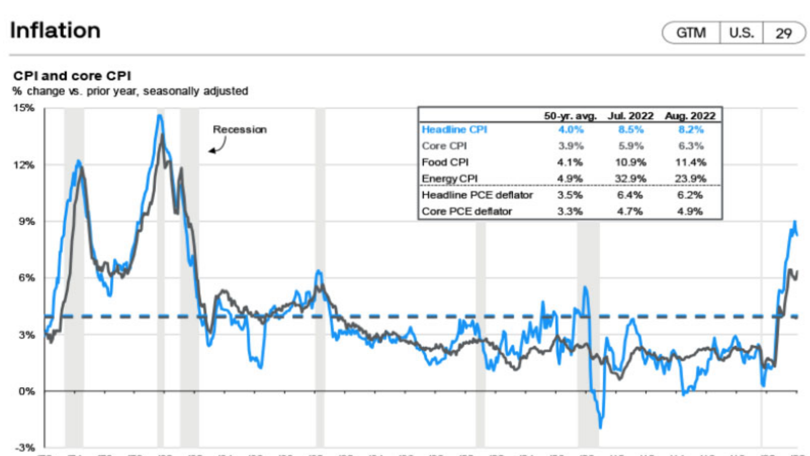


Figure 2- Source- JPMorgan Asset Management

It is hard to imagine the stock market rising meaningfully until investors believe the Fed will pause its work. That's because inflation affects so much in our lives: interest rates, economic growth, or lack thereof, oil prices, food costs, housing, and jobs (although we haven't seen a tick-up in unemployment thus far in 2022).

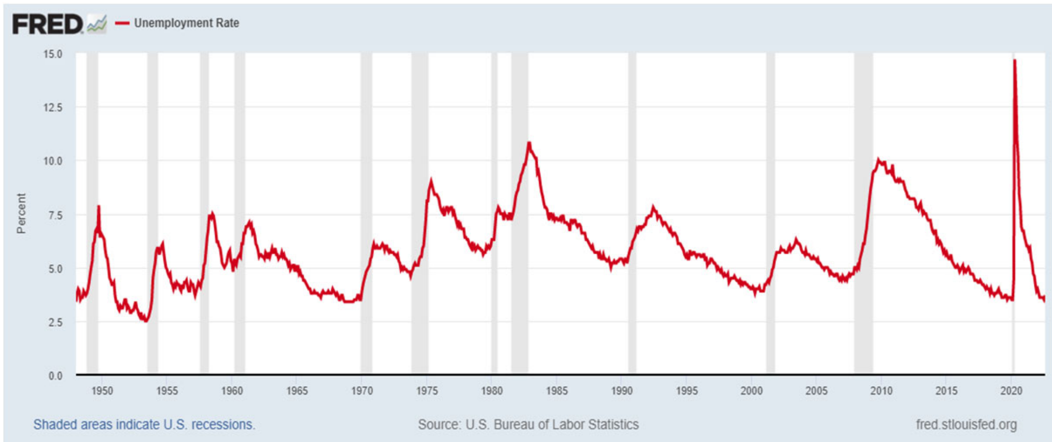


Figure 3- Source FRED

A COSTLIER WINTER AHEAD?

Continued conflict in Ukraine, along with other suspicious acts of (potential) sabotage regarding the Nord Stream pipelines, has led to significant volatility in the natural gas markets. Russia now supplies about 40% of the natural gas used in the European Union, and European consumers will endure most of the damage, with significant energy price increases expected. Most economists are calling for a deep recession in Europe, which is likely to impact any US-based companies with significant European exposure. In addition, US-based consumers will also see higher heating bills this winter; the NEADA forecasts a 34% increase in heating bills for homes reliant on natural gas.

IS THERE ANY GOOD NEWS?

Yes. There are signs of hope for the future:

- Stocks are getting cheaper, with the average forward P/E on the S&P 500 dropping to under 17x, in line with the 25-year historical average.

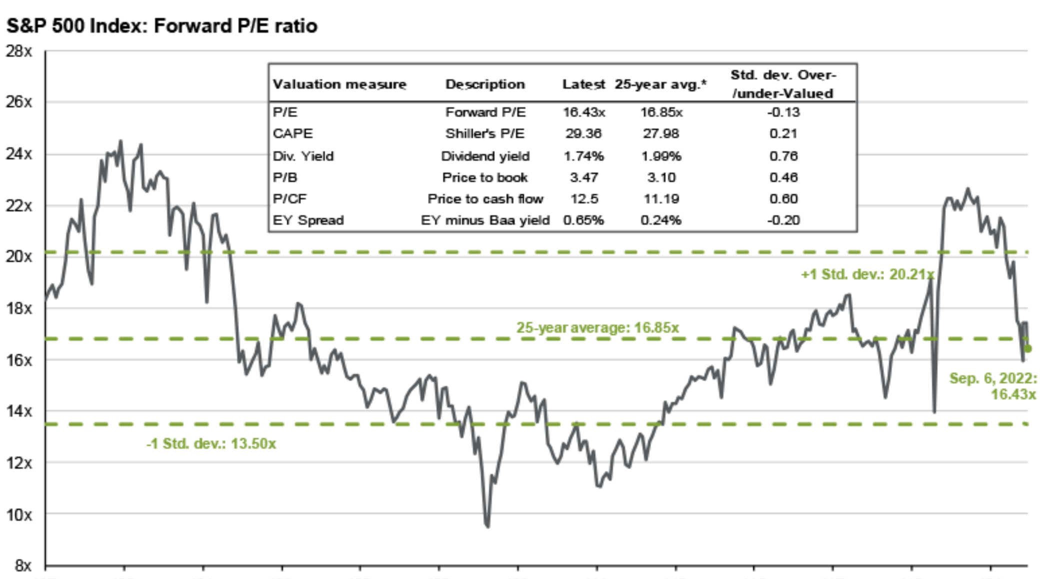
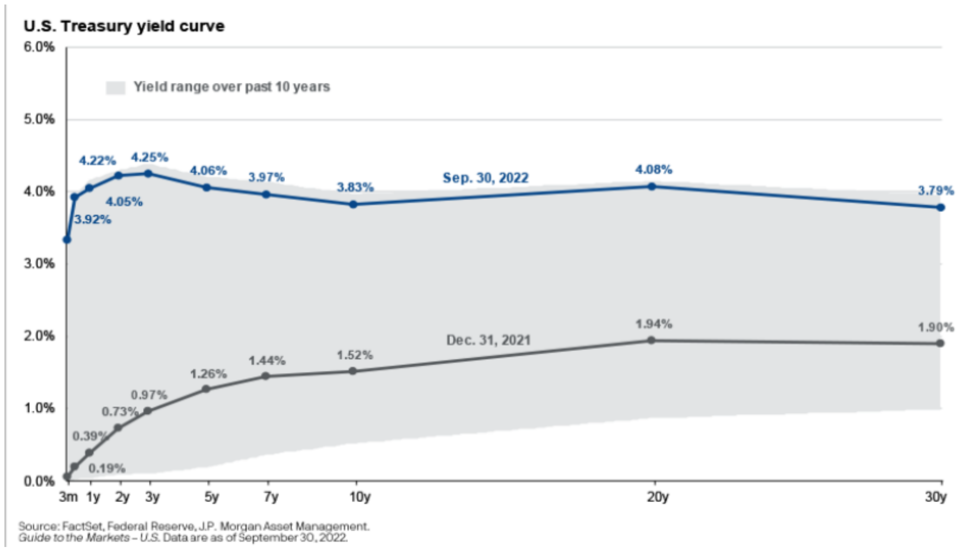


Figure 4- Source JPMorgan Asset Management

- High-quality stocks and dividend growers look particularly attractive and pay decent yields to investors while they wait for a recovery.
- Quality bonds like the 10-year Treasury offer current yields near 4%, the highest in decades, and 2-year Treasuries above 4%!



- Cash finally pays…a reasonable rate! Online banking rates have risen to 2% after years of paltry payments due in part to ZIRP (the Fed's zero interest rate policy).
- Gas prices have fallen by over 20% in the last three months.
- Unemployment remains incredibly low, well below the 4% historical average.
- Corporate balance sheets are healthier than in past selloffs.

HOWEVER

We do not expect a sustained rally or recovery until the market sniffs out that the Fed will be pausing its rate increases or even cutting them. Unfortunately, that keeps risks IN the market for the time being. With higher mortgage rates, it's likely that the housing market and construction will soften. The problem with the tools that the Fed has at the ready is that they are blunt instruments. Just as the low-interest rate environment led to excesses and bubbles in our markets and our economy, so are these increases likely to be wide-ranging in their damage.

Earnings for companies have been weakening, and it would be prudent to expect that they will worsen before they get better. The Fed doesn't know how much they have begun to restrain the economy because it takes time to determine the impact of the moves they have made based on the recent past and present.

Complicating this for investors is that the market is a *leading* indicator. For example, our real economy has yet to fall into a recession. But the stock markets are down 20-30% for the year, with the S&P 500 on track for the fourth worst calendar year return of all time.

The stock market is looking ahead 9 to 12 months into the future while the Fed is raising rates, looking backward at the side view mirrors with limited visibility in their windshield for what is ahead!

However, if the market gets too bearish and stock valuations reflect the direst of outcomes, the potential for a strong rebound is quite likely. This song has been played many times before, and often the path from these extreme lows is solidly positive over the longer term.

When the S&P 500 is Down 25% or Worse Since 1950

Peak	Trough	% Decline	+1 Year	+3 Years	+5 Years	+10 Years
12/12/1961	6/26/1962	-28.0%	31.2%	69.2%	94.8%	171.1%
11/29/1968	5/26/1970	-36.1%	32.2%	44.3%	27.9%	97.5%
1/11/1973	10/3/1974	-48.2%	1.4%	23.8%	42.0%	188.4%
11/28/1980	8/12/1982	-27.1%	43.9%	81.2%	238.6%	403.9%
8/25/1987	12/4/1987	-33.5%	14.7%	34.1%	96.8%	387.1%
3/24/2000	10/9/2002	-49.1%	0.2%	1.9%	21.5%	38.3%
10/9/2007	3/9/2009	-56.8%	-6.9%	3.7%	61.2%	209.6%
2/19/2020	3/23/2020	-33.9%	56.4%	???	???	???
1/3/2022	9/30/2022	-25.2%	???	???	???	???
Averages		**-37.6%**	**21.6%**	**36.9%**	**83.3%**	**213.7%**

THREE OF SHOREPOINT'S MOVES

With fears of inflation ahead, Shorepoint added **inflation-protected bonds** to client portfolios, which should protect purchasing power for our clients.

Another move our firm made was to develop a **Limited Partnership** ("Fund") that invested in private debt and real estate with an income emphasis a few years ago. The genesis of that idea grew from the lack of yield in the public markets; cash, savings, money market, and bond funds sported paltry yields. We used this Fund to enhance returns from the bond and alternative investment sleeve of client portfolios. The strategy has worked and done its job thus far. Investors will be receiving significant distributions of principal back on the closed first Fund in the next 12-24 months; stay tuned for a possible second LP Fund coming in 2023.

As you know, Shorepoint has remained more defensive than usual in our asset allocation. Our **cash** positions have normally hovered around 1-2%. However, as high market volatility continues and bonds have also produced negative returns, we have boosted cash levels from 5% to 7.5%. This will provide you with a partial hedge against corrections, the ability to earn attractive short-term yields of about 2.5%, and provide us with dry powder to take advantage of the occasional deals that arise in today's markets.

SHOREPOINT AS SKIPPING RECORD

The metaphor of the skipping record may be lost on many of our readers. We understand our advice may seem frustratingly similar and simple to articulate-that is, keep buying the dips in cheap, quality asset classes. We are upgrading the quality of clients' fixed-income positions now that we do not have to "reach" for yield.

Keep dollar cost averaging as consistently as you can. Hold steady. Opportunities arise from what we perceive as risk and pain—in this present moment! We came into this correction raising cash, ready to deploy it and reallocate portfolios amidst the creative destruction of markets. We have aggressively performed tax loss harvesting with our stock, mutual fund, and bond investments. We cannot escape volatility but will make the most of it to harvest losses for the future – tax losses can be an asset to minimize and/or eliminate future taxes.

Shorepoint's process is thoughtful, disciplined, and flexible. Please know that our team is working diligently to manage risk and returns and position your portfolio for the long term. There are always reasons not to invest, but staying the course usually wins. We believe that appropriate portfolio diversification amongst asset classes can help buffer your portfolio from the ups and downs of market volatility. We will continue to monitor the risks/rewards of both asset classes and sectors to rebalance appropriately.

Team Shorepoint