



## VIEWPOINTS

3<sup>RD</sup> QUARTER 2022

ADVISORY NEWSLETTER

MARKET COMMENTARY

FREDRIC W. WILLIAMS

*Cycles...*

*“A time to build up, a time to break down  
A time to dance, a time to mourn  
A time to cast away stones, a time to gather stones together  
To everything (turn, turn, turn), There is a season (turn, turn, turn)”*

As Pete Seeger wrote in the 50’s, and The Byrds popularized with their rendition in 1965, the long-view of history tends to suggest that our universe demonstrates a not-too-surprising tendency for cyclical-like repetition. From speculation in tulip bulbs, to dotcoms and meme stocks, to washing machines, bicycle wheels....and yes, to even economies and markets, there is not always a one-direction linear progression. Whether it’s statistical excesses in the capital markets facing a regression to the mean, or our annual trip around the sun, reality is not solely a one-way escalator, so a return to “normal” metrics should not be unexpected.

*“Things work in cycles...”*  
- Joan Jett (nee Larkin) – *The Blackhearts 1981*

Albeit hers is a slightly more succinct observation, it’s none-the-less instructive for prudent market participants to recognize the inevitable existence of these cycles, and work to take advantage of them. Much like the internet bubble of the 90’s, or the new tech/social media craze since the Great Recession of 2008, retail investors once again believed the “it’s different this time” mantra, eschewing things like, to name but one, the macro-impact of the low cost of capital on overly extended price-earnings ratios – and what might happen when that cycle changed.

Often, as we’ve written about previously, investors have a “recency bias” with the near past influencing their vision of the future. Of late this reality has been further compounded by fact that many believe information found on the internet has unquestioned veracity – which we all know is subject to more than just a casual debate. The Social Science Research Network

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published a research paper this summer with the provocative title “Confidence Without Competence: Online Financial Search and Consumer Financial Decision Making”<sup>1</sup> – which was subsequently reviewed by Mark Hulbert, from [www.hulbertratings.com](http://www.hulbertratings.com) :

*“The researchers showed that using the internet to answer questions leads people to attribute to themselves the knowledge they instead had obtained from the internet. That’s because, after using the internet to look up information, people will subsequently forget that they had done so, This phenomenon sometimes is referred to as the Google Effect – the blurring of boundaries between internal and external knowledge that leads “people to think they know more than they really do.”*

Nearly thirteen-years after the 2009 lows, during which the escalator war primarily in “up-mode”, save for a few brief pull backs, the protracted downward grind in the capital markets during 2022 has soured public sentiment on the markets, and forced many a “day-trader” back to their day-jobs – something some would argue is the perfect contrarian indicator:

*“Amid the torrent of reports – everything from monthly inflation and jobs numbers to seemingly every utterance of Federal Reserve officials – it’s easy for investors to get caught up in the here and now.”*

*“Yet investing success is most dependably achieved with a long-term perspective.”*

*“A punishing nine months of returns has left many stock sectors considerably cheaper than they have been for years, while fixed income is actually providing meaningful income for the first time in a decade and a half.”*

• N. Jasinski, *Barron’s*; 9/29/22

*“Now, market sentiment is at historically low levels. An American Association for Individual Investors survey recently showed a reading of lower than negative 30%. According to RBC, it is the lowest result since the 2008-2009 financial crisis, when all forecasts were for a horrid recession.*

*“Sentiment doesn’t usually go lower than that level. In fact, one has to look back to 1990 to find a time when it did.”*

*“The last time sentiment was this bad, stock market returns were stellar over the following year. The S&P 500 posted a gain of more than 30% a year after sentiment hit its crisis-era low, RBC data show. This shows that when the market is already deeply in the red – with lousy outlooks for corporate earnings and the economy to boot – signs of improvement can offer hope and send stocks surging.”*

• J Sonenshine, *Barron’s*; 9/26/22

So perhaps a more constructive way to look at the past year is to put it in the perspective of a prudent longer-term investor who recognizes an inflection point between cycles and chooses to be positioned to take advantage of that new dynamic going forward.

*“Despite these uncertainties, it isn’t time to give up on equities. Long term investors saving to build a retirement nest egg need to invest in a portfolio heavily weighted with common stocks. Stocks, representing the*

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<sup>1</sup> A. Ward – University of Texas at Austin; T. Grillo – University of Alberta; P. Fernbach – University of Colorado at Boulder

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*ownership of real assets, have been an effective inflation hedge for more than a century and are likely to be so in the future.”*

- *B Malkiel “A Random Walk Down Wall Street”*

In recognizing the past cycle, and how it was different than the one going forward, we need to understand what was, and how that has changed, so we can better take advantage of what will be:

*“To understand the market drivers of the next decade, it’s important to look at the past cycle. After the 2008-2009 financial crisis, the US economy was characterized by slow economic growth, low inflation, rock-bottom interest rates, and quantitative easing by central banks across the globe. It was a Goldilocks environment, particularly for financial assets with longer duration – essentially those with a greater share of their cash flows far off in the future. That includes long dated government bonds and corporate bonds, but also shares of growth-oriented companies.”*

*“That environment favored a relatively narrow group of stocks that trounced the market for most of the past cycle and came to dominate major market indices, name the Big Tech giants and other fast growing, but not necessarily profitable, businesses.”*

*“Cash-generating investments are back in vogue for the next decade. Higher volatility adds greater uncertainty to future predictions, while higher interest rates mean that far off cash flows are worth less when discounted back to the present, and securing financing is more expensive. This dynamic expands the universe of winning stocks to value-oriented sectors and makes bonds a real alternative again.”*

- *N. Jasinski, Barron’s; 9/29/22*

And as always, despite how compelling these analyses may be, they need to be considered based on a review of your overall allocations, and within the context of your specific goals and objectives. From an implementation standpoint, prudent investors can use a tried-and-true strategy to mitigate any global macro concerns and use volatility to one’s benefit.

*“Regular savers can realize the advantages of dollar-cost averaging in their investment programs. Periodic investments of equal dollar amounts ensure that holdings aren’t purchased at temporarily inflated prices and that some shares will be bought after sharp declines. Because you buy more shares when prices are low, your average price per share will be lower than the average price at which the purchases were executed. Dollar-cost averaging makes it possible for investors to gain positive returns even when the market averages don’t increase. And the greater the volatility of the stock prices, the greater the potential for gain.”*

- *B Malkiel “A Random Walk Down Wall Street”*

There may not be anything “cutting-edge” about implementing dollar-cost-averaging investment strategies, but they do provide another opportunity for the asset-allocating-tortoise to potentially once again beat the day-trading-hare.

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## CAPITAL MARKETS OVERVIEW

Index Returns			
Equities	Percentage Change for the 3 <sup>rd</sup> Quarter	Percentage Change for the Year	Annualized 10-Year Returns
S&P 500	-4.88%	-23.87%	11.70%
MSCI EAFE*	-9.36%	-27.09%	3.67%
MSCI Emerging Markets*	-11.57%	-27.16%	1.05%
Bloomberg Commodity Index	-4.11%	13.57%	-2.14%
FTSE NAREIT Equity REIT Index	-9.94%	-28.13%	6.26%
Fixed Income			
Bloomberg Barclays U.S. Aggregate Bond	-4.75%	-14.61%	0.89%
Bloomberg Barclays U.S. Treasury Inflation-Linked Bond	-5.14%	-13.61%	0.98%
Source: BlackRock, Bloomberg, FTSE™, NAREIT®. *Returns are calculated with net dividends in USD			
<small>Index returns are for illustrative purposes only and do not represent actual performance of any investment. Index performance returns do not reflect any management fees, transaction costs or expenses. Indexes are unmanaged and one cannot invest directly in an index. Past performance does not guarantee future results.</small>			

### Domestic and Global Market Recap...

### OPA INVESTMENT POLICY COMMITTEE

*“The Federal Open Market Committee's overarching focus right now is to bring inflation back down to our 2 percent goal. Restoring price stability will take some time and requires using our tools forcefully to bring demand and supply into better balance. While higher interest rates, slower growth, and softer labor market conditions will bring down inflation, they will also bring some pain to households and businesses.”*

- Federal Reserve Chairman Jerome Powell, August 26, 2022

The third quarter was defined by volatile economic data and markets. It began with rally that resulted in the S&P 500 gaining 17% from June 16 to August 16. The optimism came from hopes that the Fed policy would pivot and rates would hikes would be tempered. The market eventually rolled over and hit new lows to close out the quarter. The Bloomberg U.S. Aggregate Bond Index followed a similar path, gaining 5.6% from June 14 to August 1 before falling 8.1% and making new lows just before the end of the quarter on September 27.

The market rally was jeopardizing the Fed’s ability to return inflation back to their mandate, and further risking their credibility. Fed Chair Jerome Powell took this head on in his statement from the Federal Reserve’s Jackson Hole Economic Symposium. His topic this year was supposed to be “reassessing constraints on the economy and policy.” However, on the heels of rallying markets, easing financial conditions, and increased inflation expectations for July and much of August—the opposite result from what the Fed had been seeking—Powell tore up his original speech and decided to be blunt. He made it clear – as quoted above – this would be uncomfortable. The Fed would not be pivoting on monetary policy

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anytime soon. The strong and explicit rhetoric reinforced the focus on lowering inflation, even at the expense of the broader economy and asset prices.

The S&P 500 Index fell 4.9% in the third quarter. Large cap value stocks outperformed large cap growth stocks, as the Russell 1000 Value Index fell 3.6% while the Russell 1000 Growth Index fell 5.6%. Small cap outperformed large cap, with the Russell 2000 dropping 2.2%.

The energy sector was among the only bright spots, returning 2.3%, despite West Texas Intermediate crude oil falling from \$108 to \$79 per barrel over the quarter.

Despite this dramatic market sell-off, valuations for the S&P 500 are still not cheap compared to history. The Shiller Price/Earnings Ratio, a commonly referenced measure of valuation, measured 28.5 at the end of September, which is at the 74th percentile over the last twenty years and above the twenty-year median of 25.9.25

Stocks outside of the U.S. trailed their U.S. counterparts during the quarter, primarily because of the strong U.S. dollar, which gained 7.1% over the quarter. Foreign developed market equity returns, as measured by the MSCI EAFE Index, fell 9.7% in U.S. dollar terms. The MSCI Emerging Markets Index fared even worse, down 11.4% in U.S. dollar terms.

Within fixed income, U.S. taxable bonds—as proxied by the Bloomberg U.S. Aggregate Bond Index—again failed to offer meaningful diversification over the quarter, losing 4.8%. The 10-Year Treasury yield peaked at 3.95% on June 27, its highest yield since April 2010. Due to both the strengthening U.S. dollar and European bond market turmoil, developed market bonds underperformed, down 10% over the quarter, as measured by the S&P International Sovereign ex-U.S. Bond Index.

Year-to-date, U.S. stocks are down 24%, and U.S. bonds are down 15%, their worst year ever after posting their fourth worst in 2021. Foreign stocks and bonds are in even worse shape as global central banks are almost all pursuing similar policies.

Throughout the market turmoil, one theme has remained dominant—global inflation is high and has yet to show signs of meaningfully receding. It is important to remember the lag between monetary policy changes and their intended effects. As a result, inflation may in fact be on the decline, but it remains unclear how quickly it will recede and how low it will go. The answers to these questions will have dramatic implications for the markets.

The Fed is attacking inflation with three actions: raising interest rates, reversing quantitative easing (selling bonds it acquired during its years of quantitative easing), and using its words intentionally. Taken together, these tools are designed to whack asset prices—stocks, bonds, and housing—to create a negative wealth effect, curtail demand, and hopefully bring inflation down. For now, we are patiently waiting for the much more desirable scenario in which the Fed declares victory over inflation.

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*Year End Planning Items*

Clifford P. Ryan, CLU®, ChFC®

**Medicare**

According to a recent study by the Kaiser Family Foundation, more than two-thirds of Medicare enrollees do not check for more cost-effective or suitable plans annually. As we approach **Medicare's Annual Enrollment Period (AEP)**, it might be a good opportunity to do so. Many participants look at this as a one-time decision, but savvy beneficiaries will look to be sure their plan is appropriate to their circumstances and that they're getting a favorable deal.

The plan designs and premiums change frequently from year to year. Medicare Insurance specialist, Jeff Harder, recommends clients review their options at least annually but also as health or usage changes.

A few things to ask yourself:

- How long has it been since you last evaluated options?
- Have you had any changes in your health or healthcare usage?
- Is the plan prescription formulary covering your medications?
- What additional benefits such as dental, hearing and vision may be desirable?

*The Annual Enrollment Period (AEP) runs from October 15 to December 7. Another opportunity to address issues around dissatisfaction and amend your initial decision is during the Open Enrollment Period (OEP) between January 1 and March 31 annually.*

**Tax Planning**

As we near the end of the tax year for most personal tax filers, there are but a few months left to review and address any **issues that may affect your tax picture**. Here are just a few:

- Have you had any major changes in the amount of income that you receive from salary, bonus or business profits?
- Have you realized any gains on the sale of capital assets such as a car or second home?
- Have you made any gifts to IRS-recognized charities? Do these gifts fall within the deductible limits of \$300 per single filer and \$600 joint filers? Do you have proof of these gifts?
- Have you made larger gifts that might mean it makes sense to itemize your deductions instead of going with the standard deduction? Have you considered "bunching" charitable deductions together in one year rather than spreading them out?

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Gifts can be made from your IRA if you are age 70 1/2 or older – known as a Qualified Charitable Distribution (QCD). But like other gifts, these will be credited in the tax year in which they are made.

Although you can contribute to your IRA or Roth IRA up until next April (tax-filing date), Roth conversions need to be completed within the regular tax year.

Because of the poor market performance, this year we are likely to see lower dividend and capital gains from mutual funds. This will lead to lower taxable income for many who invest in these.

If any of these items ring a bell, it might be time to contact your advisor or tax preparer to look into them.

## **OPA NEWS & COMMUNITY EVENTS**

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*COMMUNITY EVENTS* - As we continue to emerge from the societal fog of covid over the last couple of years, so too have our community entities as they continue in their support and enrichment activities. This space is usually filled with the event calendars for a variety of the non-profit and cultural organizations that we as a firm, our employees, clients or colleagues are involved with. It's through these events, annual or otherwise, that they further their fundraising efforts and support the ongoing delivery of their missions. The organizations below are far from a complete listing of worthy entities, but you can celebrate the return to live events by supporting these, and other, organizations in any way you feel comfortable.

*PORTLAND CHILDREN'S DYSLEXIA CENTER* – OPA will be sponsoring a theme-decorated tree in the Center's *Festival of Trees*, to benefit their free tutoring classes, as well as their teacher-development programs. The festival will be held on November 25<sup>th</sup> to 27<sup>th</sup>, and December 2<sup>nd</sup> to 4<sup>th</sup>, at The Masonic Building on Congress Street in Portland. For more information go to <https://www.portlandfestivaloftrees.com>.

*DREAM FACTORY OF MAINE: PORTLAND CHAPTER* – This holiday season will see the in-person return of the Haven's Candies benefit "Making Dreams Come True One Candy Cane at a Time" Additional information regarding dates, tickets and other Dream Factory events can be found at <https://www.facebook.com/dreamfactoryportland/>

*THE LOCKER PROJECT* – Is celebrating 11 years of providing extra food to children via their school pantries initiative, as well as now also rescuing fresh fruits, vegetables, meat and bread, that would otherwise go to waste. and share those with food-insecure families. To support or volunteer go to <http://mainelockerproject.org/about/>

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