

**ANTONE MERCURIO LLC**  
INVESTMENT COUNSEL • FINANCIAL PLANNING  
CA INSURANCE LIC# OB68606  
2100 GARDEN ROAD, SUITE A203  
MONTEREY, CA 93940  
ANTONEMERCURIO.COM  
(831) 717-3158

**When Will This Bear Hibernate?**

Dear Friends,

October 20, 2022

That's a good question and one many clients are asking. So far, clients seem concerned, not panicked. Hopefully, that's because we talk often and regularly review your financial plan. I want you to know I hear those concerns and it seems the level of concern has picked up recently. In monthly calls with clients, I've heard instances of someone they know postponing retirement, an engagement celebration and a niece's freshman year at college. If there is someone you care about who's concerned, have them give me a call. I'm happy to offer a second opinion.

There are several pieces enclosed. One from the Capital Group and another from my indispensable research team at Commonwealth. Both do a good job of putting this selloff in perspective. Also included, a chart from J.P. Morgan Asset Management. I want you to know, if we've done a financial plan together it accounts for markets similar to those we are in now. The reason for the articles is to address concerns, assist with keeping a longer-term perspective and sticking to your plan.

I recently wrapped up quarterly meetings with some of the different research and portfolio people in the investment world. Here are few larger points that stuck with me.

From Vahid Fredrick of the Capital Group on inflation:

Three important issues we're still dealing with.

First, the Fed created 3.8 – 4.2 trillion dollars during the pandemic when the velocity of money was low. (The velocity of money measures the number of times a unit of currency is used to purchase goods and services within a given period).

Second, the mix of what we were spending money on has switched from entertainment, travel and restaurants to stuff (goods).

Finally, the world is still dealing with supply line shutdowns, especially in emerging markets where a lot of goods are produced. We've all heard of China continuing to lock employees in factories when there is an outbreak.

And from Peter Hamburger of J.P. Morgan

Inflation is cooling except for some hot spots like food and shelter. Headline inflation down from 9.1% in June to 8.3% (See bar chart).

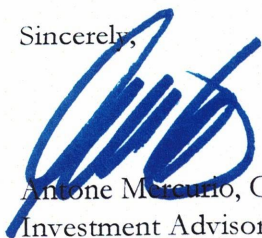
While higher interest rates are having an impact on housing prices, rental prices are a little tougher. You don't need a mortgage to rent a house. I think it would take higher levels of unemployment to soften the rental market.

Over the course of these discussions, I sense a feeling on Wall Street that once we get to next summer, and the inflation numbers are "annualized" (see bar chart), there will be a marked improvement in the inflation rate. I'm hopeful but unconvinced. The Fed has been pretty aggressive and hasn't had much success so far. Their target is 2-2.5% inflation. I don't think the Federal Reserve has the will to do what is necessary to get us there. Maybe we can get to 4%. Still painfully high. So, in a nutshell, we get down from dangerously high to painfully high, maybe. Across the board, everyone I talk to sees a good chance of recession by late next year. I agree but suppose a recession will be more of a concern when the unemployment rate picks up.

Shifting gears, I was out in the Philadelphia area last month. My wife, Gretchen, and I flew out to see our son Matthew and watch his football game against Monmouth University. He's the place kicker at Villanova University. They lost but he had a great game. We spent some time with him showing us around and were able to enjoy some nice dinners together. It was great seeing him and Gretchen was finally able to see where he lives. It's getting harder to take a red-eye flight and then turn around and do it again two days later.

Again, we speak regularly and I feel like I know all of you pretty well. I hear the concern among clients. I will stay in touch but don't wait for my call. You can call me anytime. Finally, thank you for your patience, trust and confidence.

Sincerely,

A handwritten signature in blue ink, appearing to read "Antonio Mercurio". The signature is stylized and fluid, with a large loop at the end.

Antonio Mercurio, CFP®  
Investment Advisor



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# When will the bear market end?

As stocks and bonds continue to tumble a week after the Federal Reserve's latest rate hike, investors are understandably asking how long this painful bear market will persist.

"It's been a difficult year, and the pain may continue," says Capital Group economist Darrell Spence. "But it's important to keep in mind: One of the things that all past bear markets have had in common is that they eventually ended. Ultimately, the economy and the markets righted themselves."

While past market results are not predictive of future results, it can be constructive to look at history. Based on the trajectory of past downturns, bear markets that were associated with a recession tended to last, on average, about 18 months, Spence notes. So it wouldn't be unusual for this one to continue well into 2023.

With a recession looming in the U.S. – and probably already underway in Europe – it's tough to see a catalyst for a near-term rebound, Spence says. Stocks and bonds are likely to come under further pressure as long as the Fed continues to aggressively tighten monetary policy in an attempt to curb inflation, which is hovering around 8%.

## Stocks and bonds have tumbled this year as the Fed fights inflation

Total return YTD (%)



Sources: Capital Group, Bloomberg Index Services Ltd., Refinitiv Datastream, Standard & Poor's. As of September 23, 2022.

## Fed rate hikes shift into overdrive

Last week, the Fed raised its benchmark interest rate by 75 basis points for the third time since June. That hike brought the federal funds rate to a target range of 3.00% to 3.25%, the highest level since 2008. Based on the latest Fed projections, the central bank intends to take that rate above 4.50% in the months ahead.

Confirming the central bank's hawkish stance, Fed Chair Jerome Powell said tighter financial conditions are necessary to achieve the goal of restoring price stability. That means bringing the inflation rate closer to the Fed's 2% target.

"We have got to get inflation behind us," Powell said during the Fed's September 21 policy announcement. "I wish there were a painless way to do that. There isn't."

Financial assets have declined sharply since then, weighed down by the realization that the Fed and other central banks around the world may have to raise interest rates more than previously expected. The S&P 500 Index, the Dow Jones Industrial Average and the tech-heavy Nasdaq Composite are all in bear market territory, defined as a decline of 20% or more from a recent high. The U.S. bond market, as represented by the Bloomberg U.S. Aggregate Index, is down about 14% on a year-to-date basis, as of September 23.

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## Mounting troubles in Europe

Markets have also come under pressure due to events outside the U.S., including Russia's escalation of the war in Ukraine, an economic downturn in Europe and a controversial U.K. tax-cut proposal that has triggered fears of a fiscal crisis. U.K. bonds and the pound have plummeted since the plan's unveiling on Friday.

A European recession may already be underway due to the impact of higher energy prices, which have been exacerbated by the war, according to Capital Group European economist Robert Lind. A harsh winter could make matters worse, sending energy prices even higher.

"The depth and duration of the recession will depend largely on two factors: the war and the weather," Lind says. "Both of which are impossible to predict."

At the same time, Lind adds, the European Central Bank and the Bank of England have no choice but to continue raising interest rates since they face the same elevated inflation levels as the United States. He expects the ECB and the BoE to raise rates through the fall and winter months.

## The Fed pivot

Looking ahead to 2023, investors will turn their focus to another key question: When will the Fed stop raising rates or even start cutting again?

At the moment, there is little pressure for the Fed to change course, says Capital Group economist Jared Franz. Consumer spending is relatively healthy. The U.S. job market is extremely strong. And the unemployment rate remains near a record low of 3.7%.

But when the unemployment number starts moving higher – as it typically would during a recession – Fed officials will be forced to choose between fighting inflation and pushing millions of Americans out of work, Franz explains.

"It's easy to talk tough on inflation when your unemployment rate is under 4%," Franz says. "But what happens when it climbs to 6% or 7%? In my view, that's about as much pain as the Fed is willing to accept. At the current pace of rate hikes, we're on course to hit 7% unemployment in the

second half of next year. I think it would be very tough to keep monetary policy tight in that environment."

**Darrell R. Spence** covers the United States as an economist and has 29 years of industry experience (as of 12/31/2021). He holds a bachelor's degree in economics from Occidental College. He also holds the Chartered Financial Analyst® designation and is a member of the National Association for Business Economics.

**Robert Lind** is an economist with 34 years of industry experience (as of 12/31/2021). He holds a bachelor's degree in philosophy, politics and economics from Oxford University.

**Jared Franz** is an economist with 16 years of industry experience (as of 12/31/21). He holds a PhD in economics from the University of Illinois at Chicago and a bachelor's degree in mathematics from Northwestern University.

The S&P 500 Index is a market capitalization-weighted index based on the results of approximately 500 widely held common stocks.

The Bloomberg U.S. Aggregate Index represents the U.S. investment-grade fixed-rate bond market.

The NASDAQ Composite Index tracks the performance of more than 3,000 stocks listed on the NASDAQ and is often viewed as an indicator for the newer sectors of the economy.

The Dow Jones Industrial Average is an index of 30 of the largest blue-chip stocks in the market. The DJIA is a price-weighted index, as opposed to one that is market-cap weighted, such as the S&P 500.

The market indexes are unmanaged and, therefore, have no expenses. Investors cannot invest directly in an index.

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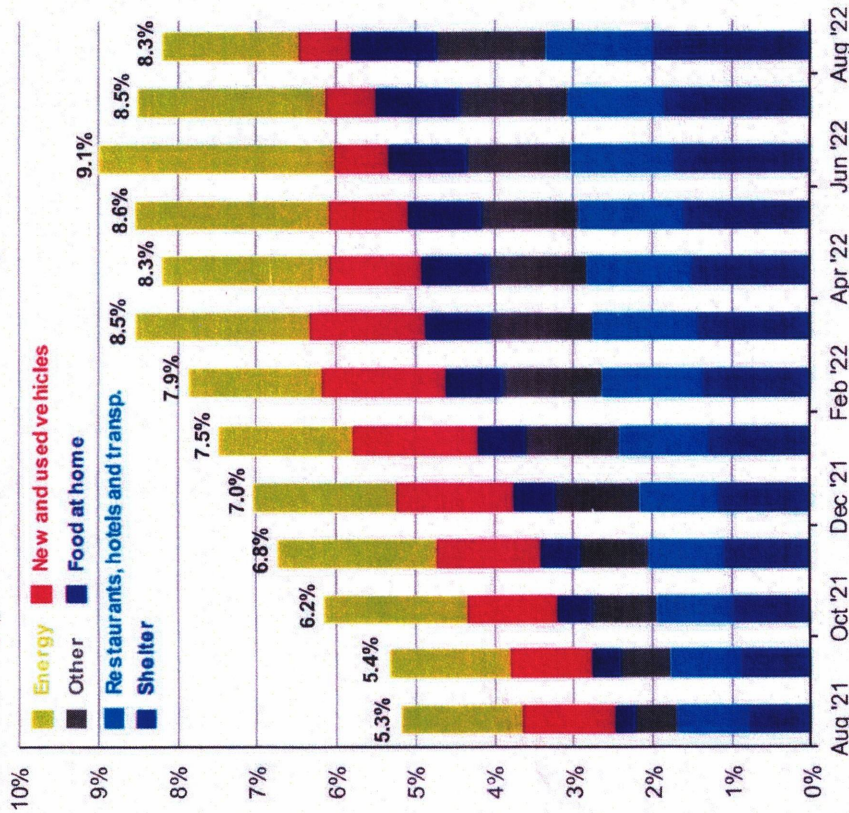
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# Inflation drivers and expectations

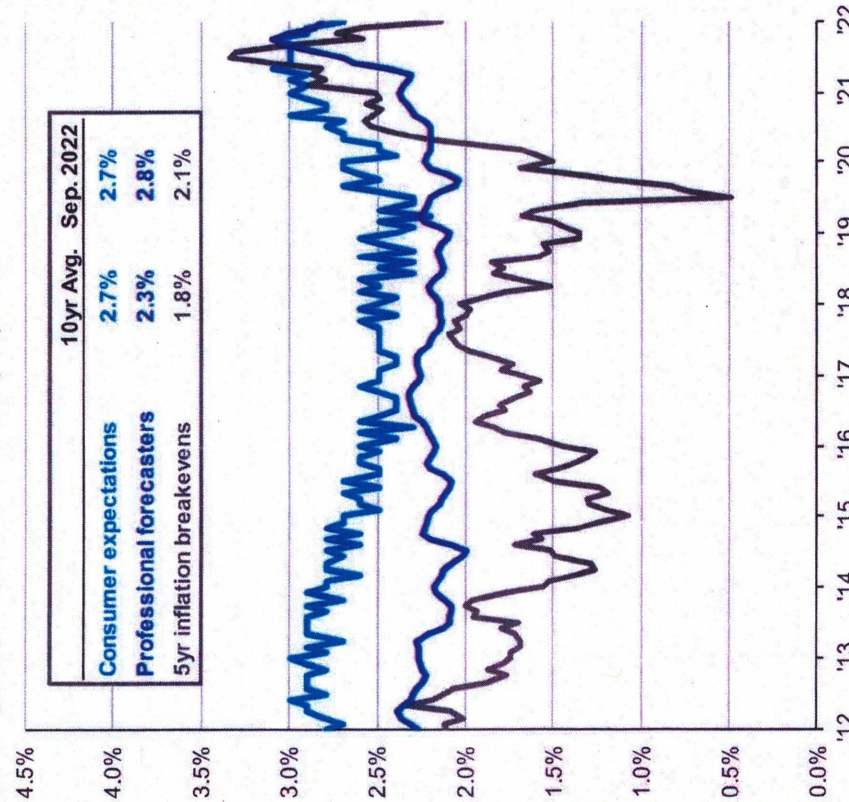
## Contributors to headline inflation

Contribution to y/y % change in CPI, not seasonally adjusted



## Inflation expectations, next 5 years

% change vs. prior year, non-seasonally adjusted



Source: Bureau of Labor Statistics, FactSet, Federal Reserve Bank of Philadelphia, University of Michigan, J.P. Morgan Asset Management. Contributions mirror the BLS methodology on Table 7 of the CPI report. Values may not sum to headline CPI figures due to rounding and underlying calculations. "Shelter" includes owners equivalent rent and rent of primary residence. "Other" primarily reflects household furnishings, apparel, education and communication services, medical care services and other personal services. Professional forecasters reflects the latest quarterly Survey of Professional Forecasters on a 1-month lag. The Survey of Professional Forecasters is conducted by the Federal Reserve Bank of Philadelphia and reflects the median estimate by professional forecasters of average CPI inflation over the next 5 years.

**J.P.Morgan**  
ASSET MANAGEMENT

# Why You Shouldn't Panic About Higher Rates and a Falling Market

Presented by *Antone Mercurio*

As we encounter another downswing in the ongoing bear market, it's only natural to be concerned and ask questions. Here's where we are at the moment: using the S&P 500 as a measure, the markets are down 22 percent from the peak at the end of last year, and just under 14 percent from the end of the most recent rally in August. This year, there have been four drops and three rallies. We're down quite a bit, and that doesn't feel good. The question to ask is: what should we do about it? To figure that out, we need to look at two things.

## Bear Markets in History

First, have we seen this before? In the broader sense, yes. We've seen this many times. Bear markets, generally defined as declines of more than 20 percent, are typical enough that they were given this name. Looking back to 1980, there has been a decline of 20 percent or more about every five years. That statistic changes to every two to three years when talking about 15 percent declines. Significant drops are a regular and recurring feature of the stock market, and it has always bounced back. This one is no different. We can reasonably expect the markets to bounce back at some point.

## Why the Decline?

The second thing to ask, now that we know history is on our side, is: why is this happening? The primary reason is because the Federal Reserve (Fed) is raising interest rates in order to combat inflation. Generally, when the Fed is raising rates, the market will have a tough time. This is what's meant by the old Wall Street saying, "Don't fight the Fed." So, just as the existence of the phrase "bear market" speaks to how normal that phenomenon is, the reason for the drop is also normal enough to have its own catchphrase. These are both things we've seen before.

## Looking Ahead

When we look at the primary cause of the pullback—inflation and the consequent Fed tightening of interest rates—we see reasons for both caution and hope. The Fed has committed to raising rates until inflation is brought under control, which is what sparked the current renewed downturn. This is a reason for caution. We can expect continued market turbulence for some time. When inflation eventually pulls back, however, that will open the door to sustained growth and market gains, as we've seen many times in the past. The Fed is performing metaphorical surgery on the economy right now. In the short run, it's painful; but in the long run, it's a healing process. This healing will set the stage for a healthier economy and markets just as we've seen historically.

## A Positive Spin

Even in the short term, despite the pain, it's not all bad news. There are some positive side effects. Higher rates offer an opportunity for savers, who can finally get a decent, low-risk return. For those who are still putting money aside, a bear market offers a chance to buy stocks on sale, potentially leading to better future returns when the market recovers. Lastly, as always, a bear market gives you a reason to take a good, hard look at your portfolio, and find out if you're really comfortable with the risks you're taking.

## The Bottom Line

This is where we stand. The Fed is in the middle of a painful policy change and, while the headlines and current numbers are certainly scary, that change will lead to a healthier economy and stronger future growth. A bear market offers plenty of reasons to worry, but that has always been the case. Looking at history, bear markets have always come back to future gains. And, while markets are down at the moment, we're also seeing new opportunities appear. If you look at the bigger picture, and the longer term, we as investors are still in a position to work towards meeting our goals over time.

*Certain sections of this commentary contain forward-looking statements that are based on our reasonable expectations, estimates, projections, and assumptions. Forward-looking statements are not guarantees of future performance and involve certain risks and uncertainties, which are difficult to predict. Past performance is not indicative of future results.*

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Authored by Brad McMillan, CFA®, CAIA, MAI, managing principal, chief investment officer, at Commonwealth Financial Network®.

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