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THE INVESTOR INSIGHT

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CELEBRATING 20 YEARS AS AN INDEPENDENT RIA

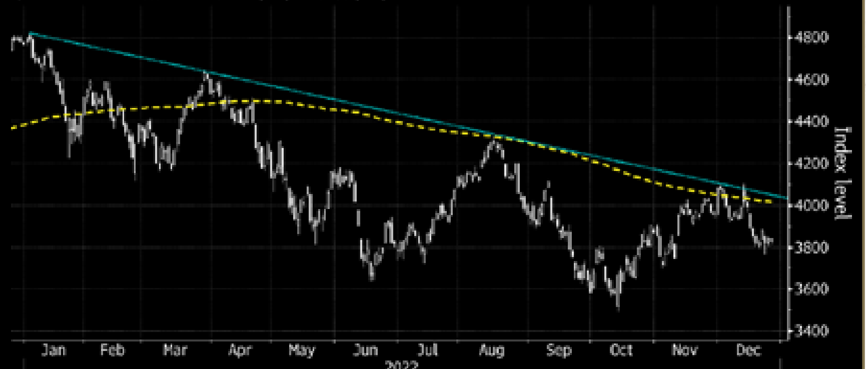
Q4 Commentary

Too much.... too fast

During Q4, investors continued to dump equities at a record pace as major central banks signaled that they won't be deterred in their fight against inflation—a fitting end to the worst year for world stocks since the 2008 global financial crisis. According to Bloomberg Analytics, equity funds experienced outflows of more than $42 billion, the highest ever, in a week when the Federal Reserve, the European Central Bank, and the Bank of Japan all continued their staunchly hawkish tone in their policy outlook for next year, even in the face of recent evidence that inflation has peaked and is heading lower.

In our Q3 commentary, I noted the potential damage the Fed could wreak on the economy and markets if it continued to increase rates at the pace and size it did in 2022 (the fastest and greatest percentage increase in rates in history). We are already seeing impacts in housing, where mortgage rates more than doubled in less than six months. In fact, any area where consumers depend on borrowing has seen a considerable slowdown. And market sentiment reflects the lack of positives. By many measures (AAII, put/call ratios), investors have never been as bearish on the stock market as they are now. (Is this an opportunity? More on that later.)

Economic data has been weak, and getting weaker, in consumer-facing sectors. Yr/yr readings of leading indicators have continued to trend lower. In fact, every other time the yr/yr leading indicators have been this extreme to the downside, the economy was already in, or within three months of, a recession (source: Bespoke Research). Remember, we did have two consecutive negative GDP quarters during 2022 which, according to The Bureau of Labor Statistics, is the definition of recession. Could the Fed be right this time, and the yield curve inversion we are experiencing will lead to a soft landing, not a recession? Anything is possible, but if history is a guide the Fed started raising rates late and (in my opinion) has already gone too far, too fast. This has been case in the past where the Fed was late and reactionary. If it keeps up its scorched-earth policy toward inflation, the Fed poses the risk of losing control of the narrative and making a (potential, if we are not already in one) recession deeper.



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Here's 2022's biggest market cap losers:

Amazon - $785B
Microsoft - $709B
Alphabet Inc. (Class A) - $685B
Tesla, Inc. - $675B
Mete Platforms - $650B
Apple Inc. - $632B
Nvidia - $369B
Netflix - $183B
Paypal - $137B
Adobe Inc. - $119B
Disney - $111B
Salesforce - $107B

The impacts are reflected in all market sectors—even safe havens such as bonds, which have seen a whopping 22% decline from their peak. Indeed, there was no place to hide in 2022. Many bellwether stocks (especially technology) that have led the markets over the past five-plus years have seen declines of more than 50%–70% during this period. Not since 2008 have we seen this type of corrective action in the markets. 2022 was a year all about war, inflation, and the Fed, and the latter has now become enemy number one. While the markets were playing catchup to the Fed all year long, they appear to have reached equilibrium since October. Frankly, I am not sure what the Fed is looking at regarding inflation and its trajectory—all signs seem to show that inflation has peaked and is declining rapidly. Headline CPI is likely to be in the 3% range by mid-2023.

In my view, the Fed's initial read on inflation—transient—will likely be correct. The definitive causes of the current inflation spike seem to be COVID (entering year three), war in Ukraine, and supply chain disruptions from both. All of these are temporary. Recent months have seen supply chain disruptions ease and COVID stabilize/decline (except for China, which recently abandoned its zero-COVID policy), and war in Ukraine could end at any point. The price of oil—a prime example of the inflation spike—is currently below where it was before Russia invaded Ukraine, and many other commodities have eased significantly as well. Lumber, which is leveraged greatly to the housing market, has declined more than 70% as higher mortgage rates hammer the housing market. Historically, housing has been an excellent leading economic indicator for the broader economy, and it has been very weak as higher rates and affordability issues halt activity in the sector. Employment had been an economic bright spot, but layoff announcements have risen sharply over the past quarter, particularly in consumer-facing sectors.

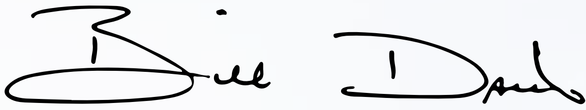
Will the Fed start to take notice of these factors and slow its pace or halt outright? Possibly. As I noted in previous commentaries, Fed Chairman Powell reversed course in 2018 after it pushed rates too high and the economy started to slow faster than the Fed wanted. For now, the path has been set and announced by the Fed: at least two more rate hikes (one in February and another in March). Economic data prior to those meetings could change that, if the data continues to weaken at the current pace. Regardless of any future Fed actions, the negative wealth effect to date has already resulted in 2022 being the fourth-worst year for the stock market since 1945, behind only 1974, 2002, and 2008. So, what to do as we enter 2023? One thing for investors to keep top of mind moving into the new year: the market likely has already priced in most of the abovementioned worries. Daily, CNBC and other financial news networks, newspapers, and newsletters all feature one prognosticator after another pointing to a recession coming in 2023 and more downside for the markets. These periods remind me of market bottoms, rather than another cliff the markets are ready to fall off of. No one can predict market tops or bottoms, but more often than not the masses are usually wrong, and in my view this level of extreme fear and negative sentiment has marked many bottoms. It may be stormy now, but it will not rain forever.

The two most recent large corrections like what we are currently experiencing (2000 and 2008) did not last and, in fact, were exceptional opportunities. Another thing to keep in mind: since 1928, the markets have seen back-to-back negative years only four times (source: Bloomberg Analytics). The backside of the vast majority of these periods produced multiple years of above-average returns for investors who either held through—or even better, took advantage and added during these periods. This is not always easy to do, but successful long-term investors are those with intestinal fortitude. Volatility is the price paid for exceptional long-term performance, and those who can add to investment accounts during these rare periods tend to do well in the years that follow. Those who can't stomach volatility, who let fear take over, usually make poor decisions during these periods (for example, by exiting the market). The problem with this strategy is that it involves timing two decisions—when to get out and when to get back in—and what's the probability of timing both of those things perfectly? In the course of my 32-year career, I have seen many investors leave, only to get back in at higher prices. As Warren Buffett said so well, "You pay a very high price in the stock market for a cheery consensus."

To reiterate, sentiment on the market has never been lower. This too shall pass, and as we move forward our team is researching companies for possible investment that we believe can do well going forward, many that are currently selling at or below book value, enterprise value, and near cash they have on their balance sheet. We have not seen those type of factors since market bottoms in the past two large pullbacks (2000 and 2008). Again, one need only look at the years following those periods to understand why we are excited about the potential opportunities.

We expect to work diligently to seek and vet those opportunities and to reap the benefits in the years to come. I would like to thank all of our clients for their trust—a very Happy New Year to you and your family!

Kind regards,



William D. Davis Jr.
CEO and Portfolio Manager

Why You Should Name a Trusted Contact

To help us protect you, securities regulations require that we ask clients for the name of a Trusted Contact. But what is that? A Trusted Contact is simply someone who can help us help you, if needed—someone that you trust us to contact, in limited circumstances, if we are unable to reach you.

Maybe you're traveling, or you've been displaced by a natural disaster. Maybe there's a concern about fraud, or you've been hospitalized unexpectedly. A trusted contact can help your firm connect with you.

The infographic shows what a Trusted Contact can and cannot do. Importantly, a Trusted Contact CANNOT access your account, trade, or otherwise have any authority over your account. A Trusted Contact is not a power of attorney.

Please call us at 804.644.6380 to designate your trusted contact today.

Peggy Myers Walz
Chief Compliance Officer

WHAT IS IT?

A "trusted contact" is a person you authorize your financial firm to contact in limited circumstances.

WHO SHOULD HAVE ONE?

We suggest a trusted contact for anyone who has an investment account.

How would having a trusted contact help me?

Maybe your investment professional needs to get in touch with you but can't when:

You are traveling

There is a natural disaster

There is a concern about fraud

You are having a health issue

Your trusted contact **CANNOT** make trades in your account

Your trusted contact **CANNOT** make decisions about your account

Being a trusted contact **DOES NOT** make them a power of attorney, legal guardian, trustee or executor

It's Time to Have "The Estate Plan Talk"

Talking with loved ones about estate planning and inheritance can be challenging, especially as it deals with two taboo topics: money and death. But talking with your adult children about their inheritance can provide significant advantages for you and them. It can help your heirs better prepare for the future and give you a chance to explain the reasoning behind your decisions. Here's a look at the importance of discussing your estate plan with your kids and how to start that conversation when you're ready to have it.

Setting and managing expectations

Your children might have some idea of your assets, but they likely won't realize the full picture unless you tell them. If you're comfortable doing so, walk your kids through your estate in detail, discussing exactly what they will inherit. If dealing with exact figures is too much, even a general idea of the size of your estate can help inform your kids' financial choices and manage expectations about what they may (or may not) inherit.

Discussing your estate is also an opportunity to talk with your kids about your family legacy. Share the decisions you made throughout your working years to build and preserve wealth. Discuss charitable giving priorities and values surrounding how to handle money. You may also wish to pass along financial wisdom, such as financial mistakes you've learned from over your lifetime. Such conversations could open the door to financial topics your kids may not have felt comfortable discussing with you before.

Finally, be sure your children know where you store important documents and how to access them. Similarly, provide them with the contact information for important players in your estate plan, such as your financial advisor, estate attorney, and whoever has power of attorney.

Explaining your choices

Depending on how many kids you have, their ages, and other life factors, the inheritance each child receives may not be equal. Maybe you've decided to leave more to one child due to a disability or health condition, or even giving most of your money to a favorite charity, leaving less for your kids overall. Going over these decisions now can head off hard feelings and confusion about how you want your money managed after you die.

If you'd like one of your kids to take on an important role such as executor or power of attorney, explain their responsibilities ahead of time. You may discover they don't feel up to the task and that you need to choose another person. Whether you've chosen someone else in the family or even a professional executor, use this discussion to explain why.

How and when to begin the conversation

There's no perfect time or place to bring up an emotional topic like estate planning, but some situations may be better than others. While it may be tempting to open a dialogue around the holidays when everyone is home, family get-togethers can be stressful and chaotic. Instead, find a quieter time of year, and pick a comfortable environment with positive associations.

If you're unsure of how to begin, your financial advisor can help you facilitate the discussion. They can answer your children's questions and explain their responsibilities in the execution of your estate.

It's okay if the discussion doesn't go exactly as planned. You're opening a dialogue, and it may take more than one conversation to get everyone on the same page. But working through any issues now reduces the risk that they'll develop into conflict later and increases the chances your wishes will be carried out as planned.

— Brant Jones, CFP®

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