ARCHVEST® WEALTH ADVISORS
P: 925-215-5600
F: 925-272-0215
2820 Shadelands Dr., Suite 130
Walnut Creek, CA 94598

The Archvest Advantage Q2 2022 Newsletter

August, 2022

Market Review

If you recall from our Q1 2022 newsletter, our economy has been experiencing booming demand, supply-chain interruptions, an ensuing Russia-Ukraine war, and rising interest rates, all of which have contributed to notable market volatility. Well, the volatility has continued throughout the 2nd quarter. US stocks, for example, as measured by the S&P 500, have declined by 16.1%, bringing the year-to-date decline to 20.0%. For another measure of our slowing economy, "growth investing"— meaning investors' willingness to focus on capital appreciation through investing in quickly growing companies in spite of relatively pricey shares— has declined 20.8% for the quarter and 27.6% for the year. Meanwhile, "defensive investing"— meaning investors' willingness to invest in companies that appear undervalued— has also declined, but by only 11.4% for the year. In bear markets, we do tend to see defensive stocks outperforming growth stocks, which they did by 16.2% for the year. Finally, bonds are down 3.8% for the quarter and 9.1% for the year.

On a broader scale, an appreciation of the US dollar has contributed significantly to a decline in international equities, which are priced in foreign currencies— by 14.5% for the quarter, and 19.6% for the year. As the Feds continue to raise interest rates in order to combat our inflationary global economy, we've seen a pullback across all asset classes. We do expect high levels of volatility to persist until inflation has stabilized.

Portfolio Design & Economic Downturns

In light of this volatility, it may be tempting to put all your assets in cash, as there is no price risk. However, there is also no expected real return (meaning no return as adjusted for inflation). So let's focus our attention on the two asset classes which, when used strategically, can be combined to create optimized risk-adjusted portfolios: bonds (aka fixed income) and stocks (aka equity). What are they, and how do they function differently for an investor?

Bonds vs. Stocks

Fixed income, or a "bond," is a promise that an amount of money will be paid by a borrower to a lender over a set period of time according to the "term" of the bond. At the end of the term, the borrower must return the initial cash borrowed to the lender along with the final interest payment. Historically, bond prices tend to remain relatively flat over time, and the investor receives regular income from the bond. That is why "bond" is just another word for fixed income.

ARCHVEST® WEALTH ADVISORS

P: 925-215-5600
F: 925-272-0215

2820 Shadelands Dr., Suite 130
Walnut Creek, CA 94598

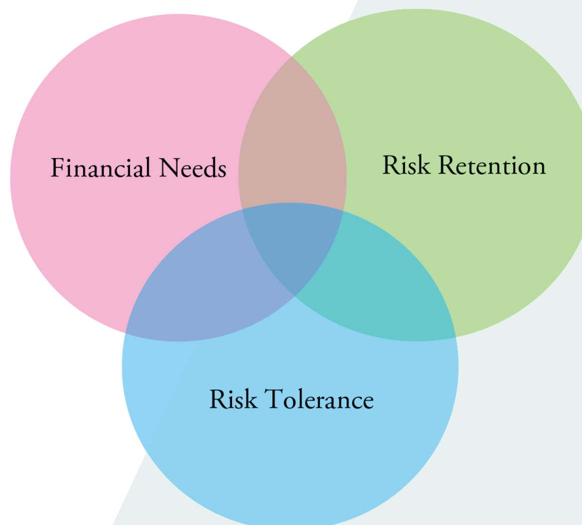
One key aspect of the "term" of the bond is the interest rate that the borrower must pay to the lender. The lender will set a higher interest rate when the length of the bond is longer and/or when the creditworthiness of the borrower is lower. For example, the 5-year Treasury bond issued by the US government has a current interest rate of about 3% right now. However, if a start-up company with minimal credit history came forth as a borrower, the lender would adjust the interest rate to about 8% to compensate for the additional risk they are taking on by lending to a borrower which, according to its creditworthiness, may not pay the money back in full and on time.

By contrast to collecting a predetermined and steady flow of income from a bond, investors can also choose to purchase stocks, or equity of a company. In doing so, the investor, or "shareholder," is entitled to share in company profits. What makes stocks so risky is that their value fluctuates greatly depending on myriad factors like earnings, forward guidance, and company rumors, and, at the end of the day, there is simply no promise of repayment of principal investment. For some relevant perspective, in the event of a company bankruptcy, bondholders are paid out first, while shareholders are not guaranteed anything.

As you can see, fixed income and equity have vastly different risk profiles and operate very differently within an investor portfolio. Stocks are the driver of returns in the long run, while bonds act as a ballast to the portfolio by mitigating the risks associated with owning stocks. For this reason, an ideal risk-adjusted return portfolio will hold a thoughtful balance of both of these asset classes. But what does that mean for you?

How Much Risk Is Right For You?

We believe that the ratio of stocks and bonds within your ideal portfolio should be determined by the overlap between three fundamental and fluid aspects of who you are as an investor: your financial needs, your risk tolerance, and your risk retention, as pictured below.



By “financial needs,” we mean how much you need to earn in investment returns in order to satisfy your financial plan. By “risk tolerance,” we mean your mental ability to tolerate risk. And by “risk retention” we mean your practical ability to sustain risky investments even during a market downturn and recession. In other words, during a slowing economy with increasing inflation, how vulnerable are your sources of income— be they employment-based, investment based, a rental property, or some combination thereof— to fluctuation?

We believe that your ideal ratio of stocks and bonds lies at the intersection of these factors. As we navigate this continued period of inflation and increasing interest rates, we believe that it is especially important to understand how these factors— unique to you and changing over time with your circumstances and goals— apply to you. And we are here to help.

Thank You For Putting Your Trust In Us

As always, we greatly appreciate the confidence you have placed in us to work alongside you as you financially prepare for your future. If you have any questions or concerns, please contact us and we will be happy to meet with you and review or refresh your overall plan. Follow us on Facebook, LinkedIn, and Twitter, as well as our RSS feed, to stay up to date on what we're reading and thinking.

THE Archvest Team