

The Archvest Advantage Q3 2022 Newsletter

November, 2022

Market Review

2022 has been an odd year. Both stocks and bonds are negative year to date. Since 2000, the correlation between US equities and US Treasuries has been consistently negative¹, which means that when one has gone up, the other has gone down. That's why it's so unusual in 2022 to see high-quality bonds and stocks decline simultaneously. Specifically, in the third quarter, US equities declined by 4.9%, and international equities declined by 9.4%, bringing the total year-to-date decline for stocks to 23.9% and 27.1%, respectively. Meanwhile, rather than acting as the usual counterbalance to negative stock returns, high-quality bonds also declined, by 4.4% for the quarter and 14.6% for the year. This is the worst bond return in over 200 years. Over time, we do expect stocks and bonds to regain the negative correlation we're accustomed to—with bonds counteracting the risks of stocks. The reason why these two tend to be negatively correlated is a bit too complicated to flesh out in this newsletter. If you're interested in a technical explanation of this, let's schedule a time to discuss further.

Investors & Inflation

You may recall from our Q2 newsletter that in response to the highest inflation rates since the 1980s, the Federal Reserve has begun a series of interest rate hikes in order to gradually stabilize prices. These hikes are necessary so that we don't enter a period of hyperinflation, but in the short term they're bringing up a great deal of uncertainty for investors, who are accustomed to the low interest rates the Federal Reserve set after the 2007-2009 financial crisis. Investors want to know, how much will the Federal Reserve raise rates, and when will they stop? How will inflation impact the labor market? How will supply chain issues be resolved? How will rising interest rates impact the rapid ascent of the dollar? And how will rising interest rates impact company profits? After all, prices can't stabilize without reduced consumer demand, and with less spending comes reduced company profit and less cash flowing into investors' pockets over time, which could lead to a lower (net present) value of the stock today. In response to all these uncertainties, many investors are selling at risk assets and adopting a risk-averse approach, which is altogether leading to a decline in stock prices. So, what has caused the simultaneous decline in bond prices? Well, interest rates set by the Federal Reserve are used as reference points for interest rates on bonds, including those that are already issued and in the marketplace. When the Federal Reserve raises interest rates, the interest rate on newly issued bonds tends to increase, and older secondary bonds with relatively lower interest rates suddenly become less attractive. Existing bonds are then "marked to market," which in this case means having their prices marked down to reflect the higher interest rate environment. This is why bond prices are on the decline.

¹ Rolling 10-year correlation between US equities and US Treasuries (AQR, 2022)

How You Can Respond as an Investor

We know that it can be scary to invest in the current economic environment where returns from stocks, bonds, and real estate are all negative year-to-date. You may have even considered moving your money into cash options, as cash is the only reliable method of protecting your investments. But, bear in mind that a portfolio immune to the downturn is immune to appreciation as well. We do not believe an investor can accurately predict where the market will go, so we do not try. Instead, we focus on collaborating with you to identify the amount and type of risk appropriate for your circumstances. It is natural for markets to go up and down in the short run. However, in the long run, we know markets go up in value.

Solar Credit Incentive

We'd like to draw your attention to a change in tax law that might help you save money over time as a homeowner. On August 16th, President Biden signed the Inflation Reduction Act, which increased the solar tax credit to 30% for any project installed between 2022-2032. With solar power becoming more affordable over time and this tax credit, solar is making more economic sense, and you can even reduce your carbon footprint. We think it's worth exploring as an investor. Let us know if you'd like to discuss this option further.

Housekeeping Items

In addition to the file sharing services with us through Box.com, we have implemented a secure mail system called Proofpoint, which will allow us to securely transmit sensitive documents and other information via email. The next time we need to send you a secure email, we will be doing it through this system, and you will receive an email informing you that a secure message is waiting for you on the Proofpoint site. You will then be asked to set a password before accessing the secure message. If you reply to the message on the site, it will be sent securely to us through the system. Please feel free to call us if you receive an email and have any questions or if you are unsure if it's a phishing email.

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