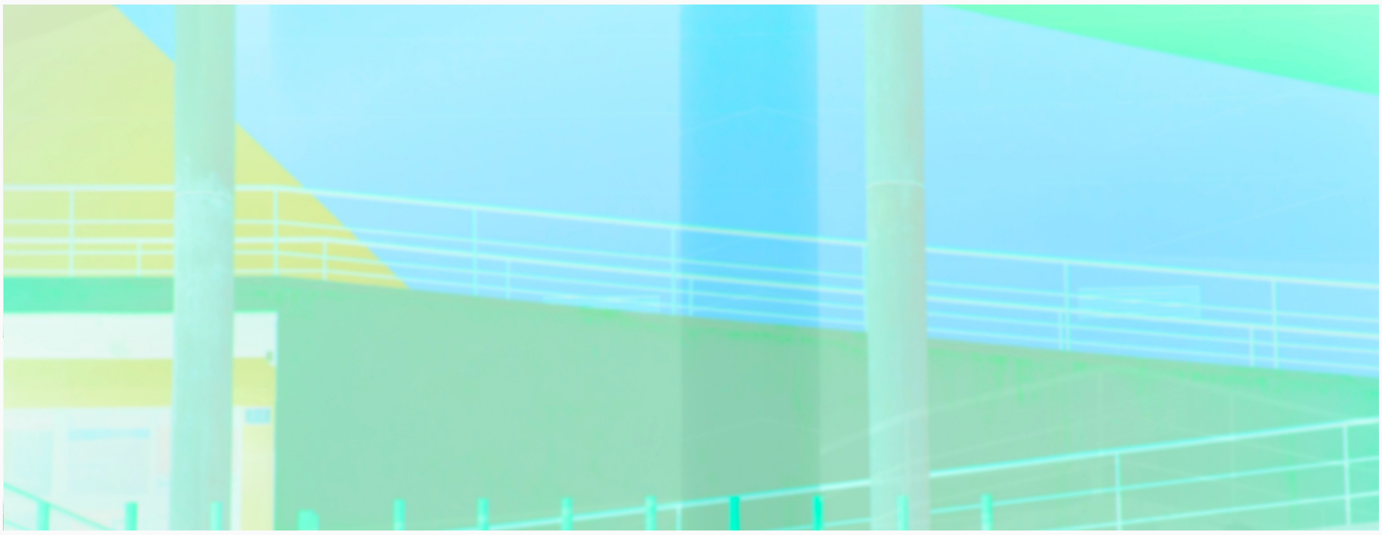
OCTOBER 2022/Q3 NEWSLETTER

MOSAIC FI MARKET INSIGHTS

-Planning and Investing for Life



Q3 2022

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There was simply nowhere to hide last quarter. Stocks, bonds, real estate, commodities, inflation-protected securities, crypto, hedge funds, floating rate securities, and cash all suffered.   Yes, even cash. We lost over 2% of the value to inflation.

Assets around the world are simply less valuable when interest rates are higher. In some ways it is basic math. When we value an asset/investment we look at the expected cash flows over time and discount those cash flows to the present. When we discount/divide a cash flow at a higher interest rate the present value is going to be lower.

To contain the worst inflationary environment in four decades, the central banks around the world have slammed on the brakes of the global economy; and then, come what may. If these actions cause a global recession, then that will be the price worth paying to contain runaway inflation. The Federal Reserve raised the fed funds rate by 75 basis points in July and then again in September.

Q3 2022:

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For the first time in 11 years the central bank for the EU raised interest rates by 50 basis points; the central bank of Canada raised rates by 75 basis points in September, etc., etc. Inflation is absolutely an issue the economies around the world are dealing with.

Will the bleeding ever stop?! While it feels like this will go on forever, history has shown us that it will come to an end at some point and when the shift happens it will likely be dramatic. It is very tempting to want to stop the bleeding and sell everything. Once the market recovery takes hold you will be faced with the decision of when to get back in. As you can see in the chart below, missing just 5 or even 1 day of market performance can have a significant impact on long-term returns.

The Equity Markets

Global equity markets, as measured by the MSCI All Country World Index, were down -6.19% in the 3rd quarter. International developed equity markets underperformed US equity markets.

The US market, overall, was down -4.46% for the quarter and is down -17.63% so far in 2022. International developed markets were down -9.20% for the quarter. Emerging markets underperformed developed markets and were down -11.57% for the quarter. US REITs again performed poorly, down -11.12% for the quarter and are down -29.32% so far this year.

Small cap stocks outperformed large cap stocks in the US but across the board growth stocks outperformed value stocks. For the quarter, large cap value stocks were down -5.62% while large cap growth stocks were down -3.60%. For the year-to-date, large cap value stocks are down -17.75% and large cap growth stocks are down -30.66%.

The Fixed Income Markets

With the continued tightening of interest rates by the Federal Reserve in the 3rd quarter, the bond markets declined again in value as yields rose. The Bloomberg Barclays US Aggregate Bond index was down -4.75% (again!) for the quarter and is down -14.61% so far for the year.

The municipal bond market again outperformed the taxable market, declining -3.46% for the quarter and is down -12.13% year-to-date. Yields across the maturity spectrum increased. In the 10-year part of the yield curve, yields rose by 85bps, ending the quarter at 3.83%. At the shorter end of the curve, the two-year yield increased 130bps, ending the quarter at 4.22%. At the very short end of the yield curve, interest rates increased even more dramatically along with the higher federal funds rate; the one-month treasury bill increased by 151 basis points to a yield of 2.79%.

The high-yield market was the 'outperformer' and came close to eking out a positive return for the quarter. It returned -.65% in Q3. But the year-to-date performance is nothing to smile about, down -14.74% so far in 2022.

US TIPS (inflation protected securities) also had a tough quarter. Overall, they were down -5.14% for the quarter and are down -13.61% for the YTD. While counter-intuitive, this negative performance during a high inflationary period is due to their high duration/interest rate exposure.

So, what did all this mean for investors? It was another 'do I really want to open my statement' quarter. Again, with stocks and bonds down, an allocation to bonds just meant your performance was 'less negative'. Depending on the asset allocation, a diversified portfolio returned between negative –5% to -7% for the 3rd quarter.

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Looking Ahead

As we look ahead, it is likely that we will have a few more interest rate hikes. The Federal Reserve is committed to bringing down inflation. The only way to convince people that they cannot keep demanding raises or job-hopping for higher pay, and that businesses cannot keep raising prices on their goods and services, is to choke off demand for those goods and services by inducing a recession.

Of course, all of this takes time. We all want to hold on to the hope that we can continue to get pay increases or raise prices for our goods and services. So, we will resist until the job offers evaporate or the customers stop buying your goods or services at the higher prices.

There is a lot riding on the mid-term elections. While the polls are mixed, history tells us that we are unlikely to maintain a Democrat majority in the House and Senate.

Exactly what the implications are in any scenario is unclear. Typically, the markets would put a lot of focus on the outcome of an election year such as this. This year is a little different.

The markets are so tunnel-visioned on inflation and what it will take to contain it makes everything else, just noise.

To end on a high note, there is a silver lining in all of this. While living through a rising interest-rate environment has been painful in many ways, the process is getting us to a point where fixed income assets can serve as a reasonable source of income. As an example, one of the fixed income funds we invest in provided a yield of 4.6% at the end of 2021. Now that same fund is yielding 6.6%. The fund is now providing over 40% more income than it offered 9 months ago. That makes a substantial difference to someone looking to live off their fixed income assets in retirement.

The downward roller coaster ride will end at some point; it always has. Staying focused on your goals and objectives and how to achieve them is what matters most to us.

As always, we would love to hear from you, so feel free to contact us at any time.