October 2022

THE CAPSTONE QUARTERLY

It is hard to believe we are already heading into the fourth quarter of the year. And what a year it has been! You might say what a *couple* years it has been! In this newsletter, Bryce breaks down the reasoning behind raising interest rates to quell inflation, and Casey gives an update on the stock market and current positioning for our clients. We have moved our offices so please note our new address at the end of this newsletter.

BRYCE'S POINT OF VIEW

Bryce Pease, CFP®
Chief Investment Officer

Federal Reserve

You've probably noticed the volatility wreaking havoc in the markets over the past few weeks. To understand what's going on, let me use an example many of you can relate to.

Have you ever tried to follow a tricky recipe?

Imagine if that recipe just said, "add salt". It includes no specifications as to amount, but you know the ingredient is necessary. Too much and you have the chance to over salt it, making it inedible. You could also under salt it, leaving it bland.

Crazy as it may seem, this little scenario actually describes some of what's going on in the markets right now. (Except the chef is the Federal Reserve, the food is the economy, the recipe is for bringing down inflation, and the salt is interest rates.)

For the last nine months, the Federal Reserve has been trying to follow an incredibly tricky recipe: bring down inflation *without* bringing down the economy. In other words, produce a vibrant economy with low inflation. Just as chefs use salt to flavor food, our nation's central bank uses interest rates to help moderate runaway consumer prices. The problem both face is it can be difficult to know how much of that magical ingredient to use. Just as too much salt can make food unbearable to eat, raising interest rates too high, too fast can trigger a recession. Raising interest rates too little, however, might do nothing to quell inflation. And consumers need relief from inflation *now*.

Many investors have their own opinion on what the Fed should do. More importantly, many investors are trying to guess what the Fed *will* do. That guessing is the prime reason for all this volatility. Fed Chairman Jerome Powell delivered a speech at the end of August where he stated that their #1 priority for the foreseeable future will be to continue to fight inflation. This means that the fed will continue to raise interest rates.

In other words, bringing down inflation is simply more important than stimulating economic growth right now. (or, propping up the markets)

This is why there has been so much volatility in the markets lately. It is also why we can expect volatility to continue, at least in the short-term. On September 21st the Fed hiked interest rates by another 0.75%, the Dow promptly dropped over 500 points[1]. The Fed has also indicated further hikes later this year. So, don't be surprised to see more volatility before and after the next announcements.

While volatility is never fun, it is not unexpected. It has not taken us unaware. Nor, frankly, do we feel it's something you need to stress over. As your financial advisors, our job is to help you achieve your financial goals, in part by making sound, long-term decisions, not overacting to what the Fed does – or says – or what the markets think about it.

To put it simply, the volatility we've seen lately is the same old story we've been reading about all year long. It's the same story we'll probably continue to read about moving forward. For that reason, my advice is to enjoy the little things in life and not stress about market headlines. We will continue to monitor our clients' portfolios and send out notifications if anything changes. And, of course, if you ever have any questions, please let us know.

CASEY'S CORNER

Casey Morris, CFP®

Trending Market

Have you ever seen a major river from above? If so, you'll have seen how it always takes the easiest course. Sometimes it flows straight; sometimes it bends and curves back on itself. Sometimes it flows fast and strong; sometimes, it barely moves at all. It cannot fight against gravity, so it never tries to go uphill. But it always keeps moving, from source to destination.

If you've been paying attention to the financial markets at all this year, it has been quite a wild ride. Interest rates are on the rise, inflation is remaining stubbornly high, and volatility is dominating the markets. But, as investors, this is exactly the time to think about that river and the fluidity and flexibility it displays.

Even in the best of times, many investors are rigid and inflexible in their approach. It's in the hardest of times that this rigidity comes back to bite them. For instance, many investors take the approach that they must stay invested all the time. Since the whole point of investing is to grow your money, they are constantly in growth mode. In reality, though, investors like this simply fear missing out on future growth. As a result, they are constantly climbing towards the top of the mountain, even when the cliff becomes straight and sheer, without a single ledge or toehold to cling to.

As of this writing, the S&P 500 is down 17% for the year.[2] At one point, it was down over 20%. Perhaps that slide will continue, perhaps it won't. I don't know; no one does. What I do know is that, when the cliff gets sheer, it can be a long drop down to the bottom. Other investors, perhaps burned by this approach, become inflexible in another way. They sit out the markets permanently, or invest only in bonds, or some other approach that makes them feel "safe". Better to risk gaining nothing than to risk losing anything. As a result, these investors never move at all. They simply stay where they are…even if where they are isn't where they want to be.

When you think about it, our entire investment philosophy here at Capstone Pacific is based on emulating that river. As you may know, we follow long-term market trends. Sometimes, the markets trend up. Sometimes, the markets trend down. Sometimes, the trend is short; other times, it's long. Sometimes, different sectors of the markets will trend in different directions, or not trend at all. (This is why we don't try to invest in everything, but choose our investments based on their strength compared to other, similar investments.)

Whichever way the trend goes, though, we don't fight it. Like water and gravity, we know that you can't fight it. Instead, we adapt to it. When the trend is down, we may move into cash to protect against undue risk. When the trend is up, we do the opposite. Sometimes, this shift may occur month to month or even week to week. But we are always on the lookout for opportunities to invest your money where it will try to do the most good.

Did you know?

Even pirates have their own stock market! The exchange was established in 2009 in Harardheere, about 250 miles northeast of Mogadishu, Somalia. According to the Wall Street Journal in 2011, the exchange is open 24 hours a day and allows for investors to profit from ransoms collected on the high seas, which can approach $10 million for successful attacks against Western commercial vessels. There aren't many credible statistics regarding the exchange, nor would we ever recommend a client invest in Somali pirates – but it does make for some good party conversation starters!

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Like water, we try to follow the path of least resistance, adapting our approach to the lay of the land. Sometimes we will be in growth mode; other times we will be defensive. Just as water will speed up or slow down, flow straight or curve backward, sometimes we will, too. In our opinion, this approach – being flexible and adaptable – is the surest way to your destination. By not trying to constantly scale the cliff, we do not risk the fall. And by not being afraid to move, we do not risk forever staying in one place.

The reason I mention all this is because investors have so much noise to contend with right now. On Tuesday, September 13 alone, the news came out that the inflation rate for August was at 8.3%, higher than many experts hoped for.[3] This means it's even more likely that the Fed will continue to raise interest rates, which is hardly welcome news for most companies. The result? The Dow fell over 1100 points.[3] For rigid, inflexible investors, numbers like this represent a major obstacle. Some will crash into it in their attempts to plow through. Others won't even bother trying. For us, however, it's merely another data point.

We have been primarily in money market for our advisory clients over the past couple months. Right or wrong, we don't feel like the risk is worth the reward at this time. Even though the headlines may seem scary, there are opportunities on the horizon and we are positioned to try and take advantage of those when they arise.

Over the coming weeks, it's possible we'll have more days like September 13. I don't know how long this volatility will continue; no one does. Either way, our strategy will help us get around it. I hope you take comfort in the fact that we'll continue adapting to changing market trends with great flexibility, all based on your needs and goals. We'll be like the river. As always, please let us know if you have any questions or concerns about your portfolio. We are here for you.

FINALLY…

WE'VE MOVED! As of October 1st we are working from our new office location in Brea, with the same great team and high level of customer service you have always been used to. Our new location is:

265 S Randolph Ave, Suite 240
Brea, CA 92821

We are conveniently located near the Brea mall, parking is easy, and there is an elevator to the second floor. Our phone number, email addresses, website and fax number have not changed. We are excited to welcome you to our new office.

Sincerely,

The Team at Capstone Pacific

P.S. If you ever run across anyone who could use our services or is unhappy with their current adviser's performance, we always appreciate it when you pass on our name.

1 "Fed Oks another massive interest-rate hike," Marketwatch, https://www.marketwatch.com/story/fed-approves-third-large-interest-rate-hike-and-signals-more-before-year-end-11663783628?mod=home-page

2 "S&P 500 Historical Data," Investing.com, https://www.investing.com/indices/us-spx-500-historical-data

3 "Stocks Fall on Hotter-Than-Expected Inflation Data," The Wall Street Journal, https://www.wsj.com/articles/global-stocks-markets-dowupdate-09-13-2022-11663065625