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# Thoughts on 2022

We are foregoing the Factor Report for the week ended September 23,2022 in order to share some thoughts on 2022. So here goes:

- The MSCI All Country World Index (ACWI) was lower by 4.96% this week. Non-US Developed (think the world but without the US or Emerging Markets, which includes China) was the worst performer, followed by the US. YTD, the ACWI is down 23.74% through Friday.
- The week started out optimistically as investors hoped that the Federal Reserve might give one last big interest rate hike and then pause to let this year's moves work their way through the system. In my humble opinion, that would have been the right thing to do. Everything in the financial markets is about overshooting. Stocks go up too much. Bonds go up too much. The Federal Reserve pours too much money into the marketplace. And then it all has to go sharply in the opposite direction.
- The result of the above isn't good. It gives the investor a volatile portfolio and that scares and upsets people. It causes some (not all) people to do the wrong thing at the wrong time. It makes portfolio management difficult as well, particularly when stocks AND bonds are down at the same time.
- So why is this all happening? The obvious answer is the Federal Reserve is trying to quell inflation. That's what everyone says. But how did we get here? This is not a natural cycle of the economy. This is man-made. When the Covid pandemic began in 2020 (actually 2019, which is why it's called Covid 19, but it was widely recognized in 2020), the world hit the brakes. Work became remote. People stopped going to restaurants. Has anyone seen a picture of New York City during the Covid lockdown? I have and I'm amazed there was even anyone there to take the picture.
    - So if no one is going anywhere, why would ExxonMobil keep refining gas? Why would Goodyear keep making tires? Why would restaurant suppliers keep shipping supplies? Inflation is all about supply and demand. And supply for many products evaporated when there was no longer demand. And on the other side of the coin, there wasn't enough supply for things that went through an unexpected spike in demand. The housing market went nuts, as did home improvement.
    - When economies reopened (relatively quickly), demand spiked and (a) there wasn't supply to meet it – auto manufacturers had to ramp up production, oil companies had to refine more fuel for cars, etc. and (b) companies didn't (and in many cases still don't) have the workers to get everything going again. So as the cost of production went up,

companies had a choice of eating costs and reducing profits or raising prices. Most companies did both.

- So where does that leave us? Headline inflation (including food and energy), which is not the Federal Reserve's measure of choice, is running around 8% as of the most recent reading. Core (excluding food and energy) is running just over 6%. This is a good point to stop and think about what the Federal Reserve does. The Fed has a dual mandate: (1) maximize employment and (2) maintain stable prices. The first is doing just fine, although the labor participation rate has something to do with that. Conversation for another day. The second is not and that is why the Fed is aggressively raising interest rates. To choke off the housing market (mortgage rates are now approaching 7% when they were around 3% or lower last year) and corporate profits. Notice there is nothing in the mandate about maintaining consistent stock market (or bond market) returns.
- On that last point, Fed Chairman Powell said on Wednesday that he is aware the interest rate hikes are causing pain, but they have a job to do and they are going to keep doing it until inflation is closer to their target rate – 2% core inflation. We are currently around 3 times that target. Which brings me back to why I believe a pause is in order. This is a big economy. You don't do an immediate U-turn with the QE2. It takes time for things to make their way through the economy. The Fed has raised rates by 3% this year. That is a big shock to an economy that enjoyed near-zero interest rates for most of the last decade plus. Instead, they said there will be another 1.25% this year and they expect the rate to be around 4.5% next year and no rate cuts until 2024. That flies in the face of Wall Street economists who expected the Fed to pause soon and start cutting rates next year.
- And let's talk about that. Forecasts and predictions. This is where investors' high fees go – to pay people that are wrong at least half of the time. Click here for a great article on that. Inflation is cooling. Recall that in June headline inflation was over 9%. But because the numbers are coming in higher than useless forecasts, the Fed is acting aggressively.
- So what's the point? At Metric Financial, we manage portfolios according to people's timelines – when will clients need the money? Not for when they will retire. Not for when kids go to college. Not for any time other than when they will need the money. Near-term cash needs are kept in just that – cash. Because stocks, and in many cases bonds, can be volatile. They go up and down. And it's generally not a good idea to sell when things are down, other than for unexpected cash/income needs. We invest in these volatile things because we know in the long-run, they generally go up and provide a return significantly higher than bank deposits. It's how we grow our nest eggs to outpace inflation. But we pay a price in exchange for that return and we're all paying it in 2022.
- This will reverse course at some point. Again humbly, I don't know when. It could be Monday. It could be next March. If it never does, we have much bigger things to worry about than our

portfolios! In the meantime, we welcome questions and discussion. For those of you that are clients or know me well, you know I have been doing this for almost 3 decades and am very passionate about what we do here at Metric. Reach out anytime!

- I'll leave you with this table as there has been talk recently about whether or not the 2020s will be a "lost decade". If you hear that term, it refers to 2000-2009 when stock returns were negative overall. We all know why that happened. 2008 and early 2009. We've moved on since then and we will move on from this.

## S&P 500 Growth By Decade

| Decade | | Growth |
|---|---|---|
| 1950-1959 | ↑ | +486% |
| 1960-1969 | ↑ | +112% |
| 1970-1979 | ↑ | +77% |
| 1980-1989 | ↑ | +404% |
| 1990-1999 | ↑ | +432% |
| 2000-2009 | ↓ | -9% |
| 2010-2019 | ↑ | +256% |

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