Financial Alternatives
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Investing Newsletter

July 2022

Executive Summary

- "Far more money has been lost by investors preparing for corrections, or trying to anticipate corrections, than has been lost in corrections themselves." – Peter Lynch
- Make sure you have enough cash and other conservative investments so you will never have to sell stocks in a bear market even a prolonged bear market.
- Expect stock markets to fall further after you rebalance, in other words mentally prepare for this so you will not be overly bothered by it.
- Even Warren Buffet cannot pick the bottom of a bear market.

Quarterly Market Review Newsletter

Stock market returns around the world have fallen sharply and we are currently in a bear market (defined as a decline of twenty percent or more). Bond markets have also experienced negative returns year-to-date. Be sure to read our Quarterly Market Review Newsletter which provides you with both long and short-term investment returns from markets around the world. This quarter's Market Review Newsletter also includes an interesting article entitled, "Three Crucial Lessons for Weathering the Stock Market's Storm."

Some Thoughts on bear markets from Peter Lynch and Warren Buffet

Peter Lynch, the former manager of the Fidelity Magellan Fund, is one of the most successful investors of all time. He offers some wisdom and insight that we hope you find helpful. In his first book, One Up On Wall Street, Lynch writes, "If you can't convince yourself 'when I'm down 25 percent, I'm a buyer' and banish forever the fatal thought 'When I'm down 25 percent, I'm a seller,' then you'll never make a decent profit in stocks".

Lynch offers a profitable tip for peace-of-mind stating, "I think if you decide that a certain amount that you've invested in the stock market will always be invested in the stock market, you'll save yourself a lot of mistimed moves and general agony."

Here's a final quote and Lynch assessment: "Far more money has been lost by investors preparing for corrections, or trying to anticipate corrections, than has been lost in corrections themselves."

What Lynch is talking about are the mistimed moves investors make when they attempt to avoid corrections. And in doing so, they often miss out on bull market advances, only to end up buying back at higher prices or never buying back at all. In short, you must get two decisions precisely right: Not only sell at just the right time, but then buy at just the right time. Markets often hit bottom when things look the most dire and hardly anyone would have the fortitude to invest. Moreover, we continue to live in a world where the future is filled with unexpected and far-reaching surprises. Some recent surprises include the first global pandemic in a hundred years, devastating armed conflicts, the ongoing repercussions from government policies, geopolitics, and interactions between nation-states.

So how can one implement Peter Lynch's recommendations? A simple, effective strategy is to decide on a target stock allocation percentage and then be disciplined, by rebalancing back to the target allocation, especially during bear markets.

Why is this difficult to do? It's difficult because the future is uncertain. Investors never know how low the market will go. And it can be agonizing to put more money in stocks only to see them drop further, resulting in even larger short-term losses.

A good example of this was the bear market of 2008 – 2009 brought on by the financial crisis.

- On January 1st, 2008, the S&P 500 was at 1,447.16. (All S&P 500 prices are from Yahoo Finance)
- By October 17th it had fallen to 940.55 for a drop of 35% when Warren Buffet, another one of the greatest investors of all time, wrote an Op-Ed exhorting people to buy stocks.
- The market ended 2008 at 903.25 down another 2% for a total loss of 37% for the year.
- The market fell an additional 27% from January 1, 2009, to March 9th 2009 when it finally it hit bottom at 676.53!

From this low on March 9th the market rebounded over 60% by the end of the year to close at 1,126.42. The final result was a 27% gain for all of 2009.

Yes, if you could have bought or rebalanced on March 9th of 2009 at 677 you would have made even more money.

But the point here is you can never know where the bottom will be, just as Buffet had no idea where the bottom would be during the 2008 - 2009 bear market.

In Buffets Op-Ed piece, he wrote:

> "Let me be clear on one point: I can't predict the short -term movements of the stock market. I haven't the faintest idea as to whether stocks will be higher or lower a month or a year from now. What is likely, however, is that the market will move higher, perhaps substantially so, well before either sentiment or the economy turns up. So if you wait for the robins, spring will be over. "

The point we are trying to make here is that nobody can predict the bottom of a bear market, not even Warren Buffet - and you don't need to. If you rebalance when stocks are down 20% to 40%, the odds are pretty good that you will be happy with your decision in the long-term - even if things drop further in the short-term.

Key Points

- Decide on a sensible allocation percentage to stocks based on your risk tolerance and financial plan and stick with it over the long term. If you decide to change it, only lower it in a bull market and only increase it in a bear market.
- As Peter Lynch said, banish the ideal that you are a seller of stocks during a bear market.
- Make sure you have enough cash and other conservative investments so you will never have to sell stocks even in a prolonged bear market.
- Rebalance during bear markets, in other words be a buyer of stocks when they are down.
- Expect stock markets to fall further after you rebalance, in other words mentally prepare for this so you will not be overly bothered by it.
- Always maintain a long-term perspective.

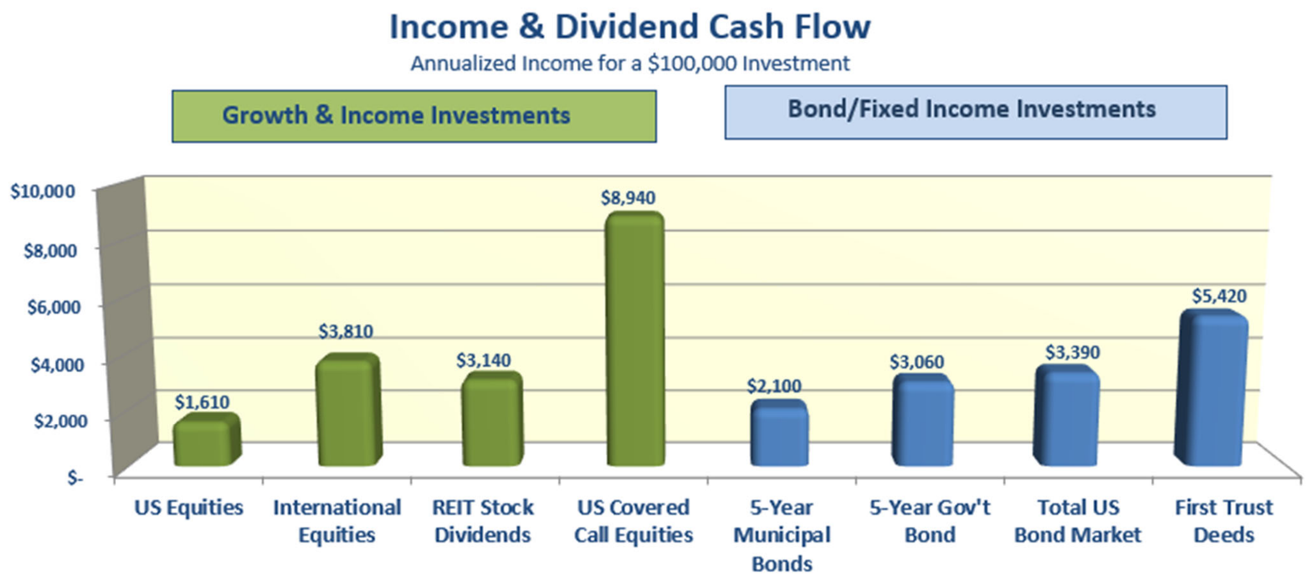
S&P 500 Past Bear Markets Since 1950

Looking at past bear markets can help you to focus and maintain your long-term perspective. The chart below shows the peak and the trough date for every bear market since 1950 along with the percentage decline, the number of days it took to go from peak to trough and then how many days it took for the market to return to its high point before the bear market began.

As you can see the market has recovered from every one of these corrections. Some recovered very quickly and the longest one took 5.8 years to recover. The key point to remember here is that during each one of these bear markets stocks went "on sale" and became cheaper for those who decided to add to their long-term stock holdings.

S&P 500 Bear Markets Since 1950

Peak	Trough	% Decline	# of Days	Breakeven	# of Days	Years
7/15/1957	10/22/1957	-20.7%	99	9/16/1958	329	0.9
12/12/1961	6/26/1962	-28.0%	196	9/3/1963	434	1.2
2/9/1966	10/7/1966	-22.2%	240	5/4/1967	209	0.6
11/29/1968	5/26/1970	-36.1%	543	3/6/1972	650	1.8
1/11/1973	10/3/1974	-48.2%	630	7/17/1980	2114	5.8
9/21/1976	3/6/1978	-19.4%	531	8/15/1979	527	1.4
11/28/1980	8/12/1982	-27.1%	622	11/3/1982	83	0.2
8/25/1987	12/4/1987	-33.5%	101	7/26/1989	600	1.6
7/16/1990	10/11/1990	-19.9%	87	2/13/1991	125	0.3
7/17/1998	8/31/1998	-19.3%	45	11/23/1998	84	0.2
3/24/2000	10/9/2002	-49.1%	929	5/30/2007	1694	4.6
10/9/2007	3/9/2009	-56.8%	517	3/28/2013	1480	4.1
4/29/2011	10/3/2011	-19.4%	157	2/24/2012	144	0.4
9/20/2018	12/24/2018	-19.8%	95	4/23/2019	120	0.3
2/19/2020	3/23/2020	-33.9%	33	8/18/2020	181	0.5
Averages		**-30.2%**	**338**		**603**	**1.7**



Portfolio Paychecks: The Income Component of Investing

Many investments have a sizable income or dividend component and make regular cash dividend or interest payments, typically on a monthly or quarterly basis. Especially during turbulent times, it's both comforting and reassuring to receive predictable income from investments.

As part of a diversified portfolio, income paying investments reduce risk and serve as the consistent component of total returns – unlike the much more random and haphazard capital gains (or losses) that is part and parcel of stock investing. An apt analogy is that Income – whether from bond interest or stock dividends – provides an "all seasons" Portfolio Paycheck, whether winter, spring, summer or fall. As part of the portfolio design process, we personalize portfolios based on our clients goals and objectives while considering many variables (e.g. age, cashflow needs, risk tolerance, taxes and other variables).

Bonds are fairly straightforward as their primary role is to provide interest income and lower risk diversification. In the chart all bonds show their most recent period current annualized interest rates (based on either daily rates or rates for the last 30 days). Unlike bonds, stock or equity investments are more volatile and exhibit varying degrees of both growth and income characteristics. For example, most fast growing technology companies paying little if any dividends as they reinvest capital and profits as fuel to accelerate their growth. On the other hand, many companies in mature sectors such as utilities, telecommunications, energy and banking pay their shareholders handsome dividends.

In the chart above please take note that all four of the *Growth & Income Investments* measure the annual dividends or cashflow generated over the last twelve months, excluding any capital appreciation or losses during this same time period. Notice that international stocks pay more than twice the dividends relative to the US market. Counterintuitively, US Covered Call investments tend to be less volatile than US equity markets as a whole despite their breathtaking income. One trade-off is that when markets surge, these investments tend to lag market returns. Another merit of covered call funds is that during turbulent markets, including most bear markets, these investments generate higher cashflow commensurate with higher market volatility.

The Bond Market & the First Trust Deed Investment

When interest rates rise bond prices fall – this is because existing bonds are not as valuable as newly issued bonds which pay higher interest rates. So far this year, interest rates have increased substantially and thus bonds prices have fallen in turn. A year ago, the yield on a one-year treasury bond was just 0.07% and the yield on the 10-year treasury bond was 1.24%.

As of the writing of this newsletter the yield on a one-year treasury bond is 2.80% and the yield on a 10-year treasury bond is 3.10%. The yield on the 10-year bond has been as high as 3.5% this year.

As a result of higher interest rates, the US Bond Market has declined by 10.35% (Bloomberg US Aggregate Bond Index, Morningstar). Some believe the worst of the bond market correction may already be behind us. In this case, higher quality bonds should provide helpful diversification, including serving as a hedge that helps offset potential declines in the stock market.

In any case, some good news is that bonds are now paying much higher interest rates resulting in more generous cashflow to investors on a go-forward basis. Thus, should you have a lot of cash at the bank, you can now earn higher rates with a variety of investments such as conservative short-term bonds and money market funds. If you have extra cash, we encourage you to give us a call to discuss appropriate options.

The first trust deed investment we have used for clients since 2006 has reopened after closing a little over a year ago and is now accepting new investors again. We will reach out to discuss this investment with you if we feel it is appropriate for your circumstances.

If you would like to discuss your investments or any other aspect of your financial life in greater detail, please give us a call. Wishing you all the very best.

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