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The Advisor

QUARTERLY NEWSLETTER

2022 Q1 REVIEW:

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GENERAL MARKET COMMENTARY

During the quarter, the markets had to adjust to reports of increasing inflation, rising oil and commodity prices, and the war in Ukraine. This tragic humanitarian crisis continues to be painful to watch.

When the war started, it was difficult to focus on investing money or stock market movements when our hearts were breaking for the people of Ukraine whom we all wanted to help! It is in times like this that family and the simple things in life become significantly more important.

Monthly inflation numbers continued to increase this past quarter. Hearing the media report on these numbers is one thing, but constantly seeing notable price increases at the grocery store, at the gas station, in energy bills, housing, transportation costs, and consumer staples is quite another.

The repercussion of these higher costs results in consumers having less discretionary income to spend. This will impact the retail, travel, home improvement, housing, and entertainment segments of the market. But despite these factors, by quarter's end, a sense of normalization had returned to the stock market. Daily volatility diminished somewhat, and investors looked to make new investments or add money to existing positions. The first quarter ended with the three market averages all registering declines: - 4.6% for the Dow Jones Industrial Average, - 4.9% for the Standard & Poor's 500 Stock Index, and - 9.1% for the technology-heavy NASDAQ.

The Federal Reserve began increasing short-term interest rates with a ¼ percent rise and signaled more increases to come. The Federal Reserve, whose mandate is full employment and stable prices, is behind the curve in maintaining stable prices. Chairman Jerome Powell has done an excellent job in leading us through the pandemic, but he now has a difficult job ahead in trying to engineer a "soft landing." That is, he must slow price increases in a very strong economy without pushing the country into a recession, thereby aggravating unemployment. Increasing interest rates over the next two to three years should begin to slow inflation.

Consumers will ultimately begin to cut back on discretionary spending as budgets are crimped or instead will choose to invest in higher interest-yielding products.

In a rising interest rate cycle, which typically lasts two to three years, the stock market can still appreciate. The appreciation may not be as much as the growth-oriented markets over the last 12 years, but mid-to-high single digits can be expected. A conservative-leaning portfolio, with a focus on value and growth stocks, income, and a commodity exposure is important. Ultimately, as the market perceives that inflationary increases are slowing or peaking, economic growth in real terms will improve, bond prices will rise pushing down interest rates, and the stock market will perform well.

Throughout the quarter, our portfolios, which focus primarily on a diversified mix of growth and value large-cap stocks along with dividend income, outperformed the markets. Integrated energy stocks performed well on the back of steep increases in oil prices. The more conservative and higher-yielding pipeline companies such as Enbridge and The Williams Companies also appreciated. Defense stocks such as Lockheed Martin and agricultural companies like Deere & Co. traded at 52-week highs. Drug and healthcare sectors performed well, as healthcare is viewed as a safe sector in an inflationary environment. Demand for electricity continues to increase from 2020 pandemic lows causing utility stocks such as Duke Energy, CenterPoint Energy, and others, with their attractive dividend yields, to trade at multi-year highs.

Fourth quarter earnings reported in January and February were impressive despite ongoing supply constraints, labor shortages, cost increases, and the Omicron variant. We have seen numerous dividend increases including double-digit increases from Corning, DuPont, The Home Depot, Zurich Insurance Group, and others. These dividend increases, along with the potential for price appreciation from the underlying security and the rise in short-term interest rates, will help clients increase their portfolio's cash flow this year and likely into the future. These cash flow increases also provide a nice hedge against rising prices, particularly for retirees who are more dependent on portfolio income and principal distributions for retirement.

Interest rate increases, which have been anticipated for several months, began to be reflected in the short-term Treasury market rates. By late March, the rate on 2-year Treasury Notes exceeded 2%. 1-year obligations were 1.75%. After numerous years of near 0% interest rates, these increases were a breath of fresh air.

As many of you know, during the past few years, when a bond matured or was called, we frequently invested a portion of the proceeds into the dividend yielding stocks in one's portfolio and swept the remainder into the Schwab Money Market Fund. Our goal was to keep one's cash flow constant and increasing. This strategy worked well.

But now, with rates on the increase, it is time to rebuild bond portfolios to make sure, at a minimum, one has an adequate amount of available cash to cover anticipated outflows for the next couple of years. Historically, interest rates are still very low. However, given the 0% environment we have all been dealing with, the increases and the comfort level of owning a bond backed by the U.S. government is very appealing.

We also like to remind you that the Treasury bonds we purchase through Charles Schwab & Co. not only provide safety and liquidity, but are also commission free. This means the bonds are not marked up or down and you don't have to pay a flat fee plus an additional fee per bond. Also, the interest paid by Treasury obligations held in a non-IRA account is exempt from state income taxes where they exist. Last, Treasury Notes, unlike most corporate bonds, cannot be called. This means that an investor won't lose his or her bond should interest rates decrease. Corporate bonds, on the other hand, are frequently called when rates decrease. Given the increasing yields, we are planning on using Treasury obligations where appropriate.

> The inflation rate in 1980 was 13.5%. Tight monetary policy was necessary to combat inflation but caused recessions in 1980 and 1981-82.

Last, in mid-March, Amazon.com made a very interesting announcement: a 20-for-1 stock split would occur in early June 2022. This means that a shareholder with 1 share of AMZN today will receive 19 additional shares on June 6th — bringing the total held to 20. Of course, today's price of approximately $3,270 will be reduced to around $165. On paper there is no change in value. It's no different if one has a $20 bill, four $5 bills, or 20 singles. The value is the same. However, from a marketing perspective, it is a big deal. Not only will more investors (particularly retail investors) be able to purchase the stock, but also psychologically, the stock is more attractive. Investors prefer to own 60 shares of a $165 stock versus 3 shares of a $3,285 stock.

When a company announces a stock split, it can be inferred that management is optimistic about its business prospects over the next couple of years. In Amazon's case, its fundamentals are attractive. While the stock has not appreciated much over the last 12 - 15 months, it is a company that should now be put into one's portfolio.

Amazon is a diverse company used by businesses and individuals all over the world from its web services (cloud businesses), to online retailing, to advertising, to streaming and to the numerous benefits from being a Prime member. After the stock split, there is also the possibility that AMZN could be added to the Dow Jones Industrial Average, which attracts passive money that invest in indexes. It is our opinion that we could see the initiation of a dividend in the next 12 – 24 months.
In closing, despite all the negativity and turmoil in the world today, as well as market volatility, the main thing to do is keep calm and carry on (as the British War Department said during WWII). These are things we have no control over. Will you see swings in your portfolio's value? Probably. But you can take solace that your portfolios contain quality investments that should hold up well and produce a steady flow of income. As always, we are here for any questions or concerns you may have.

FINANCIAL PLANNING – WHAT TO (FINANCIALLY) EXPECT WHEN YOU'RE EXPECTING (WRITTEN BY ALEXANDER HEMSLEY)

Having a child is a life-changing event even for the most prepared couples.

Between making sure the house is baby-proofed, the baby monitor is working, and having enough diapers, preparing financially for the additional expenses and your child's future often falls by the wayside.

COLLEGE IS A LOT CLOSER THAN YOU THINK

A new baby brings many new responsibilities and greater expenses—in addition to a lack of sleep! The family budget will have to increase for food, diapers, clothing, and possibly daycare. But one of the largest costs is also the furthest away—college. The price of college admission has skyrocketed over the last two decades. Private universities have increased 144% and in-state universities have seen prices go up by over 211%, which is an average rate increase of 7.2% and 10.55% per year, respectively, well outpacing inflation over the same period. Today, four years at a private university with room and board can cost as much as $70,000 per year!

New parents think that college is far off in the future. But in reality, the years go by quickly. Therefore, it's never too early to start saving for college. Not many realize that you can start to save for college via a 529 (education saving plan) even before the first child is born. All that is needed to open a 529 plan is that a beneficiary be named. Anyone can be listed as the beneficiary, including yourself, older adults who are not yet grandparents, or other family members. The beneficiary of the account can be changed at any time. Therefore, once the child is born, they can be listed as the beneficiary. There may also be some tax benefits to contributing to a 529 plan depending on what state you live in.

INSURING FOR THE LOSS OF A PARENT

The costs of raising a child add up quickly. The U.S. Department of Agriculture estimates that the cost to raise a child born in 2022 until age 18 would be $272,049. This is a tremendous financial burden for one parent to bear should something happen to the other parent. Therefore, we recommend parents purchase life insurance, either an individual policy or in combination with available group term benefits. The purpose of securing a policy is to cover the loss of earnings in the event one parent passes away.

Term insurance is the most affordable and provides the greatest amount of protection for a young couple. The amount of insurance required will vary based on the loss of earnings a parent contributes to the household or the economic value of the stay-at-home parent, i.e., the cost of hiring someone to perform the duties. Term insurance is generally inexpensive so one should think in terms of at least $1,000,000 in coverage. Getting a child through college, paying a mortgage, and allowing the surviving spouse to maintain their accustomed lifestyle requires a lot of money!

COVERAGE FOR ACCIDENTS

Accidents do happen to both children and adults. When children are playing, they may fall off the trampoline or an adult may slip on the ice while walking on your property. If a child or adult gets hurt at your house, typically homeowner's insurance covers unreimbursed medical expenses up to a small amount and personal liability resulting from the homeowner's negligence.

It is the potential for long-term medical care or the inability of the injured to maintain their earnings power caused by the accident in your home or on your property that should be of concern. Having this additional liability protection is an area many people don't think about. Yet this protection is relatively inexpensive.

An umbrella liability policy provides this protection above what is provided by your homeowner's and auto insurance policies. Similar to term life insurance, it is relatively inexpensive. As a general rule, all homeowners should have at least a $1,000,000 policy and ideally more. For a minimal cost each month, not only will you be protected against many of the perils that could disrupt your life, but it will also provide peace of mind.

UPDATE OR CREATE ESTATE DOCUMENTS INCLUDING WILLS AND TRUSTS

Finally, parents of newborns should at least have documents in place that, in the event of a common disaster, designate a personal representative for your estate and a legal guardian for your children. Having this document in place allows you to control who will take care of your children versus the state deciding. A more comprehensive approach is to have a trust or trusts drawn up to provide for the financial management of your assets, including insurance proceeds, until your children reach adulthood or specified ages.

COPING WITH INFLATION

The last time many of us saw inflation rates this high was in the early 1980s when prices continually increased. We have been fortunate to have had little to no inflation in recent years. As a result, many individuals have never experienced an inflationary economy. During these past years, while we were still cautious in our spending, our budgets were not severely impacted if we paid Instacart upcharges or delivery fees to deliver our food and other items. No thought to price was given if we went to the nearest grocery store if we ran out of something. The additional costs were worth our time and convenience. But with prices literally increasing each day, it is important to try to save and adjust our behavior. Some examples include:

- Plan your routes to do errands as so not to backtrack and save gas as we did when gas prices increased in the first decade of this century.

- Plan your meals around what is on sale at the grocery store that week. Look at the ads online or in the paper. Clip those digital coupons. Same for cleaning or personal items such as toothpaste, shampoo, etc.

- Buy non-perishable items when on sale so you don't have to pay full price when you need it. Buy in bulk and split with your children, friends, or other family members.

- When eating out, think twice about having that second glass of wine or drink. The money saved may enable you to go out another time.

- When traveling, check multiple websites. See if you qualify for a discount—AAA, AARP, etc. Check with the Costco travel site.

These are just a few little things that don't require much effort but will leave you with a few extra dollars each month. In summary, use your creativity in developing habits to combat higher costs. These habits can be used the rest of your life to efficiently manage your cash flow.

As always, do not hesitate to call us with any questions. We always enjoy talking with our clients.

Happy Spring!

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1. This newsletter may include forward-looking statements. All statements other than statements of historical fact are forward-looking statements (including words such as "believe," "estimate," "anticipate," "may," "will," "should," and "expect"). Although we believe that the expectations reflected in such forward- looking statements are reasonable, we can give no assurance that such expectations will prove to be correct. Various factors could cause actual results or performance to differ materially from those discussed in such forward-looking statements.

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