



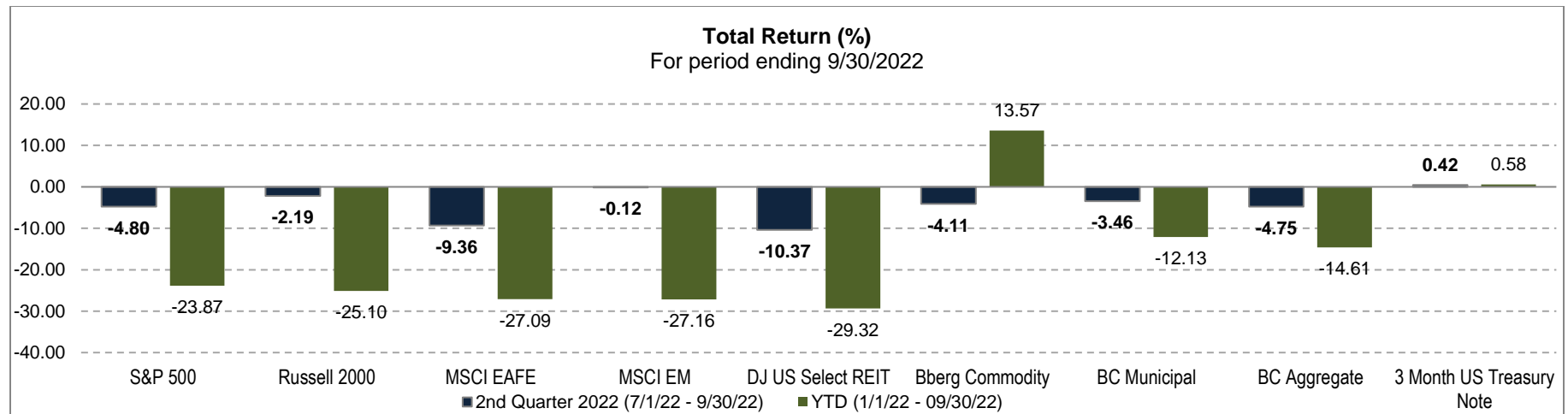
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Wealth Management



This Time Wasn't Different: Facing the Backlash of a Pandemic

Schneider Downs Wealth Management Advisors, LP
Q3 2022 Market Commentary



The most infamous words in finance are: this time is different. These four simple words are uttered in almost every economic, business, and investing cycle to justify valuation or price largesse of the current “darling” of the investment world. In past cycles, it was applied to real estate (Home prices will never go down they say!), the dot-com bubble (You don’t understand, the internet is taking over the world. It doesn’t matter that Pets.com doesn’t have any revenue; it will totally grow into its \$290 million IPO market capitalization.¹), and most recently we were told over and over again that given persistently low interest rates and despite significantly elevated stock valuations, that TINA (there is no alternative) to owning stocks. Well, home prices did go down during the Great Financial Criss, Pets.Com filed for bankruptcy less than 9 months after it went public, and despite the protests of the TINA evangelists, price and valuation still do, in fact, matter. The United States, along with most other countries around the globe, put the global economy into a coma to fight COVID, which felt appropriate enough in the early days of the pandemic when it seemed COVID might be the second coming of The Black Death.² However, the global monetary and fiscal response in 2020 and 2021 managed to turn prudent cautionary action into a monetary and fiscal experiment never before entertained or implemented (even on a small scale).

Here at home, the monetary and fiscal experiment provided unprecedented stimulus into the economy via 0% interest rates and several hundred billion dollars of bond purchases, reinforced business balance sheets to incentivize employers retaining employees via the \$349 billion PPP program³, and if that were not enough, three rounds of stimulus checks. The sheer scale of the stimulus program - 472 million payments totaling \$803 billion dollars⁴ were sent to households. The economy was in a recession (self-induced), but businesses and households were suddenly flush with cash. Markets snapped backed and went on to all-time highs, everyone had a friend/relative/colleague who was crushing it day trading stocks and crypto, and businesses were never more profitable. Home prices made new highs seemingly every day, cars were impossible to buy, and when you found one, you paid over sticker to get the car. If all that was not enough, Amazon brought everything you desired to your doorstep within two days (and in some cities, two hours!). Almost every single person and company was winning – and that as it turned out, was the problem. In capitalism, there are winners and losers; it’s a messy yet efficient system that eventually rewards prudent investment and capital allocation and punishes the opposite.

¹ <https://www.begintoinvest.com/lessons-from-pets-tech-bubble/>

² The Black Death refers to an outbreak of the Bubonic Plague in Europe and Asia in the mid 1300s, estimated to have caused over 75 million deaths.

³ https://en.wikipedia.org/wiki/Paycheck_Protection_Program#:~:text=The%20Paycheck%20Protection%20Program%20was,3%20and%20April%2016%2C%202020.

⁴ <https://www.pandemicoversight.gov/data-interactive-tools/data-stories/three-rounds-stimulus-checks-see-how-many-went-out-and-how-much>

However, from March 23, 2020, through the end of December 2021, everything worked. Despite knowing that everything working is a problem, central bankers kept interest rates low and monetary conditions loose in the face of mounting evidence that inflation would be far from “transitory,” and an economy that appeared fully recovered. Central bankers and market bulls screamed on TV, Twitter, and every other outlet that this time was different... and in 2022 we learned that this time was not different. In fact, through 9/30/2022, investors have returned most of the earnings from 2020 and 2021.

Inflation and interest rates are now firmly driving capital markets. Due to higher levels of both (inflation and interest rates), the majority of traditional capital markets have seen sharp declines in price. Whether we are talking about the U.S. Treasury and Agency bond-heavy Bloomberg U.S. Aggregate Index (-14.6%), U.S. Large cap stocks (-23.9%), or publicly listed real estate (-29.3%), almost no asset class was spared as a combination of higher inflation led global central bankers to raise interest rates. Domestically, the U.S. has raised interest rates much more swiftly than other nations, as Chairman of the Federal Reserve Jerome Powell turned from a policy “dove” into a fierce policy “hawk” almost overnight.⁵ The hawkish monetary policy being enacted by the Fed has led to the US dollar strengthening against all other forms of currency to its highest level in over 20 years. A strong dollar has had a cascading effect on everything from the Euro currency to emerging market stocks and bonds. In essence, the U.S. is exporting its inflation to other countries with dramatic results.

The first three paragraphs recount why we are where we are in capital markets; the following words are about where we go from here. To the surprise of a few people, I am sure, things look better than the market would have you believe. First and foremost, traditional fixed income is looking attractive for the first time in years. Bonds are like a seesaw; as prices go down, yields go up (and vice versa). This year, the traditional ballast of a portfolio, fixed income, has come under pressure as bond yields have dramatically risen from levels where they were at the start of the year. After a decade plus of 0% interest rates, municipal bond yields have breached the 4% level (tax free!) and taxable corporate yields are well above 5%. Coming into the year, stock valuation levels were meaningfully elevated. Stock valuations are much more palatable now, and even attractive in the case of U.S. Small Cap companies, where the forward valuations trade at levels last seen in 1990.⁶ U.S. medium-sized companies also trade at attractive levels, where valuations are the cheapest since 2009⁷. The surprising strength of the U.S. Dollar, combined with the war in the Ukraine, have certainly depressed international and emerging market stock returns, where stocks still trade at a significant discount to their U.S. peers. While a catalyst is needed to see international and emerging market stocks re-rate higher, their valuations suggest attractive future returns over the medium to longer term. Finally, our exposure to real assets (infrastructure, farmland, timberland) and high-quality commercial real estate (multi-family housing and industrial/logistics most prominently) continue to provide a ballast to the portfolio as well as exposure to assets that do well during times of elevated interest rates and inflation.

In the moment, it is easy to look at the macroeconomic (higher inflation, strong U.S. dollar, high interest rates) and geopolitical (war in Ukraine, tensions with China/Taiwan, volatility in our politics domestically) issues and say, “this is bad, we have never been here before.” That statement is as dangerous as saying “this time is different,” in so much as the world and the market are constantly evolving. Real Estate (private residential and commercial) had never seen stock-like volatility until the Great Financial Crisis. The Dot-Com spectacular run up and equally spectacular burst were novel – the internet was a “thing” for less than a decade! I point this out because the market is always dealing with something new and novel – it is what makes studying and following the markets fascinating. Admittedly, I am a prisoner, at times, to the minute-by-minute stock market banners on

⁵ In a change of positioning/rhetoric that would make even the most opportunistic politician blush.

⁶ Bank of America/Merrill Lynch US Equity & Quant strategy; FactSet

⁷ <https://www.yardeni.com/pub/peacockfeval.pdf>

CNBC. When I feel myself falling into that minute-by-minute mindset, I look over to a sticky note just below the rainbow picture my two daughters, Caroline and Claire, made for me that has six words written on it: Rome wasn't built in a day. Those six words serve as a reminder to me to zoom out and focus on the bigger picture. The bigger picture is this: markets, over time, have always grinded higher. There are setbacks for sure, and make no mistake, we are in a volatile market where the current news is less than ideal. However, it is at these precise moments where we need to take a step back and realize the lower prices of today are the building blocks for higher prices in the future. Money that we put into the market now, where we can buy stocks and bonds at lower prices, are the exact ingredients needed to generate better returns in the future as the S&P 500 chart to the right demonstrates⁸. Governments and Central Banks tried to make everyone a winner during the pandemic and subsequent recovery – it worked right up until the point it didn't. It was a new and novel concept – we know a thing or two about those.

S&P 500 Total Returns Following 25% Drawdown (%)

25% Drawdown Period	Peak-to-Trough Drawdown	1-Year	3-Year	5-Year	10-Year
Dec 1961–Jun 1962	-28	34	70	100	178
Nov 1968–Apr 1970	-36	35	47	28	100
Jan 1973–Apr 1974	-48	1	23	44	189
Nov 1980–Aug 1982	-27	61	108	272	485
Aug 1987–Oct 1987	-34	28	55	119	471
Mar 2000–Mar 2001	-49	2	1	24	37
Oct 2007–Sep 2008	-57	-5	11	65	209
Feb 2020–Mar 2020	-34	62	-	-	-
Jan 2022–Sep 2022	-25	-	-	-	-
Average	-38	27	45	93	238

While markets have certainly been difficult, the investment and advisor teams have been working behind the scenes executing tax loss harvesting trades that will help offset future capital gains and lower your future tax liabilities. Our portfolios have benefitted from our real asset and real estate exposure, where both strategies have a positive year-to-date return. Coming into the year, portfolios were positioned to have less sensitivity to interest rate movements, which has helped avoid some of the pain the bond markets have felt this year. There are some positives to point toward amid a very difficult year for markets and portfolios. We look forward to having conversations and meetings with you over the next several weeks and months to discuss this letter, the constantly evolving markets, and our portfolio positioning. As always, we are grateful for your trust and support as we navigate these volatile times together. If you have any questions, please reach out to your SDWMA advisor.

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⁸ Source: Bloomberg and Goldman Sachs Asset Management. As of October 6, 2022.