

Market outlook as of October 2022

“If you’re not willing to react with equanimity to a market price decline.....you’re not fit to be a common shareholder and you deserve the mediocre result you’re going to get compared to the people who do have the temperament, who can be more philosophical about these market fluctuations.”

Charles Thomas Munger, (born January 1, 1924) just turned 98 years old is an American billionaire investor, businessman, and former real estate attorney. He is vice chairman of Berkshire Hathaway, the conglomerate controlled by Warren Buffett; Buffett has described Munger as his closest partner and his right-hand man.

This was the third consecutive quarterly decline for US equities. Investors have had few places to hide so far in 2022, with stocks (both US and foreign) and bonds posting negative returns. We are now officially in a bear market with the major averages represented by the S&P 500 being down 23.9% and the technology heavy Nasdaq 100 down 32.4% for the year and corporate bonds down 21.2%.

Inflationary pressures remain the most dominant economic issue for U.S markets. September was an even tougher month after the Fed cautioned that there would need to be “some pain” as more tightening was needed.

Reality hit that inflation is going to be harder to tame than most originally thought, including the Federal Reserve itself.

The Federal Reserve, now behind on inflationary pressures is playing catch up by raising rates very aggressively, mainly targeting payroll and wage increases that remain overheated. The labor market is still extremely robust with two job openings for every unemployed worker. Wages are a very “sticky” driver of inflation and have been running hot with workers threatening more strikes in many industries. We think the Fed can get core inflation to reach to around 4% but getting to the Fed’s target of 2% will be a lot harder.

Unfortunately, what is generally regarded as good news (a happy and healthy consumer) is now regarded as bad news as the Fed needs to target wage growth. Strong consumer spending will continue to exert upward pressure on prices, making the Fed’s job much harder, potentially leading to even higher interest rates. Markets will more than likely remain volatile (in both directions) until the markets sense’s that the Federal reserve is done tightening.

We continue to be in the softish landing camp, with a mild recession ensuing as we are not aware of any dislocations or excesses such as the mortgage crises of 2008 or the dot.com bubble ending in 2000. Household/consumer (which account for 70% of GDP) and business balance sheets

(especially big tech companies) are in very good shape but need to see inflationary pressures dissipate before Fed will stop tightening. Supply bottle necks have eased, and industrial metals such as copper have also trended lower in the last few months.

Implications of a stronger dollar.

The US Dollar has risen to its strongest level in decades and is still very well entrenched in its “world safe-haven” status despite many predicting its demise due to the rise of China, which currently has its own economic issues.

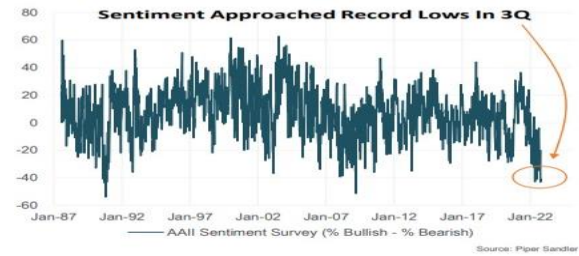
The good news is that it will help slow US inflation due to lower imported prices and is also pushing commodity prices down (i.e., Oil is now around \$80.00 a barrel down from \$120.00)

The bad news is that a strong dollar has an effect on large US multinational corporations that rely on exports as their prices become more expensive for foreign buyers. It will help foreign companies that export to the US especially European based. This is a time to avoid emerging markets especially those with high denominated U.S Dollar debt such as Mexico, Chile, Turkey, and Brazil which has 10.8% of dollar denominated debt to GDP.

These are reasons to keep one’s head and stay the course.

It is increasingly easy to become concerned in volatile periods. We need to remind ourselves that most of the “bad news” is already priced into the market with pervasive pessimism, which should mean that we are

much closer to the end of this bear market. The AII investors sentiment survey shows the highest percentage of bears since March 2009 (the lows of the credit crises) which proved to be very good contrarian indicator.

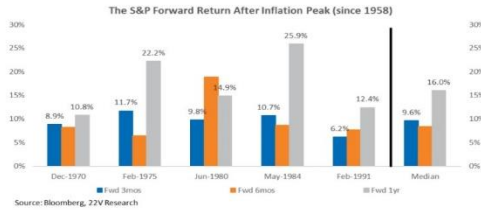


Unlike 2008/9, the US financial system is on a solid footing and should earn higher profits from higher interest rates as there is a lag by banks in passing on higher rates to CD holders.

The top 10 NASDAQ 100 Index tech stocks have \$150 billion in cash (way more than previous bear markets in 2009 and the early 2000s) and healthy earnings prospects to go on a buying spree acquiring smaller companies that fit into their long-term growth plans.

Most markets “capitulate” reaching a low in a sharp fashion for a quick period, shaking the last of the “weak hands” out, with a very rapid recovery. The S&P 500 being up on average 16% in the first 30 days of a recessionary bear market bottom. This takes place while the news is still troubling.

Also, S&P Returns are usually positive after inflation peaks



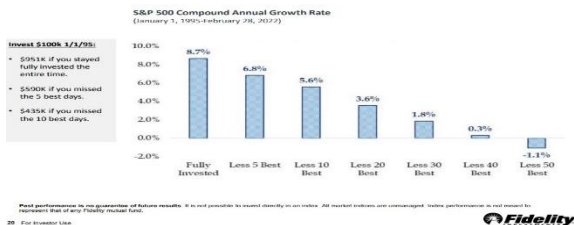
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Bear markets don't last...in the past 60 years the markets go up more than two thirds of the time with upside returns trouncing bear markets draw down by more than five to one. On average bear markets (market drop of more than 20%) occur every 6 years. Unfortunately, it's a natural part of the long-term investment process.



Long term market returns can also be dramatically affected by trying to time the market as represented by the chart below.

And if a rebound rally should occur, missing it could be expensive as it is often "About Time in the Market, Not Timing the Market"



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We know market volatility is extremely unsettling, but historically part of the process. Diversified portfolios that match your time horizon and tolerance for risk, are in the big picture a blip on one's long-term investment plan. Most investors today hardly remember

the mortgage crises on 2008, where the S&P lost over 50% from peak to trough!

Crises, creates opportunities and in this regard, we are seeing numerous companies that are trading at much fairer valuations. We have started replacing companies that we think will be "dead wood" for now due to inflationary pressures and rising interest rates and harvesting tax losses where appropriate and purchasing companies that have come down to good buying opportunities.