WEALTH MANAGEMENT NEWSLETTER

SUMMER 2022

Michael Mellberg
CERTIFIED PUBLIC ACCOUNTANT

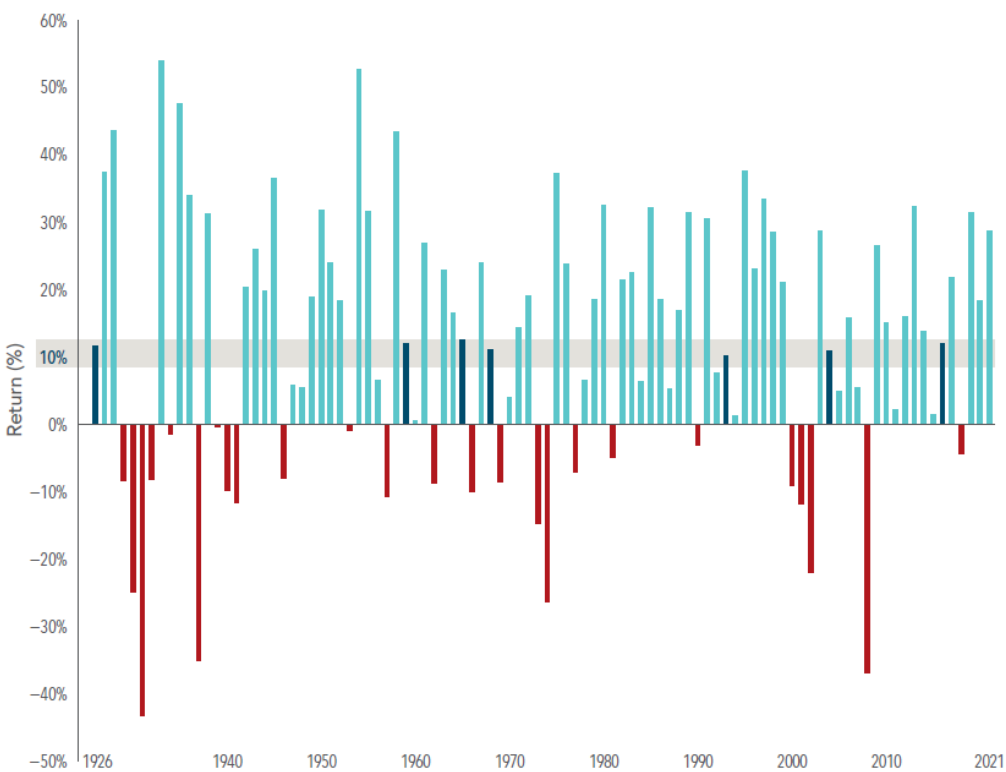
THE BUMPY ROAD TO THE MARKET'S LONG-TERM AVERAGE

Since 1926, the US stock market has rewarded investors with an average annual return of about 10%. But it's important to remember that returns in any given year may be sky-high, extremely poor, or somewhere in between.

- Annual returns came within two percentage points of the market's long-term average of 10% in just seven of the past 96 years.
- Yearly returns have ranged as high as up 54% and as low as down 43%.
- Since 1926, annual returns have been positive 71 times and negative 25 times.

Understanding the range of potential outcomes can help you stick with a plan and ride out the inevitable ups and downs.

S&P 500 INDEX
ANNUAL RETURNS 1926-2021



see disclosures on page 2

IN THIS ISSUE

MEME INVESTING? TRY HUMAN INGENUITY INSTEAD

When Wall Street or meme investors think they can capitalize on "mispricing," they're not betting against Wall Street so much as they are betting against human ingenuity.

PAGE 2

UNDERSTANDING INTEREST RATES

Interpreting the Fed's target funds rate and how it impacts various economic activities.

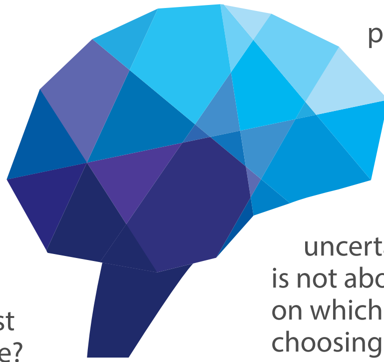
PAGE 3

INFLATION

Our two cents on inflation and how, as investors, we can navigate these turbulent times.

PAGE 4

MEME INVESTING? TRY HUMAN INGENUITY INSTEAD.



We've all been conditioned to see meme investors and Wall Street in opposition, but it seems to me that they have a lot in common. Both believe in picking stocks and think they can beat the market. In my mind, the important distinction is that Wall Street stands to make a lot of money off meme investors, simply from trading costs. For those who say apps don't charge for trading, think about it: When was the last time Wall Street gave away anything for free?

I think the best long-term investing strategy has little to do with prediction or stock picking, and everything to do with investing in human ingenuity. Human ingenuity is the engine that drives the stock market. The real anti-Wall Street revolution began in academia in the 1960s and evolved into the formation of index funds more than 50 years ago. The academics spearheading this revolution found no compelling evidence that any individual can consistently beat the market, but that the market itself returns, on average, about 10% a year.[1]

Why do individuals have such trouble beating those returns?

In transparent public markets governed by the rule of law, enormous numbers of buyers and sellers come together to trade. Both sides of every trade must feel like they got a good deal. Otherwise, they wouldn't trade. That's what people mean when they say prices are fairly set.

So when you bet on individual stocks, you might win or you might lose, but over 10 years, you're unlikely to harvest a better return than if you invested in the whole market. If you stop and think about it for a minute, this makes sense. Markets only work if they are unpredictable. After all, they are constantly responding to all the new information that comes in every day. If we could predict when the market was going to move, there would be no market. The fact is nobody knows when a certain stock will go up or down. Contrary to what both Wall Street and meme investors want you to think, there is no method of analysis, no matter how "proprietary" or sophisticated, that tells us what's going to happen when.

So when Wall Street or meme investors think they can capitalize on "mispricing," they're not betting against Wall Street so much as they are betting against human ingenuity. I'm referring to the millions of people working hard to maximize the value of their companies, and millions of investors trying to make the best possible trading decisions based on all available information. Sometimes speculators get lucky, and sometimes they don't. Regardless, I don't call what they're doing investing. I call it speculation—even gambling.

Buying the market is a totally different approach. It's investing in human ingenuity. People working to maximize the value of public companies are innovative and resilient. They adapt to improve products. They create new processes to solve problems. While you can't predict what any one person will do on any given day, you can predict that humanity will persevere. The market reflects this simple truth.

The market can reward us for having faith in our fellow human beings. Investing—like life —is full of uncertainty, but at the end of the day, it's uncertainty that drives opportunity, and returns. Investing is not about trying to outguess Wall Street or meme investors on which stock will go up or down and when. It's about choosing to side with human ingenuity and betting on a future that's better than today—because of the hard work of everyone you know, and the many millions you will never meet.

David Booth, Executive Chairman and Founder

March 28, 2022

1. In US dollars. S&P 500 Index annual returns 1926–2021. S&P data © 2022 S&P Dow Jones Indices LLC, a division of S&P Global. All rights reserved.

UNDERSTANDING INTEREST RATES

At its March 15–16 Federal Open Market Committee (FOMC) meeting, the U.S. Federal Reserve raised its federal target funds rate by a quarter point. It was the first increase since December 2018, but it wasn't a huge surprise. Fed Chair Jerome Powell had already said we should expect as much, with the potential for additional hikes before year-end.

Along with interest rates, inflation remains a related topic of conversation … not to mention the economic toll and humanitarian tragedy being wrought by Russia's horrific warmongering. To our distress, there is only so much we can do to alleviate the heartbreaking news coming out of Ukraine. But as a financial advisor, we can at least help you put these interrelated influences into thoughtful context. We want to reinforce the core principles we already incorporate as we help people navigate their financial interests across time and through various market conditions. The news may be new, but the timeless tenets driving our patient and personalized advice are enduring and, if anything, even more relevant during periods of increased uncertainty.

What's Up With the Fed Rate?

Almost everyone is familiar with interest rates. That said, far fewer know what to make of the Fed's **target funds rate** in particular. Everyone from economists, to politicians, to the financial press seems to always be talking about them. Markets rise or fall when the Fed comments on them. They're often treated as synonymous with interest rates in general. They must be important, right? Well, yes, the target funds rate is important. But not in the way you might expect.

As the central bank for the United States, the Federal Reserve is tasked with setting monetary policy to promote "maximum employment, stable prices and moderate long-term interest rates … thereby supporting conditions for long-term economic growth." In this supporting role, the Fed uses its target funds rate as one of many "levers" to achieve its aims. When the Fed increases or decreases the target funds rate by specific points—such as the recent 0.25% increase—it's actually establishing a range of rates. Current rates are thus 0.25%–0.50%, up a quarter-point from 0.00%–0.25%. Banks and similar institutions then target this range when they lend overnight money to one another. They use these hyper-short-term loans to collectively maintain their required cash reserves, or to otherwise raise immediate operational cash.

Keeping Time With the Fed

Think of the banking system as an intricate timepiece. Each bank operates independently. Each can choose when or if to lend to or borrow from other banks within the Fed's current target rate range. Each also sets its own, public-facing retail rates. When banks stay in synch with one another and the Fed, the economy will hopefully keep good time. But if even a few cogs get jammed, it can stymie the entire operation. In our analogy, the Fed plays the role of a master timekeeper. Or at least it tries to.

When the Fed increases the target funds rate (as it did in March): It's hoping to reduce the flow of excess cash or stimulus in the economy, which in turn can help temper inflation.

When the Fed lowers the target funds rate (as it did during the pandemic and the Great Recession): It's hoping to keep stimulating cash flowing through the economy … without letting inflation get out of hand.

Along with adjusting the target funds rate: The Fed also can inject or extract cash into or out of the system, in an effort to quicken or slow the wheels of commerce, increase or decrease inflation, ward off a recession, tamp down "irrational exuberance," and/or otherwise spur or check economic activities.

However, we must emphasize: No single entity can just flip a switch to power the economy off and on. The Fed is in a relatively strong position to encourage long-term economic growth through its actions. Often, its actions will trickle down to other types of loans and move them in a similar direction, for the same purpose. But not always, and rarely across the board. As in any complex system, any given move interacts with countless others, with varied results. This is especially so globally, as most countries have central banks and "timekeepers" of their own. Which brings us to our next point.

The Fed Rate Isn't Every Rate

To review, the Fed's target funds rate is the rate range at which banks lend each other overnight cash. Rising rates are meant to help unwind earlier stimulus programs, and manage rising inflation by tinkering with the cash flow in our banking systems. But as an admittedly blunt tool, there is an even more tenuous connection between the Fed's rates and the interest rates you personally pay or receive.

For example, existing fixed-rate debt such as home and student loans may not be as immediately affected by rising rates, while free-floating credit card debt is more likely to creep quickly upward in tandem with the Fed's rates. It's generally wise to avoid credit card debt to begin with, given their persistently higher rates. It's even more critical as rates rise.

Similarly, you may or may not receive higher rates on interest-bearing instruments such as bonds, CDs, bank accounts, etc. That's because it's the banks and similar entities, not the Fed, who set these rates. Savers shouldn't get their hopes up. … Banks have little incentive to raise the interest they pay on deposits because they simply don't need the money.

Time will tell whether this or future Fed rate increases contribute to lower inflation and a healthy economy. Similar actions have been known to help in the past. But of course, each era comes with its own challenges and opportunities. Current events are certainly no exception to this rule! In particular, current global strife may well have a much larger influence on inflationary risk than what the Fed can and cannot do about interest rates.

INFLATION

I am sure that most of you have noticed inflation recently when you go to the grocery store or buy almost anything. Some economists say that inflation of between 2-3% is necessary for a healthy economy.

Inflation is the rate at which money loses its purchasing power over time. As you might guess, there are many ways to measure such a squishy figure. There are various economic sectors, such as energy, food, housing, and healthcare, which can complicate the equation by exhibiting wildly different inflation rates at different times. There is ongoing debate over which figures are most relevant under what conditions.

There also is today's inflation rate, versus the rate at which inflation has changed or is expected to change over time. For example:

- Measured by the U.S. Consumer Price Index, inflation stood at a February 2022 annual rate of 7.9%, fueled significantly by increased energy prices.
- Measured by the Intercontinental Exchange (ICE) U.S. Dollar Inflation Expectations, 1 Year Expected Inflation was at 5.74% on March 23, 2022.
- Measured by the Federal Reserve's 10 Year Break-Even Inflation Rate (the U.S. market's expected average annual inflation rate for the next 10 years), expected inflation was hovering at around 2.94% on March 23, 2022.

While that's a wide range of numbers for seemingly the same figure, they all share one point in common: By nearly any measure, inflation is higher than it's been in quite a while. One need only visit the $1.25 Dollar Tree (or nearly anywhere else these days), to realize that $1 doesn't buy what it used to.

We hope that the steps that are being taken by the government will help to curb the rate of inflation, but we have often said that historically one way to either keep up with or possibly beat inflation is to maintain a diversified portfolio which includes investments in the stock market. There are no guarantees as to what the market will do. It may not always be pretty, but in the past it has often resulted in a long-term successful investment experience. Even though past results cannot be used to predict future returns, we can possibly use the past for some guidance in the future. Please contact us with your questions and concerns. We are here to help. Wishing you an enjoyable summer!

Michael Mellberg
CERTIFIED PUBLIC ACCOUNTANT
A Nevada Registered Investment Advisor