



July 2022: Staying the Course



Inflation is roaring after years of easy credit, the pandemic's and war in Eastern Europe's impact on the supply chain. The Federal Reserve's attempt to quell inflationary flare-ups by raising interest rates inflicts on us the pain that comes with the move to higher rates. It's a narrow path leading back toward economic normalcy or to global recession. Here at home, those on the far-right and far-left may rattle us with extreme talk. We wonder if our institutions are out of touch with middle America. We don't trust much of what is proclaimed. Disarray in the equity and fixed income markets continues.

So, here at Willink, we have been asking each other, "Have Clients been calling you to get them out of the market?"

The answer for weeks now has been a pretty resounding, "Nope."

It's tempting to pat ourselves on the back. Proclaim that we've done a decent job of preparing clients to deal with whatever the markets, economy, or life might have in store.

But with so much bad news to go around and poor market performance among the headlines, the lack of client calls and the calmness of client conversations when we reach out is still surprising.

Maybe the good weather and holiday get-togethers have kept you from dwelling much on the market news in the media and in those pesky portfolio statements we send you.

Perhaps you have been through enough market and economic rough passages before that you are willing to take a wait-and-see attitude. Or, maybe you are just a little numb at this point.

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In any event, like the fellow in the rapids above, now is probably not the best time to get out if you can help it. You had a plan when you entered the markets. If nothing significant in your life has changed, stick with the plan.

Here is why:

- *Leave the markets now and you lock in losses, perhaps forever.*
- *Sell now and the buyer will happily put the future profits at recovery in his pocket, not yours.*
- *Sell now in taxable accounts for no wise purpose and the government will be happy to collect taxes from you.*

So, stay pat. Maybe make some prudent buying on dips if you have the capital.

Here is why:

- *If you are like most of our clients, you are resourceful, don't live high on the hog, can adjust with circumstances, and are reasonably patient.*
- *You have a reasonable store of cash reserves or other resources with which to ride the rapids to recovery.*
- *You need not risk big market timing bets, given your portfolio's diversification across asset classes.*

Some Observations on the Bond, Cash Equivalent and Stock Markets

It is highly unusual to see the quality bonds in your portfolios in negative territory for the first time in decades as interest rates rise rapidly. So, we have met with bond and bond fund providers. Here is how they describe the eventual way back to reasonable earnings. It is relatively straightforward math, even if our reliance on higher credit quality and shorter maturities won't get us there quickly or smoothly.

- *Bond funds hold hundreds to thousands of individual bonds with varying maturities, say between 1-to-5-year terms. As some mature, they are replaced with higher returning fare. Others may be sold at a short-term loss, the loss to be overcome in months (6, 12, 18?) by replacement with better yielding new issues. This should restore a fund's ability to perform its primary functions—offset stock volatility, earn some income, and provide a back-up to cash to meet surprise demands for liquidity. While bond funds don't offer a known maturity, individual bonds do. And these pretty reliably return your principal at maturity.*
- *We are having more success finding certificates of deposit and other stable products for the mid-term (2 to 3 yrs.) offering reasonable earnings. Recall, however, that for near-term (1 to 2 yrs.) cash needs, liquidity on demand remains king, not interest earnings).*

The stock market is different. While credit quality and sensitivity to interest rate changes are pretty much the whole story for bond fundamentals, **stock fundamentals** (*debt and cash levels, earnings, profits, management quality, competitiveness, etc.*) **provide maybe only half the story.** The other half is often represented by a metric known as the P/E, industry jargon for the “price-to-earnings ratio”. In plainer English, the price that a rational investor will pay for a dollar of company earnings. The stock market trading community may account for some 70% of all daily trades. As you might suspect, even Wall Street's brightest don't always act rationally. Emotions can swing between fear and greed.

- *Stock funds and individual stocks that soared during the heydays of money printing are giving back much of what in hindsight appears to have been froth. In hindsight, too many of the gains had little to do with a reasonable expectation of earnings and were based more on hope and a good story.*
- *With all that said, there is likely better news ahead—despite misleading relief rallies and rougher waters along the way. Supply is now catching up with demand. Employment numbers are reasonable. The US stock market is highly dependent on consumer demand for everything from autos to food to health care to travel. If demand slows for a time from inflation fears, prices will come down. That should help improve consumer confidence, and by extension, investor confidence and stock prices. **
- *We will continue to emphasize value and seek the opportunity for a few bargains along the way.*

No advisor can assure you that a recession is not around the bend. But take a closer look at the fellow in the canoe. That's a fishing rod poking up in the stern. He thinks there are calmer waters and opportunities ahead. Faith in the markets and staying the course have managed to work for us so far.

Please enjoy the summer while you can. But if the markets are marring your enjoyment, please don't hesitate to call.

**We will address the danger of disinflation, and alternative investments from real estate to precious metals, structured products, cryptocurrency and more another time.*



Fred R. Fadel, CFP®



Theo Fadel, CPA, PFS

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Willink Asset Management LLC
25 Hamburg Street East Aurora, NY 14052

T: 716.687.0648

WWW.WILLINKADVISOR.COM