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FINANCIAL ADVISORS

FROM THE DESK OF
KEN SOUTH

Our team adheres to a set of principles designed to provide an exemplary client experience.

We believe the trust of our clients is earned over time and remains our most important asset.

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We take great pride in the professional quality of our work. Exceptional client service that is proactive, thoughtful, and customized.

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Competitive investment returns with a focus on risk management.

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Sophisticated financial planning — an essential pillar in the development of your customized investment strategy.

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We believe in continuous improvement. As our clients' needs change, we learn and adapt.

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We stress teamwork in everything we do and remain accountable for our responsibilities.

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Integrity and honesty are at the heart of our business. Integrity: we do what we say we're going to do, full disclosure and no surprises.

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Honesty means we give it to you straight, even if means having a difficult conversation

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We regularly receive confidential information as part of our normal client relationship. It is our responsibility to protect against the unauthorized disclosure of this information.

July 06, 2022

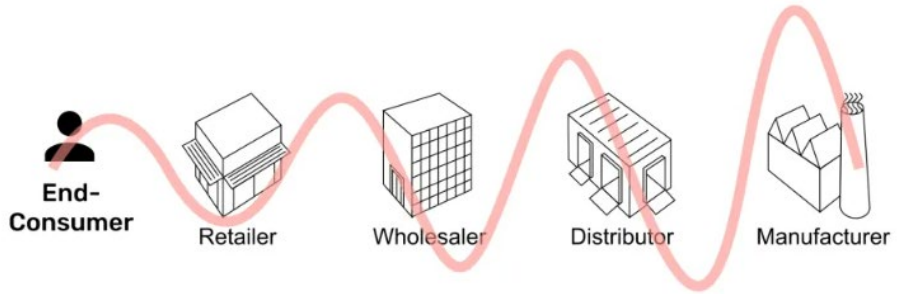
Price Stability Is The Federal Reserve's Mandate

In the June Federal Reserve meeting (when it raised interest rates by 75 basis points, or 0.75%), it issued an updated economic forecast based on incoming economic data. It is currently looking for the economy (GDP) to grow by 1.5-1.9%. In normal times, this is a really slow growth rate, so in today's note, I would like to address this issue and why the growth rate is slow but the Fed continues to raise interest rates.

The economy continues to struggle with numerous headwinds, including:

1. Elevated levels of inflation force consumers to spend more on essentials such as food and gasoline
2. A rapid deterioration in the housing sector caused by sharply higher mortgage rates and prices, both of which have continued to reduce the affordability of housing
3. A continuation of the supply-chain disruptions which contribute to inflation whenever excess demand is chasing scarcity in many product categories

The term that is being used to describe all of these points combined is the "Bullwhip Effect." This is the term due to the fact that it really begins with the consumer wanting something, the provider slowing or speeding up orders to have inventory to meet demand, and then manufacturing having to ramp up or slow down production due to these orders.



The Bullwhip Effect, a crucial notion in supply chains

Source: zensimu

This is the ultimate dilemma that we are living in right now. We have been dealing with issues as follows:

- COVID hits and the world basically comes to a screeching halt.
- People all over the world get scared and start stockpiling (remember the pictures of empty shelves at Target and Walmart).
- The retailers increase their orders dramatically to meet demand from their wholesalers and distributors.
- The wholesalers and distributors go to the manufacturer and tell them they need more products.
- Due to COVID, the normal business cycles are impeded, and, therefore, even though more orders are coming in, fewer goods and services are happening.
- Due to increased demand and fewer goods, prices spiral upwards dramatically.
- The Fed sees prices going up, notices all the money they have thrown at the economy, and starts raising interest rates to stifle inflation.

The price gains in the food and energy sectors include the impact of the war in Ukraine, which is causing dislocations in the grain and energy markets. Ukraine is a major producer of grains, and Russia is a huge exporter of oil. Ukraine's grain production is suffering during the war, and oil exports from Russia are under massive sanctions due to the invasion of Ukraine. The dilemma we are faced with is that our Federal Reserve policy has no impact on either of these problems as its efforts are limited to reducing the problems in the US.

We are now seeing the demand slowing dramatically and prices coming down for basic materials like steel, copper, aluminum, and lumber. Oil seems to be topping out as well. This should help to slow the pressure the Fed needs to put on interest rates and the economy should normalize.

We will begin to see second-quarter earnings coming out next week, starting July 14th, when the major money center banks give us an idea of what they are seeing from capital demand from borrowers. My hunch is that they will show a decrease in demand from rising rates, but not a recessionary decrease. Then we will get earnings reports from everyone else. I believe the same thing will be the case --companies will talk about business slowing a bit, but not going negative.

As painful as it seems, this is what it feels like to buy things on sale. I might be early, but if portfolios are built around companies that the world can't live without, then as things stabilize portfolios should be rewarded. The first six months of this year were the worst since 1970. But what the media conveniently forgets to mention is that in the second half of 1970 the market rallied 33%! I'm not saying that the coast is clear and that an investor should be super aggressive, but opportunities should begin to present themselves.

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On this note, I will let you chew on the following chart, courtesy of my friends at LPL's Investment Strategy:

Horrible Quarters Often Followed By Smiling Bulls

S&P 500 Index >15% Quarterly Declines (1950 - Current)

Date	Quarterly Return	S&P 500 Index Returns		
		1 Quarter	2 Quarters	4 Quarters
6/29/1962	-21.3%	2.8%	15.3%	26.7%
6/30/1970	-18.9%	15.8%	26.5%	37.1%
9/30/1974	-26.1%	7.9%	31.2%	32.0%
12/31/1987	-23.2%	4.8%	10.7%	12.4%
9/30/2002	-17.6%	7.9%	4.0%	22.2%
12/31/2008	-22.6%	-11.7%	1.8%	23.5%
3/31/2020	-20.0%	20.0%	30.1%	53.7%
6/21/2022*	-16.9%	?	?	?
Average		6.8%	17.1%	29.6%
Median		7.9%	15.3%	26.7%
Higher		6	7	7
Count		7	7	7
% Higher		85.7%	100.0%	100.0%

Source: LPL Research, FactSet 06/21/2022 * The current quarter isn't over yet
All indexes are unmanaged and cannot be invested into directly. Past performance is no guarantee of future results.
Performance back to 1950 incorporates the performance of predecessor index, the S&P 90.

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Important Disclosures:

The opinions voiced in this material are for general information only and are not intended to provide specific advice or recommendations for any individual. To determine which investment(s) may be appropriate for you, consult your financial professional prior to investing. All performance referenced is historical and is no guarantee of future results. All indices are unmanaged and cannot be invested into directly.

All information is believed to be from reliable sources; however LPL Financial makes no representation as to its completeness or accuracy.

Investing involves risks including possible loss of principal.

The Standard & Poor's 500 Index is a capitalization weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

The Dow Jones Industrial Average is comprised of 30 stocks that are major factors in their industries and widely held by individuals and institutional investors.

The Nasdaq-100 is a large-cap growth index. It includes 100 of the largest domestic and international non-financial companies listed on the Nasdaq Stock Market based on market capitalization.

The Russell 2000 Index is an unmanaged index generally representative of the 2,000 smallest companies in the Russell 3000 index, which represents approximately 10% of the total market capitalization of the Russell 3000 Index.

This information is not intended to be a substitute for specific individualized tax advice. We suggest that you discuss your specific tax issues with a qualified tax advisor.

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