Q2 2022 Update: Unprecedented Times

Mike Mills
Managing Partner
CFP, CLU, CFS

Dear Clients,

As most of you are aware, 2022 has been a tough investing climate. It is rare that both stocks and bonds do poorly at the same time. The last time this happened was almost 2 decades ago in 1994, and only bonds ended the year down. However, it's the first time in at least 50 years that stocks, and bonds are both down more than 10% at the same time.

S&P 500 Down Years (1976 - 2022)			
Year	**S&P 500 Total Return (Stocks)**	**Bloomberg US Agg Index TR (Bonds)**	**60/40 Portfolio (S&P 500 / Bloomberg Agg)**
1977	-7.2%	3.0%	-3.1%
1981	-4.9%	6.2%	-0.5%
1990	-3.2%	9.0%	1.7%
2000	-9.1%	11.6%	-0.8%
2001	-11.9%	8.4%	-3.7%
2002	-22.1%	10.3%	-9.2%
2008	-37.0%	5.2%	-20.1%
2018	-4.4%	0.0%	-2.6%
2022 YTD	**-20.0%**	**-10.4%**	**-16.1%**

Even though this is rare, it is not a complete surprise. We had experienced a long bull market and valuations in the US were at all-time highs due to the FED's QE policy which held interest rates at zero since the Covid crisis began. By then end of 2021, it was one of the most challenging investment environments in my 25-year career, because it was difficult to sit in cash at negative real rates of return, yet everything looked expensive, and full of risk.   This was true of cash, gold, bitcoin, stocks, and even bonds looked scary because of the high chance of rising interest rates. I think we have survived the market in pretty good shape, performing better than the US indices, but it is always easy to Monday morning quarterback with hindsight. I think the reposition we are beginning to do will bear much fruit over the next 5 years because many areas of the market are beginning to offer more attractive risk adjusted returns especially when compared to the required returns, we needed to hit your financial goals.

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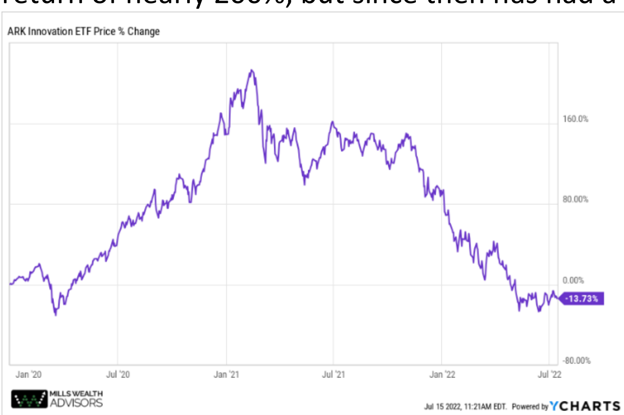
Section I: 2nd Quarter Market Review Slide Deck

In MWA's 2nd Quarter Market Review (link) **slide deck:** You'll notice that ALL Equity, Real Estate Markets AND Bonds were down, again. Also, this quarter is the first quarter in a while that the 1 Year return is negative for all markets.

Section II: MWA Market Commentary

Interest rates and values work like a seesaw; when rates rise, valuation of bonds, stocks and real estate fall and vice versa. When valuations adjust from rising interest rates, generally the farther into the future it is expected to be until cash flow is returned to investors in the form of dividends or share repurchases from company profits, the more those assets will decline when interest rates rise. For the past 10 years tech has posted some of the best returns on record, until rates began rising, then investors dropped unprofitable tech like a bad habit with the Growthiest of investments suffering the largest declines. The poster boy is the ARK innovation fund. I think this fund shows how ugly it has been in some corners of the market. The major indexes, while down over 20%, are not likely to be off near as much ARK, which had a 2020 return of nearly 200%, but since then has had a -73% decline, erasing ALL of its 2020 gains.



Today's markets have only suffered about ½ of the declines realized when prior market bubbles like the tech bust, or the financial crisis popped. The million-dollar question is, "**Have markets corrected enough: Are we at the bottom, or just halfway there?** It is difficult to know. Today's situation appears much different than when those bubbles popped. Consumer spending which makes up about 70% of US GDP is very strong because of healthy balance sheets, full employment, rising wages, and strong housing demand. When the financial crisis occurred, panic set in and the whole system grinded to a halt from counterparty risk and falling asset prices (housing and stocks). Declining wealth immediately caused consumer spending to nosedive. Today's environment is nothing like 2008. America has a lot of problems, but they pale in comparison to the financial crisis.

The Tech meltdown of the late 1990s was different than the financial crisis and has some similarities to today yet it is still not the same. What was interesting about the late 1990s, is that the bubble was only in tech. As technology stocks rose on "hopium" of a new digital future, capital was sucked out of everything except Technology Stocks. Because of this phenomenon, almost all the assets outside of technology had reasonable valuations, so when the market selling occurred the non tech assets immediately offered compelling valuations. Furthermore, interest rates were much higher then, than today, so as markets fell the FED had ammunition to lower rates which eventually helped prices rebound.

Today we still have low interest rates and some of the highest profit margins on record. Profits margins should continue to revert toward the mean because companies will have higher cost in the future from items like rising human capital cost, and the capital investment required to re-shored factories to America or American friendly suppliers outside of China. The change from just in time to just in case logistics will required a large capital investment that will use up some of today's profits that may weigh on stock prices through this year.

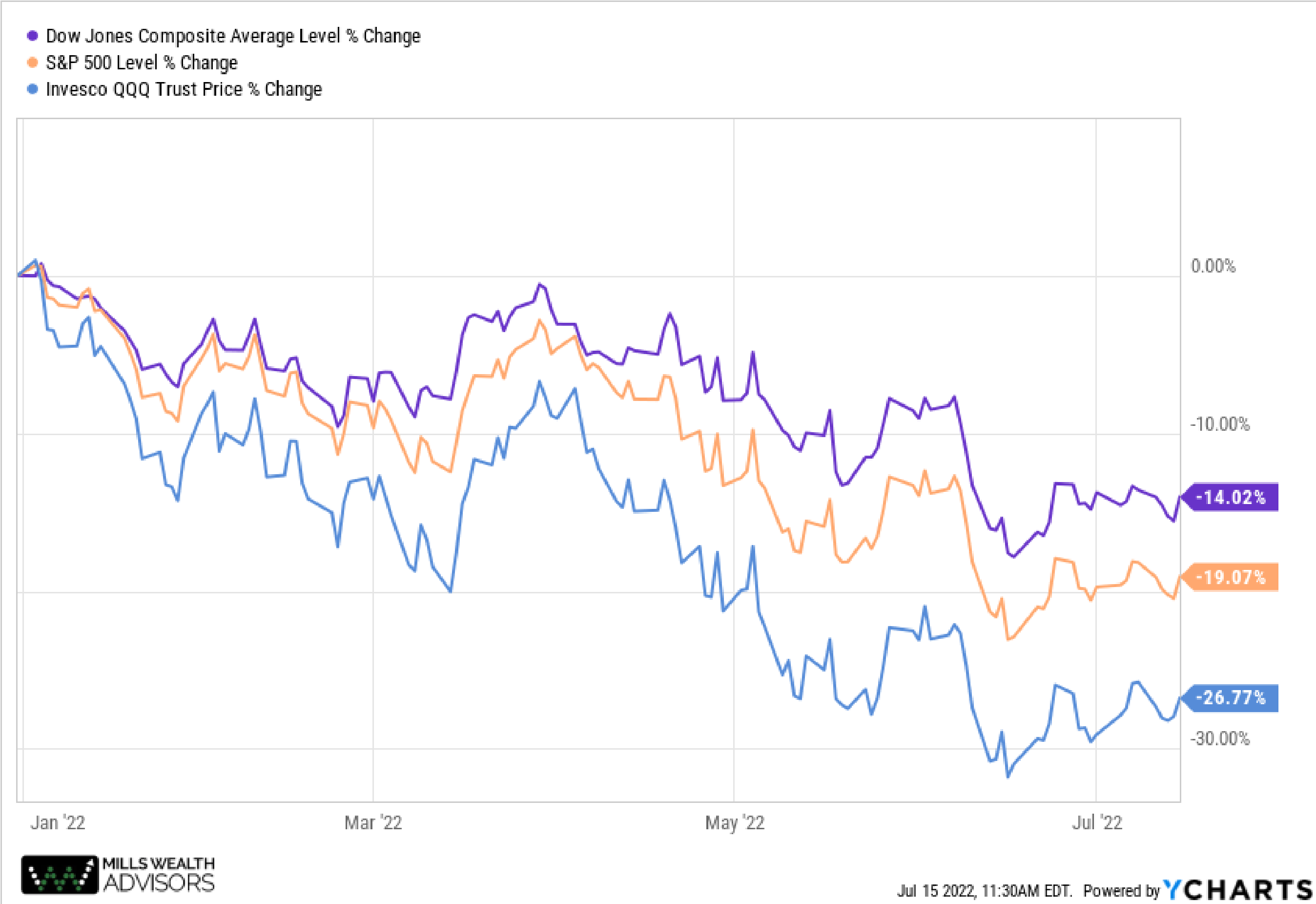
When it comes to the direction of interest rates, I believe rates will not rise much above 3.5% because of the effects of rising rates. When America raises rates, and the rest of the world doesn't, the dollar gets stronger. This makes exporting more expensive. In last few weeks we have seen the dollar go to parity with the Euro for the first time in 20 years, and the Japanese Yen has fallen like a rock because they want a weak currency to help with exporting. As an example, counties that have weak currencies vs the dollar risk having higher inflation (rising food cost, higher energy prices, etc).

Because the dollar is the reserve currency, and our mound of debt in America is so large and getting bigger each day as the baby boom begins drawing their Social Security, I think the Fed has boxed themselves in and won't allow the interest rates to rise much more. The FED and our political leaders will eventually need to choose between deflating or defaulting. Because the debt in denominated in US dollars, defaulting is really not an option, so we will just continue to print money to meet the obligations America has committed to. Choosing the deflating option is the path all the fallen empires from the past eventually chose. Each of these reasons listed above is negative for risk assets, except money printing. Owning debt (bonds) are the mo

So back to the million-dollar question, **what should we do given these possibilities?** I think we need to own a hedge of bitcoin or (gold, silver or rare metals) to protect any debt owned in the potfolio because fixed income will be the hardest hit by money printing. I still fully expect bitcoin will eventually exceed 100 and more people will migrate to the network. I also think all of the other coins getting wiped out is good for the long-term owning of bitcoin and its network effect. I'm unsure if we are at the bottom of the market, but I do expect volatility to continue through the fall. I think it is possible markets could pull back another 10-20%, but I think it is equally possible the bottom has already been set.

The 10 trillion of stimulus after the Covid Crisis was unprecedented. The inflation that occurred from this policy action has now caused both the values of offensive and defensive assets to fall at the same time. I think it is worth noting that this correction has been much more orderly than most emotional "sell it all" bear markets. While the most expensive areas of the market have sold off precipitously (See Figure 2: Ark Innovation chart above down -73%), Value stocks in the US and around the globe have held up much better than the equity indexes. Why? Mainly because value stocks are cheaper, they offer larger dividends, and they typically pay a premium to the rest of the market of the long run. This premium has been missing the last decade, but given its recent outperformance, I think it is probable that this trend continues into the immediate future. Please know that as we receive data that indicates we are at or near a market bottom, we will complete rebalancing and reallocating trades and harvest tax losses that can be used to offset future gains.

Below is a graph of the most common US Indices and how they have done this year:



Section III: Recent Questions We Have Heard

I heard we are in a recession, should I expect that markets fall another 20%?

It is impossible to know for sure. Many areas have been hit very hard and are beginning to see buyers return. An easy-to-understand example is in AMZN stock: It is a strong business that has fallen to a point where it is the cheapest it has ever been yet given its prospects for growth when looking at their earnings estimates 3-4 years out, it offers an attractive risk/return tradeoff. Many analysts think the stock offers about 80% upside from its price of $110. Markets tend to overshoot on the way up and over-correct on the way down, providing attractive entry points for long-term investors. You may remember last year we advised being more defensive than normal, and I think we are approaching valuations where investors can begin nibbling back into equities, especially on future market weakness as we retest lows that have been set, esp. if the lows hold and don't go lower. Market bottoms are a process not usually 1-day. We could be experiencing another bear market bounce, or we could have set the lows it is impossible to know for sure. As we deploy defensive reserves just remember we are looking 3-5 years out. Most money added after a 20%+ decline will be profitable over that time frame, even if market prices go lower before they eventually head higher.

I read the FED is about to raise interest rates at its next meeting will this make stocks/real estate/bond prices fall when that is announced?

Prices are forward looking instruments, so today's prices have already moved to reflect the economic data and what the market believes the FED will do. Prices already assume the FED is going to rise rates .75% at its next meeting, so if the FED does exactly what the market expects, prices would theoretically not move all. Markets are very complex, and many factors can affect prices, so the market could still move down on a .75% increase, but it may be for reasons other than that which coincided with the rate increase.

How has this market decline been different than the last 3-4 corrections?

So far, this correction has been an orderly repricing of risk due to interest rate changes and inflation fears, except for crypto and unprofitable technology, those areas have been gutted. The rest of the market has not seen capitulation-based selling like these areas of the market. This could be because investors are trained to buy the dip thinking the FED will always come to the rescue if markets fall too much. (called the "FED Put") or it could be because there is a lot of money on the sidelines that needs to find a home.

Is the 60/40 portfolio dead?

Worst US 60/40* Returns Through June (1976 - 2022)		
Rank	**Year**	**Total Return**
1	2022	-16.1%
2	2008	-6.7%
3	2002	-6.4%
4	1984	-3.6%
5	1994	-3.6%
6	2001	-2.6%
7	1982	-2.0%
8	2010	-1.9%
9	1977	-1.7%
10	1981	-0.5%
*60/40 = 60% S&P 500/40% Bloomberg US Agg		

No way. Diversification works as well today as it ever has. A key component of any portfolio strategy is rebalancing, which is where we sell the best performer and add more to the worst performer to bring the percentages back in line. We have already been doing this with new money added to your portfolio, but you will likely begin to see some tax loss harvesting and further rebalancing as we retest lows.

Investors need both offensive and defensive strategies in their portfolio and while we had shied away from using mostly bonds as our primary form of defense (because of the fear of rising rates) as interest rates rise back above 3-3.5%, we think intermediate term high quality bonds offer a portfolios defense that is worth the risk of additional deflation from future FED money printing, (esp. if it is linked with a small Bitcoin/Gold/Silver position to hedge some of this risk). Should there be a fear-based market selloff in the future, fixed income should eventually be an effective defensive strategy that can be used to protect portfolios from further declines. We think it is unlikely that the US treasuries see 5-6% interest rates soon. If rates approach 4% on the 10-year bond, we would continue to increase our length of bonds. Unless we are instructed not to, we will also continue to keep a sliver of Bitcoin or gold as a hedge to having the Fed choose to slowly devalue the dollar. Because this is the easiest choice for politicians, I think you can almost bank that money printing will return in the future.

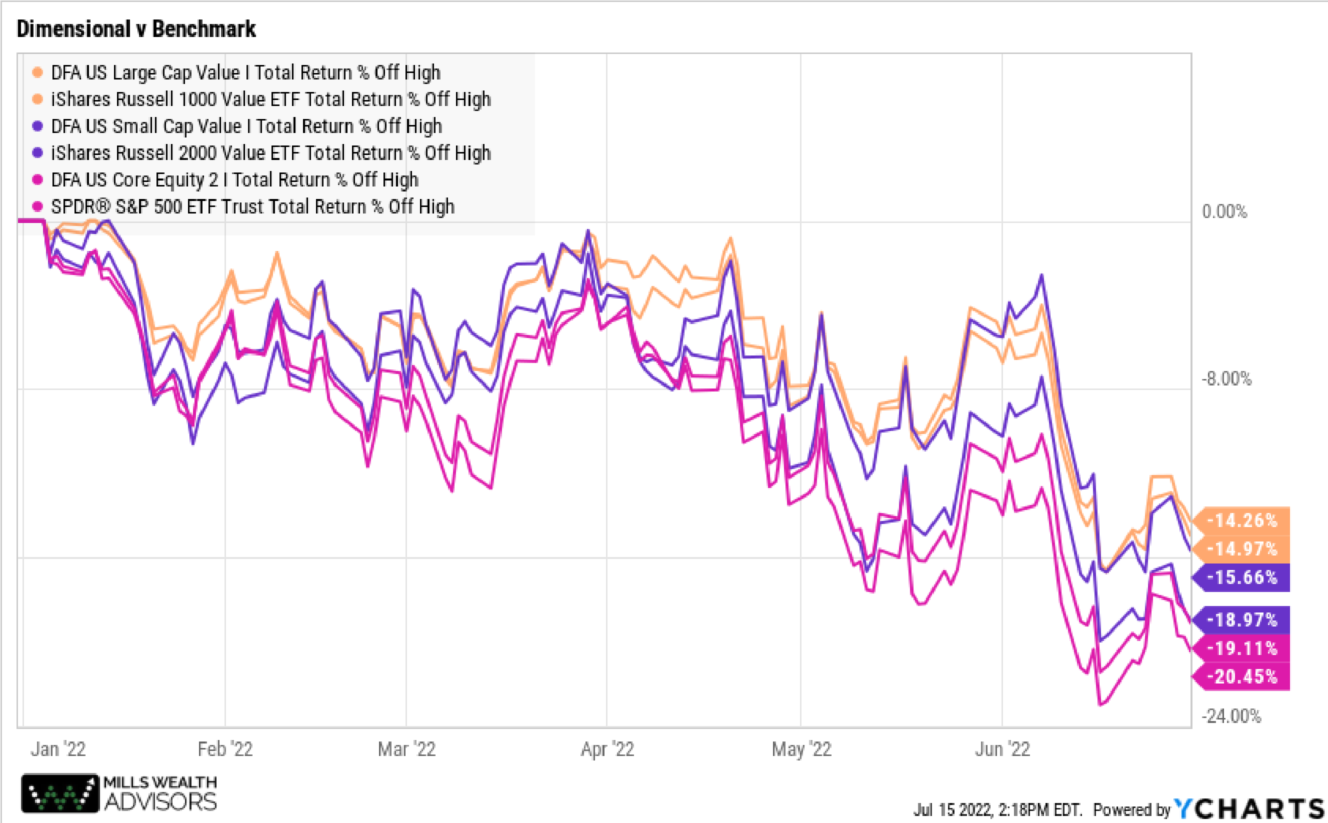
I like to say, "The cure for high prices is high prices." We have seen this already in mortgages. Home financing rates approached 6% interest rates and demand for new homes finally slowed. We are still 4 million homes short in the US and I am still of the opinion that once consumers adjust to the 6% mortgage, they will continue to buy new homes or fix up the old ones. Housing is one of the backbones of full employment and is extremely stimulative. If America is building houses, it is hard for the economy not to move forward. Every house that is built employs lots of subcontractors and small businesses. One of the reasons I think we are not going to see a bear market like the financial crisis is because consumer's balance sheets are healthy, employment is strong, and there are millions of homes and apartments that need to be built. Combine demand for housing with healthy balance sheets and near full employment, and I think markets stop declining soon.

How has my portfolio done amid this market volatility?

Not every hedge we used worked, but overall, I'm proud of our models, they have held up pretty well vs the indexes. You will notice rebalancing trades starting to get placed as we retest lows, especially in bonds. In taxable accounts we will try to lock losses at the widest points and capture the losses by buying a similar investment with a different name, but similar holdings. One of the main defensive hedges we used was a fund from GMO. Below is a picture of how it has compared to bonds and stocks. We sold some bonds and stocks in October to buy this, and it has been very good.

Our models have held up better than the broad US indexes because some of our portfolio positioning that we changed last year after the market run up has worked well. We came into 2022 with shorter duration bonds than the Barclay's Agg, so as interest rates rose, the shorter duration bonds declined less and the GMO hedge held up better than our typical defense. Bitcoin did not help yet, but don't give up on it, I think it will still help the portfolio when the FED returns to money printing. Today's prices will allow us to continue to lower the cost of our basis in this position.

Below, you can see a picture comparing a few of our US funds to their benchmark. In each instance the Dimensional funds we own have outperformed this year, and many last year as well.

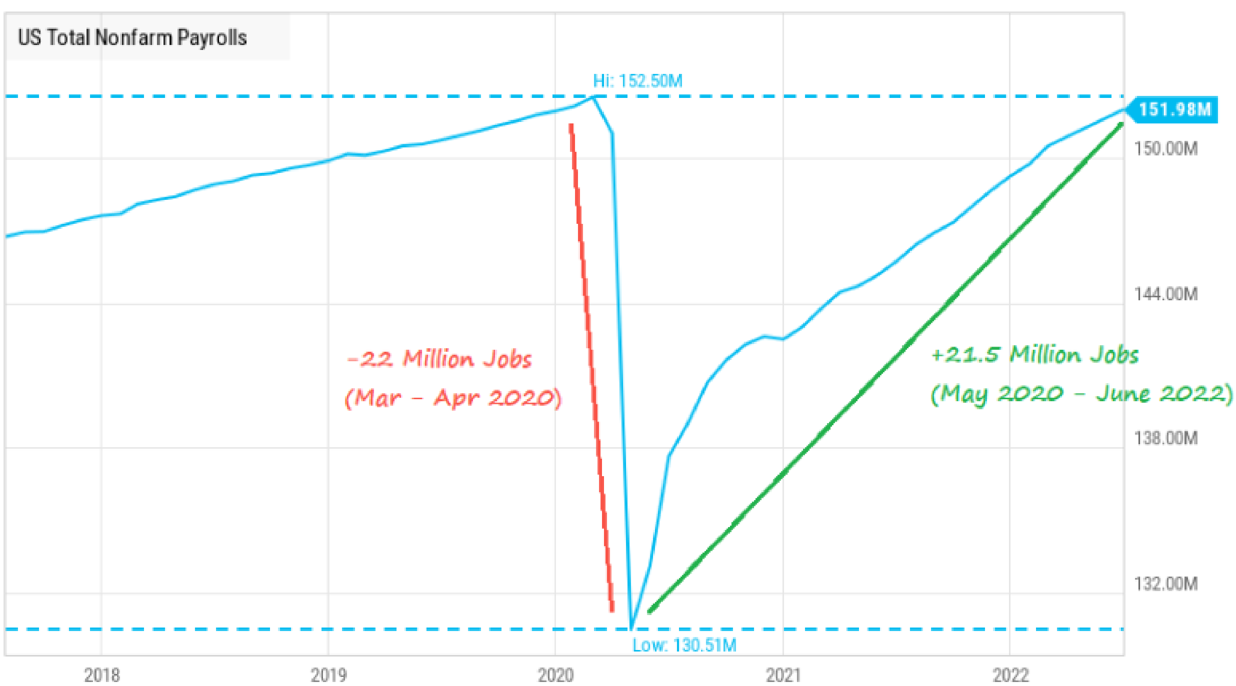


If you combine the fact that our equities have outperformed their benchmark, and that our fixed income have outperformed their benchmark, we find that our portfolios have outperformed their benchmarks as well. Below is one of the many models we use (60/40) versus its benchmark.


MWA Model v Benchmark
MWA Moderate Growth Total Return % Off High
60 / 40 Global Benchmark Total Return % Off High
0.00%
-6.00%
-12.00%
-15.24%
-17.06%
Jan '22
Feb '22
Mar '22
Apr '22
May '22
Jun '22
MILLS WEALTH ADVISORS
Jul 15 2022, 4:20PM EDT. Powered by YCHARTS

Section IV: Pictures Worth Looking At

Wilshire 5000 - Worst 6 Months Periods & Forward Returns (1971 - 2022)									
Worst 6 Month Periods				Forward Total Returns					
Rank	Total Return	Start Month	End Month	3-Month	6-Month	1-Year	3-Year	5-Year	10-Year
1	-42.4%	Sep-08	Feb-09	26%	42%	56%	102%	189%	372%
2	-36.4%	Jun-08	Nov-08	-16%	6%	27%	53%	132%	288%
3	-34.7%	Aug-08	Jan-09	8%	23%	35%	73%	147%	309%
4	-33.3%	Apr-74	Sep-74	9%	36%	41%	84%	153%	392%
5	-31.0%	Oct-08	Mar-09	17%	36%	52%	91%	167%	341%
6	-29.5%	Jul-08	Dec-08	-11%	4%	28%	52%	134%	246%
7	-29.4%	May-08	Oct-08	-14%	-7%	11%	41%	108%	250%
8	-27.3%	Apr-02	Sep-02	8%	4%	26%	66%	115%	129%
9	-26.3%	Mar-74	Aug-74	-1%	18%	29%	62%	121%	333%
10	-21.4%	Oct-00	Mar-01	7%	-10%	3%	9%	33%	55%
11	-20.9%	Jan-22	Jun-22						
12	-20.4%	Jun-87	Nov-87	18%	17%	24%	49%	120%	432%
13	-19.6%	Sep-00	Feb-01	2%	-7%	-8%	2%	22%	44%
14	-19.3%	Feb-74	Jul-74	-5%	1%	21%	50%	90%	255%
15	-18.5%	Aug-87	Jan-88	5%	10%	21%	44%	103%	387%
16	-18.3%	Jul-87	Dec-87	8%	15%	18%	43%	109%	405%
17	-18.2%	Jul-74	Dec-74	25%	46%	38%	70%	135%	356%
18	-17.9%	May-74	Oct-74	7%	22%	26%	51%	100%	318%
19	-17.9%	Feb-02	Jul-02	-3%	-5%	13%	51%	85%	98%
20	-17.8%	Jun-74	Nov-74	19%	35%	36%	65%	123%	334%
Average Worst Periods				**6%**	**15%**	**26%**	**56%**	**115%**	**281%**
Average All Periods				**3%**	**6%**	**12%**	**41%**	**79%**	**219%**
Differential				**3%**	**9%**	**14%**	**15%**	**36%**	**62%**



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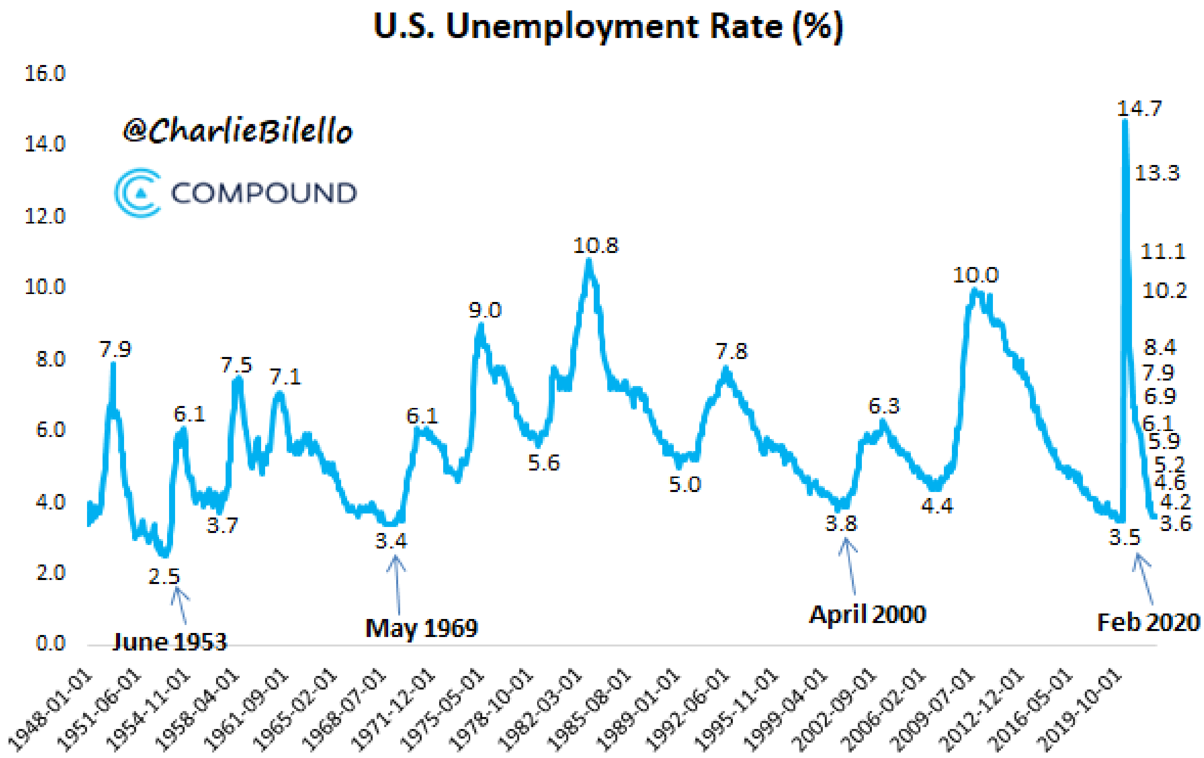
U.S. Unemployment Rate (%)
@CharlieBilello
COMPOUND
16.0
14.0
12.0
10.0
8.0
6.0
4.0
2.0
0.0
7.9
2.5
June 1953
6.1
3.7
7.5
7.1
3.4
May 1969
6.1
9.0
5.6
10.8
5.0
7.8
3.8
April 2000
6.3
4.4
10.0
3.5
Feb 2020
14.7
13.3
11.1
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6.9
6.1
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1948-01-01
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1954-11-01
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1961-09-01
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1968-07-01
1971-12-01
1975-05-01
1978-10-01
1982-03-01
1985-08-01
1989-01-01
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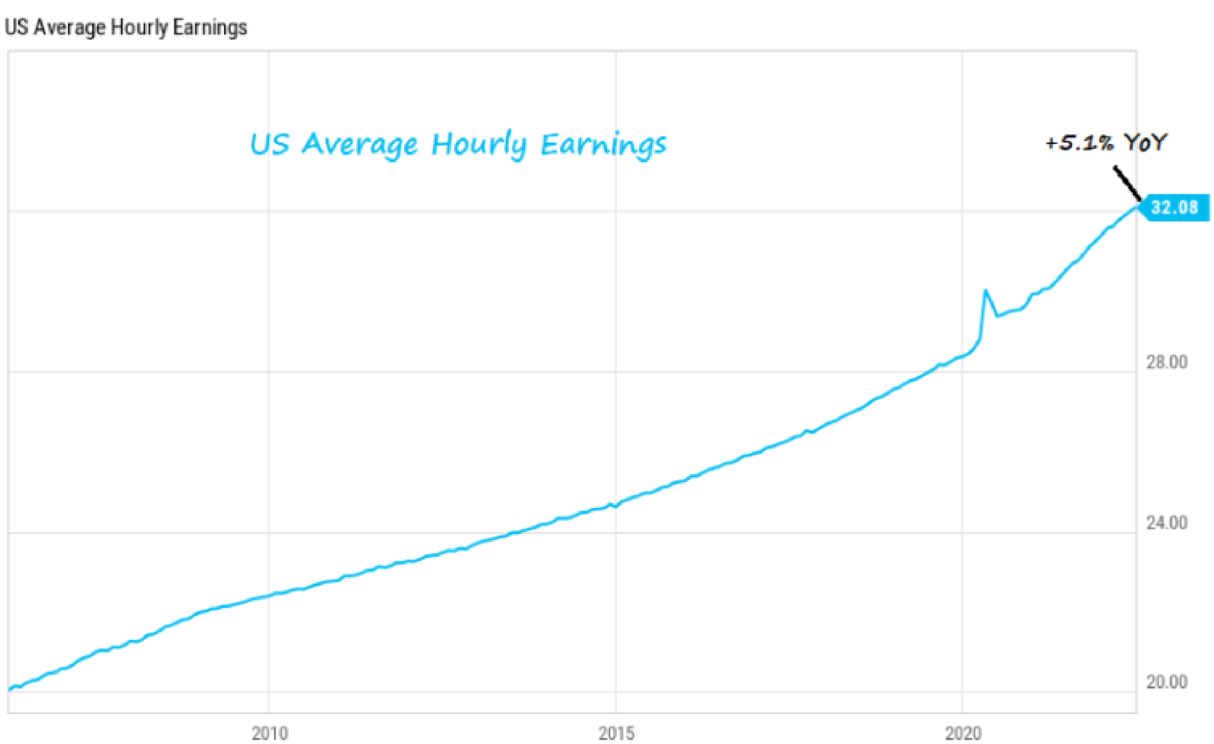
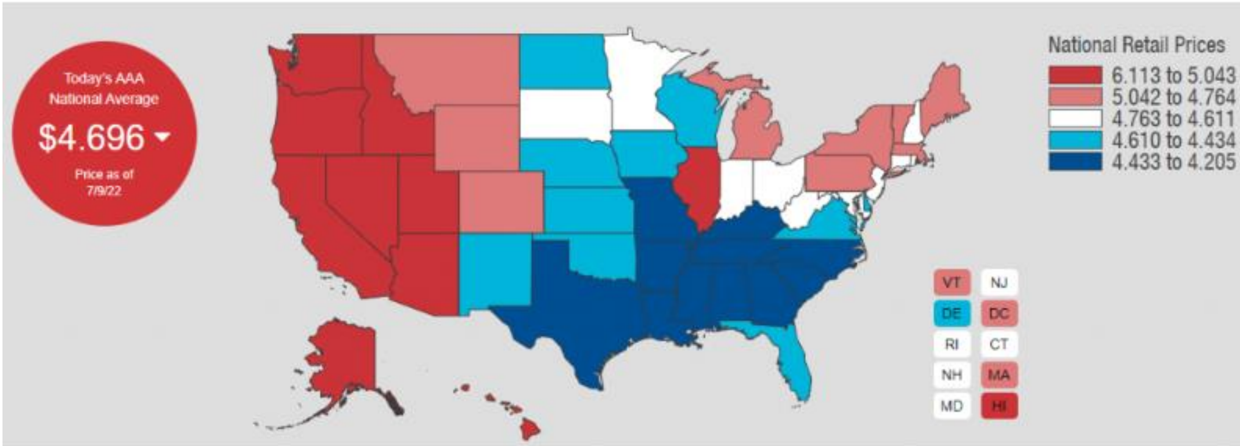
2016-05-01
2019-10-01


US Average Hourly Earnings
US Average Hourly Earnings
+5.1% YoY
32.08
28.00
24.00
20.00
2010
2015
2020


Today's AAA
National Average
$4.696
Price as of
7/9/22
National Retail Prices
6.113 to 5.043
5.042 to 4.764
4.763 to 4.611
4.610 to 4.434
4.433 to 4.205
VT
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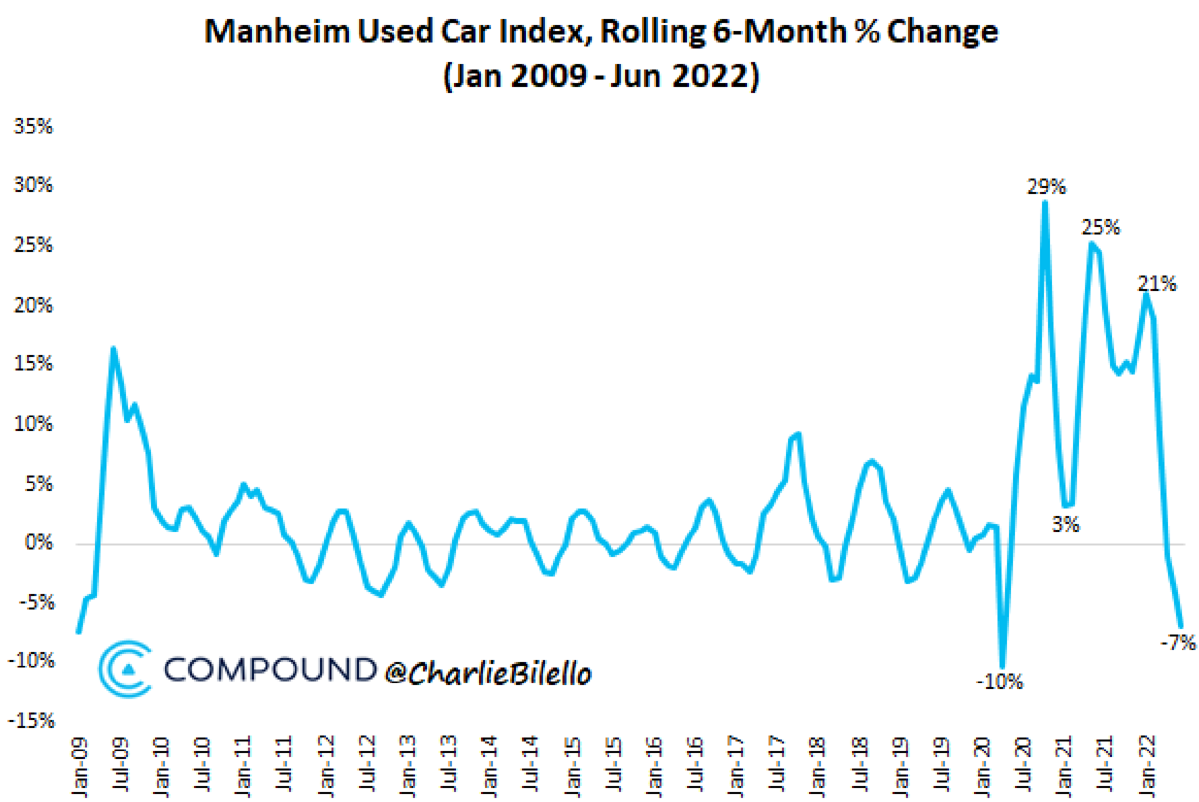
CT
NH
MA
MD
HI


Manheim Used Car Index, Rolling 6-Month % Change
(Jan 2009 - Jun 2022)
35%
30%
25%
20%
15%
10%
5%
0%
-5%
-10%
-15%
29%
25%
21%
3%
-10%
-7%
COMPOUND @CharlieBilello
Jan-09
Jul-09
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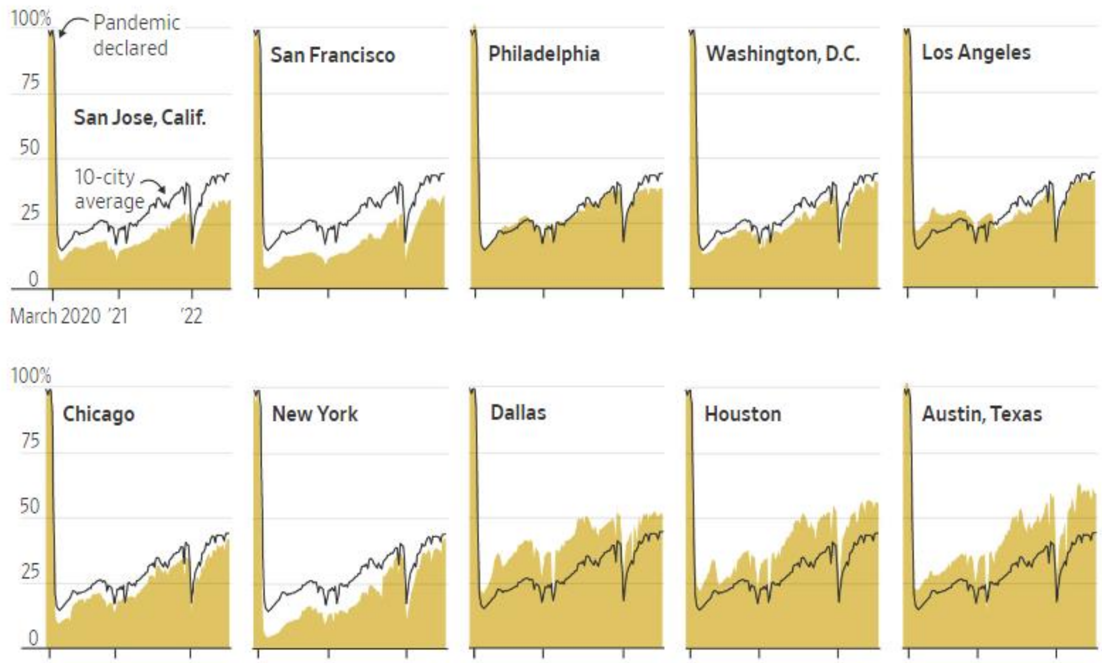
Jan-22

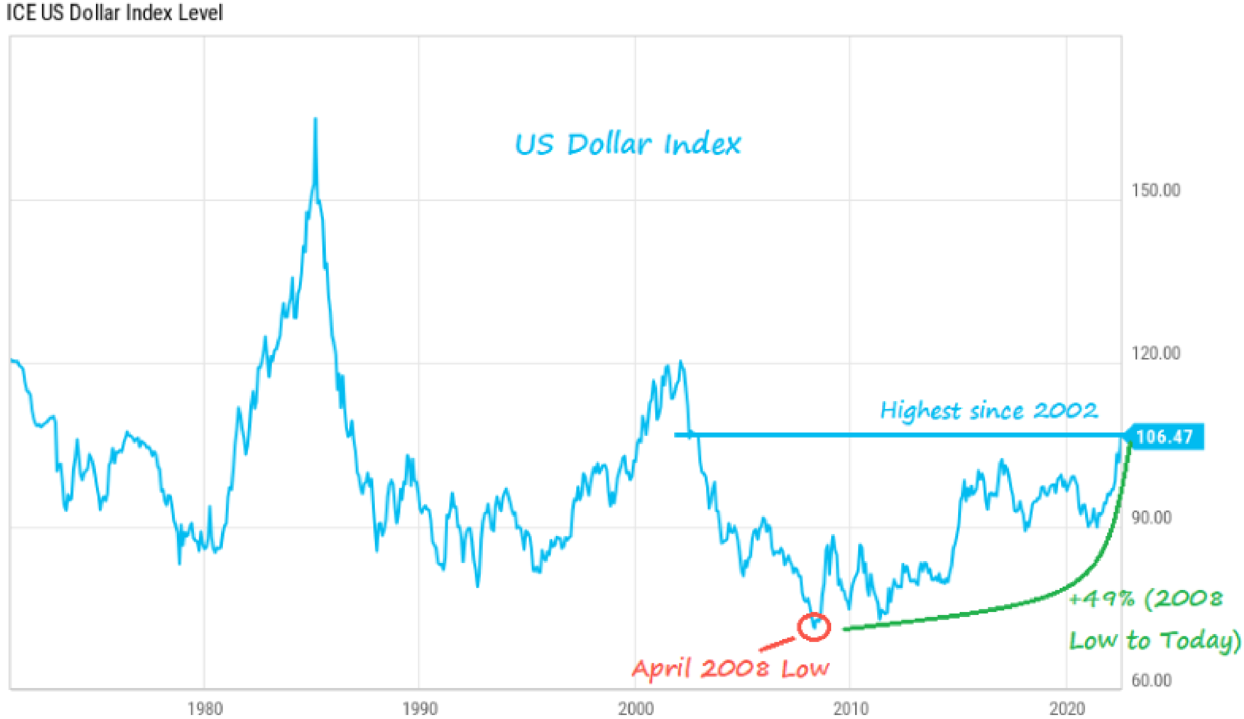
Office occupancy rate by metropolitan area



Note: Data based on swipes at buildings using Kastle Systems access control
Source: Kastle Systems
Ming Li/THE WALL STREET JOURNAL

Source: WSJ

ICE US Dollar Index Level



Section V: Around the MWA Office

You'll see a new face around our office the next time you visit the office (or Zoom). We hired Chelsea Gonzales, CPA in July. Chelsea has a background in banking and accounting and will work with many of our clients in a planning capacity. Though she is a CPA she is working on her CFP and will be working in a financial planning role focused on Business Analysis. We are excited to add her to the team and expect you will enjoy working with her.

Chelsea is originally from Waco, TX. She attended Texas A&M University graduating with both a bachelor's and Master's degree in Accounting. She is a CPA and Investments Advisor Representative and is currently working on her CFP license. Chelsea has a diverse background with over ten years of experience in financial services including banking, public accounting, and financial planning. We believe she will be a great addition to the team as she will add another layer of financial planning with business analysis and tax strategies.

In her spare time, Chelsea is a travel enthusiast and avid sports fan. She currently sits on the Induction Committee for the Texas Sports Hall of Fame.