KNOX & DOWNING ADVISORS
A Member of Advisory Services Network, LLC

FALL 2022

The bear's growl was heard again in the third quarter of 2022 as a modest summer rally in the stock market gave way to renewed declines. The S&P 500 (Standard & Poor's) has declined by 24.8% year to date as of September 30th, confirming a bear market with a decline of over 20%. The stock market decline has been broad based as other assets classes, such as small cap, foreign developed markets and emerging markets have all declined more than 20% so far in 2022. With bonds losing ground as well due to rising interest rates, there were few places for investors to hide in 2022.

The decline in individual stock sectors was also broad based as, according to Argus Research[1], all sectors of the S&P 500, except for Energy, declined year to date. Argus reports that 9 of the 11 S&P industry sectors declined by more than 10%, with Technology down 32% and Communication Services (social media and telecom) down almost 40% year to date. The impact of inflation and higher interest rates on the economy is causing analysts to reduce earnings estimates for 2022 and 2023 so that while the current P/E ratio of the S&P 500 based on consensus estimates seems reasonable after the decline in the market, there is very little confidence in even these reduced estimates.

The impact of higher interest rates on stocks is also significant as a 4% return on a 2-year Treasury Note begins to look very attractive in a volatile and declining stock market. For the last few years investors have heard commentators talk of TINA (there is no alternative) as stocks seemed the best investment option in a world of miniscule yields on bonds and cash. This philosophy, fueled by easy money, led to the significant and ultimately unsustainable advance in stocks and other assets such as housing. The impact of ultra-low mortgage rates and readily

[1] Argus Research Market Watch 10/11/2022

available funds led to the extraordinary bidding wars for houses. With mortgage rates now approaching 7%, housing prices seem vulnerable to a correction as well.

It is difficult, amid the current turmoil in the markets, to maintain a long-term perspective, but it is critical at times like this. In a recent article on Yahoo Finance by Sam Ro[2], he stated that while the long-term average annual returns for stocks was 10%, it was very rare that the market returned 10% in any given year. Long term positive returns occur in often very volatile short-term markets. In annual S&P 500 return data from NYU in the Sam Ro article, it is apparent that investors must withstand significant short-term volatility to achieve positive long-term returns. The NYU data lists annual market returns from 1977 through the 3rd quarter of this year and in those almost 45 years we had annual returns close to 10% (9.9, 10.7 and 11.8) only 3 times. There were 8 years with annual returns over 30% and 9 years with returns over 20%. The worst year was 2008 with a loss of 36.5% and the 3 years from 2000-2002 had a similar cumulative negative return. If the S&P 500 finishes the year where we are now or lower, it would be the second worst year since 1977.

This is not to make any sort of prediction about near term returns but only to point out how success in investing is often achieved by perseverance amidst volatility. Many well-known investment experts fear further damage to the economy and the markets, and their concerns may be well founded. However, there appear to be stocks trading at reasonable prices and we believe the current problems bedeviling the markets are not insurmountable. As you might expect, we advocate patience and a willingness to take advantage of the current situation if your individual goals and risk tolerance allow. We encourage you to discuss your concerns with us and wish you all the best.

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[2] Yahoo Finance, Sam Ro, The Stock Market Rarely Produces Average Returns 10/11/2022

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Indexes are unmanaged and do not include management fees, costs, or expenses. It is not possible to invest directly in an index. Returns are shown without deductions of advisory fees, trading fees or internal management funds expenses. The deduction of such fees and expenses, and the compounding effect of such fees and expenses, will reduce returns over time. Return numbers, unless indicated, are through September 30, 2022.