PRATO CAPITAL

Some FAQs About Investing Today

November 2022

Stock market volatility has continued through October and many investors have questions about their portfolios. This month we will look at some concerns and provide some information we feel is appropriate for our clients and other long-term investors.

How have interest rates affected fixed income this year?

Inflation has been much more persistent than most economists predicted this year. The Federal Reserve has raised interest rates significantly in an attempt to cool the economy and slow the inflation rate.

As interest rates have risen, the price of bonds has decreased. With our clients fixed income portion of their portfolios, we have stayed short-term for several years now. This has allowed our clients to avoid the large losses the longer-term bondholders have seen. Now that rates are increasing, we are following the possibility of increased yields.

I understand the messaging but what is being done specifically with my portfolio?

Specifically, rebalancing and we have talked about this before. This is keeping the right balance of stocks and bonds within the portfolios of our clients. Rebalancing can also be used effectively within each part of a portfolio, within the areas of stocks and bonds.

For Stocks: Now, we are using a strategy that rebalances from the more relatively appreciated areas in our global investment strategy to where our experts see value. Since the market declines of 2022 started, the experts at Dimensional Funds are seeing increased areas of value in International markets, especially Europe and Emerging Markets.

Here in the US, some of the hardest hit sectors, such as technology are also offering great value, as evidenced by Apple reporting “decent” earnings and then seeing its largest one-day gain in many years. Academic research points to the fact that great companies and great global market segments can look not so great short term and that can create opportunities in the long term.

For Fixed Income: We have stayed short-term for years now and for good reason. With the recent dramatic increase in interest rates after years of next to zero, our strategy has paid off as many long-term bondholders have suffered. As interest rates rise, we can look at other opportunities to provide a buffer to stock market volatility. One example is CDs, now paying over 4%. We do not recommend CDs for everyone due to lock-in periods, but it may be appropriate for some and may warrant a discussion. Longer-term bonds will start paying more interest also, but with rates still rising and the chance of a possible recession these areas can be much more volatile.

Do I need to worry about the mid-term elections and my portfolio?

Many believe that when Congress is governed by one political versus the other, it can be better or worse for stock market returns. History has shown that market returns are not correlated to any political party controlling Congress (or the White House for that matter) and long-term investors have been rewarded regardless of which party is in power. We caution investors against making short-term changes to their investment plans based on these opinions. Our September newsletter, "The Impact of Mid-Term Elections" discusses this in more detail.

With stocks down, should I sell some or all of my stocks and wait for a recovery?

When stock markets decline it can be frightening to watch the value of a portfolio decline. But selling because markets are decreasing is another form of market timing. Academic research has proven that consistently timing the ups and downs of the market is impossible, even for the professional fund managers who follow markets for a living.

The long-term investor should consider that the stock markets have always recovered from bear markets like we see today. Even with all the negative economic news, the stock market will often turn positive before the economy. We saw this in 2008 and 2009 after the financial crisis and again in 2020 after the pandemic. We recommend an article from David Booth, Chairman, Dimensional Fund Advisors, about long-term investing: "Worried About Stocks? Why Long-Term Investing Is Crucial".

Conclusion

The stock markets have always recovered from bear markets to set record highs again. Over almost 100 years, the S&P 500 has returned about 10%. With the declines we have seen this year from the S&P 500, a 17.6% decline from the record high set in January, the 3-year and 5-year average returns of the S&P 500 are still 10.5% and 10.55% respectively.[1] Even after the declines we have seen this year, returns over longer periods are still very close to that 100-year average of nearly 10%. A longer term perspective can be helpful when markets are volatile.

All the information included in this article is general information and everyone's financial situation is different. Financial plans and investment plans should be unique to each investor and should be discussed and planned with a financial advisor, like Prato Capital. A personal plan on how to navigate the markets today and tomorrow while still planning for the long-term is the best advice we can give any long-term investor.

"The farther back you can look, the farther forward you are likely to see" —
Winston Churchill

[1] The S&P returns include reinvestment of dividends. Data provided by YCharts on October 28, 2022.