



Summer 2022

Market Review



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The Flight Will Land

“Inflation is when you pay fifteen dollars for the ten-dollar haircut you used to get for five dollars when you had hair.” — Sam Ewing

The first six months of 2022 have been full of surprises, namely inflation. Bonds have had their biggest decline in nearly 40 years and tech stocks have crashed. The days where everyone felt they were going to miss the crypto-bitcoin train are over. It seems like we might be in a recession. And as we brace for these risks at home, numerous risks exist in Japan, Europe and other parts of the world. While we admire the market forecasters who continually and in earnest attempt to put a probability on various events like a recession, they might as well be forecasting ranges of where a roulette ball will land in a given spin of the wheel.

We continue to ask our **Rebalance** clients to “stay the course.” We liken these moments as an investor to being a passenger on a flight suffering from extreme turbulence. We have our seat belts fastened. We are nervous. The flight attendants are strapped in too. In spite of our fear, we all believe ultimately *that flight will land safely*.

For many investors, who have permanently lost money investing in individual stocks, or narrowly focused funds, the nervousness of today's market can be particularly acute. So why are we so confident that this market turbulence will soon end and that our portfolios will recover? That the flight will land?

The answer is that we are invested in specifically selected broadly diversified index funds that, combined together offer an extremely safe portfolio that harnesses the forces of a global capitalistic system that as a whole, adapts, changes and prospers.

Change before you have to

Jack Welch, the famous CEO who ran General Electric used to say, “change before you have to.” Corporations are constantly finding new ways to survive and prosper on behalf of stakeholders. The businesses we own in our **Rebalance** portfolios are constantly in search of strategies to succeed despite challenges like constantly changing consumer tastes, new competition, and rapid product obsolescence.

Netflix went from renting DVDs to streaming video online. Disney shifted its reliance on Donald Duck and Mickey Mouse and bought Pixar Studios, Marvel and the Star Wars franchises. Amazon went from selling books to the world's largest internet retailer and how helping to spawn large companies like Etsy where entertainment meets shopping. The pandemic has reshaped healthcare with digital health services like Zoom visits to doctors and many companies offering lower cost medical visits, monitoring, and interventions. Companies like Tesla have risen in response to global warming and the need to electrify cars.

Our **Rebalance** portfolios contain the largest of these businesses, built to adapt to and prosper from external shocks. The big shock today is inflation which is largely the result of “supply chain” disruptions or the systems or pathways that products follow on their way to the consumer. The war in Ukraine, tariffs, Covid related lockdowns, material shortages, have all impacted the supply chains for most global industries because supply chains, have grown increasingly complex over the last 30 years as manufacturing and assembly moved offshore to faraway places to drive costs down. When multiple critical links in the chain like shipping, labor or component supplies, product shortages, are disrupted, causing inflation. For example, with both new and used cars shortages of semiconductors and steel are wreaking havoc with supply and pushing prices up significantly.

But companies are built to quickly adapting and they will find ways to maintain and increase earnings. Much of the world's manufacturing happens in China, but China's zero tolerance lockdown-oriented response to COVID has presented a major snag in repairing supply chains. Companies like Apple are therefore moving assembly operations to other low-cost geographies such as Malaysia, Vietnam, Brazil and India.

Why index investors “land”

The great companies find a way to thrive despite their operating environment, political change, and other challenges. As investors, we count on them to innovate, adapt to changing conditions and grow their earnings over time which increases stock prices and dividends. This adaptability is one of the mechanisms that make stocks a good long-term investment.

Many investors fear that their portfolio will not “land” because they have experienced devastating investment results in periods like 2022. They may have permanently lost their money investing in stocks or funds heavily weighted in an industry that does not adapt. To be sure, many companies go bankrupt and are acquired at a fraction of their prior value.

Not all companies can adapt and thrive. In fact, great companies are failing in increasing numbers. The chart below reflects a recent study showing that in 1965, the average tenure of companies on the S&P 500 was 33 years. By 1990, it was 20 years and that is expected to shrink to 14 years by 2026. That means about half of the S&P 500 will change ever 10 years! Consider Eastman Kodak, National Semiconductor, Sprint, US Steel, Dell, and the New York Times – all companies no longer part of the S&P 500. During the pandemic the old retailers, Nordstrom, Macy’s, Kohl’s, and Tiffany dropped off as well.



Data: Rolling 7-year averages. Standard and Poor's, Innosight research based on public S&P 500 data sources

Why do we feel strongly that **Rebalance** portfolios will “land?”







At **Rebalance**, we invest strictly in index funds. As index investors, we don’t need to figure out which companies will survive, thrive or fail. We receive the average returns of them all and those averages have historically increased at very satisfactory returns through all kinds of markets. While we will own some of the losers, we own all the companies that thrive and drive up the value in the index funds we all own.

Successful long-term investing requires confidence in your investment strategy which helps us have staying power during difficult market conditions like we are experiencing. We have been through many shocks and business cycles over many decades. If you have any concerns or questions about your investments, please don’t hesitate to call your advisor. We would love to hear from you.

World Markets Review

Second Quarter 2022

The **Rebalance** Investment Committee works with two broad asset classes as the basic building blocks of our client portfolios: Growth and Income. During the second quarter of 2022 these asset classes performed as follows:

	US Stock Market	International Developed Stocks	Emerging Markets Stocks	Global Real Estate	US Bond Market	Global Bond Market ex US
Q2 2022	Stocks				Bonds	
	-16.70%	-14.66%	-11.45%	-17.22%	-4.69%	-4.01%
						
Since Jan 2001						
Avg. Quarterly Return	2.2%	1.4%	2.6%	2.3%	1.0%	0.9%
Best Quarter	22.0% Q2 2020	25.9% Q2 2009	34.7% Q2 2009	32.3% Q3 2009	4.6% Q3 2001	4.6% Q4 2008
Worst Quarter	-22.8% Q4 2008	-23.3% Q1 2020	-27.6% Q4 2008	-36.1% Q4 2008	-5.9% Q1 2022	-4.1% Q1 2022

Past performance is not a guarantee of future results. Indices are not available for direct investment. Index performance does not reflect the expenses associated with the management of an actual portfolio. Market segment (index representation) as follows: US Stock Market (Russell 3000 Index), International Developed Stocks (MSCI World ex USA Index [net dividends]), Emerging Markets (MSCI Emerging Markets Index [net dividends]), Global Real Estate (S&P Global REIT Index [net dividends]), US Bond Market (Bloomberg US Aggregate Bond Index), and Global Bond Market ex US (Bloomberg Global Aggregate ex-USD Bond Index [hedged to USD]). S&P data © 2022 S&P Dow Jones Indices LLC, a division of S&P Global. All rights reserved. Frank Russell Company is the source and owner of the trademarks, service marks, and copyrights related to the Russell Indexes. MSCI data © MSCI 2022, all rights reserved. Bloomberg data provided by Bloomberg.

Growth Asset Classes

Large U.S. Stocks. Large-cap U.S. stocks fell in Q2 2022 based on fears of continued inflation, tighter monetary policy, and the increasing chances of recession in the U.S. Certain U.S. economic statistics did deteriorate during the quarter while inflation readings remained high. High dividend paying stocks once again outperformed broader markets during the quarter.

Small Cap Stocks. Small company stocks fell in concert with their large company counterparts during the second quarter based on concerns the Federal Reserve will be increasingly aggressive in its battle against inflation and related economic concerns.

International Developed Stocks. Foreign developed markets fell slightly less than U.S. stocks during the second quarter. European central banks are not raising interest rates as aggressively as the Federal Reserve despite increased exposure to higher energy prices. The ongoing war in Ukraine is more disruptive to the European economy than the U.S. given dependence on Russian natural gas and oil.

Emerging Market Stocks. Emerging markets stocks fell during the second quarter as their currencies weakened vs. the dollar, continued Covid related lockdowns in China, and high exposure to food and energy inflation raised concerns of credit issues in developing economies. Latin American markets like Columbia, Peru and Brazil were among the weakest markets alongside Poland and Hungary.

Real Estate. U.S. real estate investment trusts (REITs) fell after a rise in interest rates hurt many interest-rate sensitive sectors during the second quarter. Investors continue to favor the yields offered in real estate stocks but are concerned about the impact of higher rates on financing and how a slowing economy will impact the sector.

Income Asset Classes

U.S. Government Bonds and TIPS. Yields on the benchmark 10-year Treasury rose markedly during the quarter with the higher inflation readings, causing prices to fall sharply across all maturities including inflation protected bonds (TIPS). The U.S. consumer price index rose by 8.6% in May versus a year ago.

U.S. Corporate Bonds. U.S. investment-grade (higher-quality) corporate bonds prices fell in Q2 as interest rates rose and credit concerns negatively influenced spreads and pricing.

High-Yield Corporate Bonds. More speculative high-yield corporate bonds fell during the quarter based on increased perceived credit risk and rising interest rate spreads vs. their less risky counterparts.

Emerging Market Bonds. Emerging market bonds fell sharply during the quarter as fear of higher U.S. interest rates and a strengthening dollar increased credit concerns for sovereign issuers who face higher repayment burdens when their local currencies weaken.

Preferred Stocks. As a “hybrid” security that is part fixed income and part equity, preferred stocks are influenced by forces influencing both stock and bond markets. In Q2 2022, both stock and bond markets fell based on rising interest rates and economic concerns meaning both sides of the equation were under pressure.

The Rebalance Investment Committee

The **Rebalance** Investment Committee meets several times a year to review our client portfolio options, asset class selections, and overall economic factors. The Committee’s goal is to curate client portfolios that generate the most investment return for the least amount of risk.



The **Rebalance** Investment Committee members, April 2022. Left to right: Charles Ellis, Burton Malkiel, Jay Vivian, and Kristi Craig. **Rebalance** Managing Partners Mitch Tuchman and Scott Puritz are also members of the Committee but not pictured here.

Rebalance and its clients are fortunate to have such respected and savvy financial experts guiding key investment decisions.

Professor Malkiel is an emeritus Princeton University economics professor, a former longtime board member of The Vanguard Group, and a highly respected voice in the investment industry. Professor Malkiel has written hundreds of scholarly articles and opinions, notably the investment classic *A Random Walk Down Wall Street*, now in its 12th edition and mandatory reading in economics and finance courses in colleges around the world.

Dr. Ellis was Chairman of the Investment Committee of the famed Yale Endowment, working closely with investment legend David Swensen. He was co-founder and Managing Partner of Greenwich Associates, a consultant to institutional investors. In addition, Dr. Ellis served on the governing boards of The Vanguard Group, Yale, Harvard, NYU Stern, Exeter, the Whitehead Institute, and the Robert Wood Johnson Foundation.

Jay Vivian is the former Managing Director of the IBM Retirement Funds, responsible for over \$100 billion in IBM investment funds for more than 400,000 employees worldwide. *Treasury & Risk* named him among the “100 Most Influential People in Finance.” In 2010, *Plan Sponsor* gave him its Lifetime Achievement Award. He is on the Board of Directors and Investment Committee of ICMA-RC, which manages more than \$40 billion in public sector retirement assets.

Kristi Craig is the most recent addition to the Investment Committee. She is the Chief Investment Officer at the National Geographic Society, overseeing a \$1.4 billion endowment. Previously, she was Director of Private Investments for the Georgetown University endowment, currently valued at \$2.6 billion. Ms. Craig also led business development for the Small Business Investor Alliance and served as a Senior Investment Officer for the U.S. Small Business Administration.

We thank them for their input and wisdom.

Very truly yours,

Your **Rebalance** Team