November 2023

Mid-Quarter Update

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The final quarter of 2023 is proving to be a continuation of the volatile market environment we have been experiencing as of late. October preserved its reputation for being the most difficult month for stock prices and bonds also suffered. However, the first half of November has offered a stark contrast, reversing October's price declines for both stocks and bonds. From a longer-term perspective, when investors evaluate the markets over the last 21 months, dating back to the start of 2022, returns from both stocks and bonds are in negative territory, ranging from low to high single digits, depending on the index. This period has been frustrating for investors.

As a matter of perspective, we offer a common sense approach. Like in life, things tend to even out over time, and excesses, up or down, tend to smooth out to a more normal pattern. These periods of adjustment require patience. So it is with investing. We have often said in the past that the markets pay you when they want to, not when you want them to. That is why it is critical that long-term investors remain invested, so that when the payday arrives, they get paid.

We are not in the habit of quoting ourselves, but a few lines from one of our previous letters seems appropriate at this moment. In January of 2022, just as we were entering the difficult period noted above, we said:

> ...we merely point out that things have been awfully good for stock investors in recent years. In fact, as we pointed out in our last letter, stocks have compounded at around 18% over the last five years. This is 80% more than the average returns from stocks over longer periods of time... We are not predicting a recession or a bear market; we only suggest that we might have to go through a period of digesting some of these high returns and accept more average returns for a while.

Over the course of market history, it is has not been unusual to experience 21 months of negative returns. We must keep in mind that these periods are offset by some spectacular periods, like those referenced in the above quote. Our

economy has historically provided a constructive environment for investing; and with patience and investments in sound, high-quality companies, it has provided the opportunity to earn very attractive returns. We have no doubt this will be the case in the future also.

As to why returns have been poor over this recent period, the answer is pretty obvious. In March of 2022, the Federal Reserve (Fed) began raising interest rates in an effort to reduce demand and bring a very high inflation rate back down to an acceptable level. The pace of increases was rapid and has been disruptive to the psychology of investors. Fortunately, the inflation rate is trending in the right direction, and the Fed seems to believe that they are very near the completion of their monetary tightening. This is part of the larger transition back to more normal economic conditions after the damaging economic influences of Covid. It has taken longer than expected to complete this transition, and we are not there yet.

The poor performance of the financial markets can be attributed to the uncertainty of the current period. There is a lack of clarity as to future economic outcomes. This is why we believe so strongly that the characteristic of quality should be the hallmark of an investment portfolio. It helps narrow the range of outcomes and provides more certainty of return as well as preserves capital in down markets, such as we experienced in 2022. During periods such as this, it is important to be properly positioned for a range of eventualities. And, once financial markets begin performing well again, we will be ready and positioned to be paid.

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