WINTHROP WEALTH

FEBRUARY 2022 CLIENT QUESTION OF THE MONTH:
Market Performance During Fed Tightening Cycles

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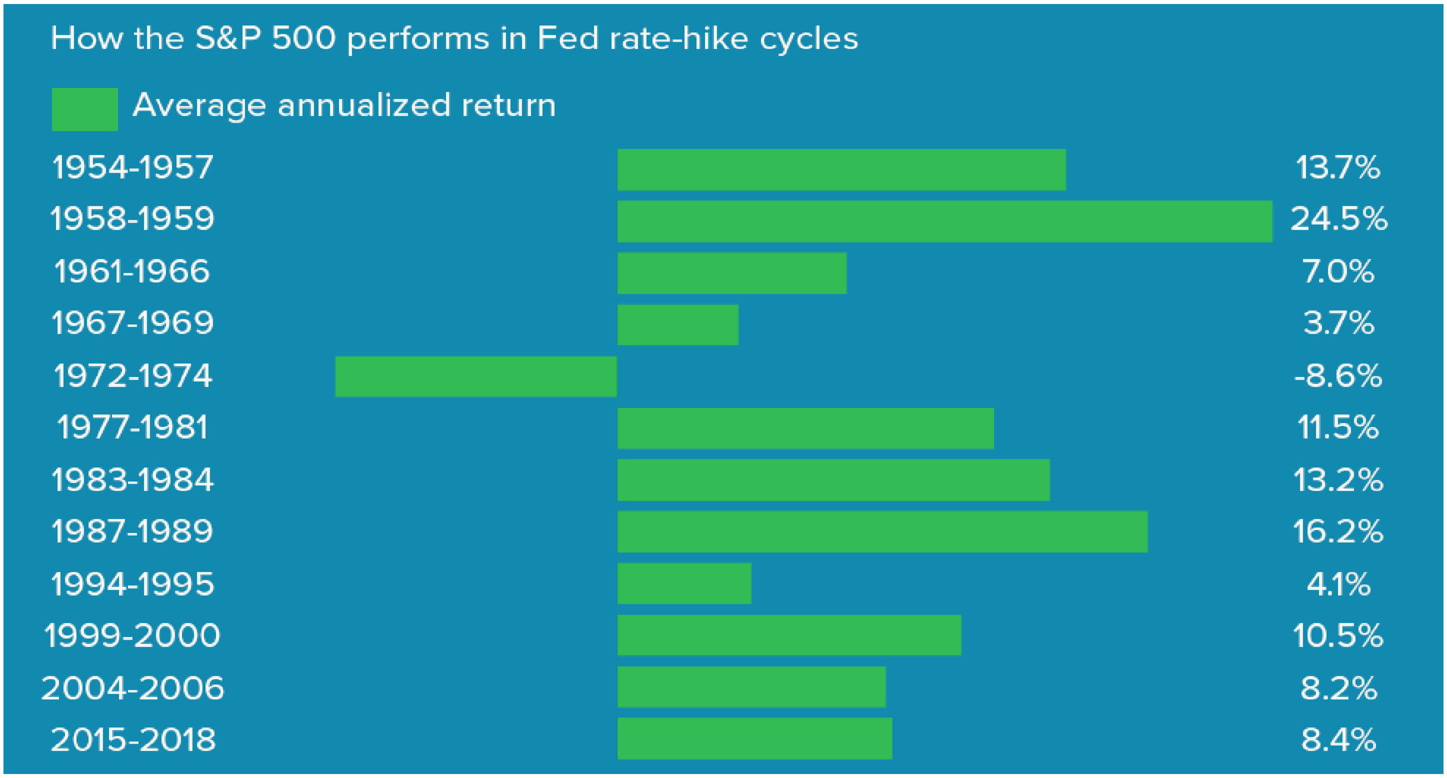
Our view heading into 2022 was that the removal of an unprecedented level of fiscal and monetary stimulus would lead to higher volatility, especially after a period of spectacular market returns. While we certainly have been pleased with market performance over the last several years, we want to be realistic with our expectations going forward. Note that recent market performance has been well above the historical average:

S&P 500 Recent Annualized Returns (through 2021): 1-Year: +28.7%. 3-Year: +26.0%. 5-Year: +18.5%. 10-Year: +16.5%.
S&P 500 Historical Annualized Return (1928 – 2021): +9.7%.

Last year was notable for the lack of volatility as the S&P 500's largest peak-to-trough decline was only -5.2%. Since 1928, the S&P 500's largest annual peak-to-trough decline has averaged about -15%. Since we know that the stock market does not move in a straight line forever, we prepared for volatility by taking profits and shifting portfolios more defensively as the markets moved higher.

2022 is off to a rocky start as the S&P 500 is down by about -7.2% through the first 6 weeks of the year (1/1/22 – 2/11/22). The market weakness was mainly due to increased expectations the Fed will begin to tighten monetary policy quicker than expected. Since the start of the year, the market forecast has shifted from 3 to 5 rate hikes in 2022 – this is a substantial shift in monetary policy expectations in a short amount of time.

Our takeaway from the latest Fed meeting is that it seems like Chair Powell and the committee want to raise rates a few times, start the balance sheet runoff process, and then reassess where the economy and inflation stand. We suspect that volatility will continue to be prevalent as markets continue to adjust to an environment without significant monetary support. However, even though the Fed is about to embark on an interest rate hiking cycle, it does not mean investors should panic. The following chart displays that the S&P 500 has increased in 11 of the last 12 periods when the Fed was increasing rates. Thus, the Fed tightening monetary policy does not mean that stocks cannot increase, it just likely means that the ride will be bumpier.



SOURCE: Truist Advisory Services

We understand that market drawdowns are stressful. At Winthrop Wealth, we believe the right mindset paired with a comprehensive financial plan and a thorough investment process can provide a sense of comfort and confidence in meeting your long-term financial goals, especially during times of heightened market volatility.

The Right Mindset – Take a long-term viewpoint and avoid the impulse to market time

"Don't try to buy at the bottom and sell at the top. It can't be done - except by liars." - Bernard Baruch

Market volatility is stressful and controlling your emotions during these periods is critical. Market timing decisions are often emotional rather than rational and data based. Making sudden large adjustments to portfolios is value destructive over time and a major reason for poor investor performance. Our investment philosophy is, never time the market. Please see our Client Question titled **Market Timing Does Not Work**, where we demonstrate that: the stock market goes up over time despite frequent drawdowns, the average investor underperforms due to market timing mistakes, and the benefit of a diversified portfolio and a long time horizon.

Financial Plan

"The Best way to measure your investing success is not by whether you're beating the market but by whether you've put in place a financial plan and behavioral discipline that are likely to get you where you want to go." -Benjamin Graham

Financial planning drives the investment strategy and provides a roadmap to each client's unique goals and objectives. The comprehensive financial plan defines cash flow needs, optimizes account structures, considers tax minimization strategies, and continuously evaluates financial risks as circumstances and/or goals change.

We also stress test the financial plan for many different environments including extreme volatility and market declines. The financial plan does not assume perpetually strong markets and linear returns. Rather it assumes that your portfolio will go through periods of weakness throughout your investment time horizon. We often update financial plans during and after volatility to quantify the impact that the market decline had on the probability that the client will reach their long-term goals and objectives. Since we account for market volatility and declines, the financial plan is less likely to be damaged when these periods inevitably occur.

Investment Process

"Good times teach only bad lessons: that investing is easy, that you know its secrets, and that you needn't worry about risk. The most valuable lessons are learned in tough times." - Howard Marks

Our investment management process is designed to provide well-diversified portfolios constructed with a methodology based on prudent risk management, asset allocation, and security selection. We help our clients navigate challenging markets by ensuring their short-term cash flow needs are met while managing the rest of their investments in a globally diversified portfolio.

Market volatility can be used to our advantage by tax-loss harvesting or reallocating to more attractive securities:

- **Tax-loss Harvesting**: Tax-loss harvesting is achieved by selling an investment with a loss and immediately purchasing a different security with similar (but not identical) exposure. The loss on the sold security can be used to offset taxable gains. Since we simultaneously sell a security to capture a loss and purchase a different holding with similar exposure, the client is never out of the market. We can capture losses during declines, and as the market recovers the new position also recovers PLUS the client has a tax-loss to offset future gains. Please see our **Client Question on Tax Loss Harvesting**.

- **Repositioning Portfolios**: Repositioning portfolios means that we can increase the overall equity allocation and/or we can reallocate among various asset classes. During a market selloff, portfolio equity allocations often fall below their target levels. For example, assume a portfolio is invested to its target allocation of 60% equities and then the stock market declines-10%. The new allocation would be about 54% or-6% below the target level. We can use the market decline as an opportunity to buy stocks at lower prices to bring the allocation back to the 60% target level. Furthermore, we can rotate to the equity asset classes that have become more attractive (for equities, we allocate across regions, countries, market caps, factors, styles, sectors, and industries). Keep in mind, some of the best buying opportunities occur during periods of market turmoil.

DISCLOSURES:

Content in this material is for general information only and not intended to provide specific advice or recommendations for any individual.

The economic forecasts set forth in this material may not develop as predicted and there can be no guarantee that strategies promoted will be successful.

All indexes mentioned are unmanaged indexes which cannot be invested into directly. Unmanaged index returns do not reflect fees, expenses, or sales charges. Index performance is not indicative of the performance of any investment. Past performance is no guarantee of future results.

The Standard & Poor's 500 Index is a capitalization weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

Financial planning is a tool intended to review your current financial situation, investment objectives and goals, and suggest potential planning ideas and concepts that may be of benefit. There is no guarantee that financial planning will help you reach your goals.

Rebalancing a portfolio may cause you to incur tax liabilities and/or transaction costs and does not assure a profit or protect against a loss.

Likewise, it is important to remember that no investment strategy assures success or protects against loss. Asset allocation does not ensure a profit or protect against loss. There is no guarantee that a diversified portfolio will enhance overall returns or outperform a non-diversified portfolio. Diversification does not protect against market risk. All investing involves risk which you should be prepared to bear.