SASSER

INVESTMENT MANAGEMENT, INC

Disciplined Value Investing

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## Q3 2022 Commentary: A time of maximum pessimism…

The third quarter concluded with little to cheer. After a decent bounce to stock prices in July, the stock market gave it all back and then some from the middle of August onward. The catalysts for the retreat were a disappointing inflation report and Federal Reserve chairman Powell's much anticipated address at Jackson Hole. Both extinguished any thought the Federal Reserve would put an end to its interest rate hikes any time soon. Powell's speech was short and not so sweet. He indicated interest rates would be unequivocally going higher. Furthermore, subsequent remarks by Fed governors have been united in their hawkish stance on interest rates. While rate hikes loom the stock market is likely to struggle. By the end of the quarter the S&P 500 was down 4.9%.

As interest rates rise, bond prices fall. Longer-term bond prices fluctuate more as interest rates rise. In accounts that hold fixed income securities, we have held short-term bonds to minimize price fluctuations in the event of rising interest rates. Now that rates are higher, we are now buying US treasury notes to lock in attractive rates without risk to principal. Further portfolio management changes involve cash management. Because zero interest policy meant cash could held without sacrificing return, we held cash. With rates up, we are now managing cash balances more aggressively to earn interest with money market funds.

The investment environment is dominated by inflation. Where inflation heads will determine interest rates and fed policy. There are signs of inflation's components moderating. However, headline inflation continues to be stubbornly high despite the federal reserve's action. Remember, it takes quite a bit of time for the full impact of monetary policy changes to be felt. This lag means that interest rate moves higher from earlier in the year are only now impacting the economy and consequently inflation. The stock market has adjusted to this new environment and stock prices are as attractive as we have seen since 2018. With a longer investment time horizon and some patience, we can focus on fundamentals which are the ultimate driver of value.

Sir John Templeton, one of the most astute investors of all time, famously observed "bull markets are born on pessimism, grown on skepticism, mature on optimism and die on euphoria." This has held true through all modern market cycles and there is no reason to think anything has changed. Recent American Association of Individual Investors polling reveals bearish sentiment to be the highest since the market bottom of the 2009 Great Recession. Conversely, the percentage of those that are bullish is at a historically low 18%. We are sure Templeton would be smiling at these numbers. As he observed, bull markets are born from the type of pessimism we see today. At these extremes of pessimism, the record of stocks being higher six to twelve months from now is very good.

This is not to forecast that markets have bottomed, it is an observation that we are in an environment of pessimism from which bull markets arise. We would caution that the transition from the current bear market to the coming bull market will continue to be volatile. The volatility reflects the uncertainty and confusion that permeates the investor sentiment. However, as inflation is brought under control, and it will, the next bull market will begin.