SASSER
INVESTMENT MANAGEMENT, INC

Disciplined Value Investing

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Q4 2022 Commentary: Setting the stage for a better 2023…

The fourth quarter offered little relief from the difficult three quarters that preceded it. As such, both the stock and bond markets fell by double digits in 2022. The rapid rise in interest rates pushed the bond market to its worst return in many decades and effectively ended what has been a 40-year bull market in bonds. The S&P 500 was down 18%, ranking 2022 among the worst ten years in the last hundred. The technology stock heavy Nasdaq performed even worse, falling more than 30%. Still, there is reason for optimism.

It is no secret that rising interest rates, orchestrated by the Federal Reserve in order to tame inflation, are the overwhelming reason for the stock market's struggle. Between covid related supply disruptions and the extraordinary covid relief stimulus, the inflation problem has proved to be more than transitory. However, Federal Reserve chairman Powell has vowed to bring inflation under control and to take whatever steps necessary to do so. Wall Street appears to believe him as indicated by the dramatic inversion of the yield curve in which short-term interest rates are considerably higher than long term rates. Interest rate inversions happen rarely, and in this case the bond market is telling us it believes inflation is a short-term problem and not a long-term concern. However, in the short term we will have to accept the Fed's medicine to ensure that the long-term objective is achieved.

Fortunately, we are already through much of the adjustment necessary for the stock market to see better days. Much of 2021's excesses have been unwound. Speculative fervor has evaporated. IPO volume has dried up and SPAC's have been relegated to the dustbin of Wall Street fads. Corrections to valuation have been rolling through market sectors since the fourth quarter of 2021. These corrections started with the most egregiously overvalued stocks, and many are down by 70% or more. These companies were growing quickly but had no earnings. It turns out, earnings matter. It turns out, valuation matters too. Stock valuations have come down to realistic levels across all market sectors. Even the highest quality and most profitable companies, particularly in technology, have had to adjust to the new environment of higher rates and slower growth. Companies like Microsoft, Alphabet and Amazon have had to face the reality that the 2020-2021 boom times would not continue and are now going through layoffs.

This is all part of the typical stock market cycle, and we are approaching the stage when a disciplined investor should be preparing for the turn higher. After 14 months of correcting stock prices, we find ourselves once again in familiar territory. Broadly speaking, the stock market and individual stock valuations are reasonable and risk has been substantially reduced.

Given the immediate uncertainties, we must remember that we are not making decisions for results next week. Instead, we must consider where we will be a year, or even two, from now. The stock market is forward-looking and anticipates what is to come. Today we are a year into the rising interest rate cycle and it is beginning to have its desired effect. Inflation is turning lower, and the labor market is coming into balance. A year from now, the investment environment should be significantly better and the stock market will anticipate it. The next phase of the cycle is when investor pessimism turns to optimism, and we must be positioned for that now. We are confident that we are closer to the end of this bear market than to the beginning.

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