Marketline February 2022

Stocks:

We can all guess why the market is sinking at the moment: Russia has invaded Ukraine and thrown the world into turmoil. We have already written about wars vs stock and bond returns (if you don't have an email address you are receiving that piece today in hard copy), so I am going to use this space to remind investors that *aside from the uncertainty of war*, the most impactful force against stocks at the moment is the Fed. It's worth exploring why that is so, because one day, the Fed's intentions will make the front page news again.

The Fed decides what rate should be charged for lending money for short time periods. The Fed Funds rate is interest charged on overnight loans that banks make to each other. This rate influences credit card APRs, other consumer loans, CD rates, money market rates, and countless other prices for money. Another modern feature of the Fed's operations is bond buying, which helps 'set' rates on the longer end of the yield curve – mortgage rates and so forth. The Fed is partially effective at its rate setting job – but results can be 'leaky'. Once in a while the market takes over and rates do something unexpected. However, that aside, let's think about rates in relation to stocks.

The dividend yield on the average stock is only 1.3%. Still, with interest rates near zero – well, 1.3% is better than zero. But offsetting that income is the fact that any stock can sink more than 1.3% on any particular day, wiping out your entire year's income! So, your return is uncertain, especially in the short term. Now, let's say that money market funds were suddenly yielding 5%. Since stocks are risky, and you don't know if the average stock will rise or fall in the short term, but money market funds are pretty safe, you would be tempted to sell stocks to sock away money in that money market fund. While this is an extreme and oversimplified example, it illustrates why stocks run into trouble when interest rates start rising. Also part of the calculus is how much companies are expected to grow over time. If growth is, say, 10%, and interest rates are only 1% - it's worth taking a gamble on the higher growth prospects of stocks. But if you can invest in a more secure instrument, even if it pays only half that long term growth rate – that's attractive.

The month of February began with these mundane worries about interest rates. All the major US indices – the Dow, the S&P and the Nasdaq – declined around 3-3.5%. Interestingly the market rebounded strongly after February 23, the day Russia rolled its tanks into Ukraine. The S&P, for example, is up 80 points since that day, largely because the market is guessing that the Fed won't hike rates so rapidly with a war going on. Consequently, we've come around to interest rates - again. Overseas, Europe and Canada were basically flat. Mexico's Bolsa actually rose 4%. Mexico is an oil producer and exports a significant portion of its production, though it is working to reduce exports in order to become more self-sufficient. In an era of $100 per barrel oil prices, that's a favorable feature.

A decline never feels good, but in volatility is opportunity. We are always keen to find those opportunities.

Bonds:

Yields rose modestly last month, and the yield curve flattened yet again. Short term notes (due in a year) are now yielding 0.98%. For perspective, this yield was 0.07% last June. The long thirty year bond is at 2.16%, not that far above last June's 2.09%. The Fed remains committed to its rate hike regime, war or not. Consequently, we expect very similar reports – rate increases in the short and intermediate maturities and more flattening – in coming months.

As far as where we are finding value, still more municipals are selling at the 3% level, though not necessarily in Oregon. We have purchased more federal agency bonds. Corporate issues have been a bit slow to react to the rise in rates, but they'll get there. When their rates rise, we'll likely turn to higher quality corporates than we've been purchasing over the last several years. Last on the scale would be lower quality issues, which have held up extremely well so far. These quasi-equity securities need to see a greater sell off to pique our interest.

Note: We are awaiting new SEC regulations around cybersecurity. We already have a robust cybersecurity plan in place, including limited access to our internet network, monitoring access to all devices, monitoring the accounts we manage multiple times per day, and training our staff. You are part of our cybersecurity plan: your accounts are only as safe as your passwords, your internet connection, your vigilance. *Please do not give out any personal information about your accounts to anyone. Shred discarded financial papers. Keep what you retain locked up. Close unused accounts.* If you want more ideas for how to protect your data, please give us a call.

*Marketline Monthly is produced by **Cascade Investment Advisors, Inc**. We specialize in value investing for individuals. We apply our approach across markets, looking for low-priced securities that offer above-average potential. We use imagination and hard work to bring performance and personal service to our clients. Phone 503.703.3622 (Michelle); our website is **www.cascadeinvestors.com**. A full list of securities we invest in is available on request; mention of specific securities is not investment advice; such investments may or may not be profitable. Index returns quoted are price only.*