

KREITLER FINANCIAL INSIGHTS

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Fourth Quarter 2022



MARKET UPDATE Q3

The Kreitler Financial team discusses what happened in the third quarter.

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CHARLIE'S CORNER

As possibilists and pathfinders, we are constantly expanding.

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TACO INFLATION

For many years, one of my lunch options was a great taco cart on Church Street outside our offices. An independent business owned by Carlos and his cousin Sebastian, they served three tacos with rice and beans for \$6 cash plus a tip for whoever was manning the grill that day.

Sadly, the pandemic put an end to my taco routine. When I returned to the office in 2020, there still were not many office workers in New Haven. The taco cart disappeared.

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KREITLER FINANCIAL IN REAL TIME

Kersti and Beau offered deliciously flavored and very practical tubes of lip balm to participants in the 25th Annual Faxon Law New Haven Road Race this past Labor Day. The weather was wonderful, the atmosphere inviting, and Kreitler Financial's table was well attended. Thank you, Kersti and Beau!



Lip Balm at the Faxon Law New Haven Road Race

BOB & THE HONEYBEES

Fall is upon us, and winter is just around the corner, and Bob just picked up about 100 pounds of honey - a reasonably good year.

His beehives near Long Island Sound are great because they produce honey all summer long, collecting pollen from the flowers in the salt marshes. Closer to home, north of the Merritt Parkway, hives produce lots of honey in the late spring but have trouble getting nectar in the summer.

Many honey processors use a method that destroys the comb in order to get the most honey out, but we use an extractor that spins the honey out and leaves the comb intact for the bees to fill with honey again next year. Once the honey is spun out it can be filtered into jars.

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People often call me an optimist, because I show them the enormous progress they didn't know about. That makes me angry. I'm not an optimist. That makes me sound naive. **I'm a very serious "possibilist"**. That's something I made up. It means someone who neither hopes without reason, nor fears without reason, someone who constantly resists the overdramatic worldview. As a possibilist, I see all this progress, and it fills me with conviction and hope that further progress is possible. This is not optimistic. It is having a clear and reasonable idea about how things are. It is having a worldview that is constructive and useful." *Hans Rosling, Factfulness*

CHARLIE'S CORNER

by Charlie Kreitler

What is a Possibilist?

I first encountered Hans Rosling in an online video that discussed development around the world including trends in standards of living, health, and longevity. Rosling was a professor of global health at Sweden's Karolinska Institute, and he captured my attention. His 2018 book *Factfulness* remains one of the best books I have read.

If you haven't seen Hans Rosling's video "200 Countries, 200 Years, 4 Minutes" it is worth a few minutes of your time. <https://youtu.be/jbkSRLYSojo>

I have since formed my own version of possibilism. Possibilism is a practical viewpoint. It is not wishful thinking, nor is it constrained by irrational fears.

I see many possible achievable futures. With patience, work, and a little luck they could all be achievable. Often the hardest part is knowing what you want and prioritizing it.

I'm passionate about expanding possibilities for people that inspire bigger and better futures. Wealth management and financial planning are the perfect place for me to be able to share this belief with others, help them to get clarity on what goals they want to achieve, and help develop the strategy to get there together.

It's why we at Kreitler Financial call ourselves possibilists and pathfinders.

Bob & the Honeybees

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Going into the colder months, bees need their honey to keep the hive warm, else they won't survive the coldest temperatures. The choice is to either leave a portion of the harvest behind or feed them sugar water to store for when they are hungry— after all, sometimes you have to spend honey to make honey. Honeybees are unique among the some 20,000 types of bees in that they live as a colony through the winter so that they can start building up their numbers in February and March and start the honey production cycle anew.

In addition to the cold temperatures, bees in the U.S. in the last twenty years have been forced to contend with a population of Varroa mites that have to be kept under control so that they won't weaken the hive.

So, fall is here, and the bees are thinking about their honey. Are your accounts in good shape for the winter? Clients who come into the office can pick up a jar of honey - we always love to see you!



TACO INFLATION

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Thankfully, there's a happy ending, as we learned they are still in business and relocated to just outside Ingalls Rink (the "Whale"). The walk is a little longer, but on a nice fall day it's a terrific way to get some exercise at lunchtime.

On my recent trip, I ordered my favorite (carnitas, by the way). Times have changed and now they take credit cards using an iPad. Something else had changed, too. Tacos were now \$10 plus tax, and don't forget the 20% tip that the iPad helpfully suggested. Over the course of less than 3 years, inflation has made my lunch cost increase 78%. Inflation is real, and for many it's a real problem.

The headline inflation rate versus a year ago is 8.2% as of 8/31/2022. The biggest components in the inflation basket are food, housing, and energy. Dining out is what I experienced first hand with my tacos. We're also reminded of this every time we go to the grocery store.

Since the start of the Covid 19 pandemic, central banks created as much as \$11 trillion in new money. The resulting tsunami of money drove up the price of assets including stocks, bonds, and even the US housing market. In 2020 and 2021, the owners of these assets benefited via increased prices.

In 2022, a series of global supply chain issues, combined with the large increase in money supply, resulted in the highest inflation since the 1980s. China's zero tolerance policy for Covid contributed to shipping and manufacturing woes. Putin's war in Ukraine caused significant increases in food and energy prices. Wages followed prices upward, entrenching inflation in a way that made it more likely to be persistent than transitory.

The Federal Reserve has made clear that controlling inflation is their top priority. After all, inflation of 3% erodes the value of money by 25% over a decade. Increase that to the 7% 12-month headline inflation experienced this summer and over the same 10 years you would lose half the value of your money. For those living off a fixed income or cash savings, the impact of this can be devastating. No wonder the Fed is willing to risk a recession and falling asset prices to put the inflation genie back in the bottle.

One of the reasons we prefer that people own their home in retirement rather than rent is they can control their costs. Property taxes and upkeep may rise, but a fixed mortgage rate (or better yet, no mortgage) means this cost doesn't change as much as the inflation index would show. Renters and those who move are hit harder.

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2022 3rd Quarter Market Update

After a bruising second quarter for stocks, investors enjoyed a summer rally. The hopes for this were dashed by the Fed's resolute course to control inflation by increasing interest rates and stopping bond purchases in the market. Fed Funds rate increased to 3.25%, and the 10-year Treasuries rose from 1.5% at the beginning of the year as high as 4% in September. The financial markets reacted to this by pricing in a higher probability of a recession as consumers and companies have to pay more for the debt on everything from houses and cars to offices and equipment.

By September 30, the S&P 500 was down 23.9% for the year. This has been painful, although we need to remember that market selloffs are normal. There have been 27 bear markets, defined as a decline of 20% or more, since 1928. In order to take advantage of the long term return of stocks, investors must be willing to tolerate these types of market swings.

The bigger surprise to many investors has been the worst bond market in a generation. The US Bloomberg U.S. Aggregate Bond Index is down 14.6% for the year and has been one of the worse bond markets in history based on performance. Many investors hold bonds for one of two reasons. Either they need to ensure that money is money is available at a specified time in the future through the bonds interest or principal, or they hope to buffer the swings in the stock market by hoping bonds will increase at times stocks fall. Neither of those has worked and combining this with the poor stock market return through September makes this one of the most frustrating years ever for investors. In our portfolios, a tilt toward bonds with shorter maturities and diversification into different parts of the bond markets helped mitigate some of the declines.

Mortgage rates rise

Mortgage rates have continued to rise, with the 30-year fixed rate reaching 6.7%. This is the highest it has been since 2007, and it represents a significant increase from the 3.01% rate seen just a year ago. This is bad news for potential homebuyers, as it significantly increases the cost of homeownership. For example, a borrower who bought a \$500,000 house with a 20% down payment a year ago could expect to pay about \$208,000 in interest over 30 years. Today, that buyer could expect to pay about \$529,000 in interest.

Taco indicator...

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Back to my tacos, their inflation since my last visit (admittedly not a 12-month period) was 78%. But if the tacos still cost \$10 a year from now, the 12-month inflation will have stabilized at 0%. Will the same math apply in 12 months' time to the consumer price index?

There are early signs that inflation is easing in some areas, but sticky in others. Gasoline prices in Connecticut declined to an 18-month low.

Home and rent prices came down in August. It is early, but these are signs that inflation may be moderating. On the other hand, wages and the price of many consumer staples may be stickier, causing many to be concerned that high inflation will be here to stay.

Our best guess is that we may have passed 'peak' inflation, but that it may remain at levels of above what we have become accustomed to in recent years for some time. Long term, the best defense against inflation is to make sure your assets grow faster than it.

One of the bright spots in portfolios has been real estate in those portfolios able to own it. As measured by the National Council of Real Estate Investment Fiduciaries, it increased in value 8.73% year to date. This surprised many who expected the impact of remote work to weigh on prices. In a year when

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2022 Q3 Market Update

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very few things worked, diversification may still provide benefits.

There remains a high degree of uncertainty, particularly in the near term. War in Ukraine continues, and Putin remains unpredictable. Europe faces a winter with a reduced energy supply. China's zero tolerance policy for Covid continues to disrupt global trade. The November elections may introduce uncertainty. There can also be unforeseen impacts from the major changes in interest rates and exchange rates. Global Central Banks are increasing interest rates, and global economic growth is slowing down.

This in turn is keeping the dollar strong. The dollar has reached parity with the Euro, and nearly did the same with the British pound. The U.S. Dollar Index (DXY) is up approximately 16% year to date. Companies or countries that have unsustainable debt loads may find themselves in trouble if their payments increase, either because of rates or because their payments are in a different currency.

On the other hand, uncertainty can also present risks to the upside. Markets often bottom before the economy, and often do so when "less bad news" occurs instead of waiting for good news. This is the reason for a strategy that allows you to stay invested and resist the temptation for market timing. The S&P 500 had an annualized return of approximately 21% and 36% one year after the two worst performing days for stocks during the 2008-2009 Great Financial Crisis.

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Market Index	YTD Return
S&P 500 Composite Index	-23.87%
Russell 2000 Index	-25.10%
MSCI Emerging Markets Index	-26.89%
MSCI EAFE Index	-26.76%
Bloomberg US Aggregate Bond Index	-14.61%

Real Returns

Real returns will be a much bigger part of portfolio conversations. Over the past 20-years, the S&P 500 Index had an annualized return of 9.84% and the U.S. Aggregate Bond Index returned 3.1%. During this time, inflation was 2.5%, so investors got a real (or after inflation) return of 7.2% for stocks and .6% for bonds.

If we remain in an environment where inflation is higher than the recent past, this relationship becomes even more important. As of 9/30/22, the yield on a 10-year treasury bond is 3.8%. If inflation were still 2.5%, the expected real return on these bonds would be only 1.3%. What if inflation is higher? An inflation rate of 4.0% (50-yr Average Headline CPI) as of 8/31/2022 would reduce the expected real return of those bonds to about zero.

Of course, the expected real return for stocks is also lower. Interestingly, though, the difference between the two real returns gets even larger. A positive real return from stocks is much better than a 0% real return. Investors need to consider this in their portfolio asset allocation, weighing whether the high expected volatility of stocks is worthwhile in seeking better real returns. Bonds will continue to play a role in meeting future cash needs and attempting to hedge equity risk, and may provide positive real returns if inflation moderates.



Investing isn't about beating others at their game.

It's about controlling yourself at your own game. -Benjamin Graham



Investors need to weigh the risk of near-term losses with the risk of underperforming inflation long-term if they miss a future upswing. If someone needs cash on a 3- or even 12-month basis, they are a short-term investor and should position themselves accordingly. On the other hand, investors with longer horizons may be well served by adding exposure to great companies through the stock market, but only if they can stomach what may continue to be high volatility in the weeks and months to come. In practice, many investors have both short- and long-term objectives, and portfolio strategy may be required to address both.

As always, we welcome your questions and are available to discuss your portfolio strategy.

MISSING THE BEST DAYS IN THE MARKET SUBSTANTIALLY REDUCED RETURNS

January 2001—December 2021	S&P 500 Annualized Total Returns	Growth of \$10,000
All 5,036 Trading Days	9.52%	\$61,685
Missing 10 Best Days	5.33%	\$28,260
Missing 20 Best Days	2.63%	\$16,804
Missing 30 Best Days	0.43%	\$10,904

As of 12/31/2021. Source: Morningstar and PGIM Investments, S&P 500 TR USD Index. This example is for illustrative purposes only and is not indicative of the performance of any investment. It does not reflect the impact of taxes, management fees, or sales charges. The S&P 500 is a weighted, unmanaged index composed of 500 stocks believed to be a broad indicator of stock price movements. Investors cannot buy or invest directly in market indexes or averages. Past performance is no guarantee of future results.

Sources: YCHARTS, J.P. Morgan Guide to Markets 4Q 2022, Hartford Funds: Informed Investor Third Quarter 2022, Tamarac Performance Data

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