NOTTINGHAM ADVISORS
ASSET MANAGEMENT

A View From the TOP

Bond Investing Rule #1: *Don't Fight The Fed*
Bond Investing Rule #2: *Don't Forget Rule #1*

As the U.S. Federal Reserve's *Quantitative Easing* program transitions to *Quantitative Tightening* (or rather as they move from expanding their balance sheet to shrinking it, thereby tightening monetary conditions), markets for assets across the investment spectrum are reacting with rising volatility and generally falling prices. Be it stocks, bonds, real estate, private investments (yes, those too do fall in value, whether private asset managers choose to acknowledge it or not), you name it, prices have been falling for most of 2022.

As uncomfortable as the declining statement balances make us feel, we should take solace in the fact that the Fed is finally getting serious about inflation. This could mean that some more pain for investors is in store, but one can't argue the need to bring rising prices under control. July's Consumer Price Index report showed an +8.5% year over year hike in the basics of food, energy, shelter and healthcare. The good news in the report was that prices were flat month over month, and the worst of the rise may be behind us. The "less than good" news is that the Federal Funds rate is still only 2.5%, and needs to rise measurably before victory over inflation can be declared.

At the Kansas City Fed's annual symposium in Jackson Hole, Chair Powell was unequivocal in stating the central bank's intent was to bring inflation "back down to our 2% goal". He astutely observed that "Without price stability, the economy does not work for anyone." Lastly, but importantly, he warned that "While higher interest rates, slower growth, and softer labor market conditions will bring down inflation, they will also bring some pain to households and businesses." Ouch.

Since the day of Powell's speech, the S&P 500 has fallen -5.8%, the NADAQ is down -6.6% and the broad bond market has dropped about -1%. Markets are likely to remain in flux until we begin to see more consistent signs that prices are stabilizing and beginning to trend lower. Labor markets remain strong (the August unemployment rate was just 3.7%) while the Atlanta Fed's GDPNow forecast suggests a reasonable 2.6% annualized growth rate for the US economy, following declines in Q1 and Q2. Who to believe and what to believe are the age-old challenges investors face. Unless, of course, one remains focused on the long-term, in which case much of this is just noise.

The benefits to being a long-term investor are many, but let me touch on a few that might help one navigate the coming 6-12 months. If one has a time horizon of 5 to 10+ years, be it for retirement, college for the kids, a vacation home purchase, whatever, today's volatility may be viewed with little more than passing interest. Monthly statement balances don't mean as much as there is plenty of time for prices to recover. Moreover, the long-term investor may be able to use a spike in volatility as a chance to scoop up some bargains. The mindset of the investor changes as the time horizon lengthens.

The long-term investor also may have a tendency to remain more patient, and ignore the need to "do something" as prices oscillate wildly around. Very often price volatility leads to short-term knee-jerk reactions to sell and get out of the way; or equally damming, catch a falling knife by rashly doubling down on something. In neither case is the investor better off. Patience is an often under-appreciated characteristic of great investors; yet it's a cornerstone of their investment discipline.

Lastly, long-term investors often have the luxury of waiting until prices hit *their* level, rather than feeling forced to accept whatever price the market is offering at the time. For instance, I happen to think that taxable bond yields of 4% to 5% on short to medium-term investment grade debt are very attractive currently. Likewise, tax-exempt yields of 3% to 4% on similar duration high quality municipal bonds make sense to me. Not knowing where interest rates will ultimately end up, and not being pressed for time, I can wait until I find the right opportunity, and then scoop up bargains when they present themselves. We're doing that now.

Similarly, with equities, a long time horizon changes how I view entry points into sectors of the market I may like. No one knows when or where the equity market will bottom (trust me, NO ONE KNOWS!), but when US small-caps recently traded down to 10 to 11 times current earnings, we felt there was some value there and waded in a little. If prices keep falling, we'll likely wade in a little more. Equity prices have always bounced back, sometimes rapidly, other times over a period of years. But time is our friend in this case, and doesn't nearly get the recognition it deserves.

So we embrace the Fed's commitment to higher interest rates – don't try and fight it! We remain patient. We continue to study the market and sift through the myriad securities offered for the ones we like at the prices we're comfortable with. We summon the courage to invest on down days, say when the Dow is down 500 points, or the 10-year Treasury yield surges. We continue to watch the data for signs that prices are softening, or that the economy is taking a turn. And we remain intellectually flexible – maintaining a willingness to modify our opinions as facts and market conditions change.

Individually, these all can be challenging things to do. But for the successful long-term investor, they are natural habits, often requiring reinforcement, but habits nonetheless. At Nottingham, we'll continue to work hard on your behalf, striving to make your long-term goals a reality. Please reach out to us with any questions or concerns you may have. From all of us at Nottingham Advisors, we'd like to wish you a peaceful and relaxing Labor Day weekend.

Larry Whistler, CFA
President
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