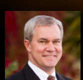
PRAETORIAN℠ GUARD

CLICK ON THE ARTICLE YOU WOULD LIKE TO SEE

3775 Via Nona Marie, Suite 220 ▪ Carmel, California 93923 ▪ **P:** (831) 622-9600 ▪ **F:** (831) 622-9002 ▪ www.praetorianguard.biz

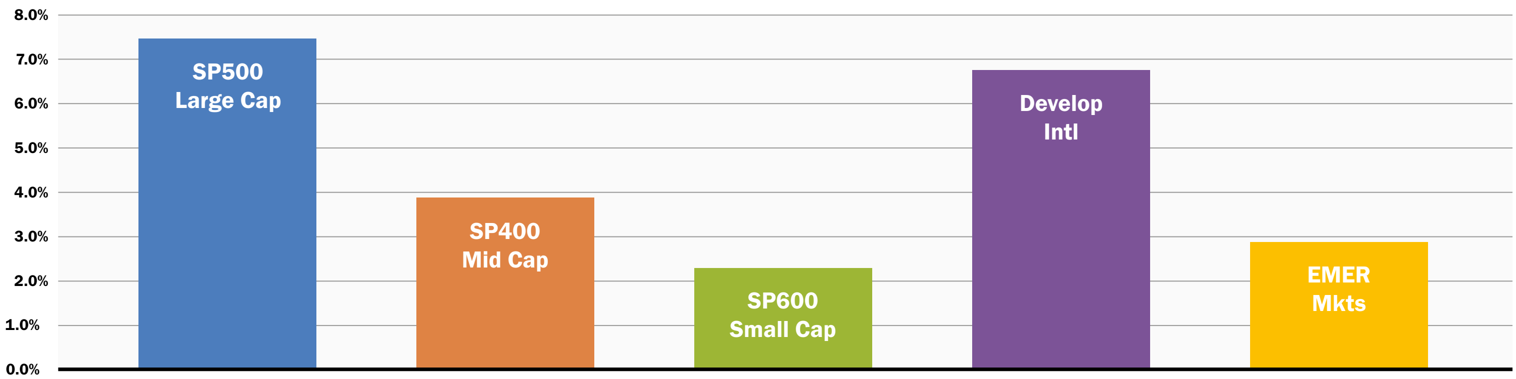
FIRST QUARTER 2023 MARKET REVIEW



By **Richard A. Hewitt, CFP®**

All equity markets generated positive returns for the first quarter of the year, and that is a welcome result.

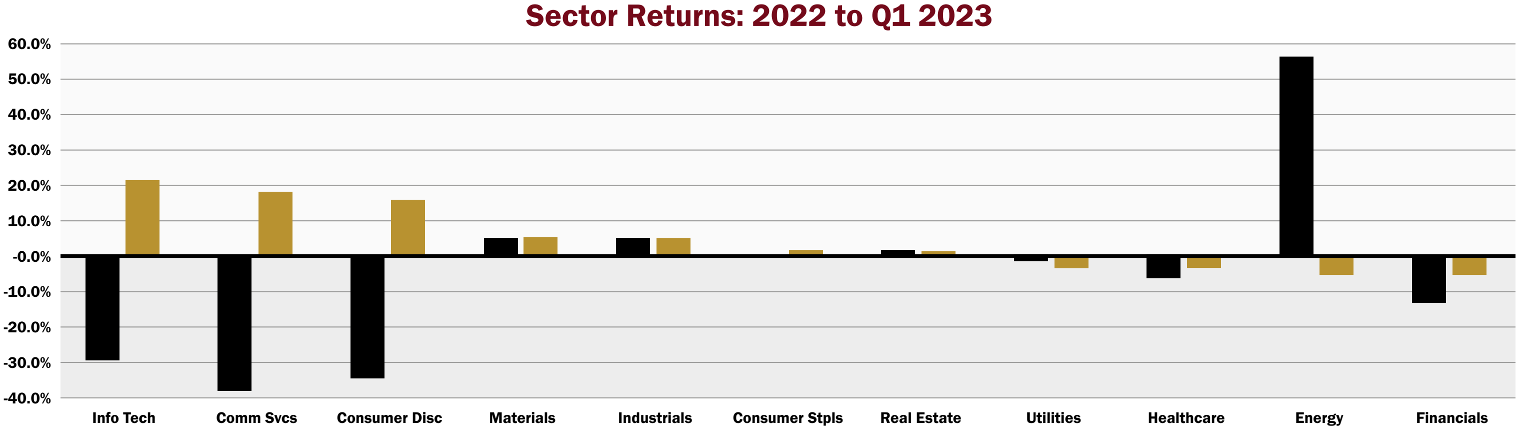
Q1 2023 Return



Source: Yahoo! Finance & MSCI

As we approach the end of the Fed's rate tightening cycle, sectors that were most sensitive to the interest rate hikes of 2022 benefited most in Q1 2023 (Sector Returns graph below shows a comparison of ALL of 2022 with the first quarter of 2023).

Sector Returns: 2022 to Q1 2023



Source: Yahoo! Finance & MSCI

Although the Fed could raise interest rates another 0.50% this year to a range of 5.25% to 5.50%, the impacts of that increase should not be as severe as those that resulted from the Fed increasing the rates 4.75% in one year.

THE CAUSE OF THE BANKING CRISIS AND ITS POTENTIAL ECONOMIC IMPACTS

By **Joseph P. Clark, CFP®**

The Federal Reserve (the Fed) conducts the nation's monetary policy to promote maximum employment and stable prices in the U.S. economy. We read and hear mostly about the latter as the Fed uses its tools to influence the availability and cost of money in an effort to keep inflation at very moderate levels. The Fed has been very focused on inflation over the last year, raising the federal funds rate nine times for a total increase of 4.75% to reach a range of 4.75% to 5.00% today. However, the Fed also is responsible for promoting the stability of our financial system by monitoring the safety and soundness of individual financial institutions. This is an area where the Fed hasn't done enough over the years, and the collapse of Silicon Valley Bank (SVB) is a perfect example.

When SVB collapsed, it was the second largest bank failure in U.S. history. It happened in part because the rapid rise in interest rates devalued its bond portfolio and created large paper losses for the bank. While there is no doubt SVB's management failed in managing its interest rate risks, there is also no question the Fed failed in its oversight mission. The Department of Justice (DOJ) and the Securities and Exchange Commission (SEC) have each launched investigations to review the actions of senior SVB executives, and the Fed has announced its own internal review of supervision and regulation of SVB with a report to be released in early May. In the end, the failure of SVB will be proven to have been caused largely by mismanagement by executives at SVB, but adequate regulation and oversight were not in place.

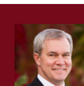
The U.S. banking system appears to be stabilized due to extraordinary government actions to head off a larger disaster. However, fallout from the SVB collapse will continue to be present as regional and community banks reduce lending activity. The U.S. economy runs on credit and loans.

Even before the SVB debacle, banks were tightening their lending. A quarterly survey of loan officers by the Fed showed that 40% reported tighter standards for loans to businesses in the final quarter of last year. Excluding the beginning of the COVID-19 pandemic, that's the highest percentage since 2009. Credit conditions could tighten further as people pull bank deposits. Total bank deposits have been falling for nearly a year — to approximately $17.6 trillion currently (from $18.1 trillion last April).

Americans have been shifting money out of bank accounts (that pay little interest) to higher-yielding savings vehicles such as Treasury bills and money market mutual funds. If the trend accelerates due to fears for deposit safety, it could cause affected banks to make fewer loans. A shift away from smaller banks to larger ones keeps overall loan numbers fairly steady, but this tightening could still restrict the availability of credit for smaller businesses and real estate investors that rely on community banks. Businesses could have a more difficult time accessing the cash necessary to hire more workers or spend on new equipment needed to expand the business.

Additionally, consumers might have a more difficult time getting a loan. On a large enough scale, that could impact the labor market and consumer demand, and in turn may help keep inflation lower. Nobody can predict how big of a credit crunch is ahead and to what extent it will hamper economic activity. However, the Fed is aware that financial conditions have tightened and it will surely affect their future interest rate decisions. Most projections call for just one more hike over the remainder of 2023 which could help the U.S. economy have a softer landing.

PRESIDENT'S COMMENTARY



By **Richard A. Hewitt, CFP®**

With all the external drama swirling around us (debt ceiling, bank runs, Tik Tok bans and a host of others), the desire to have some sense of control appears to be impossible. One thing we can affect is to consolidate, streamline and simplify some parts of our financial lives. This can be on the larger end of the spectrum, i.e., contact former employer 401K plans and get them consolidated in your current 401k plan (or rollover to an IRA) and if you have insurance coverage with more than one carrier, check to see if consolidation under one carrier is a better option. On the smaller end of the spectrum, there are options as well, i.e., music services, streaming services, and assorted "financial" leakages in our cash flow. Not as exciting as winning the lottery (!) but the odds are almost 100% that we can reduce friction and simplify things with a small commitment of time.

MARKET OPPORTUNITIES AMONGST NEGATIVE HEADLINES

By **Drew W. Nelson, CFP®**

The market volatility from 2022 has persisted into Q1 of 2023 with the Federal Reserve and the regional banking system dominating the headlines, creating some anxiety in the minds of retail investors. From our perspective, Praetorian Guard sees several upsides to these challenging economic times:

FIXED INCOME NOW PROVIDES MORE THAN BALLAST

First, fixed income instruments have become significantly more attractive as they are finally starting to pay meaningful yields for the first time in over 15 years. This has several implications:

1. Investors are better positioned to reach their target rate of return with much lower risk
2. Slowing pace of rate increases allows fixed income to maintain higher yields but with less volatility
3. Opportunity to lock in intermediate to long-term yields before the Fed cuts rates in the future

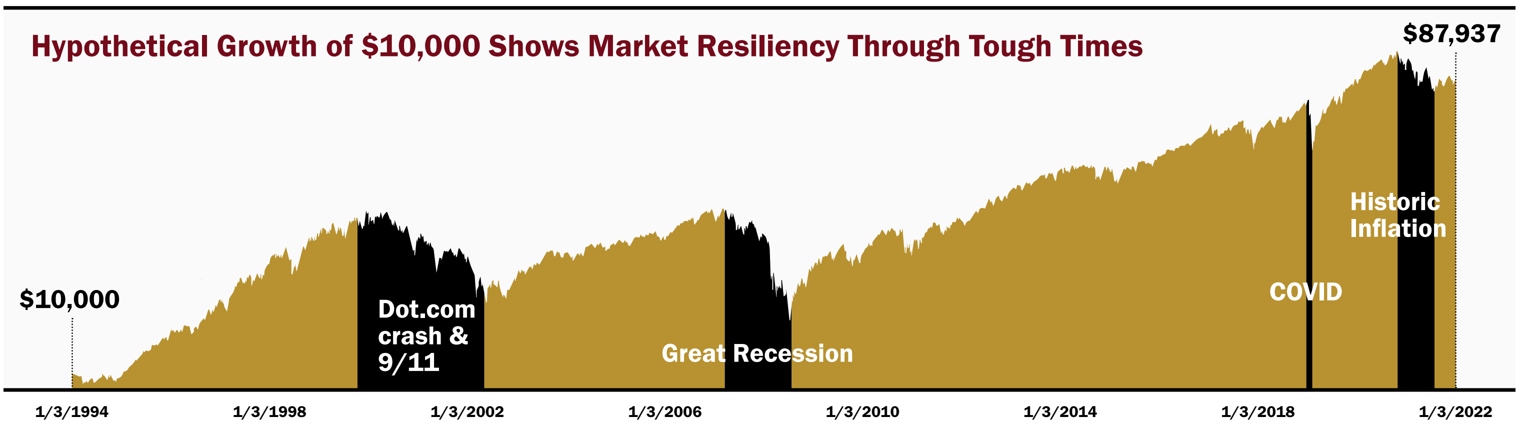
People with higher allocations to fixed income are enjoying the silver lining of the fastest rate hike cycle in over 40 years: higher bond yields. It is true that as interest rates rise, bond prices fall (as shown by a -13% drop in the U.S. Aggregate Bond Index in 2022); however, in most instances this does not impact our client portfolios as we hold most bonds until maturity.

EQUITIES HAVE EXPERIENCED A PULLBACK

Warren Buffett is quoted as saying, “The stock market is a voting machine in the short-term, but a weighing machine in the long-term.” The point he makes is that no one knows where the market is headed in the short-term, as the purchase and sale of securities is based on transitory news, emotions, and people’s perception of their value.

But in the long-term, the fundamentals of companies (and the American economy as a whole) make their value known and unavoidable, coalescing into a strong overall market. This long-term market value holds much more weight than flimsy votes on individual companies in the short-term. See below how $10,000 invested in the S&P 500 has grown to almost $88,000 over the last 30 years for some long-term perspective:

As the chart shows, the last 15 months have sent the equity markets into a tizzy but, historically, this is not uncommon. Since 1932, the S&P 500 has experienced a bear market (defined as a 20% decline from its peak) about once every 56 months (almost 5 years), on average. While it is very difficult and uncomfortable to endure, the silver lining is that stocks are now experiencing lower prices for investors. Our future selves will thank us if we take advantage of these cheaper prices and are disciplined in following our long-term financial plans.



Hypothetical Growth of $10,000 Shows Market Resiliency Through Tough Times

Source: Historical data of S&P 500 (ticker: ^GSPC) from 1/3/1994 to 3/31/2023. The index returned 781% over this period, or 7.52% annualized. This chart only considers the price return of the S&P 500, excluding dividend reinvestment. Index performance is for illustrative purposes only. It is not possible to invest directly in an index. Past performance does not guarantee or indicate future results.

This strategy mitigates interest rate risk and when bonds mature, it allows us to reinvest the proceeds into new bonds at the higher yields. The ultimate result is that investors can more reliably meet their target rates of return, something they have been unable to do over the past decade without adding more equity exposure to their portfolio than may be preferred.

Praetorian Guard sees these higher yields holding steady for the foreseeable future as the Fed is closer to pausing rate hikes now than they were six months ago. According to BlackRock, the average time between the Fed pausing and the Fed then cutting rates is about 10.5 months; but in these unchartered waters, we see that timeframe being stretched out a bit further.

> WARREN BUFFETT IS QUOTED AS SAYING, “THE STOCK MARKET IS A VOTING MACHINE IN THE SHORT-TERM, BUT A WEIGHING MACHINE IN THE LONG-TERM.”

DOWN MARKETS DO NOT LAST FOREVER

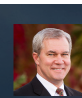
Our chart above shows that down markets do not last forever, but we only know when they end in hindsight. While it is true that the market waters have been very choppy recently, if we decide to get out of the water and sit on the beach to wait for a better time to wade back in, it will be too late; we only know when the time is right to reenter after it has already happened. In our humble opinion, the best time to get invested was yesterday!

Our President, Dick Hewitt, CFP® reminded us in his recent client communication concerning the regional banking headlines about the importance of diversification in our portfolios. Diversification and always staying invested (even when our inner voices are telling us to retreat) allow us to develop and maintain the discipline discussed earlier to adhere to a long-term plan.

This first quarter of 2023 serves as a continuing reminder that the world does not end that often. Yes, times are uncertain and markets have remained volatile, but our country has experienced many tumultuous times in its history (some much worse than now!) and it has always forged a path forward. This time will be no different.

POLITICAL AND ECONOMIC UPDATE

By **Richard A. Hewitt, CFP®**



In a few short weeks the United States' Federal political class will be unable to go more than one minute without using the words: "default" or "debt" (and I suspect a few more that are not fit for this publication). We will enter into the Federal debt ceiling "crisis" that comes around regularly and is ALWAYS solved.

The U.S. Treasury is already using "extraordinary" measures to juggle the books as technically the U.S. has reached the current debt ceiling. These include suspending new investments in some government accounts (e.g., Postal Service Retiree Health Benefits Fund) in order to buy time for a political solution.

This time will be no different. Here is what I expect to happen: things will be relatively quiet through the end of April as the immediate issue of banking stability combined with normal "noise" dominate headlines.

President Biden has said he won't negotiate on lifting the ceiling. He will. Speaker McCarthy has said that there must be cuts in spending. There won't. They will be illusionary and in the out years—sort of like starting my diet, just next week. By mid-May we can expect that the negotiations will cause some increased volatility in markets as one side or the other seems to have the upper hand. In June we will see a short-term extension while negotiations continue and by July 4th we'll have a deal. By taking a step back we see that this political drama has all the excitement and unknowns as Elizabeth Taylor's 2nd through 8th wedding nights.

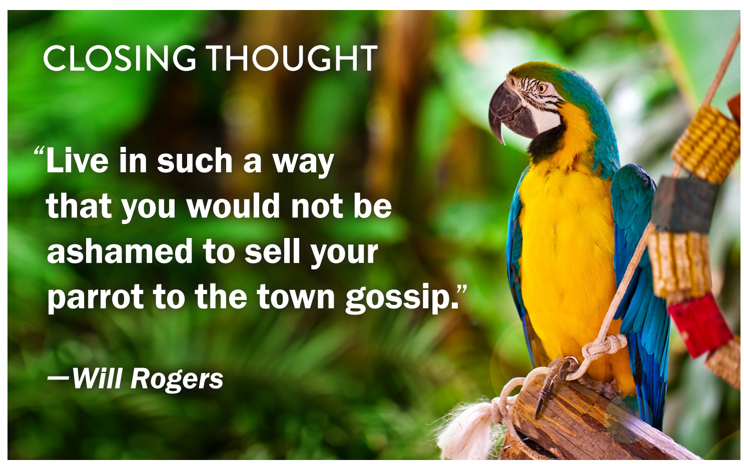
The Federal Reserve will conclude its rate tightening cycle by the June 13-14th meeting which will provide a tailwind to stock markets as economic entities will know the state of interest rates for the coming 9-12 months. We do not expect rate cuts anytime in the remainder of 2023 and unlikely the first half of 2024.

By the start of the 3rd Quarter, President Biden's reelection will be formally underway and we should know the final composition of the Republican Party's declared candidates. I expect Former Vice President Mike Pence and Florida Governor Ron DeSantis to join a field of declared candidates headlined by Donald Trump and Nikki Haley.

COVER STORIES

© Behavior Gap

CLOSING THOUGHT



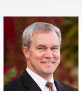
"Live in such a way that you would not be ashamed to sell your parrot to the town gossip."

—Will Rogers

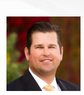
PRAETORIAN GUARD

A division of Praetorian Wealth Management, Inc.
3775 Via Nona Marie, Suite 220 ▪ Carmel, California 93923 ▪ **P:** (831) 622-9600 ▪ **F:** (831) 622-9002 ▪ www.praetorianguard.biz

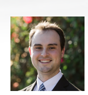
Investment Professionals



Richard A. Hewitt, CFP®
President
rhewitt@praetorianguard.biz

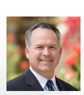


Jerry M. Ledzinski II
Managing Director
jmledzinski@praetorianguard.biz



Drew W. Nelson, CFP®
Associate Financial Planner
dnelson@praetorianguard.biz

Joseph P. Clark, CFP®
Director, Eastern United States
jclark@praetorianguard.biz



Marc A. Wehmeyer, CFP®
Director, Mid-Atlantic Region
mwehmeyer@praetorianguard.biz