SPECTRUM
INVESTMENT ADVISORS

Spectrum Investor®

Quarterly Newsletter

Q4 2022

Newsletter Summary

- Federal Reserve Raises Rates to Combat Elevated Inflation
- Stocks and Bonds Decline In the Third Quarter
- U.S. Corporate Earnings Hang Tough Amid Recession Risks

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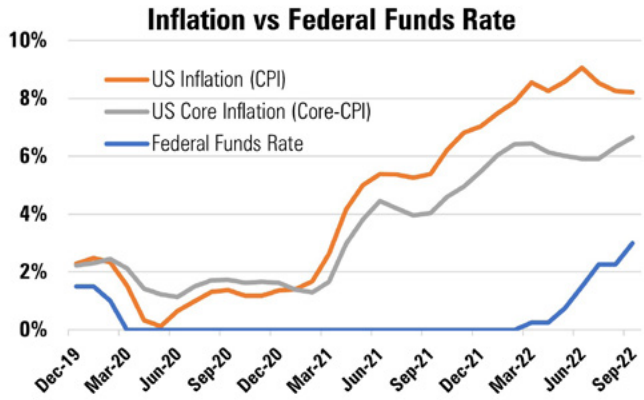
2022 has been like a broken record. For the third consecutive quarter, stubbornly high inflation and rising interest rates pushed stock and bond prices lower. Through September 30, the S&P 500 U.S. stock index was down -23.87% and the Bloomberg U.S. Aggregate Bond Index was down -14.6%. If both indexes finish down for the year, it will be the first calendar that both indexes fell at the same time since 1969, 53 years ago.

Long-term perspectives: Through the first nine months of any year going back to 1926, this has been the worst start to a year for U.S. bonds and the fourth worst start to a year for U.S. stocks. It is painful to experience, but keep in mind this is very rare. The good news is, among the other nine worst starts, the average return over the next 12 months was 9% for both stocks and bonds *(Student of the Market, October 2022).*

Market environment: Inflation has remained near 40-year highs. The longer inflation persists, the harder it becomes to control. To fight inflation the Federal Reserve is in the midst of its fastest set of interest rate hikes since the 1980s. That has had a sharp impact on stock and bond prices, but so far the economy has been relatively stable. U.S. Real GDP indicates the economy grew at 2.6% in the third quarter 2022.

Inflation vs the Federal Reserve: The economy lost its balance of supply and demand during the pandemic and has yet to find it. For the most part, demand has dramatically exceeded supply, leading to higher prices. The chart below shows inflation's ascent to near 40-year highs. A year ago, the Federal Reserve expected inflation would cool on its own as supply chain issues resolved with the economy reopening. Instead, inflation has gone higher. The blue line shows that the fed funds rate now exceeds pre-COVID levels, meaning the "accommodation" of low interest rates has been removed. There are signs that higher interest rates are cooling demand in housing and the demand for new workers, but both remain at elevated levels. Heading into next year the Fed is expected to slow the pace of rate increases, possibly beginning in December. The median expectation by Fed members is for the fed funds rate to end 2023 somewhere between 4.5% to 5%. The chart on page 2 shows more about the impact of higher rates on housing.



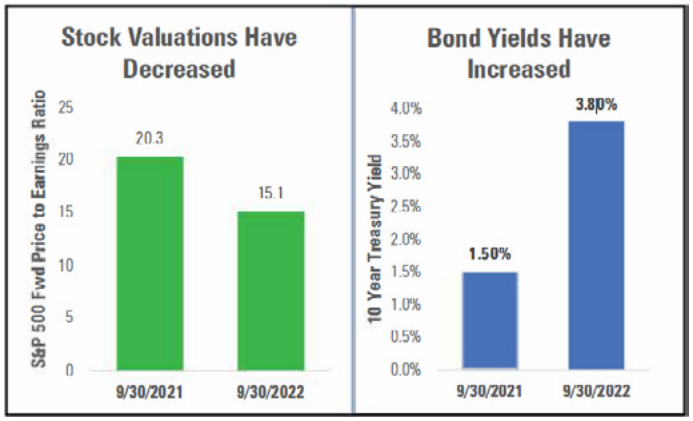
CPI: Consumer Price Index year over year change. Core CPI: CPI excluding food and energy, year over year. Source: Bureau of Labor Statistics, YCharts.

Silver Lining: During the reopening, one of the headwinds we experienced was high valuations. Like many other things, stock and bond prices rose dramatically as interest rates were expected to stay "lower for longer". With inflation and the Fed's pivot to higher interest rates, prices have declined in both stocks and bonds. The silver lining is that stock and bond prices are much more attractive and may act as a potential tailwind.

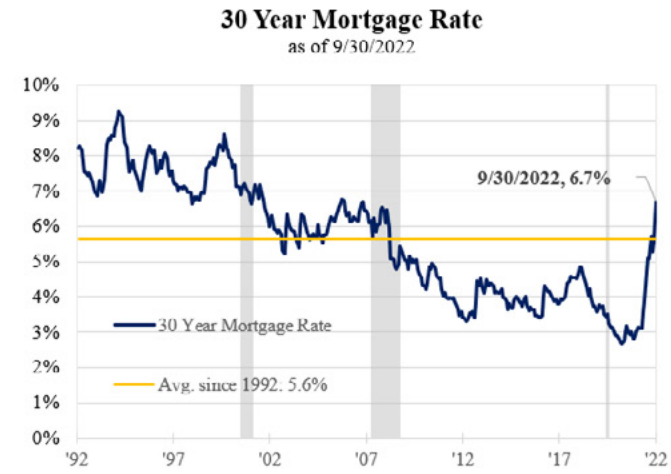
The price to earnings valuation on the S&P 500 has gone from the highest levels since the late 1990s to below its 25-year average of 16.84. For bonds, the 10-year Treasury yield climbed above its 25-year average of 3.4% by the end of September and reached as high as 4.2% in late October.

The yield on the Bloomberg U.S. Aggregate Bond index, which includes government and corporate bonds was even higher at 4.75% as of quarter end. Long-term, stocks are likely to outperform bonds, but if you are losing sleep over your portfolio allocation, especially if you are approaching or in retirement, you may want to consider rebalancing a bit toward bonds to take advantage of today's higher interest rates. Typically, when adjusting your portfolio allocation, we suggest moving in 10% increments. We are not calling for a bottom in stocks or bonds, but over the long-term, these are attractive levels.

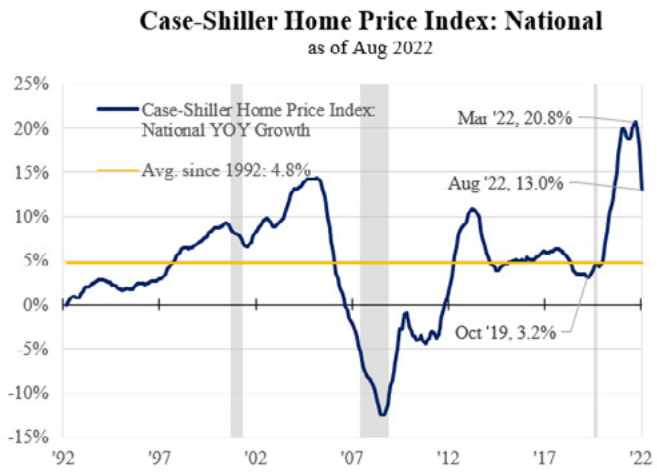
We always encourage investors to think long-term. For those of you who wish to revisit your portfolio, please contact us at 800-242-4735.



Mortgage Rates Rise



Higher Rates are slowing Home Price Growth



- Mortgage rates have risen as mortgage rates are very responsive to treasury rates.
- The Federal Reserve is hoping higher rates cool the overheated housing market.

- House prices surged over the last two years, rising at the fastest rate in 30 years.
- The pace that home prices were increasing has slowed significantly since the peak in March 2022.

Source: YCharts, Freddie Mac (left), Standard & Poor's (right)

Earnings and Multiples: With valuations having largely adjusted to higher interest rates, the path for stocks moving forward depends heavily on earnings; higher expected earnings growth should prompt a stock market rally, while lower earnings growth could bring declines.

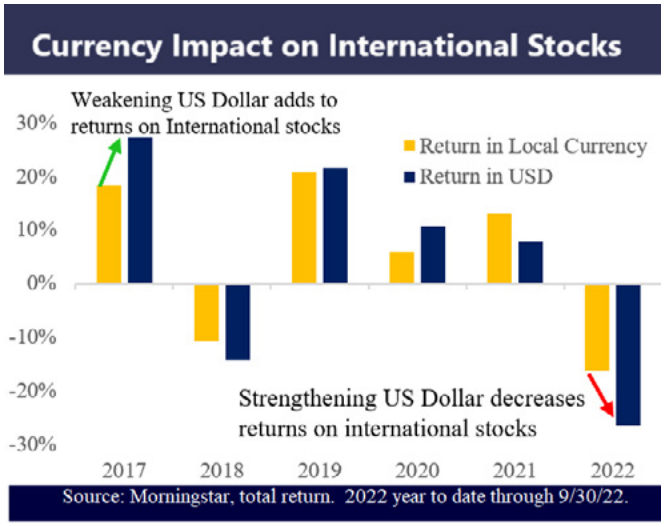
Analyst expectations have come down since last quarter , but earnings growth is still expected for 2023. This chart shows combined earnings of S&P 500 companies are expected to grow to around $240 and $260 in 2023 & 2024. A reasonable 16 times multiple (valuation) indicates an S&P 500 price level between 3,840 and 4,160. The S&P 500 closed October 26 at 3,860.

The earnings chart is also useful from a historical perspective. The green bars indicate five prior periods of earnings declines. If analysts are wrong and earnings decline, on average earnings have recovered and resumed growth within about 2.5 years. That's why you want to own stocks for the long run.

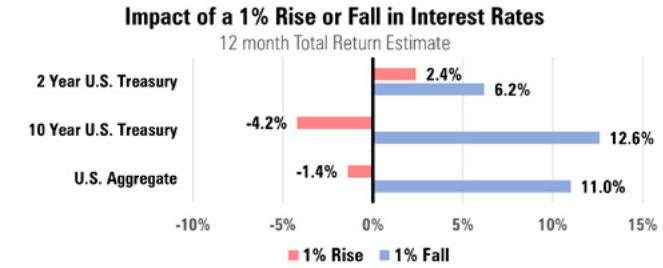
Source: JPMorgan GTM, 9/30/22. Earnings estimates are from Standard and Poor's and FactSet earnings aggregates.

The U.S. Dollar: Currencies tend to follow interest rates. With U.S interest rates rising faster than most other developed countries, the U.S. dollar has strengthened substantially this year. The dollar is currently at a 20-year high versus the Euro, a 32-year high versus the Japanese Yen and a 37-year high versus the British Pound. The U.S. dollar appreciation in 2022 has helped the Federal Reserve in their fight against inflation as a stronger currency is typically deflationary by making imports less expensive. However, a strengthening dollar hurts international returns for a U.S. investor as each unit of return in foreign currency buys less dollars.

The chart to the right shows the impact of the dollar on international investments. For example, the international stock index was down about 15% year to date in 2022, but down -25% when converted to U.S. dollars. The opposite was true in 2017 when the dollar declined. Currency forecasts are notoriously difficult to get right, therefore we recommend maintaining international exposure, regardless of currency expectations.



Yield Cushion: When yields (rates) rise, bond prices fall. That's why bond returns are down this year. Higher yields now offer more cushion for bonds to offset price declines if interest rates should continue climbing.



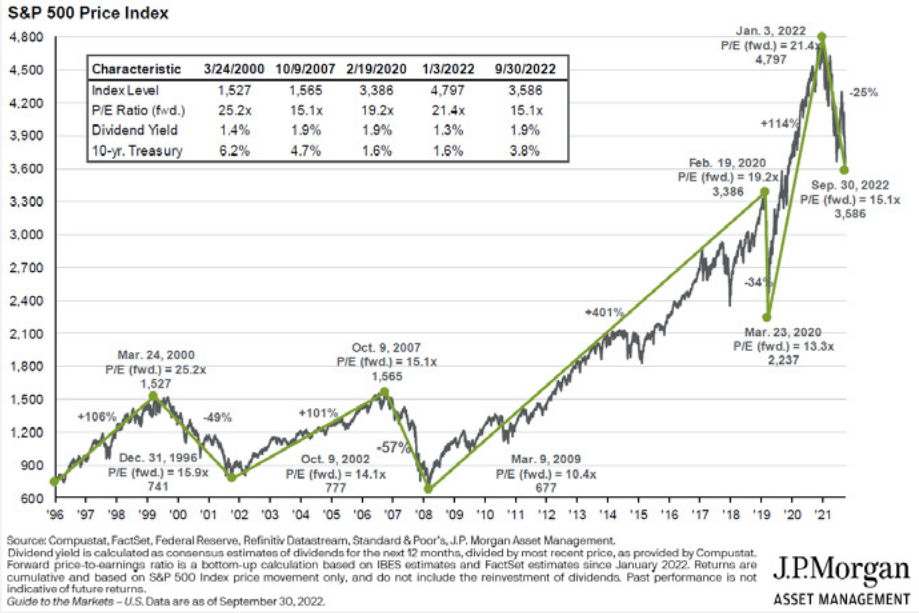
Source: JPMorgan GTM, 9/30/22, assumes 1% change of interest rates across entire yield curve. U.S. Aggregate: Bloomberg US Agg Bond Index.

Europe: The war in Ukraine raised concerns about Europe's ability to make it through the winter with enough energy resources to heat homes and keep factories running. The good news is early fall has been mild and supplies are well stocked to the point where European natural gas prices are down -70% from their peak. European natural gas capacity is at 93% and there are 60 ships carrying liquefied natural gas (LNG) waiting to be unloaded in European waters.

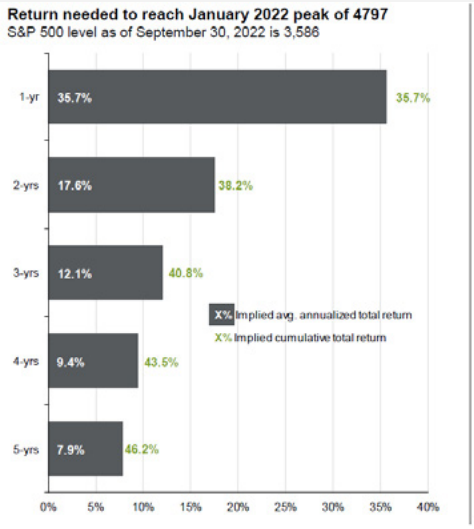
It appears the war in Ukraine is turning in favor of Ukraine under the leadership of Colonel General Oleksandr Syrskyi, who masterminded the defense of Kyiv and the counteroffensive in eastern and southern Ukraine. The risk is desperation from Putin that he may resort to nuclear weapons to reverse the course of the war.

Mid-term Elections: The upcoming elections are on November 8th. Going back to 1970, the stock market has averaged a 3.4% gain three months before the election and a 6.2% gain three months after election day. As always, when it comes to elections, we encourage you to vote with your ballot, not your portfolio. In the long-run, markets depend much more on corporate earnings and interest rates than elected officials.

S&P 500 Index at Inflection Points: The chart illustrates the performance history of the S&P 500 from 12/31/96 to 9/30/22. After gaining 18% in 2020 and 28% in 2021, the S&P 500 is down -25% (-23.8% with dividends) through 9/30/22. As of 9/30/22, the 10-year treasury rate rose to 3.8% compared to the dividend yield of the S&P 500 at 1.9%, making bonds as attractive as they have been in 13 years.



Stocks for the Long Run: The table on the right shows 14 bear markets (down 20% or more) since 1926 for the S&P 500. The average decline was down -41%. While we cannot rule out the possibility of further declines, the long-term potential favors stocks. The chart on the left shows that even if it takes five years for the S&P 500 to recover to its peak on January 3, the annualized return over the five years would be 7.9%, more than double the current 10-year treasury rate (3.8%). Stay diversified in a mix of stocks and bonds that fits your goals and risk tolerance.



Bull and bear markets

Bull markets			Bear markets		
Bull begin date	Bull return	Duration (months)	Market peak	Bear return*	Duration (months)*
Jul 1926	152%	37	Sep 1929	-86%	32
Mar 1935	129%	23	Mar 1937	-60%	61
Apr 1942	158%	49	May 1946	-30%	36
Jun 1949	267%	85	Aug 1956	-22%	14
Oct 1960	39%	13	Dec 1961	-28%	6
Oct 1962	76%	39	Feb 1966	-22%	7
Oct 1966	48%	25	Nov 1968	-36%	17
May 1970	74%	31	Jan 1973	-48%	20
Mar 1978	62%	32	Nov 1980	-27%	20
Aug 1982	229%	60	Aug 1987	-34%	3
Oct 1990	417%	113	Mar 2000	-49%	30
Oct 2002	101%	60	Oct 2007	-57%	17
Mar 2009	401%	131	Feb 2020	-34%	1
Mar 2020	114%	21	Jan. 2022**	-25%	8
Averages	162%	51	-	-41%	20

Source: FactSet, NBER, Robert Shiller, Standard & Poor's, J.P. Morgan Asset Management. (Left) The current peak of 4797 was observed on January 3, 2022. (Right) *A bear market is defined as a 20% or more decline from the previous market high. The related market return is the peak to trough return over the cycle. Bear and bull returns are price returns. **The bear market beginning in January 2022 is currently ongoing. The "bear return" for this period is from the January 2022 market peak through the current trough. Averages for the bear market return and duration do not include figures from the current cycle.
Guide to the Markets – U.S. Data are as of September 30, 2022.
J.P.Morgan
ASSET MANAGEMENT

Spectrum Investor® Update

as of September 30, 2022

Morningstar Category Averages	3rd Qtr	1 Year	3 Year
Intermediate-Core Bond	-4.64%	-14.86%	-0.40%
Allocation 50%-70% Equity	-4.48%	-14.80%	2.49%
Large Cap Value	-5.91%	-9.64%	5.27%
Large Cap Blend	-4.99%	-15.83%	6.77%
Large Cap Growth	-4.09%	-27.10%	6.77%
Mid Cap Value	-5.15%	-11.31%	5.22%
Mid Cap Blend	-3.84%	-15.64%	5.27%
Mid Cap Growth	-1.83%	-29.18%	5.10%
Small Cap Value	-5.06%	-14.77%	5.92%
Small Cap Blend	-4.03%	-18.95%	4.74%
Small Cap Growth	-1.35%	-29.71%	5.26%
Foreign Large Cap Blend	-10.10%	-25.51%	-1.79%
Real Estate	-10.66%	-18.47%	-1.96%
Natural Resources	-4.31%	-6.05%	11.38%

Source: Morningstar, 3 yr return is annualized. Morningstar classifies categories by underlying holdings and then calculates the average performance of the category. Past performance is not an indication of future results. Returns in Blue = Best, Returns in Red = Worst. Please see Benchmark Disclosures on pg. 4.

DOW: 28,725

NASDAQ: 10,576

S&P 500: 3,586

10 Yr T-Note: 3.83%

Inflation Rate: 8.2% (9/22)

Unemployment Rate: 3.5%

In closing, we always encourage investors to think long-term. The chart to the left shows most categories are still up over the last three years despite the recent downturn. For those of you who wish to revisit your portfolio, please contact us at 800-242-4735.
For more on the markets, click on the resources tab on our website www.spectruminvestor.com.

Data as of 9/30/22 unless otherwise noted. The Dow Jones Industrial Average is comprised of 30 stocks that are major factors in their industries and widely held by individuals and institutional investors. The S&P 500 Index is a capitalization weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries. The NASDAQ Composite Index measures all NASDAQ domestic and non-U.S. based common stocks listed on The NASDAQ Stock Market. Barrel of Oil: West Texas Intermediate. Inflation Rate: CPI. The market value, the last sale price multiplied by total shares outstanding, is calculated throughout the trading day, and is related to the total value of the Index. Indices cannot be invested into directly.

To determine which investment(s)may be appropriate for you, consult your financial advisor prior to investing. All performance referenced is historical and is no guarantee of future results. All indices are unmanaged and cannot be invested into directly.

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Benchmark Disclosures: Morningstar Category Averages: Morningstar classifies mutual funds into peer groups based on their holdings. The Category Average calculates the average return of mutual funds that fall within the category during the given time period. The following indexes and their definitions provide an approximate description of the type of investments held by mutual funds in each respective Morningstar Category. One cannot invest directly in an index or category average. Intermediate-Term Bonds: Bloomberg US Agg Bond Index–Measures the performance of investment grade, US dollar-denominated, fixed-rate taxable bond market, including Treasuries, government-related and corporate securities, MBS, ABS and CMBS. Allocation 50%-70% Equity–These funds invest in both stocks and bonds and maintain a relatively higher position in stocks. These funds typically have 50%-70% of assets in equities and the remainder in fixed income and cash. Large Cap Value: S&P 500 Value Index–Measures the performance of value stocks of the S&P 500 index by dividing into growth and value segments by using three factors: sales growth, the ratio of earnings change to price and momentum. Large Cap Blend: S&P 500 Index–A market capitalization-weighted index composed of the 500 most widely held stocks whose assets and/or revenue are based in the US. Large Cap Growth: S&P 500 Growth Index–Measures the performance of growth stocks drawn from the S&P 500 index by dividing it into growth and value segments by using three factors: sales growth, the ratio of earnings change to price and momentum. Mid Cap Value/Mid Cap Growth: S&P MidCap 400 Index–A market cap weighted index that covers the complete market cap for the S&P 400 Index. All S&P 400 index stocks are represented in both and/or each Growth and Value index. Mid Cap Blend: S&P MidCap 400 Index–Measures the performance of mid-sized US companies, reflecting the distinctive risk and return characteristics of this market segment. Small Cap Value: Russell 2000 Value Index–Measures the performance of small-cap value segment of Russell 2000 companies with lower price-to-book ratios and lower forecasted growth values. Small Cap Blend: Russell 2000 Index–Measures the performance of the small-cap segment of the US equity universe. It includes approximately 2000 of the smallest securities based on a combination of their market cap and current index membership. Foreign Large Cap Blend: MSCI EAFE NR Index–This Europe, Australasia, and Far East index is a market-capitalization-weighted index of 21 non-US, developed country indexes. Small Cap Growth: Russell 2000 Growth Index–Measures the performance of small-cap growth segment of Russell 2000 companies with higher price-to-value ratios and higher forecasted growth values. Real Estate: DJ US Select REIT Index–Measures the performance of publicly traded real estate trusts (REITs) and REIT-like securities to serve as proxy for direct real estate investment. Natural Resources: S&P North American Natural Resources Index– Measures the performance of US traded securities classified by the Global Industry Classification Standard (GICS) as energy and materials excluding the chemicals industry and steel but including energy companies, forestry services, producers of pulp and paper and plantations. Past performance is no guarantee of future results. This report is for informational purposes only and should not be construed as a recommendation or solicitation to buy or sell any security, policy or investment. PE Ratio is the measure of the share price relative to the annual net income earned by the firm per share.