JUNE 16, 2022

RZHadvisors

Dear Clients and Friends of RZH,

After rallying earlier this month the stock market sold off precipitously this last week, falling 10% in just five days, closing at its lowest point of the year on Tuesday. The latest route was triggered by a worse-than-expected inflation reading last Friday – the worst in 40 years. This initiated the frenzied selling of stocks and bonds as the market tried to comprehend where inflation and interest rates are headed. Interestingly, even gold (a typical inflation hedge) has declined recently. The message to me is that the capital markets have lost faith in the US Federal Reserve, as well as global central banks, to effectively tame inflation through monetary policy. It is clear - there is much uncertainty as to where global economies are headed.

To make things worse, during these periods of heightened volatility, the primary function of financial journalism seems to be terrifying us out of ever achieving our financial goals by shrieking about the market's volatility. We've been reminded of this almost hourly as the S&P 500 approached "official bear market territory," defined as closing 20% below its January all-time high.

Please know, we fully understand how unusually painful this has been. This year has seen the worst start for the stock market since 1939 and the worst start ever for bonds. We hear your concerns and feel your anxiety. As co-investors in all RZH investments, we are experiencing this downturn side-by-side with you as well.

Every market decline of this magnitude has its own unique precipitating causes. I think it's fair to say that the current episode is a response to two issues: severe inflation, and the extent to which the economy might be driven into a recession by the Federal Reserve's somewhat belated efforts to root that inflation out. (Russia's war on Ukraine, supply chain issues, Covid lockdowns in China, and the like are surely contributing to the angst, but recession vs. inflation is the main event, in my judgment.)

Here is some perspective:

From March 2009 (when the equity market bottomed at the end of the Global Financial Crisis) through the end of 2021, the S&P 500 produced an average annual compound return of 17.5%. Indeed, over those last three calendar years (2019 – 2021), despite a hundred-year global health crisis that took the lives of millions of people worldwide, the Index compounded at 24% per year. This was one of the greatest runs of all time. (Remember, the long-term annual average return for stocks is only about 10%.)

However, it's evident that some part of that extraordinary accretion in equity values was due to excessive monetary stimulation by the Fed. And to that extent, we are having to give some of that gain back, as the Fed moves to bring the resultant inflation under control. I consider this somewhat a process of reversion to the mean. We should, I believe, want them to do this, even if it means the economy slows. In the long run, the cure (possible recession) is not more painful than the disease (inflation).

For long-term investors, capitulation to a bear market by fleeing equities has often proven to be a tragedy, from which their retirement plans may never recover. Our investment policy is founded on the acceptance of the idea that the only way to be reasonably assured of capturing equities' premium returns (about 10% annually) is by riding out their occasional declines.

Short-term volatility is not risk, unless acted upon. Risk should be measured as the probability that we won't achieve our goals. So, our mission continues: not to eliminate short-term volatility, but to provide a high probability of meeting your lifetime financial objectives. The playbook for these scenarios is proven throughout history: keep 1-2 years of cash flow needs on the sidelines, maintain 4-5 additional years of investment-grade short/intermediate-term bonds and own predominately large-cap – blue-chip stocks.

As this is exactly how RZH portfolios are currently positioned, I continue to counsel staying the course. This has been a winning formula for history's most challenging economic environments. Sexy – no, effective – yes.

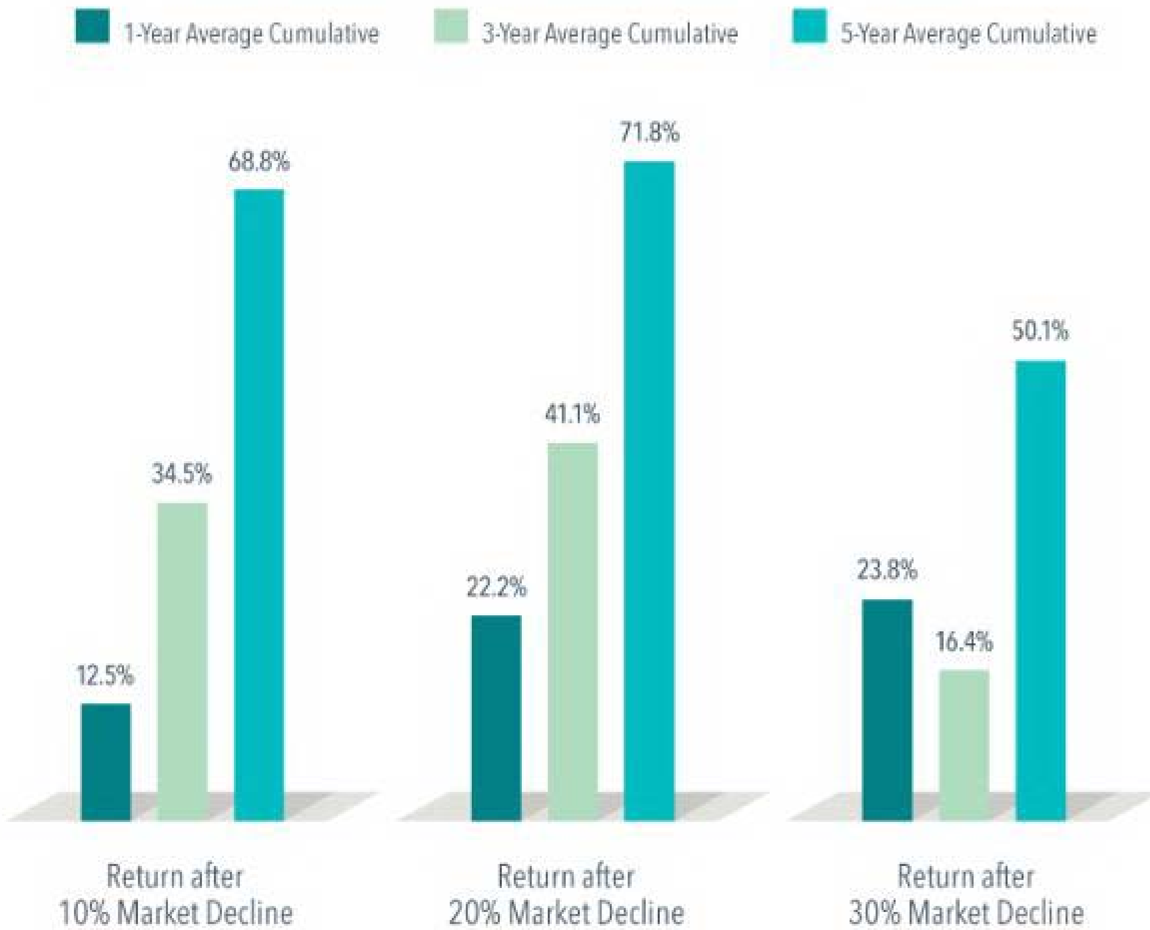
The good news…markets have usually rebounded well after periods of similar volatility (see chart)

We are always here to talk this through with you. Thank you for being our clients. It is a privilege to serve you.

Best regards,

Bouncing Back

Fama/French Total US Market Research Index Returns, July 1926-December 2021



Past performance is no guarantee of future results.

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