NEWSQUARE CAPITAL

1st Quarter • 2023

Don’t get fooled again: Three lessons from early 2023

Since the world shut down in March 2020 in response to the pandemic, investors have lived through a remarkable number of historic, unprecedented, and largely unexpected events. COVID-19 restrictions halted economic activity. Trillions of dollars of government stimulus money was pumped into the economy. Interest rates were slashed to zero, followed by one of the most aggressive interest-rising cycles ever due to inflation spiking to 40-year highs. The largest military conflict in Europe since World War II started when Russia invaded Ukraine, exacerbating the issues from the pandemic and growing into a World War III threat. Oil prices first sank to negative figures, then roared to above $100-per-barrel. The list goes on and on, right up to March 2023, when some investors were hit by the latest crisis, the second- and third-largest bank failures in U.S. history. In three years, we’ve seen enough major, market-altering events that typically would take place in three *decades*.

All these crises du jour have led us to take inspiration from one of our favorite rock and roll anthems, The Who’s “Won’t Get Fooled Again.” If we’ve learned anything from the past three months—or the past three years—it’s that bad things happen, sometimes all at once. It’s no wonder so many are fearful, and that’s why we find The Who’s lyrics “Don’t get fooled again” appropriate for these market times.

At NewSquare Capital, we won’t allow our emotions and biases deter us from a steadfast focus on our investment process, risk management, and long-term investing approach. We won’t get caught up in the day-to-day news and market movements, no matter how dire (or overwhelmingly positive, for that matter) they seem to be. It’s an old lesson, but it’s worth highlighting, once again, in these uncertain times.

Here, then, are three things we think are key lessons from 2023:

1. Expect the unexpected

We say it all the time, but it bears repeating: No one knows with certainty what’s going to happen next, with the economy and the markets, nor how governments around the world will react. We’ve certainly been reminded of that since 2020. Are we in a recession?

> *“The courage to press on regardless—regardless of whether we face calm seas or rough seas, and especially when the market storms howl around us, is the quintessential attribute of the successful investor.”*
>
> —Vanguard founder John Bogle, April 2001

Inexorably marching toward one? On pace to avoid one? Will the U.S. Federal Reserve (Fed) keep raising interest rates, or pause, or start lowering them? Will we have a soft landing, a hard landing, or no landing at all? Will tomorrow’s headline be the black swan event that cuts portfolios in half, or will it propel the next bull market?

We all have questions. No one has the definitive answers until it all unfolds. So, why get caught up in all of it? Instead, realize that any of those things *could* happen, as could any number of things you haven’t even considered. NewSquare Capital believes that’s what successful investors do. They choose an investment process that makes the most sense to them. They understand what it’s supposed to do. They believe in risk management and focus on the long term, confidently sticking to their process across full market cycles, no matter what’s happening on a certain day, month, quarter, or year. Sticking to it is the most challenging part *and* the behavior that rewards investors the most. Do that, and whatever comes next won’t shock you to the point where you make mistakes based on fear or greed.

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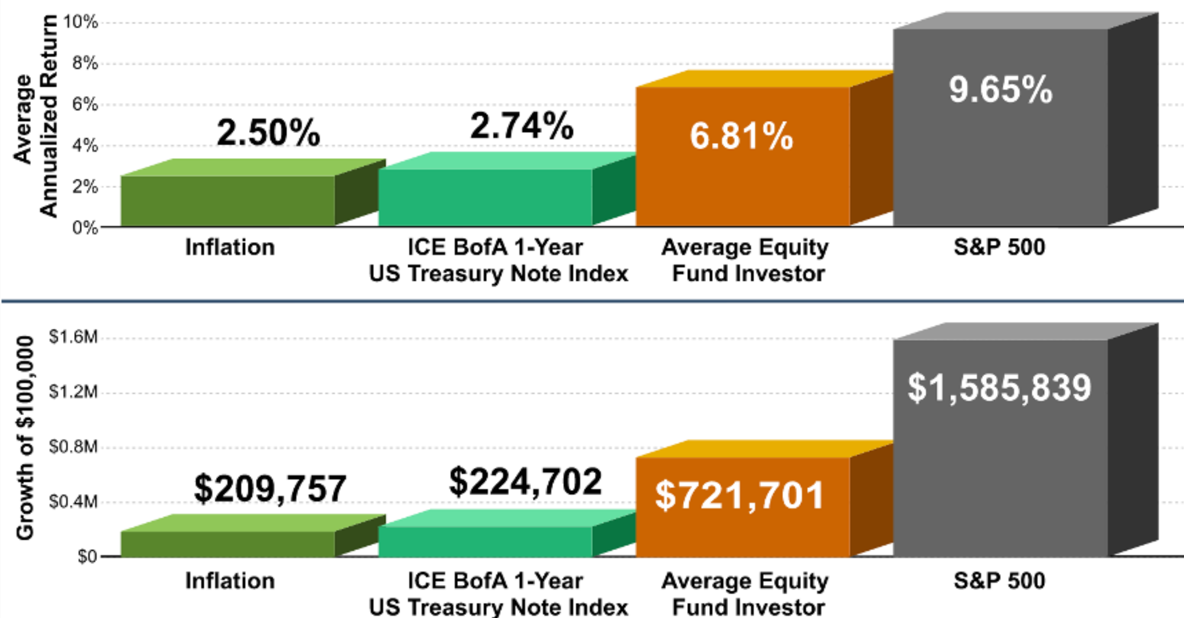
2. Don't let your emotions get the best of you

Over the 30-year period through the end of 2022, the average equity fund investor **trailed the S&P 500® Index by 2.84% annually**, according to a 2023 study of investor behavior conducted by DALBAR, a Boston-based financial-services firm*. A $100,000 investment in the index grew to nearly $1.6 million, while the average equity fund investor ended up with just over $700,000. Through Dec. 31, 2020, the number was even worse, with the typical equity investor earning only **half** of the index's return, 5% per year, compared to 10% for the index. These were not isolated events, either. In 2013, the 30-year gap was a whopping 7.4% per year. To quote The Who once more, don't get fooled because the data still shows similar trends over shorter timeframes also (i.e. 10 years AND less).

Why does this keep happening, over and over? We believe it's because people make emotional decisions, bolstered by inherent human biases, that hurt their long-term investing outcomes. and could cost them significant amounts of money. They get greedy, they suffer from fear of missing out, and they chase performance, to name just a few of the mistakes people make. Avoiding these fates can be a challenge, especially after 15 or so years in which every pullback turned, almost always immediately, into a V-shaped recovery, supported by the friendly environment of low interest rates and easy money from the Fed. A lot of investors have gotten away from risk management and tactical investing, because for so long, almost every area of the market just kept rising.

The Dalbar Study: Average Equity Fund Investor vs. Indexes Over 30 Years



Average Equity Investor as determined by Dalbar | Study source: Dalbar QAIB 2023 study, Morningstar, Inc. | Past performance does not guarantee future results. The S&P 500 Index is an unmanaged float-adjusted market capitalization-weighted index that is generally considered representative of the U.S. stock market. Other indexes may be more appropriate to benchmark your investments against. It is not possible to invest directly in an index. Data is provided for illustrative purposes only, it does not represent actual performance of any client portfolio or account and it should not be interpreted as an indication of such performance. © 2023 Index Fund Advisors, Inc. (IFA.com)

*Study source: DALBAR QAIB 2023 study, Morningstar, Inc.

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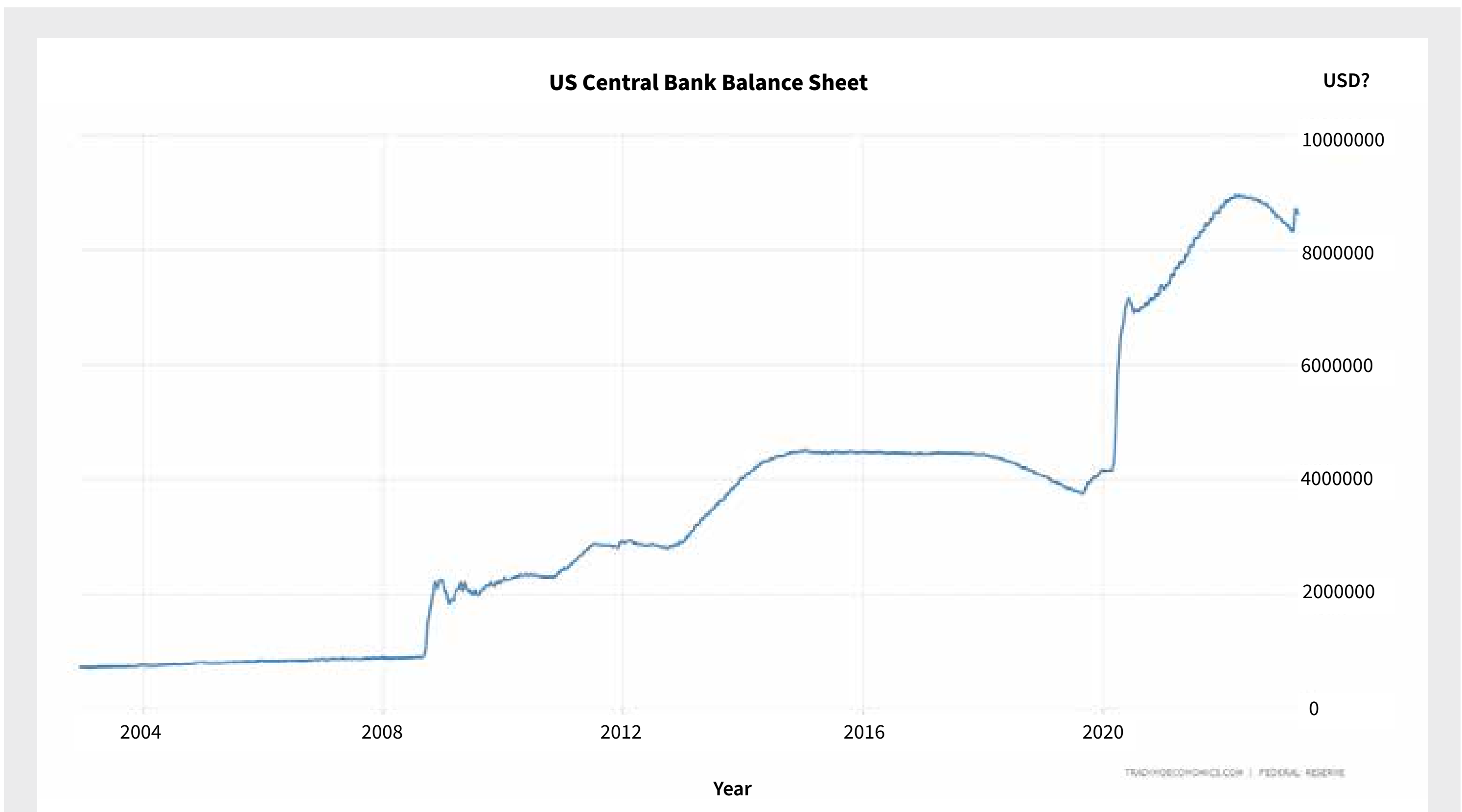
3. Can the Fed be trusted? Not necessarily.

In May 2022, early in the Fed's interest rate-raising cycle, the rate futures market was expecting a 75 basis-point (bps) hike at the next Fed meeting, in June. Fed Chair Jerome Powell told the press that such an increase was "not something that the committee is actively considering," a sentiment that helped drive the S&P 500® to a one-day gain of nearly 3%, the index's second-best day of the year. The central bank *did* raise rates by 0.75% in June. They did it again in July, September, and November, making four consecutive hikes of 75 bps. That's not to pick on the Chair, or the Fed, though we strongly believe that they were wrong to hold the benchmark federal funds rate at near-zero for most of the 15 years after the Great Financial Crisis (GFC) of 2007-2008, and to grow their balance sheet from less than a trillion dollars to nearly nine trillion.

Now, in fact, we believe they're doing the right thing, by aggressively raising rates and reducing their balance sheet as inflation continues to be a significant problem that must be tackled.

We believe the Fed is on the right path, even if policymakers were forced into tightening by the high rate of inflation and the difficult market environment of 2022, just as they were forced to protect depositors in order to contain the banks' turmoil in recent weeks. We recognize that the Fed faces a unique and difficult "trilemma" as it tries to negotiate reigning in inflation while maintaining economic growth and keeping the job market from cratering, to avoid a deep recession. What we do question is the recent trend of the market's often-dramatic moves based on the Fed's volatile "dot-plot," which measures the sentiment of central bank officials, and other statements about what's coming next. We'd argue that like a lot of day-to-day financial news, they don't mean nearly as much as some investors seem to think.



Source: https://tradingeconomics.com/united-states/central-bank-balance-sheet

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Finding certainty in uncertain times

At NewSquare Capital, we absolutely recognize that these are not easy times for investors. The confluence of inflation, tightening monetary policy, fears of a recession, and the doom-and-gloom of the 24-hour news cycle can feel overwhelming at times. But remember, no matter how bad—or good—things seem at any point in time, there is a simple answer: Take a step back from the craziness. Has anything changed in your financial life? Has your investment process changed due to this market “craziness”? If it hasn’t, that should bring calm and confidence that it will carry you through whatever’s coming and uncover opportunities over the long haul.

Market Review

Equities came roaring out of the gate to start 2023, then held on through some volatility, with the S&P 500® posting a 7.50% quarterly advance, led by growth stocks tied to technology and consumer spending. In a January rally, inflation numbers and largely encouraging economic data fueled optimism that the Fed could slow the pace of monetary tightening. Investor sentiment started to shift in February amid signals that interest rates will likely continue to rise. While inflation still appeared to have peaked in the summer of 2022, the Fed continued to express concern about the persistence of so-called supercore inflation, especially the prices of services.

In early March, Silicon Valley Bank collapsed, marking the second biggest bank failure in U.S. history. Two other banks also fell victim to bank runs, driving sharp declines in the financials sector. Although the government stepped in to insure deposits and shore up the U.S. banking system, worries about potential contagion at other banks rose, and the banking turmoil fed uncertainty around the pace of interest rate increases. The Fed raised its benchmark federal funds by 25 bps in early February and again in late March, marking nine consecutive rate hikes since March 2022, totaling 475 bps. While the bank failures may remind some of the Great Financial Crisis (GFC) of 2007-2008, we note that the current situation is largely driven by liquidity issues and rising interest rates, as opposed to the riskier actions of banks in the lead-up to the GFC.

While the Fed’s tightening cycle, the turmoil in the banking industry and the growing uncertainty about the pace of interest rate increases created some volatility for fixed income markets, bonds also broadly advanced for the quarter. The Bloomberg U.S. Aggregate Bond Index posted a 2.96% quarterly gain, largely propelled by a strong March. Commodities generally declined, with crude oil prices touching post-2021 lows amid concerns about the impact of a potential recession. In that environment, energy stocks trailed the broader market, along with financials.

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Indexes referenced:

The S&P 500® is widely regarded as the best single gauge of large-cap U.S. equities. The index includes 500 leading companies and covers approximately 80% of available market capitalization.

The Bloomberg Barclays US Aggregate Bond Index is a broad-based flagship benchmark that measures the investment-grade, US dollar-denominated, fixed-rate taxable bond market. The index includes Treasuries, government-related corporate securities, MBS (agency fixed-rate pass-throughs), ABS, and CMBS (agency and non-agency).

Additional statistical data sourced from: Bloomberg Finance, LPL Research., Morningstar, and NewSquare Capital, LLC.

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