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Important Note: As you know we use a custodian, Fidelity Investments, as required by the SEC Act of 1973. Fidelity does not typically interact directly with advisory clients, but of course they will if requested. Please remember if you have any issue or questions, please call us first here at Woodard & Company. Any item needing resolution such as address change, checks, or just about anything, we are pleased to handle for you. We will also follow-up to assure completion of any request and accurate execution of requests.

We endeavor to provide the best service possible; unlike Fidelity, we do not have a "phone tree." A person answers the phone here at Woodard & Company, typically on the first couple of rings and our job is to provide service to you, our client.

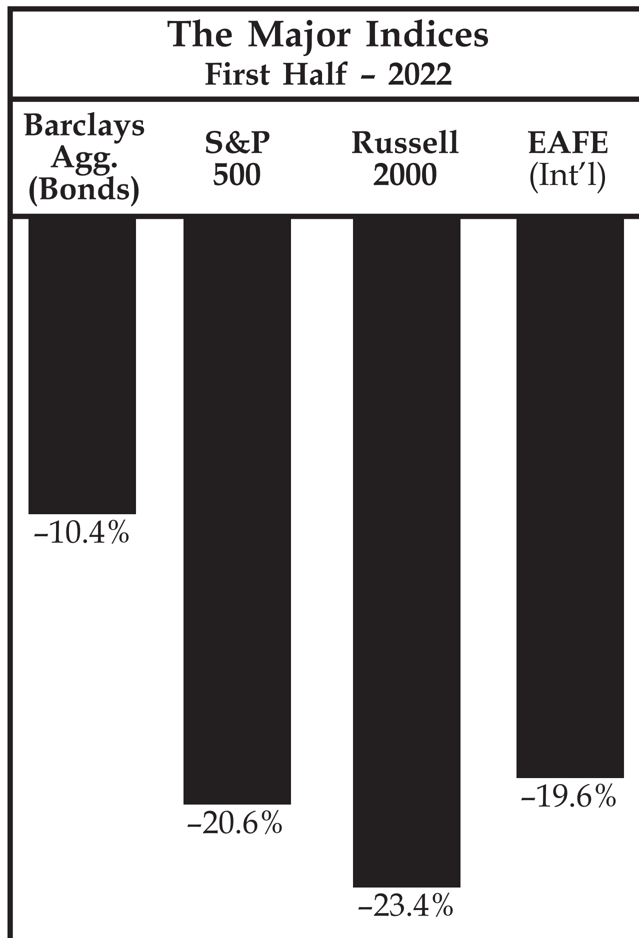
Planning idea. Here is something to think about. For your account, if it is not a joint account, you may wish to consider establishing a "power of attorney." If you are incapacitated and need funds or you need to make a change and you have named a POA (power of attorney) on your account, we can help that person on your behalf take care of your business. If you have not established a POA, our hands are legally tied. We cannot even talk to anyone about your account.

Our custodian, Fidelity has a form which you and the individual you have selected can sign, notarize and then they can instruct us on your behalf. This form is only good for your account here with us. A standard POA drawn up by an attorney would be necessary for all your other accounts and activities at other places.

Market Review and Forecast. The stock market posted the worst first half of the year since 1970. Primarily inflation and rising interest rates fed the downturn as the S&P500 declined nearly 21% thru quarter end.

The typical refuge for a declining stock market is bonds and for the most part bonds have been the portfolio safeguard for nearly 40 years. Unfortunately, that is not the case now; bonds have declined sharply thru the first half of the year in their worst start in history. The bond index, the Barclay's Aggregate, fell a substantial 10% year-to-date. Typically, in an economy tipping towards recession, as we appear to be (if we are not already in one), borrowing declines as individuals grow more defensive. Yields consequently drop and bonds increase

in value providing a hedge against a declining stock market.



As you can see that is obviously not the case this time. Due to intense inflationary pressures, the Federal Reserve is ratcheting up interest rates. Most notably this action is affecting the thirty-year mortgage rate which had been a mere 2.5% last year. Thirty-year mortgages started this year at 3.22%, and they are now a whopping 5.8%. Unless we are mistaken, it appears the Fed is attempting to create a housing recession.

The Federal government changed inflation calculations in the 1990's from primarily food and energy components to housing. Evidently the Federal government hopes by causing mortgage rates to increase that the lower headline inflation number created by a housing slowdown will instill some confidence in the consumer and slow the rate of inflation. However, we could see that the strategy may not work quite as effectively as it wishes. Indeed, the ultimate effect could be the opposite.

What have we been doing? The Market Leaders Stock Portfolio has had a significant cash position much of this year. Following the sale of securities, we had found difficulty selecting replacement stocks as prices were high relative to future earnings expectations. Furthermore, we have engaged in some tax loss selling and determined to retain some cash in anticipation of an economic slowdown and reduced earnings expectations.

For tactical asset allocation accounts, the decision late last year to increase our weighting in value stocks versus growth proved to be a good move. While we have still lost money in the declining market, growth has been hit significantly harder than value. Close to the same time as our allocation change in stocks last year and early this year, we also purchased floating rate bonds (for a significant portion of portfolios with fixed income). We made this move as a hedge against rising rates and falling bond prices. This has proved to be an effective strategy.

However, we changed the allocation again as signs of a recession began to emerge. During the past quarter we replaced the floating rate issues with short term, high quality fixed income. Floating rate securities (bonds with floating interest rates with general

stability of principal) gave us a reasonable defense from rising interest rates; but these securities can have problems as well.

Floating rate funds are backed by bank loans. During recessions, default rates on bank loans increase and principal loss can occur. Therefore, several weeks ago we moved the funds again - out of bank loans (floating rate) to primarily short-term, high quality fixed income. It has proven effective as floating rates bonds have been in decline for some weeks now for the reasons indicated above.

Additionally, in the last week of the quarter for taxable accounts we implemented tax loss selling. While we have harvested losses, we are not in too great a hurry to reinvest the funds. We expect that the slowing economy will provide better investment opportunities down the road. For retirement accounts we have sold some stock funds as well, raising cash with the intention to reallocate closer to a target "style neutral" (growth vs. value) allocation. Again, we do not expect to immediately redeploy the funds as we expect earnings contractions with the slowing economy will afford better investment opportunity in the coming weeks and months.

Interest Rates. Let's take a brief glance in the rearview mirror to see just how wild a ride (in the world of fixed income that is) it has been! 2021 began with the 10 Year Treasury yielding close to .95% and exactly one year later it began 2022 yielding 1.51%. In early April of this year, it was at 2.41%, peaking in mid-June at 3.48%. It ended the second quarter of 2022 yielding 2.97%. The 10 Year Treasury continues its wild ride as we begin the third quarter. The reason the 10 Year gets so much publicity is because in the world of bonds, it holds a similar benchmark position as its cousin, the S&P 500, does for the world of stocks.

The changes in yield mentioned previously demonstrate the volatility that has burdened the fixed income markets this year. While there are multiple factors to consider as the cause of not only the volatility but also the "rising rate" environment, inflation is the main culprit. Enter the Federal Reserve. In a too late attempt to tame inflation, the Fed is now aggressively raising their benchmark federal-funds rate to a range between 1.5% and 1.75%. Last month's meeting minutes indicate they are in agreement that it needs to be at 3% by the end of this year and would need to rise to a range of 3.5% to 4% for 2023 in order to stop inflation. They acknowledge that this will most likely cause a recession but view that as collateral damage in order to gain control and ultimately stop runaway inflation.

We have mentioned in previous newsletters that we were hoping for a gradual increase in interest rates. We like gradual moves because bond prices move inversely to interest rates and so gradual moves higher over longer periods of time are more easily processed by the bond market. The sharper and quicker the move up in rates, the more drastic the price fluctuations for bonds. The volatility described above, ultimately resulting in interest rates moving higher, has caused fixed income investments to be in the red this year along with stocks.

Fixed income is not down year-to-date as badly as the stock market but fixed income investors do not like to see negative returns. Most of the time fixed income is part of a portfolio because it stabilizes the portfolio against the wild swings of the stock assets. However, this has been a "one off" exceptional year when bonds actually contributed to the poor performance of the overall portfolio, although not as drastically as stocks.

In an effort to minimize our clients' (who have fixed income as a part of their portfolio allocation) exposure to the negative pressure rising rates inflict on bond prices, last year we shortened the maturities of our fixed income investments and increased the credit quality. By doing so, it protected clients from approximately 75% of the selloff in the bond market.

Knowing the intentions of the Fed, there may unfortunately be more downside to come in the bond market. Hopefully most of it is behind us and less in front of us. As we look down the road into 2023, there may still be bumps in the road but know that at Woodard & Company, we won't let go of the wheel.

If you have any other questions about your account or any concerns, please give us a call at 336-998-7000. We always enjoy talking with our clients.

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