Comprehensive Investment Management, LLC
Fee Only Personal Financial Planning
Spring 2023

A Review of the Financial Markets

Both the stock and bond markets finished the first quarter with single digit gains. The stock returns listed below average 4.8% and the bonds 2.8%. The previous quarter the averages were 9.6% and 2.8%. The last six months have been a welcome turn around from the previous nine from January-September 2022 when stock averaged –8.8% and bonds –4.1%. Over the last twelve months both averages are still negative, but the three year stock average is a robust 15.1%. Even the small-cap tech-heavy Brown Capital fund, which in late December had a three year average return of –5.5%, now is at a positive 3.6%.

Foreign stock funds had a better quarter than the domestics and they are also ahead double digits at the three year mark. The five year return of the foreign funds of just 2.9% indicates how they have struggled since the 2008 financial crisis. In 2017 the ten year average return of Vanguard's Total International Index Fund was 1%. Wow, ten years! There has been some improvement. Currently its ten year and fifteen year averages are 4.6%, and 2.4%. Generally CIM doesn't recommended index funds. Imagine if you had taken the advice of index proponents like Vanguard who recommend keeping 40% of your stock allocation in a foreign index fund. Vanguard advocates strict adherence to index investing, so if 40% of global GNP (gross national product) is foreign they suggest you invest 40% in foreign. The argument is you shouldn't try to out-guess the market. A counter argument is that indexing eliminates any form of discretion. If investing in the BRIC countries (Brazil, Russia, India and China) doesn't call for discretion, what does?

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Recent market and economic activity is newsworthy. However most of it can be dismissed as "noise" and not indicative of a trend. Investment performance over longer periods, while not predictive, is significantly more meaningful.

Average Annual Returns of Select Mutual Funds

At March 31, 2023	QTR	YTD	1 Year	3 Years	5 Years	10 Years	15 Years
Large Cap Stocks	4.3	4.3	-4.1	18.2	9.2	12.2	11.5
Mid Cap Stocks	7.2	7.2	-7.3	17.4	7.2	12.0	11.2
Small Cap Stocks	6.4	6.4	-11.4	14.8	6.2	10.1	10.3
Healthcare Stocks	-1.5	-1.5	-2.3	13.0	9.9	13.0	13.2
Foreign Stocks	7.8	7.8	-8.1	12.1	2.9	6.2	6.1
Short Term Bonds	1.9	1.9	-.4	-.1	1.3	1.2	2.0
Intermediate Bonds	3.4	3.4	-4.8	-1.1	1.7	1.5	3.1
High-Yield Bonds	3.2	3.2	-2.0	4.6	3.2	3.8	5.7
Wellesley Fund 65/35 bonds/stocks	1.3	1.3	-4.4	5.4	4.7	5.3	6.3
Wellington Fund 35/65 bonds/stocks	3.3	3.3	-5.5	10.6	7.0	8.0	7.5

On a deposit of $100,000, after 15 years, Wellington's balance of $306,945 exceeds Wellesley by $50,300.

Bonds were due for a breakout from their years-long doldrums and they finally got it in January. But it didn't last. February was a set-back and March saw bonds struggle just to get back to the January numbers. Newer issued bonds carry higher interest rates than they have in years, so it is just a matter of time for a turnaround. The yield on intermediate corporate bonds are at just under 5%. That's a good sign and quite a turnaround for bonds that lost 5% of their value over the last twelve months. We are patiently awaiting the benefits of our allocation in Treasury Inflation Protected Bonds. To date the super quick acceleration of interest rates has been winning the tug of war with the TIP protection features. Average inflation from 1997 to before the current run up was 2.2%. The historic rate usually quoted is 3.5%, but that includes an average rate of 9% for the ten years ending in 1982.

The path to recovery from 2022 has not been smooth and the outlook for the next nine months to a year remain uncertain. Goldman Sachs titled a recent publication: *Caution: Heavy Fog Ahead.* We are familiar with high inflation and rapidly rising interest rates. Then in the last days of the quarter the economy was suddenly presented with two of the biggest bank failures in US history. There was and still is the possibility that those failures will carry over to other institutions, especially smaller regional banks that don't have the resources of the bigger banks and financial companies. Also we now have a credit crunch. Borrowing money had been easy and cheap since the crisis of 2008. Now it's expensive. For some companies with lower credit ratings, funding may simply not be available. Over a year ago the allocation to Hi Yield bonds in CIM client portfolios was reduced in anticipation of the cutback in massive government supports extended to weaker companies at the start of the Covid pandemic. The Federal Reserve recognized that the weaker companies would be the ones most in jeopardy from disruption of the Covid pandemic.

Zombie companies are those that earn just enough money to continue operating and service their debt. They manage to meet wages, rent, and interest payments, but have no reserves to deal with emergencies, let alone to invest to spur growth. They may be just one event - a market disruption or a poor quarter performance - away from insolvency. They are especially dependent on lending facilities for financial life support. Estimates of publicly listed companies that are zombies run as high as 15%. Prior to Covid it was 6%. Zombie companies include AMC, Chewy, GameStop, Shake Shack and Uber.

Predictions for the near term are for the economy and the markets to continue to struggle. No question there has been progress on the war against inflation. However, many of the intended and unintended consequences of the measures have not yet filtered through the economy. With higher rates and tighter credit, lower corporate profits are a sure bet. The question is how much lower and for how long. A recession is in the works, although it should be a modest one.

The potential in the next few months for default by the US on its debt would no doubt be extremely disruptive. It probably won't happen because of the major negative political consequences to a government shutdown and/or a reduction in the quality ratings of US debt. On the other hand, you can expect market volatility to reflect the inevitable political rhetoric. The president says he won't negotiate the creditworthiness of the US. House Republicans want spending cuts to reduce debt by $1.5 trillion. In fact, addressing the nation's debt will require big and politically painful changes. The sooner we get started the better.

There will always be times when investment returns will not be great. That is the very nature of capital markets. Company profits are the ultimate driver of stock prices. The markets are buffeted by projections that generally look forward maybe six months to a year. Maybe two years if they have to, as they did when Covid hit. Right now some markets are optimistically pricing-in a reduction of interest rates as early as the end of 2023. The Federal Reserve is adamant that its decisions will be based on incoming data, that is, consumer spending, the job market, inflation and any surprises, for example, maybe a bank failure. If the Feds don't know what they are going to do, how can anybody else know?

Interest Rates - What a Difference a Year Makes

"I'LL TELL YOU THE MEANING OF LIFE, IF YOU TELL ME WHY BOND PRICES DROP WHEN INTEREST RATES GO UP."

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Interest rates are the cost of borrowing money or the reward for lending it. The Federal Reserve sets the federal funds rate, which is the interest rate banks charge each other for overnight loans. The federal funds rate then affects other interest rates in the economy, like the ones you see on your mortgage, credit card, savings and money market accounts. The Fed adjusts the federal funds rate depending on changes in the economy. If inflation is high, they raise it to cool things down. If unemployment is high, they lower the federal funds rate to boost the economy.

From 2009 to 2022, interest rates were at record lows. In 2009, to stimulate the economy after the Great Recession, the rates were 0% to 0.25%. These rates stayed there for years and started to rise slowly to 2.2% in 2019. However, in response to the COVID-19 pandemic, the Fed again lowered the rate to near zero in March 2020.

Then things changed again in 2022. The economy was growing fast, but so was inflation. The Fed had to deal with a tricky situation of rising prices and strong demand. In response, the federal funds rate has risen nine times since the beginning of 2022 to the current rate of 4.8%. It is the fastest rate increase in US history and resulted in the worst performance of bonds in 40 years. In fact the Federal Reserve is guided by lessons learned 40 years ago when the Fed rate was eventually raised to 21.7% to combat persistent high inflation.

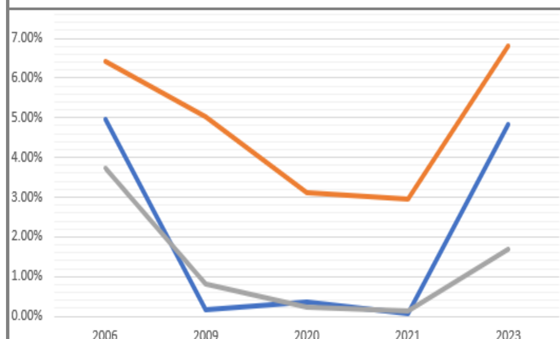
How do interest rates impact you? If you're borrowing money, it means you have to pay more interest over time. Mortgages have gone up. For a credit worthy borrower, the national average for a 30-year mortgage now is 6.8%. However, this rate may be higher or lower, depending on various factors including location. This is much higher than the record low of 2.7% in December 2020, yet close to the rates between 2006 and 2008, which were around 6%. Consider the impact on the economy that such a change can have on housing, a significant driver of the overall economy. Some would-be home buyers suddenly can't qualify for a mortgage. Home owners won't sell because they don't want to give up the low rate on their current mortgage. There's data that also shows there has been some damage in banking, commercial real estate, auto financing and manufacturing.

If you have savings, higher interest rates should mean a higher return on your bank accounts. For years savings accounts, Certificate of Deposits and money market accounts were paying next to nothing because of the low federal funds rate. You'll never get rich buying CDs, but interest rates have gone up. The national average one year CD rate is 1.68% but many banks offer much higher rates with special offers of 4% to 5%. The higher rates for CDs are generally limited to a two year term. Meanwhile mutual fund money market funds are earning a decent return for the first time in over fifteen years. Vanguard's Money Market Federal fund currently yields 4.8%.

CDs earn a fixed interest rate for a fixed amount of time, but you generally can't withdraw funds before the term is over without sacrificing some or much of the interest you've earned. While CDs with higher yields are not a bad idea to have as a security blanket, they will rarely beat inflation. Due to the fixed amount of time, you should not store cash for your emergency fund in a CD. You must be diligent when a CD matures, as you typically have just ten days to withdraw the funds before it auto renews at the new current rate, which could be significantly lower than what you were getting.

Most banks have FDIC insurance. Vanguard is covered by the Securities Investor Protection Corporation up to $500,000 per investor with a limit of $250,000 on money market funds. Coverage does not extend to market losses. The Fed jumped in at Silicon Valley Bank because it had assets of $210 billion. Do you think it will get involved if Vanguard ($8 trillion) had a similar problem?

Average Interest Rates
Mortgages Federal Funds 1 year CD's
2006-2023



Sources: USA FACTS, Fed Reserve, BankRate

Comprehensive Investment Management, LLC

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200 Locust Street, Ste. 3A
Philadelphia, PA 19106

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Harry McCullough, CPA, CFP®
Phone 610.580.5554
H@cimontheweb.com

Mercedes M. Petrellis, WMS, PMP
Phone 610.960.1068
Mercedes@cimontheweb.com

Associates

Michael C. Collins, CPA, CFP®
Brian A. Collins, CPA, CFP®
Phone 610.566.4760

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Q. How worried should I be about the security of my bank accounts?

Based on recent events in California, you don't need to worry at all, as long as the government is willing to expand FDIC insurance coverage on demand. Concerns over the collapse of Silicon Valley Bank (SVB) and Signature Bank have lessened in recent days. Other US banks including regionals appear to be capitalized sufficiently. And the Federal Reserve is ready to step in as needed. Bank runs are to be avoided at all cost. Moral hazard issues are on the back burner.

So what happened? SVB was a major lender to tech startups and venture capital firms, which have been hit the hardest during the market downturn. Venture capital began drying up, forcing startups to draw down their funds. At the same time, the bank's extensive investments in long-term bonds lost value as interest rates rose rapidly. SVB disclosed bond sales at a loss and tried to raise more capital. Customers were rattled. More than 90% of SVB's deposits exceeded the $250,000 FDIC insurance limit. The bank's customers tended to be in the tech industry, so many knew each other well. They sent urgent warnings via group texts and tweets. Digital access provided easy and immediate ability to withdraw from their accounts. Banks typically keep enough cash on hand to meet regular withdrawals, but as so many withdrew simultaneously, there wasn't enough. There was a run on the bank and the bank failed. Signature Bank had a similar business model and faced a similar crisis of confidence.

To avoid contagion the Federal Reserve stepped in. It guaranteed all deposits at the two failed banks. It also plans to make loans as needed so the bank doesn't have to sell certain bond holdings at a significant loss.

You can do several things to ensure your accounts are safe. First make sure the institution is insured by the FDIC. FDIC covers up to $250,000 per individual. In addition owners of a joint account are each covered up to another $250,000. To protect even larger balances, you could talk with your bank, as they may have arrangements with other FDIC-insured institutions. If you have individual accounts, consider adding beneficiaries to avoid the need for that account to go through probate.