GREENROCK RESEARCH

223 West Jackson, Suite 850
Chicago, IL 60606
www.greenrockresearch.com

INVESTOR INSIGHTS – FOURTH QUARTER 2022

Not the market we hoped for!

One year ago, we warned of the potential for a market decline because of the high valuation of stock prices. Today we find ourselves with the S&P 500 down 23.9% for the year and bond returns down as well with the 10 Year US Treasury down 16.9% for the year. Not the year we hoped for! We made this prediction based on valuations. The 3-year return of the S&P 500 at the end of last year saw a double in price, just the second time that had ever happened, and whatever valuation method was your favorite way of measuring stock prices, stocks were way overpriced at year-end. We were not aware of what might happen in the first nine months of this year when we urged caution, the war in Ukraine and dramatically higher federal fund rates just to name two issues but returns starting with overpriced stocks are never good. True, stocks can go from overvalued to ridiculously overvalued, but the end is always the same. Stocks revert to the mean eventually.

So, what happens from here?

Bob Farrell worked in and then headed the investment research group at Merrill Lynch for almost 50 years. We have loved his commonsense approach to investment research as well as the way he wrote about the markets. We have written about him often and think his insights into markets in general might be very helpful today as we think about where we are headed. His 10 rules for investing are part of our investment bible and several of them apply today. We will discuss four of them as we think about what the next year might be like.

Rule #1
Markets tend to return to the mean over time.

The three years ending 12-31-2021 saw a double in equity prices as valued by the S&P 500 average. As we mentioned above, this had only happened once in history. This did not happen in the great investment decades of the 1950s, 1960s, 1980s or the 2010s, all of which saw returns well above average. It did happen in the three years ending 1999, and the three years after 1999 saw the stock market decline by 40% while tech stocks were down 80%. Will that be the case for us today? Markets never decline or rise in the exact manner of historical markets, but when you study them, many are close. Our expectation is the next year or two will be very challenging and prices will be lower.

Rule #2
Excesses in one direction will lead to an opposite excess in the other direction.

While this is helpful to remember, we would not take this literally. Yes, we think there will be further declines, and we think we are far from the bottom. But the stock market does not need to decline by 50%, the opposite of the 3-year double for the period ending 12-31-2021, for this to be a classic bear market. The stock market is already down significantly with more to follow but how much more is anyone's guess.

Kevin Malone	Dave McGahay	Brendan Malone	Mark Knipfer
312.463.1301	312.463.1303	312.463.1304	312.463.1305

Rule #8
Bear markets have three stages, a sharp decline, a reflexive rebound and a drawn-out fundamental downtrend.

We have experienced the first two of these. The S&P 500 fell 20% the first six months of this year. July saw the index rebound, up 9%. So, what we are in for now is the drawn-out fundamental downtrend. How long will it last? Impossible to answer but do not expect this to be over as the snow melts from the winter. Expect this to last all through next year and then we will see about 2024. We would love to be wrong on this one, but we are likely headed into a recession and an extended decline.

Rule #10
Bull markets are more fun than bear markets.

This is obvious to everyone. Just like any part of our lives, we like it when things are going well, but we can handle life when the wind is in our face. Just like other times, we have experienced market declines, we need to be mindful of the needs of clients. It is easier for us to weather these times because we know history and have perspective, but clients know what their statements show and what they read in papers or hear on the news. Help them! We have protective portfolios that have fared well this year, perfect no but they have protected. This is not a time to expect great returns, it is a time to preserve capital. If we can help with your communication with clients, we would love to do so.

What do we do with portfolios and how have our ideas fared?

We have written in our newsletters this year that we need to be cautious and that we need to set our sights realistically. Incorporating dividend equities with 3EDGE and complementing that with illiquid investments like the Red Oak 6% 2-year fund has been our recommendation. It has fared well. 3EDGE Total Return is down 6.8% for the year and 3EDGE Conservative is down 4.9%. Both of these have significantly outperformed bonds with the 10 Year US Treasury down 16.9%. Our dividend portfolios have outperformed their benchmarks as well: Dearborn Partners domestic portfolio is down 13.7% while our small cap domestic portfolio is down 16.2%. The benchmarks for both domestic large and small cap stocks are down considerably more, the S&P 500 Index is down 23.9% and the S&P 600 small cap index is down 23.2%. Our international portfolio run by Janus Henderson is down 24.4% while EAFE is down 26.8%. So, this is how we see this performance. 3EDGE, and North Star have outstanding performance. We are disappointed in our equity strategies in general and specifically in Janus Henderson, despite their outperformance. While Europe is best described as a mess, we would have hoped for better protection from Janus Henderson. The recent action of the Federal Reserve in the UK has caused a recent run up in prices, and this is good. That said, we wonder for how long will this last. There was a dramatic reaction two days after the reduction but the long-term is still unknown. Will the UK Federal Reserve need to take further action? While no one knows we doubt their action will be enough. The domestic managers have done better against their benchmarks, but we hoped for lower losses. The losses came in two months, June and September. So, what happens from here? Dividend yields have historically protected in times of declines. The dividend yields on Dearborn Partners, North Star and Janus Henderson are 3.76%, 4.72% and 4.79% respectively. The portfolio as we weight it has a yield of 4.34%. We think the market has a further decline coming, and our expectation is that we likely have seen the bottom for our portfolios. We would not expect further declines in our portfolios as the market goes through its declines. We think, though, there is more trouble ahead for the general markets. We think 6-12 months from now, the markets will be lower, how much lower is a flat-out guess. What we would say that if history is a guide, and we think it is, sometime in the next 12-18 months global markets will bottom out. If this turns out to be correct, we will likely go through capitulation which is when almost all investor's faith in the markets will be dramatically diminished if not lost. This is when we will be excited to become fully invested. Some analysts are suggesting the S&P 500 will bottom out at 3,000, a far cry from the 4,800 it started at this year. If that is right, it would be down just under 40% from the start of this year. There will be real bargains at that time, and while we cannot predict them today, we are talking to more managers of all disciplines to make sure we understand where the opportunities might be. In addition, the way we have positioned our portfolios, we think from here will mean they will decline less than in this first part of the decline. Dividend strategies tend to get more defensive in the second half of bear markets because their dividend yields are higher. So, we like our position. If history repeats itself there will be some dislocation in one or more areas of the markets that make no sense, an exaggeration on the downside. We are always looking for these opportunities and while we have no idea where they might come, we are keeping our eyes and ears open for opportunities.

Clients

We like sunny days better than rainy days, but then again so does everyone. We also know that we get both and the markets today are raining on our parade. You have positioned the risk level of client portfolios in such a way that clients can withstand whatever decline we encounter. This is at best an inexact science, but you know your clients well. These are times to ensure you have this right. During good times, clients want to tell you about their trips or what their children or grandchildren are doing, but these are not good times. We know you are aware you need to check in with clients more now than when their portfolios are growing. In whatever way we can help with that endeavor, we would love to do so. If you would like us to do a Zoom call or an in-person meeting for individual clients or groups of clients, we are happy to do so. If you need data to show to clients, we have lots of it. Please let us know how we can help.