“PLANNING LIFE
WITH A MARGIN OF SAFETY”

Demming Financial Services Corp.

July 2022 – September 2022

3rd Quarter 2022

Special Notes:

Please be sure to inform us of any Qualified Charitable Distributions you would like to complete this year, as well as any last-minute Roth Conversions before year end.

Reminder:
Be sure to remember to inform your tax preparer of any QCDs that you completed in 2022. If you are unsure of the amount you completed, call us at the office 330-562-2122.

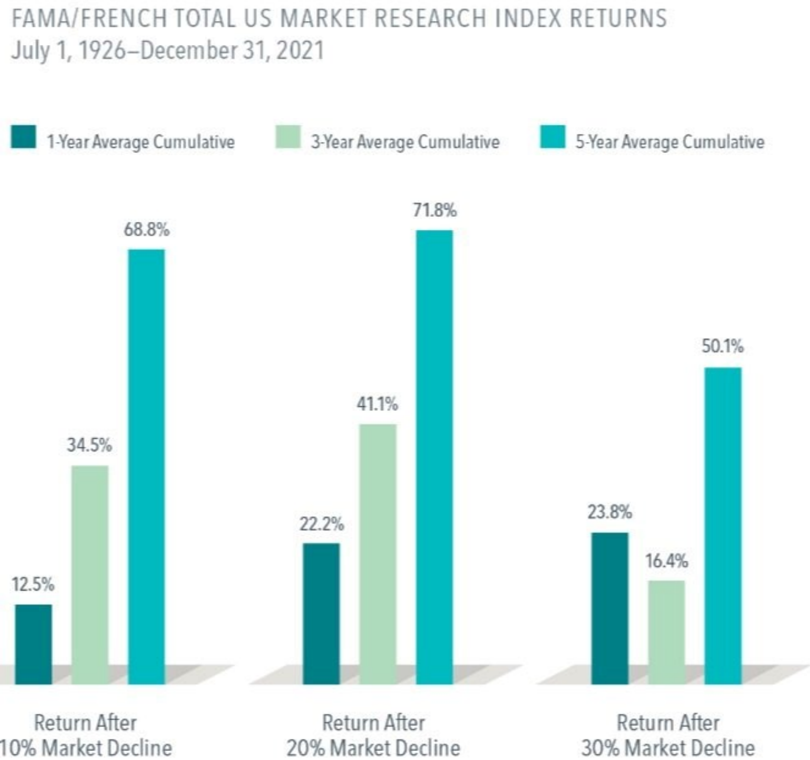
We are planning on having events for our clients in the future! If you would like to be included, please email Sandy at:
sandy@demmingfinancial.com

DEMMING DISPATCH

- Donation Drive- We are spearheading a donation drive for Access Shelter in Akron. They are a non-profit organization that helps homeless women and children. We will be sending an email blast in the coming weeks with details on how you can be involved in the drive!

- We are excited to welcome another CFP® to the team, Ryan Coulter! Ryan will work closely with the firm’s Financial Planners to help construct plans for our clients. Check out Ryan’s full bio by clicking this link

- Follow us on LinkedIn to stay up to date with blog posts, news, and more.



Midterm Elections—What Do They Mean for Markets?

It's almost Election Day in the US once again. For those who need a brief civics refresher, every two years the full US House of Representatives and one-third of the Senate are up for reelection. While the outcomes of the elections are uncertain, one thing we can count on is that plenty of opinions and prognostications will be floated in the days to come. In financial circles, this will almost assuredly include any potential for perceived impact on markets. But should long-term investors focus on midterm elections?

Markets Work

We would caution investors against making short-term changes to a long-term plan to try to profit or avoid losses from changes in the political winds. For context, it is helpful to think of markets as a powerful information-processing machine. The combined impact of millions of investors placing billions of dollars' worth of trades each day results in market prices that incorporate the aggregate expectations of those investors. This makes outguessing market prices consistently very difficult.[1] While surprises can and do happen in elections, the surprises don't always lead to clear-cut outcomes for investors.

The 2016 presidential election serves as a recent example of this. There were a variety of opinions about how the election would impact markets, but many articles at the time posited that stocks would fall if Trump were elected.[2] The day following President Trump's win, however, the S&P 500 Index closed 1.1% higher. So even if an investor would have correctly predicted the election outcome (which was not apparent in pre-election polling), there is no guarantee that they would have predicted the correct directional move, especially given the narrative at the time.

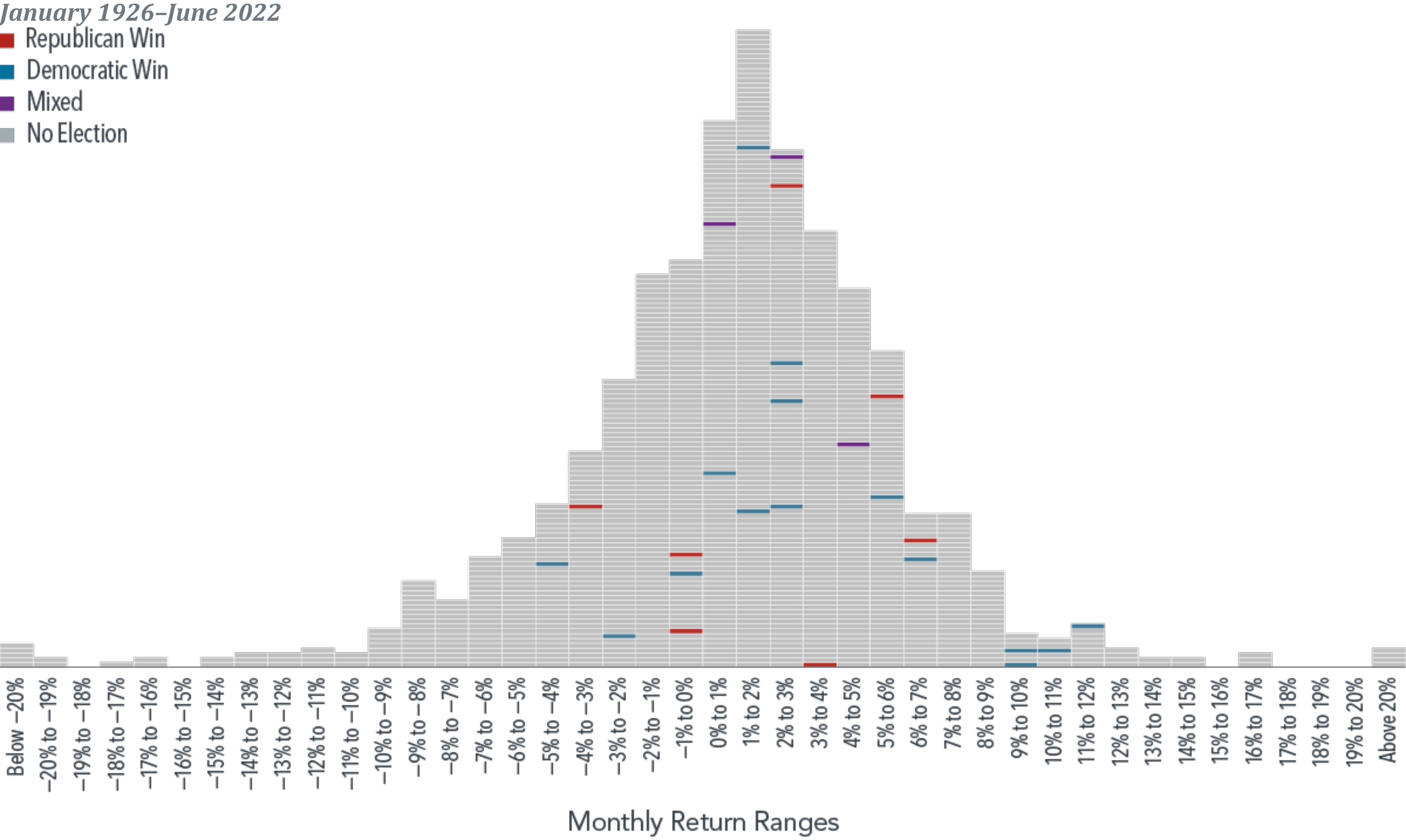
But what about congressional elections? For the upcoming midterms, market strategists and news outlets are still likely to offer opinions on who will win and what impact it will have on markets. However, data for the stock market going back to 1926 shows that returns in months when midterm elections took place did not tend to be that different from returns in any other month.

Exhibit 1 shows the frequency of monthly returns (expressed in 1% increments) for the S&P 500 Index from January 1926–June 2022. Each horizontal dash represents one month, and each vertical bar shows the cumulative number of months for which returns were within a given 1% range (e.g., the tallest bar shows all months where returns were between 1% and 2%). The blue and red horizontal lines represent months during which a midterm election was held, with red meaning Republicans won or maintained majorities in both chambers of Congress, and blue representing the same for Democrats. Striped boxes indicate mixed control, where one party controls the House of Representatives, and the other controls the Senate, while gray boxes represent non-election months. This graphic illustrates that election month returns were well within the typical range of returns, regardless of which party won the election. Results similarly appeared random when looking at all Congressional elections (midterm and presidential) and for annual returns (both the year of the election and the year after).

EXHIBIT 1

Midterm Elections and S&P 500 Index Returns, Histogram of Monthly Returns

January 1926–June 2022



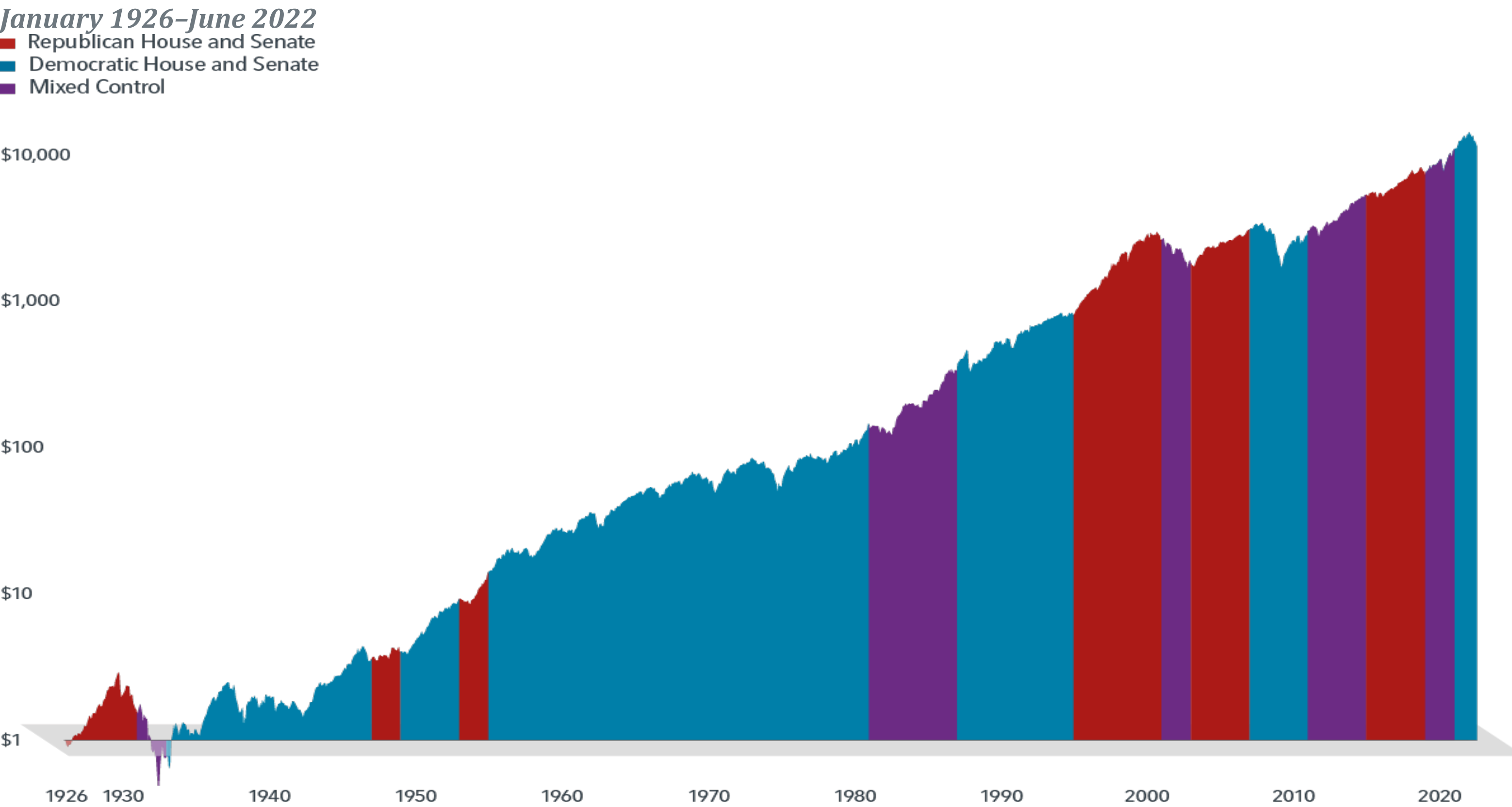
Past performance is not a guarantee of future results. Indices are not available for direct investment; therefore, their performance does not reflect the expenses associated with the management of an actual portfolio.

In It for the Long Haul

While it can be easy to get distracted by month-to-month or even one-year returns, what really matters for long-term investors is how their wealth grows over longer periods of time. **Exhibit 2** shows the hypothetical growth of wealth for an investor who put $1 in the S&P 500 Index in January 1926. Again, the chart lays out party control of Congress over time. And again, both parties have periods of significant growth and significant declines during their time of majority rule. However, there does not appear to be a pattern of stronger returns when any specific party is in control of Congress, or when there is mixed control for that matter. Markets have historically continued to provide returns over the long run irrespective of (and perhaps for those who are tired of hearing political ads, even in spite of) which party is in power at any given time.

EXHIBIT 2

Hypothetical Growth of $1 Invested in the S&P 500 Index and Party Control of Congress



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Equity markets can help investors grow their assets, and we believe investing is a long-term endeavor. Trying to make investment decisions based on the outcome of elections is unlikely to result in reliable excess returns for investors. At best, any positive outcome based on such a strategy will likely be the result of random luck. At worst, it can lead to costly mistakes. Accordingly, there is a strong case for investors to rely on patience and portfolio structure, rather than trying to outguess the market, to pursue investment returns.

2022 Third Quarter Investment Market Report

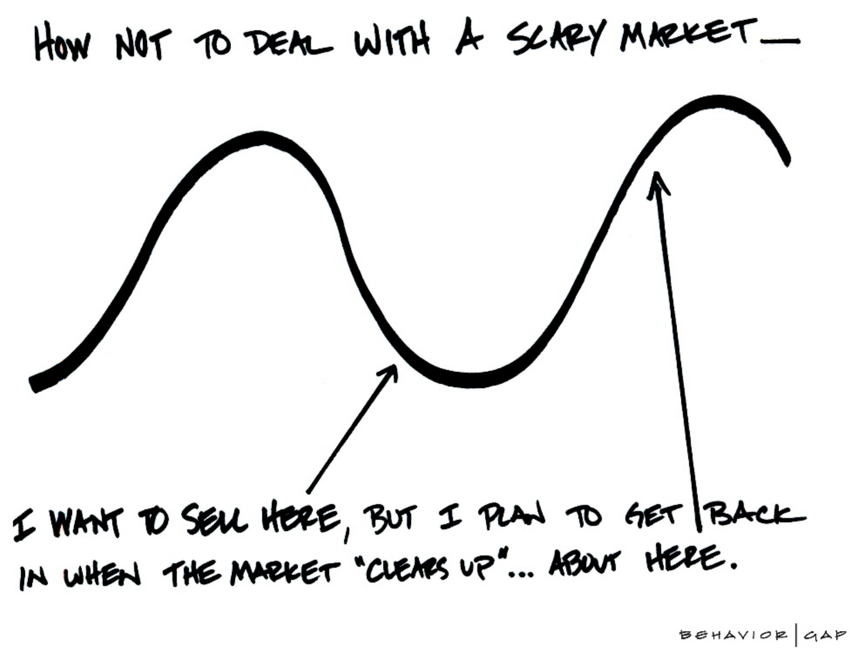
Remember that nice little rally from mid-June until somewhere around mid-August, when the market returns seemed to be moving us out of bear market territory? We don't either; that swift upturn seems like a long time ago. Better luck next run.

The past month and a half re-established the down market trend that has generally been going on since the start of the year, as markets gave back everything they had gained since the rally from their June 15 lows. The Russell 3000 index has lost 24.62% since January 3.

Looking at large cap stocks, the Russell 1000 large-cap index is sitting on a 24.59% decline so far this year, while the widely-quoted S&P 500 index of large company stocks lost 5.28% in the third quarter, and is down 24.77% so far this year.

Meanwhile, the Russell Midcap Index has given back 24.27% of its value in the first three quarters of 2022.

The Russell 2000 Small-Cap Index is down 25.10% in the year's first nine months, and the technology-heavy Nasdaq Composite Index is showing a 33.20% loss so far this year, as tech stocks continue to experience greater downdrafts than the market as a whole. Utility stocks lost a relatively moderate 6.71% during the third quarter, posting an 8.57% loss in 2022.



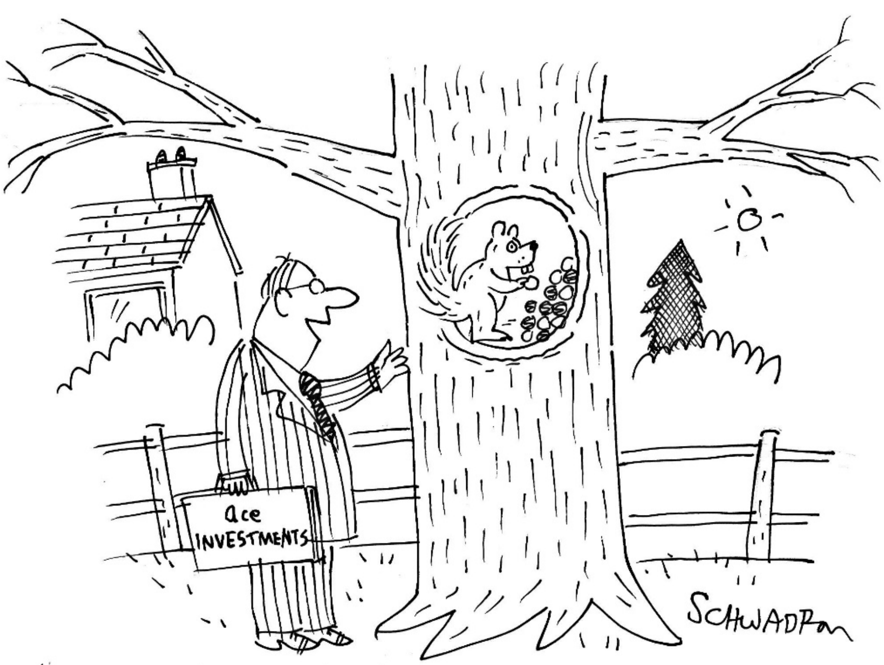
International investors are sharing our pain. The broad-based EAFE index of companies in developed foreign economies lost 10.01% in the third quarter, and now stands at a negative 28.88% return for the year so far. In aggregate, European stocks fell 10.54% in the third quarter, sending them to a 30.50% loss for year's first three quarters. EAFE's Far East Index lost 9.36% in the third quarter, putting these Asian markets at a 26.95% loss in 2022. Emerging market stocks of less-developed countries, as represented by the EAFE EM index, also joined in the global decline, falling 12.48% in dollar terms in the third quarter, down 28.91% for the year.

Looking over the other investment categories, real estate, as measured by the S&P U.S. REIT index, posted a 10.83% loss during the year's second quarter, and is now down 29.99% since January 1. The S&P GSCI index, which measures commodities returns, lost 14.31% in the third quarter, but for the year is still showing an 8.30% gain.

In the bond markets, yields are rising, but the yield curve is still inverted along its longer durations. Coupon rates on 3-month, 6-month and 12-month Treasuries now stand at 3.25%, 3.90% and 3.93% respectively, up from basically zero at various points last year. Two-year yields are now up to 4.28%, and while coupon rates have been climbing for longer durations, the yields are lower: just 4.09% on 5-year Treasuries, 3.84% on 10-year issues, and 3.78% for 30-year government bonds.

We are likely not out of the woods yet with this bear market, although it seemed like we might be getting there with the brief runup in stocks through mid-August. Market downturns come in all shapes and sizes, from the startling losses during the early Covid pandemic followed by a quick recovery, to what many of us regard as the most difficult kind to bear: the slow drip of down market days over a longer period of time. You will hear many explanations for why there are more sellers than buyers on this or that day in the market, but the only certain explanation is that, overall, the people who trade stocks actively have become pessimistic about our short-term economic future.

The good news is that most individual investors have a longer-term view, and it is possible to peek over the horizon and see the day when inflation finally returns to its long-term norm, the Federal Reserve Board stops raising interest rates, and the economy recovers its equilibrium. There is no reason to think that the companies that make up the U.S. and global indices are now 20-30% less valuable today than they were last December--and, in fact, every reason to believe that the millions of people who go to work every day at those companies are continuing to add daily incremental value despite the pessimism of short-term traders.



"DO YOU REALIZE YOU'RE NOT EARNING ANY INTEREST ON THAT?"

Why have they become pessimistic? One reason might be found in the framing that the press has been giving recent economic news. In a recent example, the companies in the S&P 500 are growing their earnings at a 2.9% rate over the past three months--which you and I might think means that they are becoming more (not less) valuable. But the investment press focused on the fact that economists had been predicting higher growth, and that the current growth rate in earnings is slower than it has been over the past six or seven quarters.

Another example is rising wages: Salary.com recently reported that the median annual pay increase for American workers has risen to 4%, and hourly earnings overall are up 5.2%. This, of course, is the result of high employment rates--and one might imagine that these are positive trends for the health of the U.S. economy. Instead, as you may have noticed in your own reading, these developments are framed as a headwind for the companies that have had to reverse the decades-long trend of suppressing their salary structures. Indeed, many of those companies are bringing manufacturing jobs back to the U.S., where they have to pay more for their labor than they did at overseas facilities. Have you read, anywhere, that the U.S. has added 461,000 new manufacturing jobs in this year alone?

Economists spend a lot of time trying to explain these downturns based on economic fundamentals, but in extreme market events, they throw up their hands because the fundamentals don't match what's going on. The better explanation is that both bull and (today) bear markets are psychological events. Humans are, in many ways, herd animals. When the herd moves in one direction or another, there is a strong tendency to move with it--to buy when others are buying, to sell when others are selling. Members of the investment press are no different; when the markets are going down, you might think, from the articles you read, that the trend will continue until it takes stock prices all the way down to zero--a 100% decline. But we all know in which direction the next 100% movement will be; we have seen the aggregate markets go up 100% from many starting points, many times in history, and never once 100% in the other direction.

It bears repeating that there are no guarantees in the investment world, but history suggests that market downturns represent a buying opportunity for the long-term, and that markets tend to overshoot the actual underlying conditions on the upside and (alas) also on the downside. There is an unfortunate tendency that we all share, where we look at recent history and somehow convince ourselves that it was obvious all along. But the future is always cloudy; we look ahead to the next month or two and have no idea what is going to happen. We look out a bit further, however, and we see that there have been only two 10-year periods since 1941 where investors experienced a negative return--and those losses were very small.

In fact, if you look at the chart showing rolling 10-year returns in the S&P 500, you see the danger in thinking that any of us know how to dart in and out of the markets. The relatively brief downturns are followed by sudden, unexpected, impossible-to-predict reversals, and the biggest danger to wealth is not suffering a short-term paper loss, but locking in a real loss and then missing the recovery.

Patient investors will accept the paper losses as a temporary blip in a long-term uptrend and the truly excellent investors will rebalance back to their original allocations, raising their exposure to stocks now that stocks are cheaper. If history holds, they will ultimately experience a recovery and no diminishment of their portfolios' buying power. The difference between a rapid 'V'-shaped downturn like the one we experienced in the spring of 2020 and this kind of slow drip bear market is that what we are experiencing now makes that patience difficult to maintain. The slow drip will cause some investors to unbuckle their seat belts and jump off the market roller coaster before it has reached the end, and I think we all know that that kind of panicked decision never ends well.

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Cartoons by: *Harley Schwadron*

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