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Sound Investments Inc.

2nd Quarter 2022

DJIA 32990.1 S&P 500 4132.1 Nasdaq 11,620.9

Summary

Mid - Year Bear

Are We in A Recession?

No, but things can change!
There is no clear answer In fact, there is a major debate. One camp states there are 11 million unfilled jobs in the US, up from 7 million pre-pandemic. Wages are rising and there is a strong demand for workers. Household balance sheets are robust. I attached parts of a recent report from the Bank of America whose internal reports show a strong economy .

The other camp or group sees a slowing economy that will lead to a shallow recession. They point to the Federal Reserve Bank which continues to raise interest rates to slow the economy and reduce inflation. At this time we are slowly starting to invest in companies with good Earnings and strong Balance Sheets.

The S&P 500 officially crossed into a bear market in June after falling 20.0% during the first half of 2022, its worst start to a year since 1970. The Dow Jones average has fallen 14.5% so far this year and the Nasdaq has fallen over 29.1% since the beginning of the year.

The sell-off has been broad, affecting all sectors (except energy) and stock markets around the world are also down as interest rates continue to climb. In our client letters, published in January and April, we discussed moving to cash and switching to value funds from growth funds. Moving to cash shelters funds from declining markets. Holding some value funds, helped as well, since they outperformed growth funds by their biggest margin since 2000.

So, what happens next? There may be more volatility ahead. The average S&P 500 bear market has lasted a little less than a year, which implies that we may be only half way through this one. Bear market losses have typically been around-30% so we may not have hit bottom yet. How this decline ends, likely depends on whether there is an economic recession.

Why Did the Stock Market Decline?

It basically comes down to the way a stream of earnings are valued at different levels of Inflation and Interest rates. As I write this on July 18th, interest rates are expected to go higher to reduce inflation. Higher rates reduce the value of the future stream of earnings. The stock market is looking forward and anticipating a slower economy and possibly lower earnings.

This year, much of the stock market slide this has been related

*This investment letter
is mailed quarterly to
our clients and
friends.*

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This is an excerpt of the Bank of America earnings report from The Wall Street Journal on July 19, 2022.

It reports the consumer is in good shape.

Banks are being closely watched for signs that the Federal Reserve's efforts to curb inflation with interest-rate increases are tipping the economy into a recession. While the biggest U.S. banks posted double-digit drops in profit, their results showed little evidence of a downturn. U.S. consumers, especially, appear to be in good financial shape, spending at a healthy clip and keeping up with their debt payments.

At Bank of America, executives said, customers have upped their spending while maintaining elevated deposit balances. Credit card spending rose 17%. Loan balances also increased.

"Despite the worries of a slowing economy...our customers' resilience and health remains strong," Chief Executive Brian Moynihan said on a call with analysts Monday.

Bank of America's shares rose in morning trading before paring most of their gains by the close. They settled up less than 0.1% at \$32.26. The bank's shares are down 28% this year, compared with a 20% drop in the S&P 500.

Bank of America's U.S. customers are spending more on services and less on goods, Mr. Moynihan said. Customers spent 41% more on travel and entertainment in the second quarter than they did a year ago. They are also paying more for fuel, spending 42% more on gas.

Default rates remain near record lows, and customers are "paying off their debt at a good clip," Mr. Moynihan said.

"The consumer's in great shape, and the Fed's got a lot of work to do," Alastair Borthwick, Bank of America's chief financial officer, said.

to lower Price / Earnings ratios (known as multiple compression), which means stock investors want to pay a lower price for a future stream of earnings. They are concerned that the stocks could fall further if companies report profits that are lower than expectations or forecasted earnings are reduced.

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- Freight or shipping rates are starting to decrease indicating a softness in demand.
- In Europe, June's slowdown was the sharpest recorded since November 2008 at the height of the global financial crisis.
- Auto loan arrears are starting to creep up and the housing markets are cooling.
- Wall Street Journal report Technology Workers Hiring Spree has started to cool.
- Reduction or cessation of federal stimulus payments to individuals and corporations.
- Last year, there was a record number of IPO or new companies issuing new shares and which are now trading down at 84% of their new issue price.

The chart on the back of this page traces S&P 500 since 1996. From Jan 1st to June 30th, 2022 the index dropped from 4797 to 3785. At this level the Price Earnings ratio is a reasonable 15.7 and it could stabilize here. However, if earnings decline, the market going down another 10% or so. Since January, I have been steadily selling and raising cash. We are now gradually starting to invest in high quality companies.

Conclusion

Accumulating wealth takes time and we may face many challenges along the way. Most accounts have cash in them and we are looking to slowly reinvest the funds over the next several months into Sound Companies with good business models and strong balance sheets. I look forward to visiting with you.

Once a year I am required by the Security Exchange Commission to offer a copy of my ADV part 2 to our clients. This outlines our companies policies and procedures. I would be happy to mail it out, or even better, come by and I will explain it to you. In addition, please find attached the company's privacy statement.

We welcome your calls.

S&P 500 Index at inflection points

S&P 500 Price Index

Characteristic	3/24/2000	10/9/2007	2/19/2020	1/3/2022	6/30/2022
Index Level	1,527	1,565	3,386	4,797	3,785
P/E Ratio (fwd.)	25.2x	15.1x	19.2x	21.4x	15.9x
Dividend Yield	1.4%	1.9%	1.9%	1.3%	1.8%
10-yr. Treasury	6.2%	4.7%	1.6%	1.6%	3.0%

Currently, the Price/Earnings ratio is 15.9 which indicates a fair value.

Old Support and Resistance Line

