Kenneth A. Gilpin CFP

Sound Investments Inc.

3rd Quarter 2022

DJIA 28725.5 S&P 500 3585.6 Nasdaq 10,575.6

Summary

We think that inflation can easily drop from 8% to 5% but will be more difficult to get back to the 2% level which is the goal. In any event, this is what is driving the market currently. For the most part, fear of uncontrolled inflation is already baked into stock prices with the market down-24%. It's hard to foretell, but assuming inflation can be reduced, most of the market distress may have already occurred.

This has been a difficult market to value. It's hard to tell. I remember well the stock market crash of 1987 ... it dropped over 30% (so far in 2022 markets are off 24%). The economy continued to do well but the market fell in 1987 as stocks were bid up too high. Today, it may well be that the economy will do reasonable well but the market is slumping as it is adjusting to more normal or higher interest rates. We think most of the pain is over, but will take some time for a full recovery.

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

Stock Market's Slide

The third quarter decline capped the worst period of three consecutive quarterly losses since 2002. At the end of September 2022, the S&P 500 was down -24.8%.

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. In August, interest rates on CD's finally hit 4% for 9 months and we are adding them to portfolios.

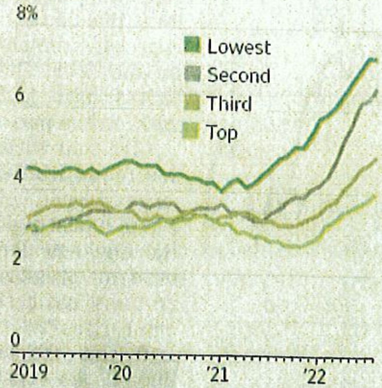
On the positive side, valuations have come down and many stocks are fairly valued now. The job market remains strong and wages have grown, especially among lower earners. (see chart on page 2) Corporate earnings reports have continued strong, yet more companies have mentioned headwinds, such as the stronger dollar and inflation, in earnings calls lately.

Seasonally, US stocks have a perfect 80-record of rising after the midterm elections. The S&P 500 has moved higher on the one year period following every midterm election since 1942. There has been an average gain of nearly 15%, after 1 year since 1942.

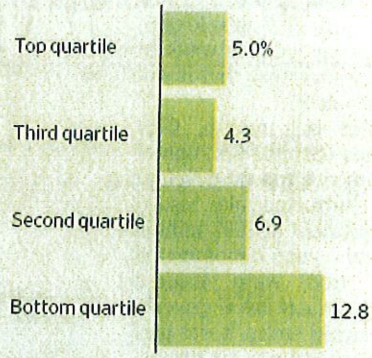
Slowing the Economy Down?

It's a strange set-up when one is hoping for a slower economy so we can have a higher stock market, but the man in charge, Jerome Powell, Chairman of the Federal Reserve Bank, is bound and determined to raise interest rates. Make no mistake, we need a stable dollar with low inflation to function as a civilization but so far, he has raised short term rates from basically zero to

Median monthly wage growth by wage quartile, 12-month moving average



Inflation-adjusted change in labor income for working-age adults from December 2019 to July 2022, by income quartile



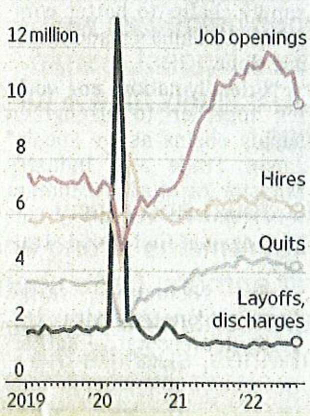
Sources: Federal Reserve Bank of Atlanta (wage growth); Blanchet, Saez and Zucman (labor income)

Wage growth, at lower income levels, is growing the fastest which is a good thing.

Job Openings Fall Sharply

Data indicate the labor market cooled in August. **A2**

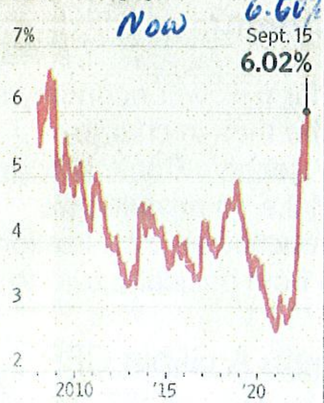
U.S. employment market



Note: Seasonally adjusted.
August 2022 data are preliminary.
Source: Labor Department

Finding a job just became a tiny bit harder.

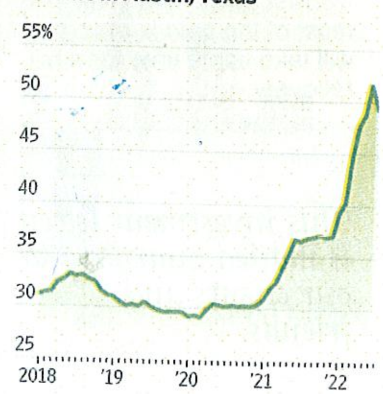
Average rate on a 30-year fixed mortgage



Source: Freddie Mac

High interest rates are making it more difficult to afford a home.

Payments on a median-priced home as a share of median household income in Austin, Texas



Note: Payments include interest rates, property taxes and insurance
Source: Federal Reserve Bank of Atlanta

to 3%. The economy is faced with the highest chance of increased interest rates since the 1980's. This has included three consecutive 0.75% hikes, bringing the short term rate to 3.00 / 3.25% and wants to raise it to 4.4%. As I write this on Oct 15th, the September job report showed the economy still expanding, but at a slower rate. The market immediately sold off 2%. The market was looking for a slower economy so rates wouldn't have to go so high.

The central bank's plan to reduce demand is working. Home sales fell during the late summer months, as higher borrowing costs reduced housing affordability.(see chart on housing cost in Austin TX on back of page 2) Likewise, manufacturing activity is slowing, according to the Institute for Supply Management, a trade group. The Purchasing Managers' Index (PMI), a survey of the prevailing direction of economic trends in the manufacturing sector, dropped to 50.9 in September, the lowest reading since May 2020. Auto sales are also down. The survey also noted that companies are adjusting to potential future lower demand. We think that inflation can easily drop from 8% to 5% but will be more difficult to get back to the 2% level which is the goal. In any event, this is what is driving the market currently. For the most part, fear of uncontrolled inflation is already baked into stock prices with the market down-24%. It's hard to foretell, but assuming inflation can be reduced, most of the market distress may have already occurred.

What do Earnings Reports Show

As has been the case in 2022, rising interest rates are pressuring the stocks of higher growth companies, particularly those in the technology and consumer discretionary sectors. The next big event for Wall Street is the release of the third quarter earnings reports. As I write this on Oct 15h, 165 of the S&P 500 companies have reasonable but lower earnings affected by higher interest rates and a stronger dollar environment. Companies have issued more negative than positive third quarter guidance. FactSet Research, estimate earnings growth rates of 2.4%. This marks the lowest growth rate since the 2020 Covid-19 downturn. Many companies have overseas business which will be hurt when foreign earnings are translated back into US dollars.

Conclusion

This has been a difficult market to value. It's hard to tell. I remember well the stock market crash of 1987 ... it dropped over 30% (so far in 2022 markets are off 24%). The economy continued to do well but the market fell in 1987 as stocks were bid up too high. Today, it may well be that the economy will do reasonable well but the market is slumping as it is adjusting to more normal or higher interest rates. We think most of the pain is over, but will take some time for a full recovery.

In previous, client letters, we expected a lower market but it's hard to get it just right. We plan to proceed with caution. In a rising interest rates environment, we continue to focus on companies that have the financial where with all to weather a potential downturn. Also, Certificate of Deposits or CD's are yieliding over 4% for 9 months and offer a positve return.

We welcome your calls.

Laid-Off Employees Quickly Find New Jobs

By Sarah Chaney Cambon

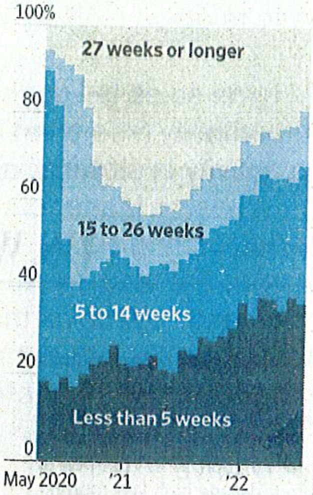
When Suki Lanh was laid off from a fintech insurance startup in early July, she worried it could take months to find a new job.

"I was definitely nervous seeing the amount of startups that were laying off folks," the 30-year-old said. "I just thought generally it was going to be really difficult to get another job for a while."

Ms. Lanh posted a video about her job loss on LinkedIn two days after she was let go amid broader cuts at a New York City-based startup. Recruiter messages started flood-

Please turn to page A6

Unemployment by duration, share of total unemployment



Note: Seasonally adjusted
Source: Labor Department

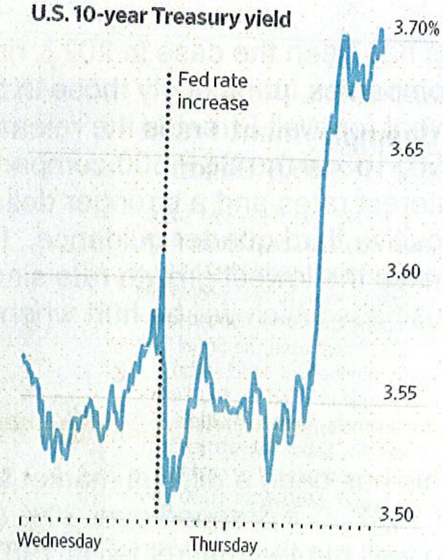
It takes time for higher interest rates to work through the economy. Over the next 6 months, it may become more difficult to find a job.

Higher bond yields slow the economy.

Bond Yields Climb on Moves

U.S. bond yields surged Thursday, after foreign governments and central banks rushed to raise interest rates or otherwise support local currencies pressured by the dollar rally. The moves unnerved investors already fearful of an economic slowdown. B1

U.S. 10-year Treasury yield



Note: 10-minute intervals
Source: Tullett Prebon

Sterling was a victim of the strong dollar, alongside the euro, until recently.

Source: Tullett Prebon

The U.S. dollar has moved up approximately 15% which is reducing earnings and this makes U.S. companies less competitive overseas.