MOMMAERTS MAHANEY
FINANCIAL SERVICES, INC
ACHIEVE MORE.

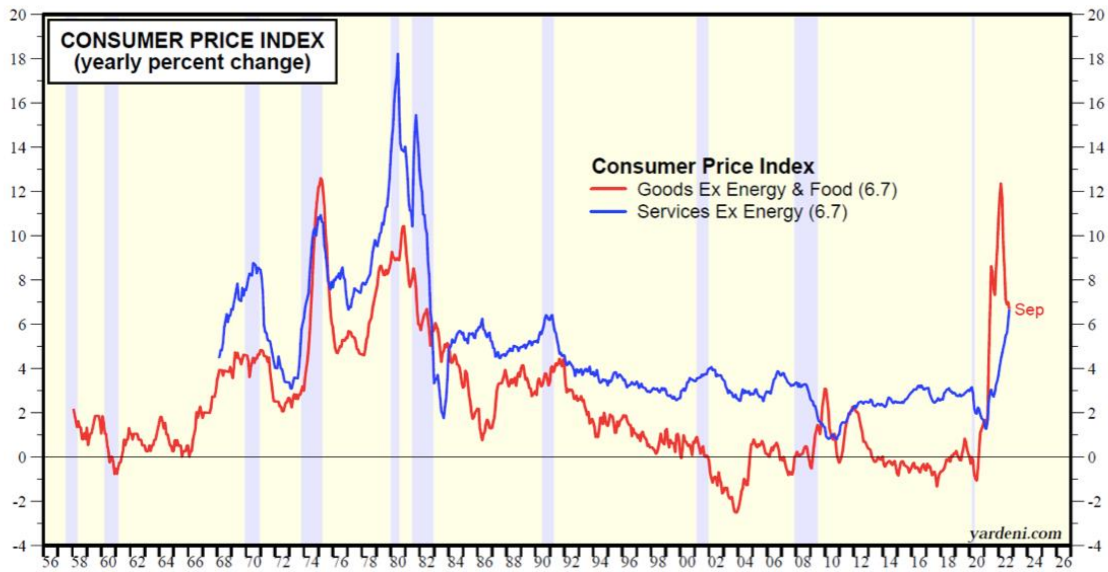
989 W Washington St., Suite # 101
Marquette, MI 49855
(906) 226-8711
www.mommaerts-mahaney.com

October 20, 2022

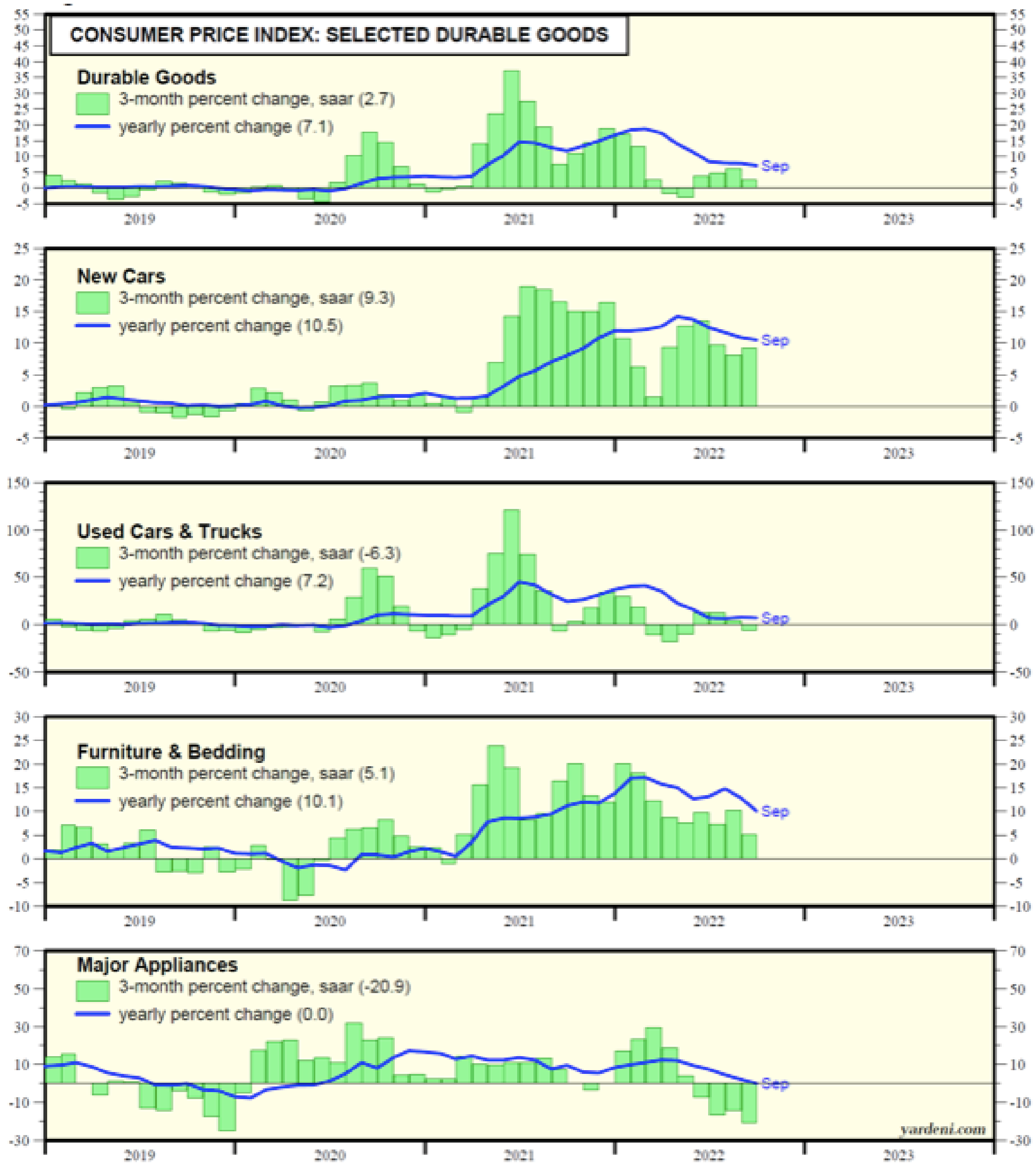
October Allocation Change

Jon C. Mommaerts Certified Financial Planner®
Robert Kea Chartered Financial Analyst
J. Matthew Tuccini Certified Financial Planner®
Jason J. Rolling Financial Advisor

We are increasing credit risk and duration (interest rate) risk in the Core Portfolios. This will increase the aggregate risk in the portfolios. We have been considerably underweight in both credit and duration risk in favor of cash (short-term treasuries). We are cutting that underweight in half. Being underweight credit and duration risk has significantly helped to limit losses in the Core Portfolios this year. Long-duration Treasury Bonds are down more than 30% this year and High Yield Bonds are down 17%. We are remaining underweight credit and duration risk, but significantly less so. Although CPI (Consumer Price Index) and PPI (Producer Price Index) headline numbers were higher than anticipated last week, it appears inflation has peaked and is starting to move lower. In response to the pandemic, the Federal Reserve and Washington Lawmakers flooded the U.S. economy with far too much stimulus. This caused a demand shock. Too much demand and not enough supply caused widespread inflation. We are starting to see supply catch up to demand. Although inflation in the services sector remains a problem (not enough workers), *goods* inflation is starting to roll over considerably. It has dropped from 12.4% to 6.7%. Supply chains are catching up.

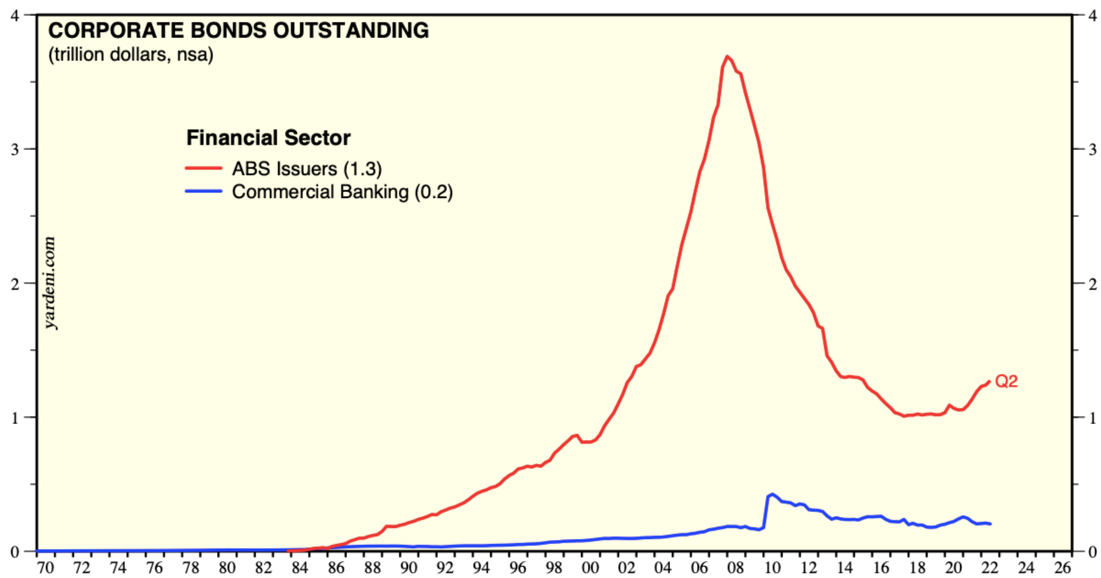


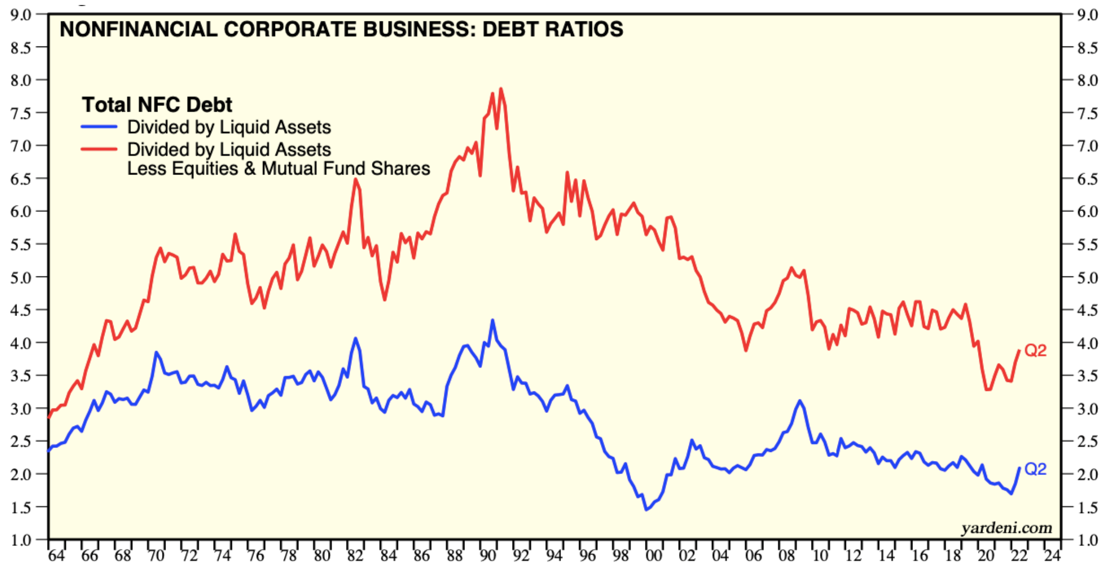
For those of you that have been waiting to buy that new or used car, appliances, etc., supply is finally catching up.



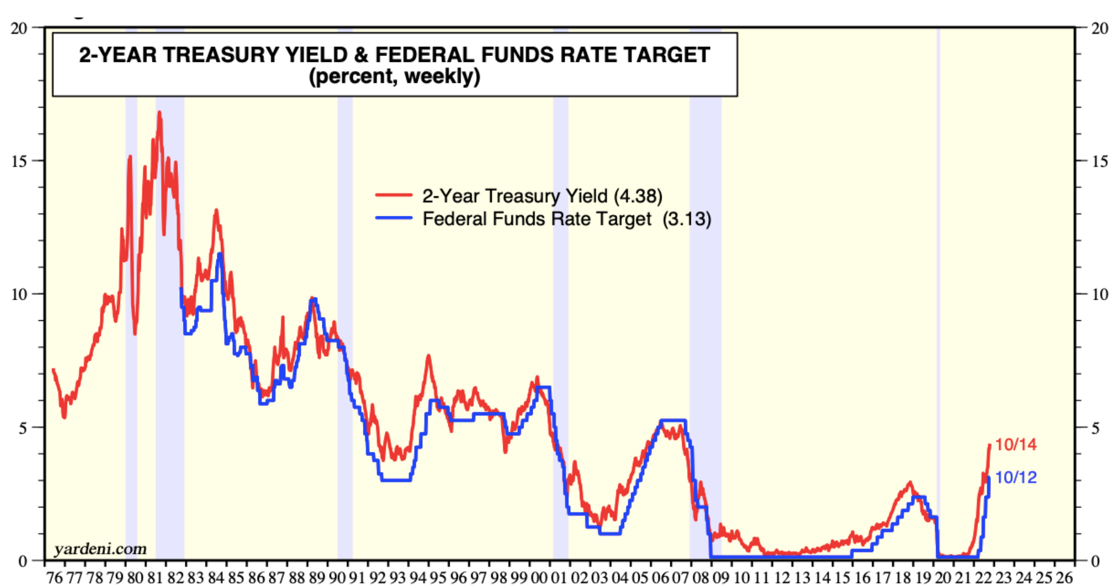
It also is becoming increasingly likely that the Fed will hike 75bps in November and 50-75bps in December, then pause. Of all the Fed's mouth-pieces, the most closely watched, other than Fed Chair Powell, is St. Louis Fed President James Bullard. This weekend Bullard said he prefers a “frontloading” approach to raising the FFR and a wait-and-see approach in 2023. This implies that the Fed has purposely been overly aggressive and plans to pause soon. We see this as the Fed's most likely path. We believe these anticipated hikes are already priced into interest rate levels and credit spreads.

Our large underweight to credit and duration was based on empirical evidence showing that when the Federal Reserve tightens, interest rates rise and credit spreads widen. The reason for interest rates moving higher is the far more obvious one. The Fed is raising interest rates by increasing the Fed Funds Rate and also ending their purchases of longer-term bonds (quantitative easing becomes quantitative tightening). The reason credit spreads widen is less obvious. As interest rates rise and the cost of debt service increases, the risk of corporate default also increases. Many Fed tightening periods end with a credit crunch and an increase in corporate defaults. The most recent and most severe was 2008-2009. Well-established and respected companies overextended themselves and went bankrupt. The corporate credit market is in far better shape today than in 2008. Tighter lending standards coupled with investors' memories have not allowed corporations, or households, to overextend themselves. The amount of corporate debt outstanding pales in comparison to the amount outstanding in 2008. Debt ratios and debt service are not overly concerning at this point in time.

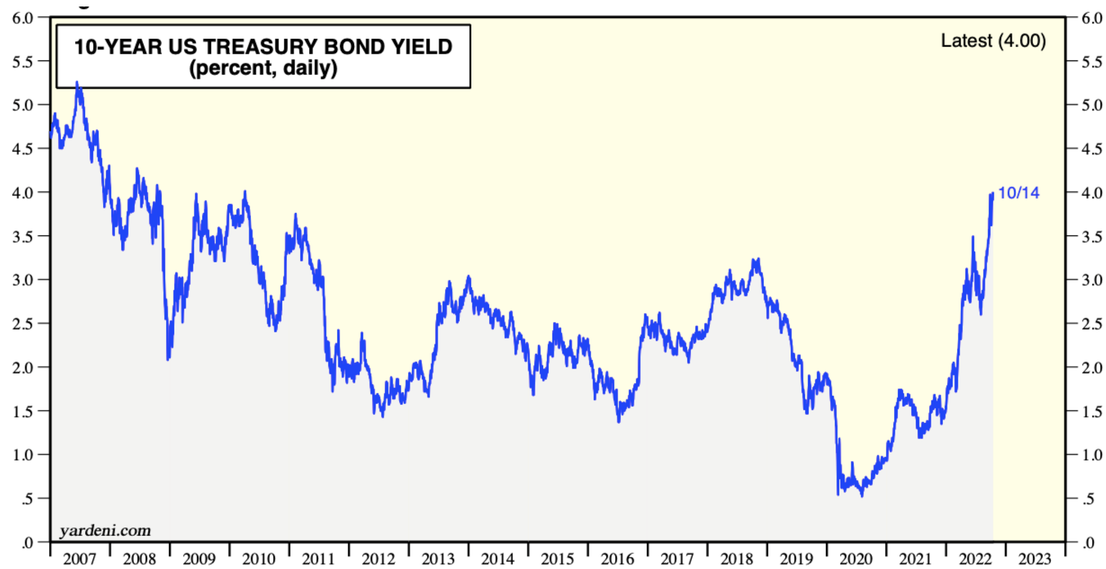


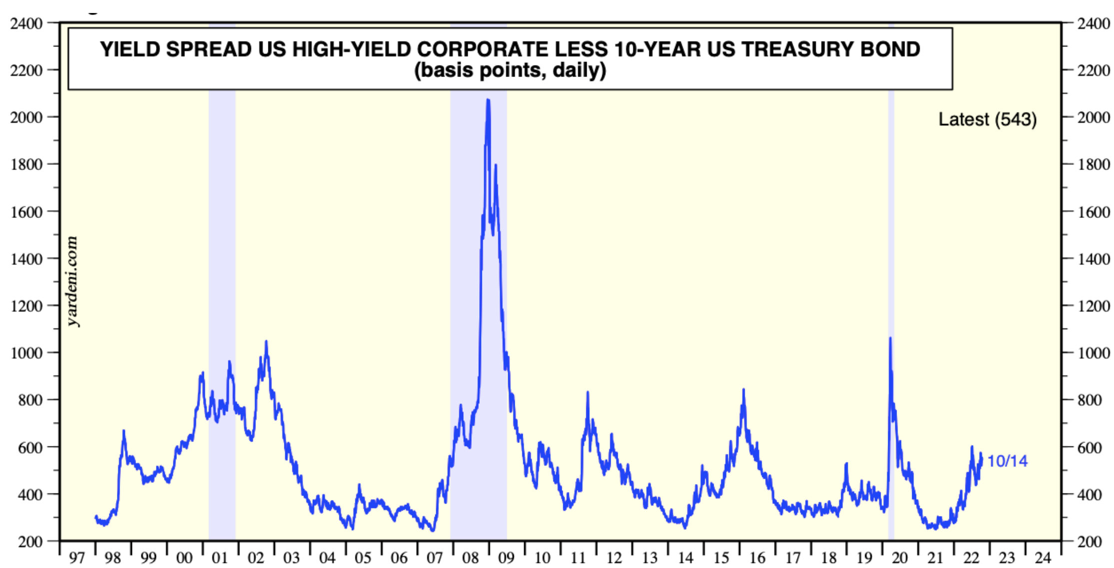


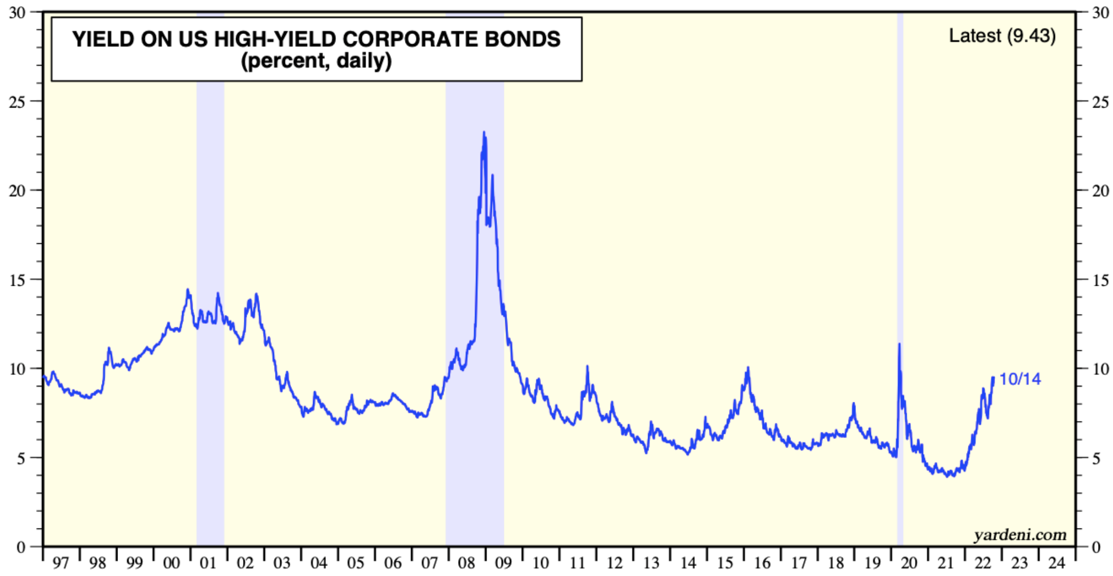
Importantly, interest rate and credit spread movements are not coincidental with Fed action. Like all financial markets, they trade based on the expectations of what the future holds. This is why market prices lead economic data and are not coincident or lagging of market data. Interest rates rose and credit spreads started to widen at the start of this year even though the Fed didn't actually raise rates until March. Although markets do not always end up being correct, markets do reflect the consensus view of the future. For example, the two-year treasury note is an excellent predictor of the FFR. Notice how movements in the 2-Year Treasury Note consistently lead actual Fed action by 3-6 months.



Interest rates have increased and High Yield and Investment Grade Spreads have widened, a lot. 10-Year Yields were 1.25% at the start of the year and are now 4.00%. HY Spreads have moved from 2.50% to 6.00%. High Yield Bonds were yielding 4.00 at the start of the year and are now earning 9.00%. It's doubtful our timing will be perfect, but the yield offered on corporate debt now outweighs the risk of corporate default.







Limiting exposure to corporate debt and duration this year has been beneficial. However, we can no longer justify carrying this large underweight given the current yield levels and the likelihood that we have entered the late stages of this tightening cycle. We think it is likely that interest rates are at or near their highs and credit spreads will tighten.

Successful long-term investing is about limiting the downside during periods like these, and then thriving during the good times. Based on our frameworks, we expect that credit markets should start to gradually improve. Another way to think about investing in corporate credit is this. If High Yield interest rates and credit spreads remain where they are for the next year, investors would earn 9%.

We are likely entering a more active period of portfolio management and expect to be adding risk back into the Core Portfolios over the next several months. It's still crazy out there, to say the least. Our plan is to be patient in bringing the Core Portfolios back up to their neutral risk levels.

We often emphasize the importance of communication during times like these. Please, reach out to us with any and all of your concerns.

The MMFS Team

Jon C Mommaerts, CFP®: Jon is a Principal of Mommaerts Mahaney Financial Services, Inc. He has over 30 years of experience working with professionals and those about to retire. He is a member of the Financial Planning Association, as well as a founding member of the Preferred Financial Advisors.

J. Matthew Tuccini, CFP®: Matt has over 17 years of experience working in the financial services industry with vast experience in retirement planning, tax strategies, and financial planning.

Robert Kea, CFA: Bob has over 30 years of experience in portfolio management. He was a founding member and Co-Head on Putnam's Asset Allocation Group, which managed $12Bn in both retail and institutional assets.

Jason Rolling, Financial Advisor: Jason has been in the financial services industry for the past 15 years. His financial experience includes retail banking, consumer & commercial lending, bank management at the local, regional and SVP level, wealth management, and financial planning.

Haley Wainio, Financial Advisor: Haley has over 9 years of experience in the financial services industry. Her experience includes retail banking, treasury management, commercial lending & financial planning.

FPA FINANCIAL PLANNING ASSOCIATION PROUD MEMBER

Mommaerts Mahaney Financial Services, Inc. provides advisory services through ERTS Wealth Advisors, LLC, a registered investment advisor.
989 W. Washington Street, Suite 101 Marquette, MI 49855
(906) 226-8711