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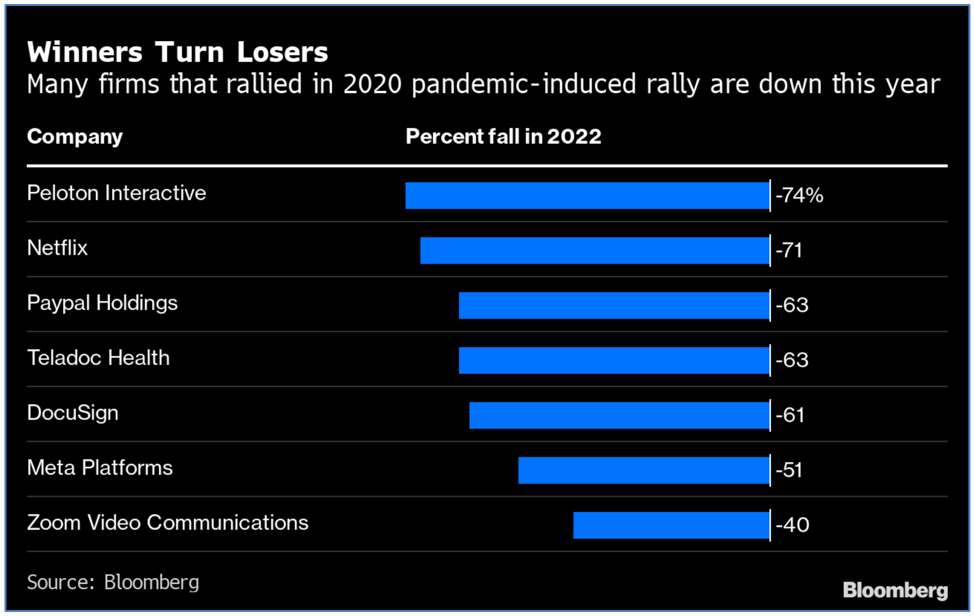
July 13, 2022

After a ~21% decline in the S&P 500 during the first half of 2022, the P/E multiple of the index has declined from 21.2x to ~15.9x (slightly less than the 25-year forward average of 16.9x). Although energy stocks advanced by 31.8%, the 10 other S&P 500 sectors declined in value, with consumer discretionary, communication services, and technology shares the biggest laggards at -32.8%, -30.2%, and -26.9%, respectively. The reasons for the decrease have included a smorgasbord of investor concerns, from inflation and interest rates to recession fears, the war in Ukraine, supply chain disruptions, and an economic slowdown in China.

The resulting wealth destruction has been severe, with the *Financial Times* reporting the evisceration of more than $9 trillion in U.S. stock market value during the first half of 2022. All major asset classes except commodities decreased in value, with even "safe" fixed-income investments declining precipitously amid a sharp increase in interest rates. According to JP Morgan, investors in 30-year Treasuries lost ~23%, investors in investment-grade corporate debt almost 15%, and municipal bond holders ~9%. Cryptocurrencies (the epitome of pure speculation, in our view) were decimated, with Bitcoin, the most popular cryptocurrency, losing nearly 60% in the first half of 2022.


The performance of the Nasdaq 100 was particularly painful, with almost a third of its value lost. By the end of June, only 21 Nasdaq 100 firms were valued above $100 billion, down from 33 at the beginning of 2022.

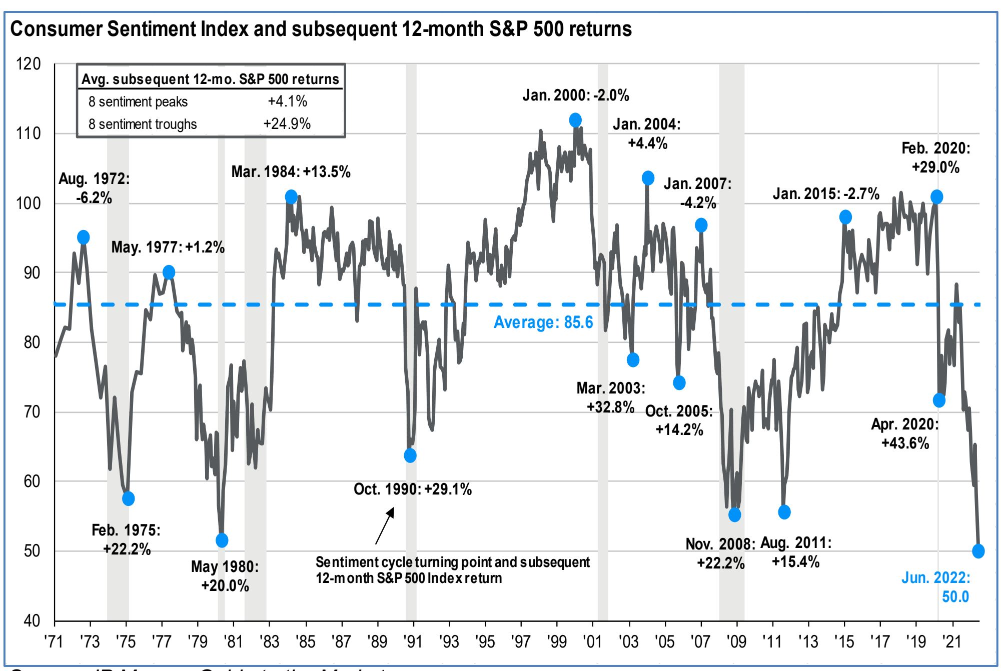
Many pandemic darlings, like Teladoc, DocuSign, and Peloton, were among the biggest decliners during the first half of 2022. We make no predictions about the performance of specific pandemic highflyers, but we do expect the current period to be reminiscent of the dotcom crash, when many former market leaders lost 75%-90% of their value, never again to approach their previous highs. ***It is worth remembering that after the Nasdaq peaked in March 2000, it took 15 years to surpass its 2000 high.*** Even if a few of the pandemic era's "fallen angels" surpass their former highs, we believe that they will be the exception, not the rule—so to those seeing these former pandemic darlings as bargains for having lost 60%-70% of their value, we say only caveat emptor.




## Market Gyrations and Current Sentiment

This year's daily market gyrations have been dizzying, with the S&P 500 moving 1% (up or down) on nearly half of trading days. If this trend continues, it will be the second time that this high a percentage of "1% days" has occurred in the past 25 years. (Notably, the other time was 2008.) Investor sentiment is at multiyear lows (Bank of America's bull-and-bear indicator of trader sentiment recently registered "maximum bearishness" 3 weeks running), and consumer confidence is even lower than after the September 11 attacks, during the 2008–2009 financial crisis, and during the coronavirus lockdowns. Both these markers have historically been great contraindicators for future stock market returns.

### Consumer Confidence and the Stock Market




*Source: JP Morgan Guide to the Markets.*

Consumer confidence could certainly decrease further, but according to JP Morgan, the S&P 500's average 12-month return after the eight consumer confidence troughs since 1971 has been +24.9%. No one knows how much further consumer confidence will erode, but historically periods of extreme weakness in consumer confidence have been some of equity investors' best buying opportunities.

In its midyear outlook, JP Morgan Global Research summed up the situation by saying, "*Positioning and sentiment of investors is at multi-decade lows. So, it is not that we think that the world and economies are in great shape, but just that an average investor expects an economic disaster, and if that does not materialize risky assets classes could recover most of their losses from the first half*." Admittedly, predicting the timing of a recovery is all but impossible, but we've found that the best buying opportunities often come when investors feel worst about the prospects for equities.

**Why Don't You Sell Now, Then Buy When the Situation Stabilizes?**

With so many negative headlines, clients have asked us why we don't sell in a downturn and wait for the situation to "stabilize." As simple as it might sound, such an idea is impossible to implement and poses a serious risk to investors' financial well-being. As famed investor Howard Marks pointed out in a recent memo, missing just a few days could significantly eat into your long-term return. According to data from JP Morgan, from 1999 to 2018, the S&P 500's annual return was 5.6%, a figure that dropped to only 2.0% for investors who missed the 10 best trading days (roughly 0.4% of the total trading days during the period). Investors who were unfortunate enough to miss the best 20 trading days made no money at all. *The market's best days tend to follow its worst days, and investors who sell out at these times of maximum pessimism are likely to miss the rebound.*

We haven't decreased our equity exposure, and we don't plan to; instead, we like to take advantage of these moments of market dislocation to increase our equity holdings. We're pained at the thought of losing money for our clients, but we see this year's losses thus far as "paper losses," not as a permanent loss of capital. After all, the price of a stock on any given day is simply what people are willing to pay for a business at that moment. But we believe that over the long term, either the stock market will come to reflect the business's true value or an acquirer will purchase it for its true worth, as we've seen so many times before. We have no reason to believe that this time will be any different.

**Putting Returns in Context**

This year's results for equity investors have been painful, but they're hardly unprecedented, and they should be viewed in their proper context. The media have taken to calling the first half of 2022 the worst beginning to a year since 1970, but that's only one way of comparing current and historical stock market performance. Historically, a 20% drop has not been uncommon: according to Adviser Investments, since 1957 the S&P 500 has declined by 20%+ on 13 occasions (roughly once every 5 years), and according to JP Morgan, since 1980 the average intrayear drop has been ~14%. What's more, Ned Davis Research reports, first-half starts where the S&P 500 has lost a significant amount historically have been followed by second-half rebounds (18.7% on average).

| Year | Through Mid-June | Rest of Year | Full Year | Bear End Date |
|---|---|---|---|---|
| 2022 | -23.1% | ? | ? | ? |
| 1970 | -17.3% | 21.0% | 0.1% | 5/26/1970 |
| 1962 | -22.1% | 13.2% | -11.8% | 6/26/1962 |
| 1940 | -20.1% | 6.0% | -15.3% | 4/28/1942 |
| 1932 | -36.9% | 34.6% | -15.1% | 2/27/1933 |

*Source: Ned Davis Research*

## Reasons for Optimism

Historically, investors who have purchased stocks during a bear market have tended to *eventually* be richly rewarded (if they had a long-term horizon and held on to their positions even through the worst of times). The folks at Miller Value Partners, a highly respected value investing firm, recently published an analysis of all the U.S. bear markets since 1939 that contained some interesting findings:

### The Good News

- Regardless of whether a bear market led to a recession, in most cases the subsequent 1-, 3-, and 5-year results were significantly above the "average" long-term stock market return.
- The median 1-, 3-, and 5-year returns of bear markets that also coincided with recessions (with 3- and 5-year returns annualized) were 34%, 14%, and 9%, respectively. When the bear market did not result in a recession, the 1-, 3-, and 5-year median returns were 8%, 11%, and 13%, respectively. *Interestingly, the 1- and 3-year median returns were higher in recessions*, but those periods experienced a deeper total drop (in percentage terms) and took longer to bottom.

### The Bad News

- The median drawdown (investors' percentage loss from high to low) was 34% during bear markets that were accompanied by a recession and 30% when no recession occurred.

- As of July 12, the S&P 500 was down ~18.5% from its highs, so if history is any guide, we may have a significant amount of downside still to come. However, many stocks in the S&P 500 and Russell 2000 are down 40% or more from their all-time highs, so although the overall market might not have bottomed, many individual stocks might have already done so.

**SPX Drawdown Analysis Starting in 1939 with a Minimum Decline of -20%**

| Start Date | End Date | Duration (Mo.) | Drawdown (Peak to Trough) | Trough Forward P/E | Forward P/E at -20% Drawdown | Peak CPI | Recession/Non-Recession | Additional Drawdown After -20% Decline | Months from Trough | Forward Performance following -20% Drawdown* 1-YR | 3-YR | 5-YR |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 10/25/1939 | 6/10/1940 | 8 Months | -32% | 8.5x | 9.7x | 2.2% | No Recession | -15% | 1 Months | -4% | 11% | 13% |
| 11/7/1940 | 4/28/1942 | 18 Months | -34% | 7.0x | 9.6x | 12.7% | No Recession | -18% | 5 Months | 9% | 19% | 16% |
| 5/29/1946 | 5/19/1947 | 12 Months | -28% | 8.1x | 10.4x | 19.7% | No Recession | -11% | 8 Months | 2% | 6% | 17% |
| 6/15/1948 | 6/13/1949 | 12 Months | -21% | 5.7x | 5.7x | 9.9% | Recession | -1% | 0 Months | 59% | 32% | 25% |
| 8/2/1956 | 10/22/1957 | 15 Months | -22% | 13.5x | 13.6x | 3.7% | Recession | -2% | 0 Months | 34% | 14% | 11% |
| 12/12/1961 | 6/26/1962 | 7 Months | -28% | 14.1x | 15.0x | 1.3% | No Recession | -10% | 1 Months | 25% | 19% | 13% |
| 2/9/1966 | 10/7/1966 | 8 Months | -22% | 13.8x | 14.0x | 3.8% | No Recession | -3% | 1 Months | 28% | 12% | 10% |
| 11/29/1968 | 5/26/1970 | 18 Months | -36% | 13.3x | 16.7x | 6.2% | Recession | -20% | 4 Months | 15% | 14% | 1% |
| 1/11/1973 | 10/3/1974 | 21 Months | -48% | 8.0x | 10.5x | 12.1% | Recession | -35% | 10 Months | -24% | 7% | 5% |
| 11/28/1980 | 8/12/1982 | 21 Months | -27% | 7.7x | 9.0x | 12.6% | Recession | -9% | 6 Months | 37% | 23% | 26% |
| 8/25/1987 | 12/4/1987 | 3 Months | -34% | 9.4x | 9.5x | 4.5% | No Recession | -17% | 2 Months | 7% | 9% | 13% |
| * 7/16/1990 | 10/11/1990 | 3 Months | -20% | 18.5x | 18.5x | 6.3% | Recession | 0% | 0 Months | 34% | 20% | 18% |
| 3/24/2000 | 10/9/2002 | 31 Months | -49% | 15.9x | 47.8x | 3.8% | Recession | -36% | 19 Months | -3% | -1% | 3% |
| 10/9/2007 | 3/9/2009 | 17 Months | -57% | 11.1x | 99.3x | 5.6% | Recession | -46% | 8 Months | -28% | 5% | 8% |
| 2/19/2020 | 3/23/2020 | 1 Months | -34% | 23.8x | 26.4x | 2.3% | Recession | -17% | 0 Months | 48% | N/A | N/A |
| Average | | 13 Months | -33% | 11.9x | 21.0x | 7.1% | | -16% | 4 Months | 16% | 13% | 13% |
| **Median** | | **12 Months** | **-32%** | **11.1x** | **13.6x** | **5.6%** | | **-15%** | **2 Months** | **15%** | **13%** | **13%** |
| Avg Recession | | 15 Months | -35% | 13.1x | 27.5x | 6.9% | 60% | -19% | 5 Months | 19% | 14% | 12% |
| **Median** | | **17 Months** | **-34%** | **13.3x** | **16.7x** | **6.2%** | | **-17%** | **4 Months** | **34%** | **14%** | **9%** |
| Avg No Recession | | 9 Months | -30% | 10.1x | 11.4x | 7.4% | 40% | -12% | 3 Months | 11% | 12% | 14% |
| **Median** | | **8 Months** | **-30%** | **9.0x** | **10.1x** | **4.2%** | | **-13%** | **1 Months** | **8%** | **11%** | **13%** |
| **Current Period** | | | | | | | | | | | | |
| 1/3/2022 | 6/16/2022 | 5 Months | -24% | 15.5x | 15.9x | 8.6% | N/A | -4% | 0 Months | N/A | N/A | N/A |

**The 3 and 5 year returns reflected above are annualized*

***The 1990 bear market fell -19.92% vs the typical definition of a -20% drawdown which we believe should qualify as a bear market and is therefore included in the analysis*

*Source: Miller Value Partners, Bloomberg, and Birinyi Associates*

*Source: Miller Value Partners*

**<u>Where Do We Go from Here?</u>**

Going through a bear market is painful, both monetarily and psychologically, but investors should remind themselves that **<u>periods of substantial declines have historically been followed by outsized gains.</u>** Investors who have the patience, and the financial strength, to stick with their positions during difficult times (and the cash to add to existing positions or initiate new ones) have typically been handsomely rewarded. Each bear market is difficult in its own way, but we see no reason the next 3- to 5-year period should differ substantially from previous bear markets. Remember—the most dangerous words in investing are "It's different this time."

**<u>Items to Monitor</u>**

This year's headlines have been dominated by fears of runaway inflation and the question of whether the Federal Reserve can navigate a soft landing by raising interest rates just enough to quell inflation but not so much as to cause a severe recession. Whether or not we will eventually meet the commonly thought of definition of a recession (two straight quarters of negative real GDP growth) is academic; stock market investors should assess whether individual equities are already pricing in a significant downturn in their business and whether a given company has the financial wherewithal to withstand a prolonged period of a decline in its business activity. They should then make their investment decisions accordingly.

We're far from being macroeconomic investors, and we try our best to filter out the geopolitical noise (since the horizon is never free of threats, waiting for all risk to subside is a recipe for poor long-term financial health) so that we can focus on the individual businesses we're buying or thinking of buying for our clients. Even so, we are paying attention to certain metrics:

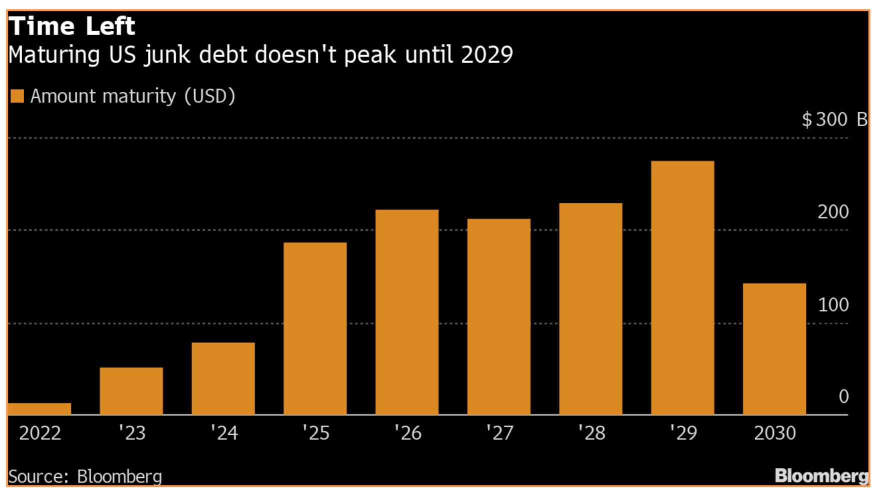
- **Savings rate:** According to Moody's Analytics, U.S. households built up $2.7 trillion in extra savings from the start of the pandemic through the end of last year. This extra savings propped up consumers during the worst of the outbreak and saved the U.S. from economic collapse but also—combined with factors like the war in Ukraine and severe supply chain disruptions—helped spur a bad case of inflation. Consumer wages are no longer keeping up with inflation, forcing families to draw on savings so that they can pay for groceries, gasoline, and other necessities. The savings rate, which stood at 8.7% in December 2021, had dropped to 5.4% by May. If consumers start pulling back as their savings are depleted, our largely consumer-driven economy (consumption accounts for over two-thirds of our GDP) could feel the effects. Thus far, at least, consumers still seem to be spending, with Bank of America reporting that credit and debit card spending was up 11% from last June (vs. 13% up in April and 9% in May), although for lower-income households, total card spending (excluding gas and groceries) fell 1%.

- **Commodity costs:** The Bloomberg commodity index was up 17.38% through July 11 from the end of last year, with commodities such as oil and natural gas advancing ~43% and ~76%, respectively—which has contributed to the significant bout of inflation we're experiencing. However, over the past month (as of July 11) the commodity index has declined by 14%, with oil and gas down 14% and 27%, respectively. The price of copper has decreased by almost 20% over the same period. If these declines continue, the Federal Reserve might not raise rates as high as investors currently fear, a development that we believe would be positive for equities. However, many other factors could significantly alter the price of commodities—the war in Ukraine, decreases in refinery capacity due to severe hurricanes, or a faster-than-expected reopening of China, to name a few—so investors should watch the news closely.

- **U.S. Housing:** Since housing accounts for about 4.8% of the U.S. GDP, investors should be following the sector closely. U.S. mortgage rates started 2022 at approximately 3.1%, and by the week of July 4, the average 30-year fixed rate mortgage had increased to 5.3%—still low by historical standards (considering that the average 30-year rate over the past 40 years has been 7.1%) but the highest figure seen since 2009. The increase in rates has significantly increased potential homebuyers' monthly mortgage payments (a primary factor in what most homebuyers are willing to pay for a home), and according to mortgage data provider Black Knight, the average price of a home is now more than 6x the median household income, the highest multiple since the early 1970s. With monthly payments having increased so dramatically (according to Prashant Gopal of *Bloomberg*, a borrower with a $300,000 mortgage today would pay ~$1,665 a month, $383 more than at the end of 2021), housing prices might be expected to decrease. So far, however, this has not happened (although according to Black Knight, in May home price growth slowed in 97 of the 100 largest U.S. housing markets), most likely because the U.S. supply of homes is historically low. In May 2022, there were 1,474,000 single-family homes for sale, versus an average of 2,405,000 since 1982. It should be interesting to see what happens to home prices under these two competing dynamics (higher monthly costs vs. a low supply of homes). A housing downturn, should one occur, would likely have a negative impact on the economy, but we do not believe that we will see a repeat of 2008 (when a housing downturn sparked a financial crisis), as banks have become significantly more selective in assessing borrowers' creditworthiness and homebuyers' credit scores have improved dramatically since the prior housing bust.

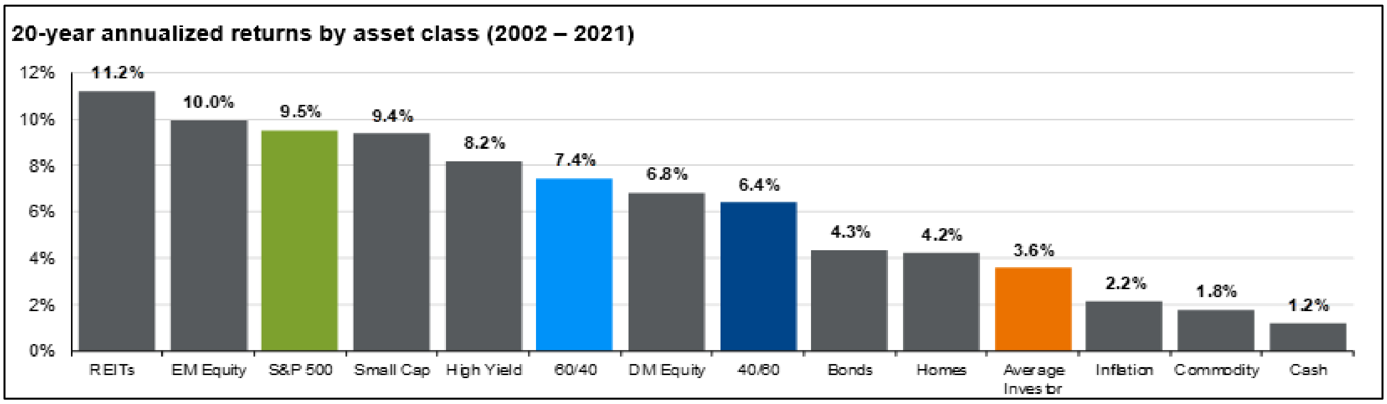
**<u>Maturity Issues</u>**

One of the major problems of the 2007-2008 financial crisis was that many companies were highly indebted, with their debt due at the worst possible time. It now seems that corporate America has largely learned its lesson, having used the ensuing years of ultra-low interest rates to significantly reduce interest costs while spreading debt maturities far into the future. According to *Bloomberg*, only ~8% of U.S. dollar company high-yield bonds are due by the end of 2024, with maturities peaking in 2029. By contrast, in the fourth quarter of 2008, fully 18% of the U.S. high-yield market was due to mature in 3 years.



## The Wisdom of Taking a Long-Term View

We've said it before, and we'll say it again: individual investors stack the odds of investment success in their favor when they stay the course and take a long-term view. *Data from Dalbar tells us that over the past 20 years, when the S&P 500 averaged a 9.5% annual advance, the average investor gained a mere 3.6%, barely beating the 2.2% inflation over the period.* Why such a degree of underperformance? Partly because investors let their emotions get the better of them and chase the latest investment fad (or pile into equities at market peaks and sell out at market troughs)—and partly because they sell for nonfundamental reasons, such as a rise in a company's share price (or in an index).




*Source: JP Morgan Guide to the Markets.*

But history tells us that taking a multiyear view instead would tilt the odds of success in investors' favor. According to data from JP Morgan, since 1950 annual S&P 500 returns have ranged from +47% to -39%. For any given 5-year period, however, that range narrows to +28% to -3%—and for any given 20-year period, it is +17% to +6%. *In short, since 1950, there has never been a 20-year period when investors did not make at least 6% per year in the stock market.* In addition, it is worth noting that from 1950 through 2021, investors in the S&P 500 have compounded their capital at 11.5%. Past performance is certainly no guarantee of future returns, but history does show that the longer a time frame you give yourself, the better your chances become of earning a satisfactory return.

As always, we're available to answer any questions you might have. In addition, please contact us if your financial circumstances have changed so that we can adjust your portfolio(s) accordingly. We can be reached at jboyar@boyarvaluegroup.com or (212) 995-8300.

Best regards,

Mark A. Boyar

Jonathan I. Boyar

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***Past performance is no guarantee of future results. Investing in equities and fixed income involves risk, including the possible loss of principal.*** *The S&P 500 Index is included to allow you to compare your returns against an unmanaged capitalization-weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of the 500 stocks representing all major industries. The Russell 2000® Value Index measures the performance of the small-cap value segment of the U.S. equity universe. It includes those Russell 2000® companies with lower price-to-book ratios and lower forecasted growth values. The S&P 1500 Value Index measures value stocks using three factors, the ratios of book value, earnings, and sales to price, and the constituents are drawn from the S&P 500, S&P Midcap 400, and S&P SmallCap 600. The Dow Jones Industrial Average is a price-weighted average of 30 significant stocks traded on the New York Stock Exchange and the NASDAQ. The volatility of the above-referenced indices may materially differ from that of your account(s), and the holdings in your account(s) may differ significantly from the securities that constitute the above-referenced indices. Your results are reported gross of fees. The collection of fees produces a compounding effect on the total rate of return net of management fees. As an example, the effect of investment management fees on the total value of a client's portfolio assuming (a) quarterly fee assessment, (b) $1,000,000 investment, (c) portfolio return of 8% a year, and (d) 1.50% annual investment advisory fee would be $15,566 in the first year, with cumulative effects of $88,488 over five years and $209,051 over ten years. This material is intended as a broad overview of Boyar Asset Management's philosophy and process and is subject to change without notice. Account holdings and characteristics may vary, since investment objectives, tax considerations, and other factors differ from account to account.*