



## The Investment Impact Of Crises In American History

**A**mid the Mideast war, stalemate in Russian-Ukrainian War, and rising tensions with China over Taiwan, it's wise to remember that the modern era has been in crisis almost perpetually.

A new crisis comes along at least every two years. The 27 crises in the 66 years from 1957 through 2023 are about as many as we could legibly fit on this page. It's missing the 1963 assassination of President John F. Kennedy, the 1979 Iran hostage crisis, the 1983 terrorist killing of 241 U.S. Marines on a peacekeeping mission in Beirut, tech bubble bust in 2000, Brexit in 2016, the pullout from Saigon in 1975 and Afghanistan in 2021, as well as many other days of infamy.

Despite this dismal past, the price of U.S. equities, the main growth engine of American investors, moved higher. The Standard & Poor's 500 stock index, a capitalization-weighted benchmark of the value of America's largest publicly-held companies, continued to average a 10.5% gain

annually, despite the unrelenting string of one crisis after another.

If you don't take the time to learn history, it's natural to assume what's happening in the world right now is going to continue. Behavioral finance has a term for this human foible: recency bias. It makes it hard to imagine a stock market crash will end or a hot investment won't keep soaring.

Recency bias is an especially dangerous vulnerability amid an anomaly-pocked post-pandemic landscape threatened by multiple geopolitical and economic crises.

Viewing recent events from the frame set by financial history, the price of the S&P 500 stock index since 1957 has grown at a compound annual rate of 7%, as shown in the red line. In addition, assuming reinvestment of dividends earned, the annual total return averaged 10.5%.

The chart on page 4 shows the great achievements in modern history, which were often driven by the U.S., *(Continued on page 4)*

## A Sign Of Progress In Solving U.S. Economic Problems

**T**he Federal Reserve appears to be pulling off a feat most experts did not believe it could: ending its aggressive inflation-fighting campaign of 11 interest rate hikes without tipping the U.S. economy into a recession.

The Covid-19 pandemic was followed by two huge federal stimulus programs and supply-chain disruptions in 2020 and 2021. Then, oil prices soared in 2022 after Russia invaded Ukraine. In response, the Fed hiked the lending rate it charges the nation's largest banks from a quarter of 1% in March 2022 to 5.25% in July 2023.

It was the most aggressive monetary tightening crusade implemented by the U.S. central bank in modern history. Inflation erodes consumer buying power and undermines confidence in an economy. Once inflation infiltrates the financial psychology of the masses, it's hard to eradicate. The last inflation crisis, during the 1970s and early 1980s, was ended only after then-Fed chair Paul Volcker famously hiked rates so much that it caused a deep recession.

The success of the Fed campaign makes it likely that the economy will not fall into a recession and will continue to grow at about a 2% rate in 2024, while inflation continues to fall toward the target rate of 2%. It demonstrates that the U.S. central banking system has grown more effective in fighting inflation and other financial economic crises, and it is a sign of the progress of the United States in solving problems..



# A No-Nonsense Financial IQ Test

**D**o you know enough about estate income tax rules and foundational principles of investing to make wise decisions?

The 10 questions below test your knowledge of concepts central to prudent investing and tax planning. They're drawn from topics covered in our news stream. If you get two or more answers wrong, you do not know enough to make long-term financial choices without expert help.

## 1. Recency is a tendency to:

- a. take advice from the last person you talked to
- b. ~~ic~~take advice from the last person you talked to believe the most recent opinion you heard on a subject
- c. overweight the impact of current conditions in long-term planning
- d. all of the above
- e. none of the above

## 2. After 4% withdrawals annually, a \$1 million dollar 60% stock, 40% bond portfolio, over 73 rolling 25-year periods from 1926 to 2023 and after 1.25% annual expenses for advisor fees and ETF and mutual fund expenses, averaged an ending balance of:

- a. 0
- b. \$520,627
- c. \$1 million
- d. \$3 million
- e. none of the above

## 3. Federal Reserve mistakes caused:

- a. every collapse of the US dollar since 1957
- b. every recession since 1957
- c. every recession since 1957 except for February/March 2020
- d. all of the above
- e. none of the above

## 4. The back-door IRA:

- a. was disallowed in 2022 by the IRS
- b. sidesteps the income limitation on contributing to a Roth IRA
- c. offers no estate tax benefits
- d. all of the above
- e. none of the above

## 5. What's true?

- a. the yield curve was inverted throughout 2022
- b. the leading economic indicators index has signaled recession for over 18 months
- c. 6.5 million jobseekers in October 2023 were outnumbered by 9.6 million job openings
- d. all of the above
- e. none of the above

## 6. The Federal Reserve:

- a. hiked interest rates more than 1000% since March 2022
- b. caused almost every recession in modern history
- c. publishes a U.S. financial stability report semi-annually
- d. all of the above
- e. none of the above

## 7. What's true?

- a. individual tax burden in US is higher than Germany and France
- b. construction employment is at a record low
- c. the Standard & Poor's 500 stock index is nearly 20% off its all-time high
- d. all of the above
- e. none of the above

## 8. Interest rates in 2023:

- a. soared
- b. reverted to their historic level
- c. made homebuying more expensive
- d. all of the above
- e. none of the above

## 9. On December 31, 2025, tax rules changed by the Tax Cuts & Jobs Act of 2017 affecting individuals:

- a. expire
- b. slash the estate tax exemption
- c. result in reversion to a 39.6% top income tax bracket
- d. all of the above
- e. none of the above

## 10. Required minimum distributions:

- a. apply to traditional IRAs
- b. are mandated after turning 70
- c. grow larger as you grow older
- d. all of the above
- e. none of the above

Answers: 1c, 2d, 3c, 4b, 5d, 6d, 7e, 8e, 9d, 10d

## Financial Crime Snitches Are In Stitches, Exacting Revenge

**T**he Securities and Exchange Commission filed enforcement actions against 501 individuals or entities in the 12 months through September 2023 — an 8% increase over the prior fiscal year.

The SEC obtained orders for \$5 billion in financial remedies, the second highest amount in history, after the record-setting remedies ordered in fiscal year 2022. The financial remedies comprised \$3.4 billion in disgorgement and prejudgment interest and \$1.6 billion in civil penalties. Orders barring 133 individuals from serving as officers and directors of public companies hit 10-year-high.

Financial corruption in the United

States is a serious problem but these figures from the federal regulator protecting American investors are reason for optimism.

The government forced \$3.4 in ill-gotten gains to be disgorged by financial crooks and ordered another \$1.6 billion in penalties to be paid in the most egregious cases. Amid great concern about Federal government efficiency, the SEC's enforcement actions are inarguably deterring investor fraud.

Moreover, the federal whistleblower program in 2023 awarded nearly \$600 million to individuals who came forward with proof that firms and individuals were defrauding investors. One whistleblower was awarded a

record \$279 million reporting, more than doubling the previous record-breaking bounty. Federal law mandates whistleblower awards range from 10–30% of the money collected when sanctions exceed \$1 million. Whistleblowers must provide the SEC with original, timely, and credible evidence that leads to a successful enforcement action and adhere to filing requirements in the whistleblower rules.

The Commission received more than 18,000 whistleblower tips in fiscal year 2023, a record number — about 50% more than the record 12,300 whistleblower tips received in fiscal year 2022.

# Office Space Reckoning Expected In 2024

Office-space delinquencies tripled in the first six months of 2023, and landlords and investors in office space through mutual funds, retirement plans, and other packaged products face a tough period ahead. Delinquencies on office-space mortgages averaged 10 times the rate of five subcategories of commercial real estate (CRE).

Lodging, second-worst of the five segments, in the first six months of 2023, experienced a 1.41% delinquency rate. That's bad, but less than half the 3.1% delinquency rate on office-space mortgages. Comparatively, multifamily homes, industrial production, and retail CRE delinquencies, were fractional.

Post-Covid America needs much less office space. With 46% of officespace mortgage loans maturing between 2023 and 2025, the cost of a

mortgage post-pandemic has soared as banks tightened loan standards, putting more financial pressure on landlords and investors at a tough time.

These are some of the key observations of Erin McLaughlin, an expert on office-space and commercial real estate and senior economist at The Conference Board. "We've had a cultural shift in how people work," she said in an October 11 briefing for corporate leaders at many of the world's largest companies. Ms. McLaughlin painted a grim outlook for the officespace segment of CRE.

## Smaller Banks (Total Assets \$100M-\$10B) Have the Highest Exposure to Commercial Real Estate and Office Markets

Bank Size	# of Banks	CRE as a % of Total Assets	Office as a % of Total Assets
25 largest, \$160 B+	25	4.3%	0.5%
\$10 B - \$160 B	135	16.2%	2.0%
\$1 B - \$10 B	829	24.3%	3.2%
\$100 M - \$1 B	2,965	18.3%	2.6%
< \$100 M	761	7.2%	1.1%
Total / Average	4,715	9.3%	1.2%

Source: FDIC, Cohen & Steers, The Conference Board, 2023

mortgaged in variable rate loans with five- to 10-year terms. The rise in lending rates that began in March 2021 is now impacting many more office-space landlords and CRE investors, at the same time they are facing tougher lending standards. Recapitalizing now is much harder and more expensive.

Converting office space into residential apartments is a pipe dream –literally. While it sounds like a great idea, TCB's economics team says windows, plumbing, and HVAC systems make it too expensive about 90% of the time. Only about 10% of U.S. office space can be converted to residences profitably.

A flight to quality is likely. Companies will be seeking high-end office space to motivate workers to show up. "If you're leasing 30,000 square feet of office space, you may decrease the size but increase amenities." Expect a flight to the best addresses downtown, the ones with rooftop facilities, pickleball courts, and scenic panoramic views.

Small and regional bank exposure. The 25 largest U.S. banks have 4% of their assets in CRE loans, while small and regional banks have about 25% of their assets invested in CRE. Bank of Ozarks is located in Arkansas but heavily invested in New York City office space. Warning of a second leg of the banking crisis experienced in March 2023, TCB members, senior executives at many of the world's largest companies, were told some banks may fail and large banks opportunistically will buy troubled smaller banks. ●

## Background.

Office-space accounts for 18% of the total value of U.S. CRE. McLaughlin said the turmoil expected may be largely contained to the office space segment of CRE. Office space generally is



# Against Dishonest Former Employers



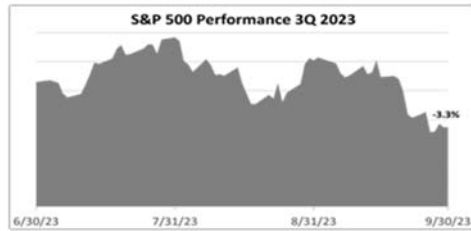
The U.S. Congress passed the Whistleblower Protection Act in 1989 and enhanced it in 2012 to better protect whistleblowers from retaliation by employers. In recent years, many nations have adopted stronger whistleblower protection laws, but such statutes have not been enacted in many countries,

including the world's second largest economy, China.

For the world's largest economy, to be on the forefront in enforcing ethical financial activities and actors is an example of what makes America exceptional among the world of nations. Investors know they can bank on the United States system, which is part of the reason why large U.S. stocks have annually averaged a 10.5% over the 97 years through 2022.

In this time of increased skepticism of the federal, it's important to recognize the strong regulations and enforcement measures protecting investors and financial markets. ●

# Market Data Bank: 3rd Quarter 2023



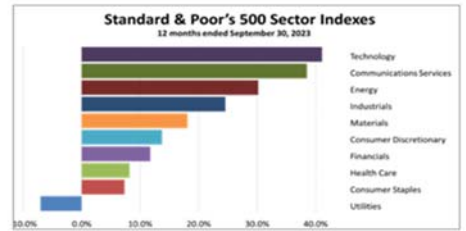
## A LOSING QUARTER FOR STOCKS

The Standard & Poor's 500 stock index lost -3.3% in Q3 2023, following strong gains in the three previous quarters of +8.7% in Q2 '23, +7% in Q1 '23 and +7.6% in 4Q '22. Stock prices were hurt in the third quarter by the rise in interest rates, which made bonds more valuable relative to stocks.



## INFLATION DOMINATES STOCK MARKET

In the 12 months ended Sept. 30, 2023, the main factor moving stock prices was inflation. The Fed's tight monetary policy drove lending rates to a 22-year high, casting doubt on whether a "soft landing" was possible and raising the likelihood of a recession. An unusually strong labor market bolstered bulls.



## 12-MONTH INDUSTRY SECTORS

Low interest helped propel tech stocks to the top of the 10 industry sectors in the S&P 500 stock index in the 12 months shown by giving them access to cheap capital to hire, acquire, and re-tool. Low rates, at the same time, made utilities the worst performer because it made their dividend yields less attractive.



## FIVE-YEAR ASSET PERFORMANCE

Of the diverse group of 13 assets represented by indexes, U.S. stocks were No. 1 in the five years through Q3 '23. Agriculture outperformed, as world population continued to grow and climate change made this commodity more expensive. Crude oil, a volatile asset, was a losing investment, as the pandemic crushed demand.

Past performance is never a guarantee of your future results. Indices and ETFs representing asset classes are unmanaged and not recommendations. Foreign investing involves currency and political risk and political



## U.S. MANUFACTURING CONSTRUCTION

The U.S. stock market in the five turbulent years shown endured two bear markets, but provided nearly triple the return of European equities and nine times the return on Asian stocks. Chinese stocks, which dominate performance of emerging market stock indexes, lost -16.6% in the five-year period.

instability. Bonds offer a fixed rate of return while stocks fluctuate. Investing in emerging markets involves greater risk than more liquid markets with a longer history. Indices are unmanaged and not available for direct

FOMC Meeting Date	Rate Change (basis points)	Fed Funds Rate
July 26, 2023	+25	5.25% to 5.50%
May 3, 2023	+25	5% to 5.25%
March 22, 2023	+25	4.75% to 5%
Feb. 1, 2023	+25	4.5% to 4.75%
Dec. 14, 2022	+50	4.25% to 4.5%
November 2, 2022	+75	3.75% to 4%
Sept. 21, 2022	+75	3% to 3.25%
July 27, 2022	+75	2.25% to 2.5%
June 16, 2022	+75	1.5% to 1.75%
May 5, 2022	+50	0.75% to 1%
March 17, 2022	+25	0.25% to 0.5%

## FED FUNDS RATE

Despite two bear markets, U.S. stock returns were No. 1 of among a broad array of 13 indexes in the five years ended March 31, 2023. While oil and energy outperformed in the last year, the index of crude oil investments lost -23.7% versus a 69.9.5% return on the S&P 500 index over five years.

investment. Investments with higher return potential carry greater risk of loss. Sector performance data from Standard and Poor's.

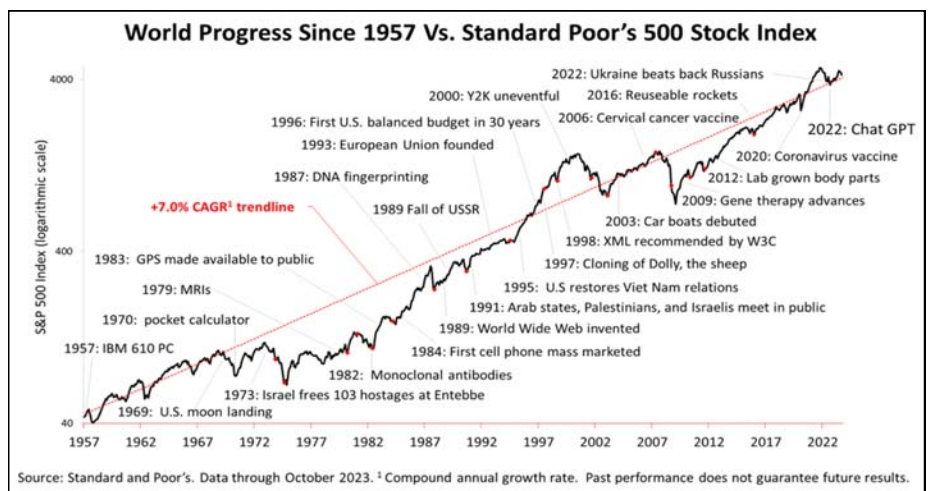
## The Investment Impact Of Crisis

(Continued from page 1)

the world's largest economy. The black line, the actual performance of the S&P 500, does not steadily rise. Rather, it suffers losses some years and underperforms its average return, which is why investors must be prepared to ride through crises.

Things could be different this time. Past performance is never a guarantee of your future investment results. However, you don't want to fall victim to recency bias by ignoring financial history. It's wise to remember that crises came and went again and again in throughout modern history, but the S&P 500, a proxy of America's progress, appreciated anyway.

Stocks are one asset-class in a



diversified portfolio that ideally is comprised of investments that historically have performed differently from each other. Stocks, however, are typically the main driver of investment

growth in a portfolio. Despite their volatility and the stream of crises, these lessons are important to keep top of mind. ●