FAHNESTOCK ASSET MANAGEMENT
of Oppenheimer & Co. Inc.

Craig W. Hutchison
Managing Director
Senior Portfolio Manager
382 Springfield Avenue, Suite 400
Summit, NJ 07901
craig.hutchison@opco.com

Phone 908-273-2100
Fax 908-273-0788
Toll Free 800-522-7857

December 22, 2022

Dear Client,

There are tons of websites that instantly calculate monthly mortgage payments. Lucky us, because the math is pretty complicated. Before the internet we used pocket sized books, each page for a rate, with a grid showing the monthly payment at the intersection of loan size and length. Craig – who throws NOTHING away – has one in his desk, © 1981.

When Drew bought his first home in Hoboken in 2014 at a rate of 3.875%, Craig was quick to share his artifact. When it was printed in 1981 mortgage rates peaked at 18.45%. The highest rate in the book was 21%, the lowest a fanciful 10%. Today's average mortgage rate is 6.75%, unthinkable both in 1981 and at the beginning of 2022 when they were half as much.

There is an inverse relationship between interest rates and asset prices, whether real estate, stocks, or bonds. **2022 was not a fun year for most investors and materially higher rates were the main culprit**. The stock market, as represented by the NASDAQ and the S&P500, is down 32% and 20% this year. However, investors expect meaningful selloffs <u>in stocks</u> to occur periodically and are compensated for greater risk with greater potential long term returns.

The real "crash", relative to perceived risk, has been <u>in bonds</u>. The Bloomberg Aggregate Investment Grade Index – made up of short, medium and long term high quality bonds – was down 20% at one point this year and is now down 12%. **We are happy to report that in early 2022 you had no maturities greater than 5 years and many paid a floating rate, thus avoiding the brunt of the selloff in bonds experienced by the index.**

In a healthy economy, longer term bonds command higher rates. At the beginning of the year the 3 month treasury yielded .5%, the 10 year 1.5%, and the 30 year 1.9%. For the last decade a common refrain among investors was "TINA – **T**here **I**s **N**o **A**lternative"; low interest rates pressured some investors to pursue marginally higher rates in longer term bonds while ignoring the risks of rates subsequently increasing. Today those same rates have rocketed and now yield 4.2%, 3.66% and 3.73% and **market values of 10 and 30 year treasuries have declined 16% and 31%, an abysmal risk/reward tradeoff in pursuit of an extra 1%.**

The silver lining to every selloff is the opportunity to buy investments at lower prices. There are now plenty of alternatives and as short term bonds in your portfolio mature, we have the opportunity to reinvest the proceeds in bonds at much higher rates or in stocks at cheaper valuations. **We think longer term investment grade bonds are the most attractive asset class in the current environment relative to risk.**

As rates spiked earlier in the year we started buying bonds with maturities in the 6-8 year range. More recently we purchased investment grade bonds with a 6.4% annual return due in 15 years, the longest Drew has lent in his career, and the longest Craig has lent since the early 90s. The high rate is attractive to income investors and the potential for appreciation should rates decline is attractive to growth investors.

Nothing is without risk. If inflation doesn't abate, the Fed will likely continue to raise rates, a negative for stocks and bonds. **The good news is inflation is moderating and markets have priced in an end to rate increases next year.** There is also the risk that the Fed stalls the economy more than intended. Should that happen, the Fed has the flexibility to stimulate the economy by lowering rates.

Craig can throw his mortgage book away. Not only do we have the internet, but we strongly believe there is little chance rates will return to 80s levels. The ultra-low rates of the last three years are equally implausible. We are ultimately pleased with today's rates as they are clearing out the economic underbrush, mostly impacting flimsy business models, speculators and overleveraged consumers supported by cheap capital. **Adapting will continue to be a bumpy process but it sets the stage for a healthier economy and the next bull market. And in the meantime, we are finally being appropriately compensated for the risk.**

We remain long term optimistic and look forward to the rejuvenation a New Year brings. We wish you continued abundance in 2023!

Happy Holidays,

Craig

Craig W. Hutchison
Managing Director
Senior Portfolio Manager

Drew

Andrew A. Westhuis, CFA, CFP
Executive Director
Portfolio Manager

PS – Craig here – I am proud to relay that earlier this year Forbes/Shook Research ranked Drew as a Top Next Generation Wealth Advisor – Best in State. He started with me in 2006 and I was immediately impressed by his thirst for knowledge, integrity, attitude, and passion for investing. He has since earned the CFA and CFP designations, my trust and that of clients, and has worked his way up to equal partner in our practice. We collaborate on everything but Drew is the primary author of these letters and has generated many of the successful ideas in your portfolio. We are lucky to have him. Please join me in congratulating him!