MONONGAHELA CAPITAL MANAGEMENT

PERCEPTIONS

4th Quarter, December 31, 2022	12/31/2022	% Change 4th Quarter	% Change Year to date
Dow Jones Industrials	33,147.25	16.01 %*	(6.86) %*
S & P 500	3,839.50	7.56 %*	(18.11) %*
Russell 2000	1,761.25	6.23 %*	(20.44) %*
BC Aggregate BD Index		1.87 %	(13.01) %
10 YR. Treasury Yield	3.87 %		
30 YR. Treasury Yield	3.96 %		

** Includes reinvested dividend*

Disappearing Tailwind

This past weekend, we made reservations for our 41st summer vacation at the Atlantic shore. The first year, twenty-five or so of our somewhat immediate family made the trip to the Outer Banks and rented a bungalow, outfitted to comfortably sleep ten. Each day, partially to escape the chaos, I would dutifully walk out to the end of the dusty road to a payphone and call the office for an update. On Friday afternoon, the last day of vacation, the report was truly astonishing. Prices were dramatically higher on heavy volume. The Dow Jones Industrial Average (DJIA) had closed up 11.13 points, or 1.4% to close at 788.05, at that time a remarkable performance. That morning, the Federal Reserve (Fed) had lowered interest rates by ½ percent, the third decrease in six weeks. The date was August 13th, 1982 and marked the beginning of a historic bull market. By the time the bull market ran out of steam, the DJIA had peaked at 11,723 in 2000.

As I entered the securities industry in the late 70's, stock markets had been in a malaise for quite some time. Progress was measured slowly, if progress was made at all. The DJIA first closed above 800 in 1966 and in August of 1982, it was still treading water slightly below 800. The catalyst for the liftoff in August of 1982 was the decline in interest rates and subsequent decline in inflation from extraordinary high levels. The strong tailwinds of lower interest rates supported rising equity and bond prices for almost forty years. In late 2021, the gale force support of low rates faded into the equatorial doldrums, leaving investment valuations that had been dependent on ultra-low interest rates to suffer significant declines and lead the broader markets into a bear market. In a reversal of fortunes, equities that benefited the most from low rates saw the largest declines in 2022. Tesla was lower by 65%, Amazon.com by 49.6%, Meta Platforms was down by 64.2% and Carvana lost 98% of its value. While most equites suffered declines in 2022, the greatest declines occurred in concept stocks and the technology sector, both very dependent on low-cost funding and low discount rates. Carvana is Exhibit One in the mindless pricing that occurred in the era of excess stimulus and artificially priced credit.

The relatively quick turn by the Fed from easy monetary policies to policies designed to restrict money flow suggest to us that there are structural changes occurring that will be long-term in nature. While there are many unemployed economists who have made errant interest rate forecasts, history would suggest that the zero and negative rate policies of the last ten years were an aberration in monetary policy. If we are returning to a more normal rate environment, equity prices will be recalibrated with an emphasis on companies that have definable and durable value. Without the tailwind of low interest rates, individual equity prices will be valued on their own merit.

Whether bull or bear market, risk assessment is always a major component of our fundamental analysis. There are two categories of risk, systematic and unsystematic. As your portfolio manager, we have little control over systematic risks, like inflation, interest rates, government policies and movement in the broader markets. However, objectively observing the trends in systematic risk allows us to manage your portfolio with a margin of safety. The second category of risk is unsystematic, that is risk to a particular company or industry sector. This is the risk we can control by identifying investments with durable earnings power that merit an investment regardless of the macro environment. Naturally, price discovery and buying at the right price is critical to achieving satisfactory long-term returns. Considering the changing macro environment in 2022, it was not a surprise to see the divergence of individual equity performance. While Tesla, Amazon.com, Meta Platforms and Carvana had very significant declines, equities like Merck & Co (+48%), General Mills (+27%) and Badger Meter (+3%) all had positive total returns in 2022.

Undoubtedly, the secular changes occurring will bring about opportunities in 2023 and well beyond. These opportunities will be different from those seen in the previous bull market, but as always, we remain comfortable with the process of finding value and minimizing risk, even if the low interest rate tailwinds have disappeared.