MARKET OBSERVATIONS
NOVEMBER 2022

SCHLINDWEIN ASSOCIATES
INVESTMENT COUNSEL

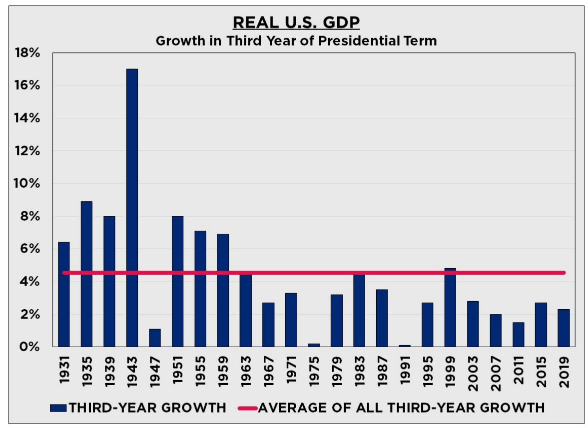
Third Year

Even though sitting presidents are not on the ballot, mid-term elections generally are a referendum on their policies and accomplishments in the past two years. The expression of sentiment is shown in Congressional races. A change in control of either the House or the Senate can shift policy direction ahead and influence outcomes for financial market returns. Policy direction and any changes therein likely will emerge in the year following mid-term elections, the third year of the current presidential term. Overall economic activity, business strategy and investor preferences all are in play. A review of key variables can provide perspective for investing amidst the dilemma at hand.

PERSPECTIVE

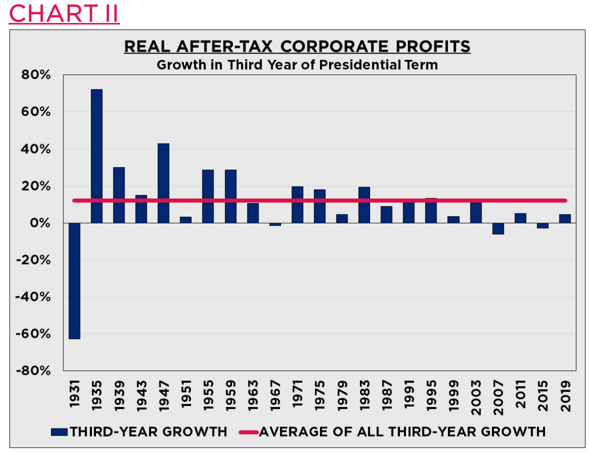
The U.S. economy grows in real terms more years than not. As shown in Chart I, the record of real economic growth ("GDP") in the third year of presidential terms has been consistently positive, averaging 4.5% per year. The last five terms included both Democrat and Republican presidents. In the third year of each term, real economic growth ran well below average. Slower than average growth has characterized most recent years, so the third-year outcomes are not outliers per se. Current consensus forecasts are for anemic real growth in 2023 of +0.4%. This outcome reflects a shallow recession in the first half of the year with a slow recovery thereafter. Financial market outlooks likely will range widely.

CHART I



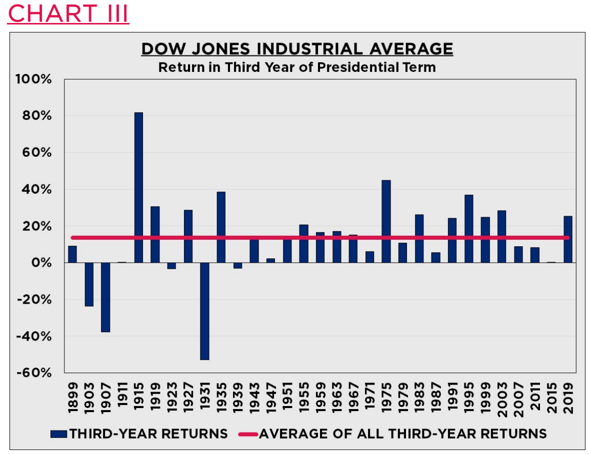
The growth rate of real, after-tax corporate profits has been more positive than not in the third year of presidential terms. Chart II shows that third-year profit growth has been positive in 19 of the last 23 terms. Third-year growth for all terms has averaged +12.7%. This average compares quite favorably to the +9.2% average growth for all calendar years since 1931. While not the only determinant of stock market return outcome, earnings are an important factor. Important as well is the level of interest rates which is used to discount future earnings. With interest rates on the rise and the rate of earnings growth likely to slow with the growth of the overall economy, stock market return could be expected to face headwinds through and beyond yearend 2022.

CHART II



Stock market returns as measured by the Dow Jones Industrial Average ("DJIA") have fared well in the third year of presidential terms. As shown in Chart III, returns have been positive in 18 of 23 years, averaging +13.5% per year. The average return for all calendar years since 1897 is +9.1%. The third-year returns have recorded a notable premium above average. Impressive as well is the 20-term streak of positive returns dating back to 1943. Return expectations for any future period always involve an element of speculation. Returns for a concentrated index such as the DJIA may not be reflective of those for either broader indexes, sector indexes or foreign indexes.

CHART III



INVESTMENT IMPLICATIONS

Difficult policy decisions bring market uncertainty and dilemmas for investors. How long will a bear market last and how deep will be the correction? How long will a recovery take to restore lost value? Should portfolio risk be reduced and when should it be increased once again? At challenging times such as now, the first investor priority is to fully understand goals, time horizons and risk tolerance so as to address any difficult choices that may arise. These choices are within one's control whereas market cycles most certainly are not.