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Quarterly insights from your friends at Armor Investment Advisors

THE DEATH OF T.I.N.A.

by Adam J. Morgan, CFA, CMT

A child, not named Tina, gets on an escalator at the mall to go from the first floor to the second floor. As the escalator ascends, the child begins to play with a yo-yo. For a moment, allow that yo-yo to represent the investment markets; they go up and down but in the long run, they rise. The primary reason for diversifying one's investments is to reduce the volatility of the overall investment portfolio, or, in other words, to shorten the string on the yo-yo. Reducing volatility not only allows worried investors to sleep easier at night, but it also steepens the grade of the escalator over time.

To help demonstrate this point I've included the table below illustrating two different hypothetical scenarios. The table shows two investment portfolios

valued at $5,000,000 at time zero. Both achieve the same arithmetic mean return of 6.5% over a ten-year period, but Portfolio B is subject to a much greater degree of volatility.

In the first example, displayed in the middle third of the table, the investor doesn't take any distributions and instead leaves the money fully invested for the duration of the ten years. Portfolio A is the clear winner by achieving a value $580,095 greater than Portfolio B simply by reducing the volatility of annual returns.

Now let's take this same concept a step further. Let's say that you've gone through the planning process with one of our financial planners, and with their help, you've determined that you need $100,000 per year to supplement what you're currently receiving in social security and pension income. You decide to take an annual lump sum distribution from the portfolio on December 31st of each year to fund the following year's living expenses. Now let's look at how each portfolio will do given the same set of annual returns as in the previous example.

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	Annual Returns		Portfolio Value with no Distributions Taken		Portfolio Value with a $100,000 Annual Distribution	
	Portfolio A	Portfolio B	Portfolio A	Portfolio B	Portfolio A	Portfolio B
Year 0			$5,000,000	$5,000,000	$5,000,000	$5,000,000
Year 1	6.5%	-5.0%	$5,325,000	$4,750,000	$5,225,000	$4,650,000
Year 2	6.5%	18.0%	$5,671,125	$5,605,000	$5,464,625	$5,387,000
Year 3	6.5%	-15.0%	$6,039,748	$4,764,250	$5,719,825	$4,478,950
Year 4	6.5%	-1.0%	$6,432,332	$4,716,608	$5,991,641	$4,334,160
Year 5	6.5%	9.8%	$6,850,433	$5,178,835	$6,281,069	$4,658,908
Year 6	6.5%	14.0%	$7,295,711	$5,903,872	$6,589,338	$5,211,155
Year 7	6.5%	-1.0%	$7,769,933	$5,844,833	$6,917,644	$5,059,043
Year 8	6.5%	28.0%	$8,274,978	$7,481,387	$7,267,291	$6,375,575
Year 9	6.5%	7.0%	$8,812,852	$8,005,084	$7,639,665	$6,721,865
Year 10	6.5%	10.0%	**$9,385,687**	**$8,805,592**	**$8,036,243**	**$7,294,051**
Arithmetic Mean Returns	6.5%	6.5%	**A difference of $580,095**		**A difference of $742,192**	
Geometric Mean Returns	6.5%	5.8%				
Volatility	**0.0%**	**12.4%**				

The visuals shown above are for illustrative purposes only and do not guarantee success or a certain level of performance. The visuals do not represent any particular investment. All investing is subject to the risk of loss. Diversification does not ensure a profit or protect against a loss.

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As you can see, the benefit of reducing investment volatility is amplified significantly if one happens to take a distribution in a year where the market is down. In our mock scenario, which includes annual distributions, controlling volatility yields a benefit of $742,192. When you consider that almost everyone takes distributions from their investment portfolio at some point and the investment market that is the most rewarding (the stock market) is also the most volatile in nature, it makes a lot of sense to diversify.

Ok, enough math… Who the heck is Tina and how did she die? I'm getting there, I promise.

It is a widely known truth in the investment world that bonds are less volatile than stocks. The reason for that is simple. The promised income produced by bonds tends to be more reliable than the capital appreciation investors hope to realize in a stock. So, in theory, adding bonds to an investment portfolio can bring down the total volatility of the portfolio and over time steepen the grade on your escalator. The problem is that for the past decade bonds haven't been paying much at all. This has had the effect of forcing investors who desired healthy returns on their capital to do so by taking on more risk and overweighting equities in their portfolios.

This concept was popularized in the investment industry by an acronym known as T.I.N.A., or "There Is No Alternative" to stocks. Bonds just haven't been a great investment in a world where the Federal Reserve was artificially keeping interest rates as low as possible. Savers trying to do the smart thing and keep a rainy day fund in a money market or savings account have had it even worse. You may not have heard many complaints, though, because the other effect of this interest rate policy is that stocks went on the longest bull market run in the history of the country. Money was cheap and the stock market ballooned. Those days are over for the time being and unfortunately, virtually every market in the investable universe has suffered losses in 2022.

> **"Who the heck is Tina and how did she die?"**

But that reset has left us with an interesting opportunity. After all, many bonds are now trading at their lowest price in years. A quick Zillow search of Wake County real estate reminds us how rare it is to see anything selling at multi-year lows. The yield on the US 10 Yr Treasury Note is at the highest level in over a decade and more than seven times higher than the low of the pandemic. The US Aggregate Bond Index, a commonly used benchmark for the US bond market, now yields 4.75%, the highest level since 2009. So, if your financial plan says that you need a 6.5% annualized return to achieve your retirement goals, the increased yield from fixed income is meaningful and ultimately allows you to invest more conservatively on the equity side of the portfolio where less is needed to meet your objective. Therefore, standing here today looking forward over a long-term investment time horizon, one may be able to achieve a healthy return with less volatility, or a shorter string on the yo-yo.

Many investors are fearful of how high interest rates may need to get to adequately modulate the impact of inflation. While there is much unknown at this point, I would point to the fact that existing sales of single-family homes are down almost 26% from their peak earlier this year. That is a sign that higher interest rates have already begun to curb demand. The Federal Reserve's own interest rate forecast known as "the Dot Plots" estimates that they will be lowering the fed funds rate in 2024. If that's true, we may be approaching a time where interest rates and bond yields are nearing their cycle peak.

I certainly don't mean to sound cavalier about how challenging this year has been for investors. Both stocks and bonds are down big, and it's been difficult to stomach. You don't have to be an expert to know that the economy and the investment markets have lost confidence. But it is worth noting the positive development that came out of all of this. Savers as well as investors who share the goal of growing their purchasing power over a long-term time horizon while investing with a risk tolerance in mind now have an alternative to simply being over-weighted stocks. T.I.N.A. is officially dead and while it hurt to watch, we're all better off for it.—*A. Morgan*

(Please see disclosures on page 4.)

WELCOME AUSTEN HAWKEY

by John Purrington CFP®

Please join me in welcoming Austen Hawkey, CPA, CFP® as the newest member of our team at Armor Investment Advisors. Austen is a perfect addition to our team. He graduated from Campbell University with a Bachelor of Business Administration in Trust and Wealth Management as well as a minor in Financial Planning and he has earned a Master of Accounting from the UNC Kenan Flagler Business School. In addition to being a CPA, Austen has earned his CERTIFIED FINANCIAL PLANNER™ mark.

Austen's education and seventeen years of experience in the profession have prepared him to guide clients through the most complex financial situations. He has extensive experience working with High Net Worth and Ultra High Net Worth families on comprehensive wealth planning including business succession planning, pre and post retirement planning, and philanthropic and gifting strategies.

Austen Hawkey, CPA, CFP®

Even more importantly, Austen brings a passion for making a positive impact on the lives of clients and for building a great business spanning multiple generations.

My connection to Austen and his family reaches back across the generations.

In January 1949, my grandfather Al Purrington Jr. who was one of Raleigh's leading business attorneys worked with his neighbor William Morris to start a new corporation "in the business of ventilating, air conditioning, refrigerating, humidifying, heating, and plumbing." My grandfather served on the board of 'Morris and Gorrell, Inc.', later 'Morris & Associates, Inc.', for several decades.

Later my father (Al III) took his father's place as firm counsel and on the board at Morris & Associates. William's son Bill followed his father as CEO and the company has flourished under his leadership. Bill and Al III worked together for many years and shared tremendous mutual respect.

Bill connected me with his son-in-law Austen several years ago and I have followed his career from PNC Wealth Management to Bank of America Private Bank where he served as a Wealth Strategies Advisor to many of the bank's Ultra High Net Worth clients.

Seventy-three years since that first venture, I am honored to continue the legacy into the third generation by welcoming Austen to our team at Armor Investment Advisors.

Austen and his wife Rachael live in Raleigh where their twin seven-year-old daughters and four-year-old son keep them on their toes. We are excited to welcome them all to the Armor family.—*J. Purrington*

ARMOR GIVES BACK

Join us this quarter for our Armor Volunteer Day with Family Promise of Wake County helping families experiencing temporary homelessness on Friday, December 2, 2022.

We extend an invitation for all to join us, as well as welcome any suggestions for volunteer initiatives you are passionate about. Reach out to Allison at amiller@armorinvestmentadvisors.com with suggestions for future events, requests to participate, or if you would like to donate towards this cause.

(Please see disclosures on page 4.)

FOUNDER'S CORNER: FED UP WITH THE FED

by Jeffrey R. Miller, CFA

These are tough times for a portfolio manager. A current most frequently asked question "Is there any good news you can give us?" Honestly, it's very hard to find.

All short-term trends, whether economic, political, financial, are moving against investors—war, global crop failures, supply chain, all fuel, persistently high inflation. The Federal Reserve Bank is bound and determined to drain the monetary swamp and force economic pain on all of us. There is NOT much to like about it. And markets are doing their best to fully reflect the perfect storm.

Federal Reserve Chairman Powell is a very accomplished individual, and I respect his life's achievements. However, I have a very different view than the Chairman of our current plague of inflation. A year ago, the common Wall Street wisdom on inflation was that it was "transitory" and would fade as the global economy moved past the worst of the pandemic. My colleague Adam and I never bought into this argument.

Inflation is being driven by many interrelated and complex forces and it has not been transitory.

> **"Inflation is being driven by many inter-related and complex forces and it has not been transitory."**

Therefore, the Federal Reserve has decided they need to inflict pain on all of us in the form of a recession. I have news for the monetary oracles – the big R has been here for six months!

I'm scratching my head. I'm actually more expressive in my thoughts when in appropriate company. Though markets can be very mysterious, they will very accurately reflect mistaken policy. I don't believe more pain is required. You don't slam the brakes on a speeding Ferrari without something bad happening.

I have saved the good news for last:

1. Inflation in key sectors has moderated.
2. The War in Ukraine is proving a disaster for the key perpetrator as thousands of Russians flee their homeland to avoid conscription.
3. The "much anticipated" recession has proven to be here since spring. The worst may be behind us unless the Fed overshoots? Unfortunately, they have a history of that.
4. More financial spokespersons are expressing a growing disagreement with Federal Reserve Policy.
5. Unemployment remains very low, fueling a resilient consumer.

Aristotle wisely advised, "moderation in all things…" We need some of that now.—*J. Miller*

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