Building long-term relationships with long-term investors

April 15, 2023

Dear Client,

Once again, we are in a quandary on what to talk about since there are so many issues facing investors. Bank failures and government intervention. Inflation and rising interest rates. Ongoing war in Ukraine. China and Taiwan. Culture wars and debt ceiling. Low unemployment. Equity versus fixed income returns. US versus international. Value versus Growth. Technological innovation. The price of oil. COVID aftermath. The list goes on. We've talked about them all, yet they persistently remain top of mind. The more things change, the more they stay the same. History doesn't repeat itself, but it often rhymes. Pick your adage.

Even with all that is in the headlines, the markets have had a decent first quarter of the year. Investors seem to have been able to shrug off all that has been in the news. This is evident by looking at the Chicago Board Options Exchange Volatility Index, or VIX. The VIX is often referred to as the "fear index" because it attempts to measure short term future volatility which is often seen as a way to gauge market sentiment and in particular the degree of fear among market participants. The higher the VIX, the higher the expected volatility in the markets. When the VIX is below 15, there is optimism in the markets. Normal market conditions are indicated when the VIX is between 15-20. When it gets over 30 extreme turbulence is expected.

The failures of Silicon Value Bank (SVB) and Signature Bank represent the second and third largest bank failures in US history, only the collapse of Washington Mutual in 2008 was bigger, so these recent events are a big deal and one would think they would generate similar fear and turmoil as the events of 2008. Washington Mutual collapsed in September 2008 and in November the VIX peaked at 80.86! That was almost 15 years ago and the world is different now so let's look at more recent market turmoil with the COVID pandemic. Not to be outdone, COVID pushed the VIX to a peak on March 16, 2020 of 82.69!

Those are both astounding figures. VIX data starts in January 1990 and other than the 2008-09 financial crisis and COVID in 2020, it has never been higher than 50. With all of today's uncertainties, you might expect the VIX to have skyrocketed back to the stratosphere, if not the 80's then at least back to pushing 50. If you read the pundits, financial "fear" is everywhere.

Before we tell you where VIX is today, we are not bringing it up to predict the future. That is impossible and VIX is simply a weathervane. It provides a measure of the mood of the markets and the expectations of participants literally all over the world processing news and information. Our investment approach does not change when the VIX is high or when it is low. Volatility and uncertainty are nothing new and investing comes with risks. Think back over the last three years and there were many excuses to panic and get out of the markets. Despite these concerns, for the three years ending March 31, 2023, the Russell 3000 Index (a broad market-capitalization-weighted index of public US companies) returned an annualized 20.41%. No doubt it was a bumpy ride with double digit losses in 2022, but when you can look beyond the short-term – ignoring the noise from the news – the markets will reward you.

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VIX ended the first quarter, March 31, 2023, at 18.70. Translation: normal market conditions expected. March inflation data has come in showing an annualized drop to 4.98% from 6.04%, the ninth straight monthly decline. Recent employment data remains strong so concerns of recession refuse to gel. In other words, the news is not all bad. There is a school of thought that VIX is low because the SVB and Signature failures revealed economic cracks caused by the rapid interest rate increases over the last year and these cracks may force the Fed to slow or even stop rate increases. The latest inflation data supports that argument. However, employment data suggests perhaps higher rates can be supported. The pundits aren't sure, some say rates should continue to go up and others say they should go back down. Bottom line: no one knows, stay disciplined.

Mentioning the financial crisis reminds us of an anecdote to share. Financial historians or fans of the book and movie "The Big Short" will recognize the name Michael Burry. He came to fame by betting against the housing market in 2007 ahead of the subprime mortgage collapse and was the character portrayed by Christian Bale in the movie. If you were looking for a credible bear, it would be Michael Burry. It was reported that on January 31 of this year he posted a one-word tweet "sell." What's interesting to us is two months later on March 30, he tweeted "I was wrong to say sell." Our necks are still recovering from the whiplash. This is simply a reminder that while many people try to actively navigate the markets, it is very difficult to predict the future.

We would like to follow up on the client-wide email we sent on March 15 about the safety of your assets at Charles Schwab in light of press reports about the firm in the aftermath of the SVB and Signature Bank failures. We want to reiterate that Schwab is much different from both those institutions. SVB's clientele was concentrated in the tech industry. Signature Bank had a high concentration in the cryptocurrency space. Schwab's clientele is much more diversified, plus Schwab has several sides to their business, most notably their brokerage and banking businesses which provide additional diversification. Schwab Bank falls under the purview of the Federal Deposit Insurance Corporation (FDIC) and eighty percent of Schwab bank accounts are below the $250k FDIC limit versus both SVB and Signature Bank had less than 20%. Schwab also maintains capital well in excess of regulatory requirements. Schwab's brokerage accounts, where most of your money is held, fall under the Securities Investor Protection Corporation (SIPC) insurance which covers up to $500k per account with a different title. If you have a taxable account, an IRA and a Roth IRA with $500k in each, you are fully insured for $1.5M in the event of fraud or theft. Schwab also carries additional insurance to cover account balances that exceed the SIPC limits. By law, all of Schwab's brokerage accounts are segregated – they are your assets and neither Schwab nor Schwab's creditors can access them. If Schwab were to become insolvent your brokerage account would be transferred in whole to a different broker-dealer much as what happened when Lehman Brothers filed for bankruptcy back in 2008. We are confident in the safeguards in place to protect your assets.

Finally, it's that time of year for our annual regulatory disclosures. We are required to disclose whether there have been any material changes made to our Form ADV, our registration with the Security and Exchange Commission, since our last Annual Amendment filing (March 28, 2022). There have not been any material changes and a copy of our most recently filed ADV remains available on our website along with our Form CRS and Privacy Notice at https://www.pinneyandscofield.com/resources. If you would like a copy on paper, please call or email us and we will be glad to send it to you.

John, Richard, Mary, and Ryan

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