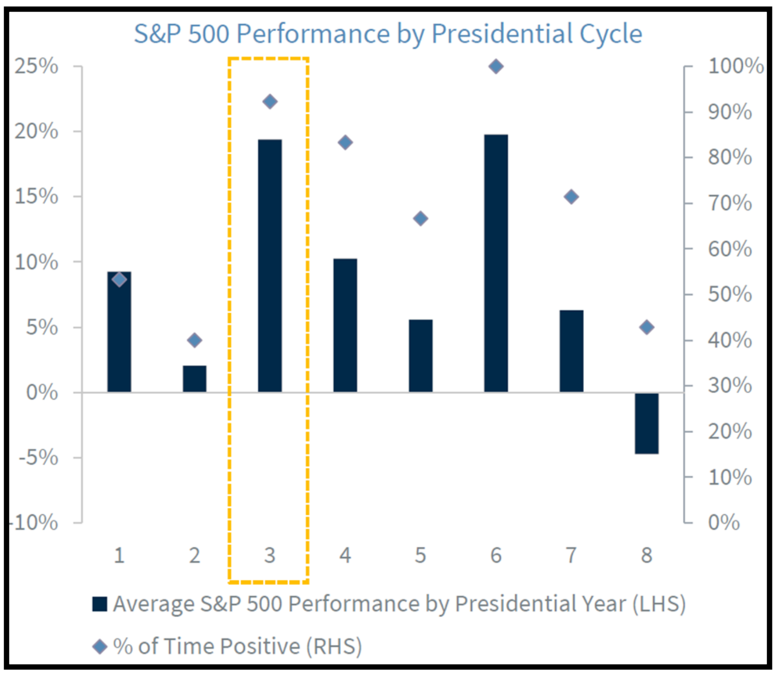
Gore Capital Management

Our only client is you.

In the time since our last newsletter was published, the earth has completed about 90 rotations of its axis at a speed of about 1,000 miles per hour. It has completed about 25% of its journey around the sun, just under 150 million miles of the annual 584-million-mile trip, at a speed of about 67,000 miles per hour. These statistics have nothing to do with the financial markets, mind you, but it is humbling to think about the scale at which things occur outside of our little blue-and-green-colored marble. Something to ponder over a cup of eggnog and a holiday sugar cookie.

In that same period of time, the publicly-traded corporations of America have completed another earnings season, more information concerning the health of our economy has been released, and a mid-term election cycle has concluded (ok, there's still a Senate seat in Georgia up for grabs). We will examine each of these important happenings in the coming paragraphs.

We'll switch things up a bit and start with politics. The mid-term elections did not deliver the "red wave" predicted by some pollsters. Many pre-election polls indicated the top issue for most voters was inflation and the poor state of the economy (topics which typically do not favor the incumbent party), but if we've learned anything from the past few election cycles, polls are of limited value at their very best. Voter motives aside, the narrow majorities in both houses are now unlikely to pass any legislation that contains so much as a whiff of partisanship. Ben thinks this is a great opportunity for Congress to cooperate on passing a bill that finally ends or permanently institutes Daylight Savings Time, but that is a matter better suited to one of his editorials. It is said that the market looks favorably upon a divided Congress for exactly the reason stated above: a purple government offers the predictability of not much getting done over the next two years, allowing executives to focus on optimizing their businesses rather than deciphering the latest legislative agenda.

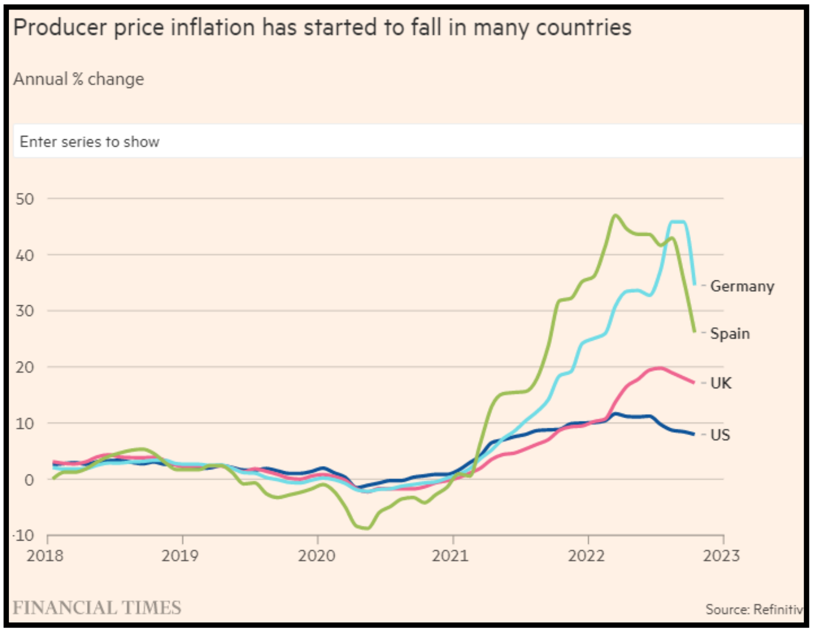


Historically, the third year of the presidential cycle is among the best for equity markets. Graphic from Raymond James's November 2022 webinar, accessible [here]

Data on the economy over the past few months has been almost as unpredictable as the pre-election polls. For the third quarter, the [Bureau of Economic Analysis] estimates our economy grew at an annualized pace of 2.9%, following a decline of 1.6% in the first quarter and a decline of 0.6% in the second quarter. One data point does not make a trend, but this one does suggest the general pace of economic growth is improving. Is a recession still a possibility?

Market Statistics	Nov '22	YTD	2021	3-Year Annl.	5-Year Annl.
S&P 500	5.59%	-13.10%	28.16%	10.91%	10.98%
Dow Jones Ind. Avg.	6.69%	-10.34%	20.28%	7.90%	8.36%
Russell 2000 (Small Cap)	2.28%	-15.22%	14.49%	6.05%	5.05%
MSCI EAFE (Foreign)	11.26%	-14.52%	11.26%	1.92%	1.85%
MSCI ACWI (Global)	7.76%	-15.02%	18.54%	6.63%	6.41%
MSCI Emerg. Mkts. Equity	14.83%	-18.95%	-2.54%	0.14%	-0.42%
Barclay's Aggregate Bond	3.68%	-12.62%	-1.54%	-2.59%	0.21%
iShares Gold ETF (GLD)	6.95%	-4.01%	-3.51%	5.87%	6.07%

Source: Morningstar, as of 11/30/22



Absolutely, and many financial analysts believe a recession could strike next year. That said, the general consensus is such a recession will likely be mild in nature.

After months of promises that inflation would subside, we finally received our first data points suggesting it might be. For the month of October, the Consumer Price Index increased 0.4%, less than expected and matching September's increase. For the trailing 12-month period, the CPI rose 7.7% which is the smallest trailing-12-month increase since January. To be clear, inflation is still elevated and prices are still increasing. What the data suggests we may be experiencing is disinflation, or a decrease in the rate of inflation. This is not the same as deflation, or a negative rate of inflation. The Financial Times (see chart in the top left) is reporting mixed data globally, with producer price indexes beginning to slow down their rate of ascent, but consumer prices still rising in the UK, Germany, Japan, and France. This may be a case of delayed reaction, as producers must experience the reduction in cost pressures themselves before passing it onto their customers. It is important to note again that one month of data does not make a trend. We will need to see consistent reductions in the rate of inflation going forward before we (or, more importantly, the Federal Reserve) can say with any degree of confidence that we're on our way out of the inflationary woods. Until then, expect the Fed's language to remain focused on curbing inflation, even if accomplishing that objective comes at the cost of depressing economic growth.

Finally, to earnings. We usually start with earnings but felt it appropriate to conclude with them this time, as ultimately it is the health of Corporate America that will dictate the equity market's trajectory as we look to 2023 and beyond. As reported by Factset, nearly all of the S&P 500's constituents have released earnings for the third quarter. Overall, 69% of companies have reported positive earnings surprises versus analysts' estimates, well below the long-term averages (77% over the last 5 years). On average, earnings surprises are 1.8% above analysts' estimates, which is also well below the long-term averages (6.5% over the last 10 years). Year-over-year, earnings growth for the quarter was 2.2%, the smallest quarterly growth rate since COVID. (All earnings data in the next few paragraphs is from Factset as well)

Digging into the S&P's sectors, the energy sector reported the highest quarterly earnings growth rate of 137%, with the refining and marketing (i.e. gas station) subsector reporting earnings growth in excess of 300%. On the opposite end of the spectrum, the communications sector (which includes some of the big tech companies like Facebook and Alphabet in addition to the mainstream entertainment businesses like Comcast and Disney) reported the worst earnings growth of the quarter with a decline of -23%. According to Factset, the worst performing companies within the sector on an earnings basis were in fact Alphabet, Facebook, and Warner Brothers; removing these three from the average calculation would produce an earnings decline of -2% instead of -23%.

Looking forward, analyst consensus for full 2022 calendar year earnings growth is a figure around 5%. For next year, analysts are expecting earnings growth of around 6%. It should be noted that these estimates tend to be moderated (read: reduced) as the time period under analysis gets closer, so we would not be surprised to see earnings estimates for 2023 revised downward quite a bit between now and the end of the year, especially if the "r-word" emerges.

That being said, you've heard and/or read our admonition many times that investing is a long game, one that tends to humble even the smartest and most confident investors who fail to treat it as such. We do not know what next year holds, but we do know that making a plan based on risk tolerance and objectives, and, more importantly, sticking with that plan through good times and bad is a proven investment strategy which has historically produced successful outcomes. Expect us to follow our own advice when it comes to your investment portfolios, with a focus on rebalancing and small adjustments rather than major shifts in strategy. We wish you and your families a happy holiday season!

Ben’s Corner

The newest addition to the Sadtler house is now 7 months old! As promised in my May editorial, I’m continuing my series on the financial impacts of raising a child. Many of our readers are parents and/or grandparents, so I would be curious for any real-life feedback or experience regarding the below.

In their 2015 report titled *Expenditures on Children by Families*, the USDA estimates the average middle income family (which they classify as $60,000-$110,000 in income) will spend $233,610 to raise a child from birth to age 17, or around $14,000 per year. Let’s see how their estimates compare to our household’s forecasted expenditures:

- The USDA claims housing is the most expensive component of their calculation, estimating $3,600-$4,600 per year in additional expense (26%-33% of the total). In order to factor in the cost of housing, the USDA calculates the average cost of an additional bedroom. I guess the thinking is that many people will need to move into a larger apartment or home when they have a child. This doesn’t apply to us because our house has plenty of space already, but I suppose it does apply to many couples who shared a one-bedroom prior to having a child (or even a two-bedroom now that many folks work from home full-time). I will say our heating and air conditioning costs have increased because we’ve tried to make our house a little more temperate. I used to keep the thermostat around 65° in the winter —my logic being that we’ve already paid for the sweatshirts and blankets but we haven’t yet paid for the heat—but my wife finally put her foot down since our son doesn’t have the luxury of using blankets yet and she was tired of having icicle hands all winter.
- Childcare is our most significant cost. Daycare facilities in Williamsburg are around $1,200 a month or a little over $14,000 a year. The USDA comes up with a similar figure but says, “Child care and education was the only budgetary component for which more than half of all households reported no expenditure.” My assumption here is that childcare has become so expensive that many dual-income couples elect to forgo one of those incomes, choosing instead to have one parent stay home full-time to raise their kid(s). I bet this is especially true of families with more than one child.
- Parents.com estimates new parents will spend $500-1,000 on diapers per year. We’re Costco members so let’s split the difference, $750.
- Baby formula. We use a mix of generic and name brand formulas. On average, we spend about $50 per week on formula or about $2,500 for the full year. Costco helps here too to some extent, but the formula shortage had us focused on finding formula, not so much on what store sells it, what brand it is, or what it costs. Thankfully that’s gotten better recently.
- We were very fortunate that our friends gave us loads of hand-me-down baby clothes, but a lot of people aren’t so lucky. Clothes are expensive and they don’t last very long (either because the baby outgrows them quickly or a... uh… “catastrophic mess” occurs). This is nearly a $0 expenditure for us but a lot of parents probably spend a few hundred bucks a year.
- Finally, there’s the accessories. Cribs, car seats, baby strollers, gadgets and doohickeys. All in, thebump.com estimated that stuff will total about $3,000 but thankfully you only have to buy most of these items once. Without having the receipts handy, I think that’s a fair guess as to what all of those items cost us.

Add all that up and we’re looking at about $20,000 for the first full 12 months. I did admit some of those costs are one-time and we also don’t have the additional housing expense. The costs that aren’t one-time, like diapers or baby formula, are likely to be replaced with other expenses like real food, activities, and toys/books as he gets older. I’m guessing years 2-5 will be more like $16-17,000 per year and the total will (hopefully) come down once daycare is over and he goes to school (daycare tends to get less expensive as the child gets older anyway). I think it’s too early to know whether the USDA’s estimate will be accurate for us, but I don’t think it’s outrageous to think they might actually be on the low side.

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