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2023 Annual Client Letter

Clients and Friends,

In what has become somewhat of a tradition, allow us to be the last to wish you a very Happy New Year. January is a time for fresh starts and new beginnings, and coming out of the volatility of the 2022 markets we are pleased to write there is reason to be optimistic.

Without a doubt, the drama in the markets last year was just short of Shakespearean. The Federal Reserve was late to the game in bringing inflation under control, and when it finally entered the arena its efforts were aggressive, triggering a new bear market in equities.

Bond prices swooned in response to significantly higher interest rates, and the U.S. equity market sold off sharply. In the first half of 2022, the Standard and Poor's (S&P) 500 fell 23.6% from its all-time high at 4,796 to a closing low of 3,666 on June 16.

It rose slightly before the end of that month, finishing its worst first half since 1970 at 3,785. At its most recent low in October 2022, the S&P 500 was down 27%. Financial pundits will refer to 2022 as a "negative year." **(Feeling optimistic yet? The good news is coming, I promise.)**

If we take a minute to look at the Big Picture, that same equity market has enjoyed 10 "positive" years since the low of the Financial Crisis. If you didn't panic and sell during that time, your stock holdings on average are up by about 5X:

S&P 500 Index - Historical Annual Data

Year	Year Close	Annual % Change
2022	3,839.50	-19.44%
2021	4,766.18	**26.89%**
2020	3,756.07	**16.26%**
2019	3,230.78	**28.88%**
2018	2,506.85	-6.24%
2017	2,673.61	**19.42%**
2016	2,238.83	**9.54%**
2015	2,043.94	-0.73%
2014	2,058.90	**11.39%**
2013	1,848.36	**29.60%**
2012	1,426.19	**13.41%**
2011	1,257.60	0.00%
2010	1,257.64	**12.78%**

2009	1,115.10	**23.45%**
2008	903.25	-38.49%

Data from: Yahoo Finance

Up 5X from 2008. Feeling optimistic yet? Repeat the trend line mantra with me: *the advances are permanent, the declines are temporary. The advances are permanent, the declines are temporary.*

Even so, it never feels good to sit in a market trough. Even when you know declines are temporary, down markets are emotionally painful to live through. This is why we work together.

You would not be human if you did not feel fear when (as it's done 13 times since 1946) you watch an average of a third of your equity investments seemingly melt away in a bear market, and no one can tell you where or how it will end. And it's OK to feel that fear, as long as you don't act on it.

It's my job to give you perspective during down markets, to zoom out and look at the big picture together. And when we do that, there is plenty of reason to be optimistic.

Yes, we have been on a stock market rollercoaster since 2020. However, despite the volatility, the market managed to close out 2022 higher than it ended 2019 (3,839.50 versus 3,230.78; a gain of nearly 19%). Not historic, but not at all bad for three years during which planet Earth upended.

We had no playbook for the pandemic. From Wall Street to Washington, nobody had lived through anything like it because the last pandemic happened about a century ago. And yet, I repeat, stocks on average closed out last year **19% higher** than they closed out 2019. We are UP from the start of the pandemic. That is the big picture.

This validates our core investment strategy at Bodnar Financial, which is and has always been: tune out the noise and keep working your long-term plan. I continue to recommend this in the strongest possible terms, especially as gossip surrounding a recession creeps into the financial news.

Rather than looking at forecasts and speculation, we prefer to examine history. History tells us that bad market years tend to be followed by good ones, especially after a midterm election year. Since 1950, there have been 18 midterms. In each instance, the S&P 500 was higher in the following year by 14.7% on average. Stocks also tend to perform well in divided government, and the most recent midterm election cycle balanced power in Washington once again.

If you need a third reason for optimism, I've got another one for you. If we look at years following negative S&P 500 outcomes, the S&P 500 had back-to-back negative years four times since 1930: Great Depression, World War II, the 1970s, and early 2000s. It doesn't happen often.

Make no mistake, we are entering 2023 with inflation and an expected recession. Corporate profit growth is expected to be flat, and consumer spending growth is expected to slow. (In some cases, when recession is anticipated, investors start to feel pessimistic and the market starts pricing that in early, which could explain some of the volatility we felt last year. Maybe the market is a couple steps ahead of the economy—it wouldn't be the first time.[1])

The burning question of the hour seems to be if, and to what extent, the Federal Reserve, in all of its inflation-fighting zeal, might tip the economy into a recession, if it hasn't already done so.

If only we had a crystal ball. This outcome is unknowable, and we can't make rational investment policy out of an unknowable. That said, if an economic slowdown over a few calendar quarters is needed to stamp out inflation, so be it. Inflation is a cancer and it must be destroyed.

Come what may, in the economy and in the news headlines, let's try to remember that these are *big picture macroeconomic issues*. And that, you and I, are not investing in the macroeconomy.

Our portfolios largely consist of the ownership of lastingly successful companies: businesses that take defensive action to endure hard times, and opportunistic action to take advantage of them.

The balance sheets of these companies are strong. And in times of political and economic worry, we can rest assured that *corporate earnings* continue to drive equity values, not events.

We closed out last year with an event called "Investing 101," a one-hour intensive on the timeless investment principles that have guided Bodnar Financial Advisors since 1988. As we head into the new year, I highly recommend watching it as a refresher on our approach.[2] I have also enclosed a copy of our general investing principles, which we are available to review together at any time.

As I always say—but can never say enough—thank you for being our clients. It is our privilege to serve you.

Happy New Year,

John Bodnar, CFP®, CIMA®

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[1] Historically, the market tends to peak before the start of a recession and bottom before it's over. Put another way, the stock market has usually recovered faster than the economy itself. Recessions and bear markets may occur simultaneously, but they should not be confused for one another.

[2] You can watch it here: https://www.youtube.com/watch?v=chSa2mwgwCE

BODNAR FINANCIAL ADVISORS
INVESTMENT PRINCIPLES

These principles have guided our firm since 1988, and they are timeless.

WE ARE LONG-TERM, GOAL-FOCUSED, PLAN-DRIVEN INVESTORS

We are not day traders at Bodnar Financial. We believe in disciplined, long-term investing. We are helping people create balanced portfolios that will work to fund three-decade retirements and family legacies. When we say "investing" we are talking about the long haul. We believe that lifetime investment success comes from acting continuously on your plan, and then meeting each year to make sure it still reflects your age, cash flow, risk tolerance, and liquidity needs.

THE STOCK MARKET CANNOT BE TIMED

Bear markets happen every 3-5 years on average. They are normal. We know they are coming, but we don't know when they'll arrive or when they'll end. But history tells us that bear markets always pass, and that bear markets tend to roar back as sharply as they dropped. We don't get windows of time to leisurely return to the market. That's why it's important to buy and *hold*.

TIME, COMPOUNDING, AND DISCIPLINE ARE OUR GREATEST ALLIES

Our minimum goal as investors is to earn a return that—at the very least—offsets income taxes and inflation. We fight inflation with compound interest, the financial miracle that lets your investments collect increasing amounts of "interest on their interest" over time. The first rule of compound interest is to never interrupt it unnecessarily. The longer your investment horizon, the more time your investment has to grow exponentially. Assuming you don't tinker with it.

THE MARKET ALWAYS GOES UP—IT JUST DOESN'T GO UP EVERY DAY

Returns have trended upward since the creation of the stock market. It's a steady climb, but not a smooth one. The trend line zigs and zags. These dips are a normal and healthy part of the market's chaotic, but permanent, climb upward. Long-term investors like us have faith in the trend line. We sit through the dips and focus on decades rather than days.

HUMAN NATURE IS A FAILED INVESTOR

Humans are wired to react to fear in order to survive, and down markets are downright scary. Investors sit through sell-offs once every 5 years on average and watch about 30% of account values disappear, without knowing when they will return. We sit through 50% declines 2 or 3 times in our lifetimes. When these things happen, disciplined investors do *nothing*. This is why we work together. Bodnar Financial is here to empathize with you as you feel the fear, and to help you decide not to act on the fear.