JENSEN
PRIVATE CLIENT

Third Quarter 2022

# Quarter In Review

Jensen Private Client

## Firm Update

The Pacific Northwest seems to have welcomed Fall quickly, unseasonably warm weather notwithstanding, and with the change in the calendar the rush to year-end has begun. **With that in mind, we encourage you to contact us as soon as possible if you have plans to make gifts to family or charities or any other year-end transactions, such as Required Minimum Distributions (RMDs) from your retirement account.** While we are experiencing higher volumes of requests, we are confident in our ability to complete transactions in a timely manner, but please note that the custodians with whom we work are experiencing longer than normal processing times.

We are delighted to announce that Philomena had her baby in September. Gideon Michael Ferree (who arrived on his due date!) is doing well, and Philomena is excited to welcome him into their family. She plans to return to work around Thanksgiving, though in her absence the Private Client Team stands ready to assist with any requests.

## Third Quarter 2022 in Review

Though the quarter began with a rebound in equity valuations, market volatility persisted, and the quarter ended with a net decline in S&P 500 index. The predominant driving force for this decline was the Federal Reserve's continued interest rate increases in response to persistently higher-than-expected inflation readings. While energy and gas prices declined during the quarter, the Consumer Price Index remained elevated with food and rent prices increasing dramatically year-over-year. While rising interest rates negatively impacted equity markets, their impact was also reflected in fixed income investments. For those investors that typically hold bonds to offset potential stock market volatility, the speed of the rate increases (and as bond prices move inversely to interest rates) also resulted in a negative return for most fixed income securities.

## Looking Ahead

While the majority of 2022 is now in the past, the factors challenging capital market returns and global economic growth – dogged inflation, geopolitical turmoil, and hawkish monetary policy – remain largely in place. As a result, we expect market volatility to persist until investors gain better clarity about the resolution of these issues.

Headline inflation in the United States is currently running at more than 8% on an annualized basis, the highest rate in forty years. Over the course of 2022, the U.S. Federal Reserve pivoted from an accommodative to restrictive monetary policy in an effort to tamp down inflationary pressure. In particular, the Fed raised the fed funds rate five times, ceased open market purchases under its quantitative easing program, and signaled additional interest rate increases in the near future. Meanwhile, corporate profit margins are under pressure due to elevated wage and commodity costs and the supply chain imbalances associated with pandemic-related shutdowns, both exacerbated by the impact of Russia's invasion of Ukraine.

Looking forward, the U.S. midterm elections in November are likely to reignite discussion of contentious and potentially impactful political topics, including healthcare and tax reform, which would add to the list of investor uncertainties. As a result of the aforementioned challenges, we are maintaining a more cautious near-term market outlook.

One element of the current landscape contributing to our caution is the expected business performance of companies across the U.S. economy. We believe that the underpinnings for long-term stock returns include earnings and cash flow growth. Consequently, we are carefully monitoring the outlook for S&P 500 Index earnings. At present, earnings growth rates have slowed meaningfully, from some 70% in 2021 to a nearly flat projection for 2022. Moreover, investor expectations of an earnings rebound in 2023 may prove to be overly optimistic given the Fed's goal of using monetary tightening to cool the U.S. economy. Consequently, we are mindful of the impact of potential downward earnings revisions when companies begin to report third quarter earnings in mid-October.

Despite numerous headwinds, we remain confident in the high-quality companies owned in the Jensen Portfolios . Our analysis indicates that these companies benefit from strong and resilient business models, durable competitive advantages, high returns on capital, substantial free cash flow generation, and manageable debt. Our long-term investment discipline is aimed at dampening the investment impact of economic volatility. While our companies, and therefore our investment strategy, are not immune to the issues of the day, we believe uncertainty increases the importance of knowing what you own. Accordingly, we believe the bottom-up portfolio construction approach that we employ can mitigate negative surprises during periods of market volatility, thereby allowing investors to achieve long-term capital appreciation with less overall risk.

At present, economic uncertainty and the pullback in equity market prices is perhaps testing the resolve of some investors. However, consistent with our long-term focus, we take comfort in our ownership of shares in high-quality companies that possess attributes we believe enable them to weather both known and unknown uncertainties. We recognize that investing involves risk, and while history is no guarantee of future results, we remain confident that our focus on the construction of an active, high-conviction collection of high-quality stocks can provide clients with the investing outcomes they seek and help them achieve their financial goals. The ride may be bumpy, yet the destination remains attractive, in our minds.

## Connect With Us

Thank you for your continued confidence in Jensen. We are tremendously grateful for your ongoing support, and as always, please do not hesitate to contact us with any questions you may have.

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The S&P 500 Index is a market value weighted index consisting of 500 stocks chosen for market size, liquidity and industry group representation. The Russell 1000 Growth Index measures the performance of those Russell 1000 Index companies with higher price-to-book ratios and higher forecasted growth values. These indexes are unmanaged, and you cannot invest directly in an index.

Sources: https://www.bls.gov/news.release/pdf/cpi.pdf

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