J.K. Financial, Inc.

REGISTERED INVESTMENT ADVISOR
8222 Douglas Ave Suite 590
Dallas, TX 75225

3rd QUARTER 2023

INSIDE:

Don't miss our blog
www.street-cents.com

Update: Looking forward

Fastest rate increases on percentage basis, EVER

John A. Kvale, CFA, CFP ®

As our lead article, we went back to review the most recent newsletters to make sure we are not beating us up too much on this subject; however, it is so important and we wanted to bring it to your attention again.

This article makes for the foundation of several other smaller subject matters in this newsletter.

(see **FEDERAL**, Page 3)

Research affiliates' Robert Arnott asset return expectations for the next 10 years

This is at least Rob Arnott's second appearance in our writings. As a reminder, he is the stately founder and chairman of the board of the very large investment and research firm called Research Affiliates (RA) based in the West coast. Arnott himself moved his personal residence to South Florida just in time for virtual to become the thing it is today.

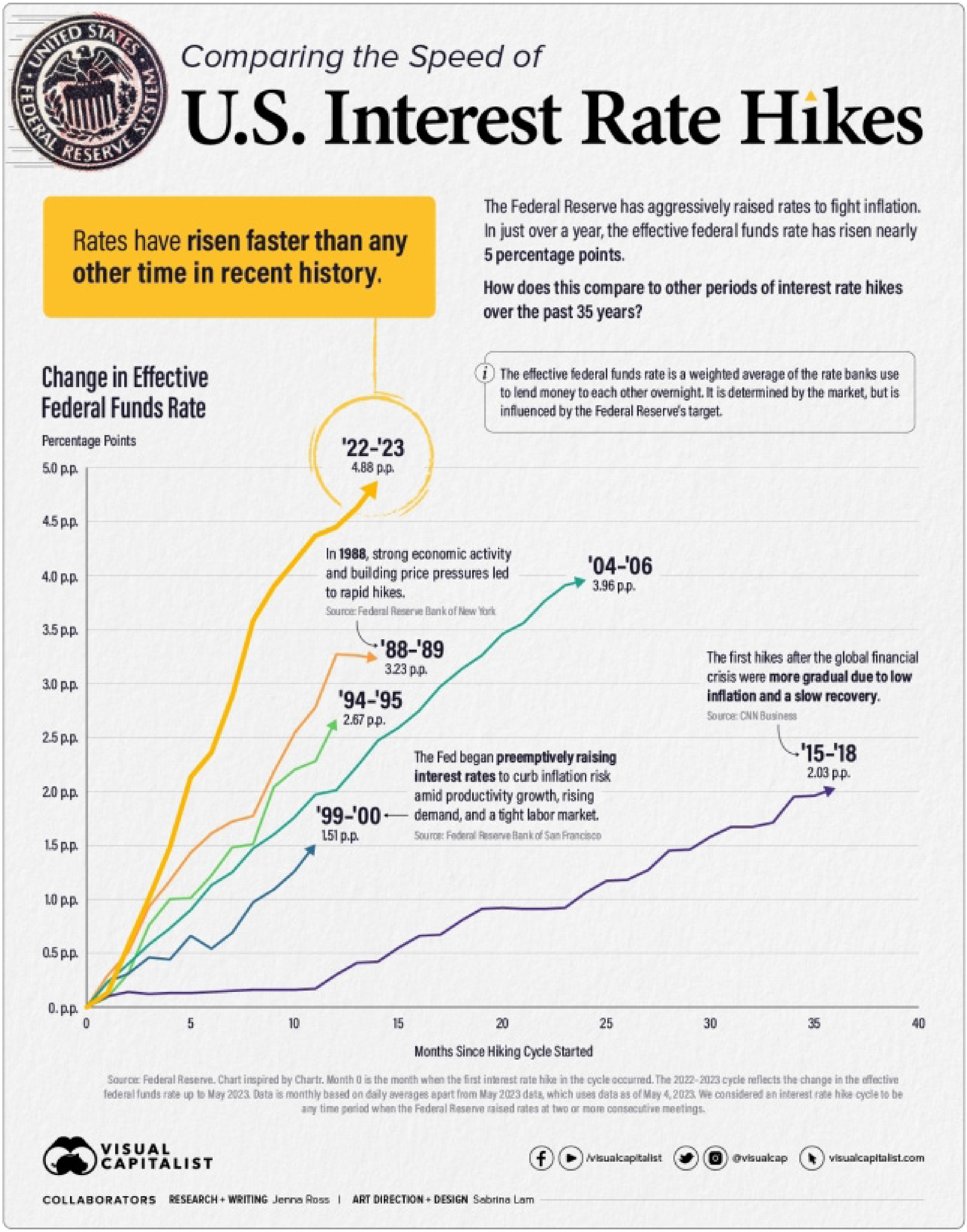
(see **Most important,** Page 4)

NO ACTION NEEDED

Important client negative consent letter

All clients will be receiving letters about the merger of TDAmeritrade and Charles Schwab, slated to occur the day after Labor day in early fall.

There is no action needed on your part!



https://www.visualcapitalist.com/interest-rate-hikes-1988-2023/

FEDERAL RESERVE:
Likely not going to lower rates substantially

(continued from Page 1)

In sticking to our promise of about a year ago in trying to keep the newsletter articles shorter, which we've had great feedback, and this also allows you to read quickly but in "start and stop" like format, we hope that the content is more appealing.

Visual update – speed and height

The graph on Page 2 is an updated pictorial of the speed (bottom axis) and representation of just how large (side/vertical axis) interest rate increases have been over the very short period of time of the last two years.

When they (Federal Reserve) first started increasing rates, we, along with good company, thought that they would never be able to get rates as high as they did without some sort of major problem.

This is very important and we wanted to bring it back to our attention for a different reason this time.

At the end of the rate increase cycle

It's very likely that the Federal Reserve is now in the 8th or 9th inning of their rate increases.

When they first started increasing rates, we, along with good company, thought that they would never be able to get rates as high as they did without some sort of major problem - (see our banking finance article).

Higher for longer

Looking forward, the most important part of investing, if we take Jerome Powell, current FOMC chairman at his word and his fellow voting members word, they are not going to lower rates substantially in the future.

This is a key thesis of our newsletter. We hope you enjoy the peripheral articles.

Caveat

Exceptions to this prior foundational statement by the Federal Reserve would be if a total regime change at the FOMC were to be installed or if something major in the financial world frightened them into suddenly lowering rates.

Exceptions to this prior foundational statement by the Federal Reserve would be if a total regime change at the FOMC were to be installed or if something major in the financial world frightened them into suddenly lowering rates.

This is a subject matter for another newsletter but in its base form would likely lead to much higher inflation and a much changing outcome of current expectations.

Most important part of investing

Possible future sizzle or fizzle over next 10 years

(continued from Page 1)

RA is stacked with high power people

RA is stacked with a very large group of financial engineers and sophisticated researchers and is a firm known for heavy duty raw research, not tied to anyone or anything that would make them biased.

This is one of the main reasons we like them so much and more importantly, they go where few will this day and age, hence the multiple appearances.

Calling your attention to our main article of a very high probability of higher interest rates for longer (see Page 3), in its base form means more expensive financing costs.

Think higher mortgages for us personally and more expenses for companies in the form of more borrowing costs. This will be reflected in future equity/stock returns.

Arnott's firm is one of the very few that actually puts its neck out on the line and makes a forecast for what the next 10 years may hold for asset classes, the most important part of investing.

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Expected returns – the sizzle or fizzle

Looking back over the past 10 or even 15 years, one may scoff at Arnott's predictions for large company U.S. stocks, aka the S&P 500.

Here is RA's expected 10 years annual return:

U.S. Large Companies aka S&P 500, yearly return according to RA is 4.9% with a standard deviation of 15.6% (risk).

Red Dot, farther right and lower on the graph on this page than the U.S. bonds.

Most important

Looking forward is the most important decision in investing. The rear view mirror is just that... the rear view.

Please note our Asset Allocation, Safe Funds article (see Page 6) for insights to the other dot on the graph.

JK

Slow motion slowdown

Why, and why it's likely not over

Historically slowdowns last between 12 and 18 months putting us on our current glidepath very near where the end of this economic slowdown should be occurring.

So what's different this time?

We avoid saying it's different this time but to completely ignore the facts is not smart either.

The stimulus remains

Just when we thought much of the stimulus pumped into the systems over the past 12 to 24 months were gone, an unforeseen stimulus hit the U.S. economy.

Employee Retention Credit

The Employee Retention Credit is known as ERC. You may know this by the preponderance of commercials that have hit the airwaves in the late innings of this tax credit.

Most notably "Where's my business tax refund?" or the like, have very likely had lingering effects much like that extra candy bar that the kids have at the pool when exhaustion sets sights on them.

While this number is very difficult to quantify, the best way that we have seen it presented is business and especially small business tax refunds which on average two years ago averaged $20 billion per month over the past nine months.

Fast forward to today and they averaged approximately twice that amount. An approximate average of $200 billion turned into $400 billion of refunds over the recent quarters.

This stimulus was pushed into the economy, possibly resulting in further strength and a long gasping economic strength, even with the Fed pumping on the brakes as hard as they have in the form of higher interest rates.

Bank Term Funding Program

As mentioned in our prior newsletter the fencing of weaker banks also known as the Bank Term Funding Program (BTFP) is a full-on government bailout of weaker banks. This program essentially bails out banks, thankfully giving confidence to consumers.

However, this bail out is also, again for a good reason, a huge stimulus to the economy. When the bailout occurs, government money is flooding into the system, essentially another stimulus.

In closing, there is an interesting reversion to the mean possibly occurring, with the 2020 slowdown being one of the shortest, only to frustratingly be followed by a much likely longer than expected slowdown.

Patience always has been a great investing attribute, likely even more important this time around.

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Asset allocations, higher interest rates, safe money gets front seat...finally!

Fixed income investments, also known as bonds once shunned to the very back of the bus due to close to a decade and a half of unnatural, abnormal artificially sustained lower interest rates, are now getting to sit happily in the front seat of many investment vehicles.

Why?

Looking back to our lead article, the surprise massive increase in interest rates, along with the expectations and in some minds, hopeful desires of higher for longer, moved fixed income investments from necessary evil cushions to in some investment portfolios a great chunk of what you need to live on. Bottom line, higher for longer as an investor means safer and more!

It's very likely when the book Is written about the early part of this century, many will point to extremely low rates as a benefiting factor of higher asset prices, both in capital markets in the form of stocks, commodities and real estate. Now with more normalized rates, balanced portfolios can take a less bumpy ride and still have a very high probability of meeting their long-term goals.

10 year expected returns by Research Affiliates Robert Arnott

Using the graph on this page, look to the Intermediate Bond expected return for the next 10 years. The purple dot labeled U.S. Mid IG – U.S. bonds, Mid Term length of Investment Grade Quality.

It has an annual expected return of 5.4% with a 4.8% standard deviation (risk). Compared to just a year and a half ago, this rate would have been much lower.

Robert Arnott is the founder of Research Affiliates, a super charged research and investment firm WITH VERY LITTLE BIASES and takes the unique step of making a 10 year forward looking expected return. This research is done with much reservation in the form of disclaimers.

As Yogi Berra said, "It's tough to make predictions, especially about the future!"

Thankfully, the pain of 2022 and what may lie ahead in the equity markets may be met with the pleasure of a long term, more stable and less nerve-racking asset returns due to just how fast rates have gone up. Please note our Robert Arnott Expected Return article on Page 4 for insights into the red notation on the graph.

Day in the life... if there is a normal day!

Here it is!

It's been many years since we have let you guys know what a normal day looks like; of course, the last few years were anything but normal but slowly but surely, we are getting back to a more normal day.

While there is no exact normal day, we do have fairly good schedules that we all loosely work around.

So here goes, a view behind the curtains.

6:45 a.m. until 8:30 a.m. Various paid-for research calls and information about everything from economics, capital markets, geopolitics and anything worldly economic or market sensitive that may be occurring; yes, this occurs every single workday of the week.

9 -10 a.m. Microsoft teams catch up and bantering back and forth on current day's events. anything from the prior day and any future events that may be coming down the pike.

Midmorning, client meeting which is very frequently virtual this day and age but sometimes in our office. Other times, less frequently out of the office meeting.

At least once a week, and not unusual to have three times a week, some type of practice, educational or compliance virtual meeting.

A client midafternoon visit, sometimes virtual, sometimes, yeah, good old fashioned phone calls and infrequently in person.

Afternoon and evening wraps up. Each of us grabbing children for the whirlwind that is an evening, peeking occasionally at the electronics, lightly tethered usually more tethered than we should be as our families remind us but getting a good start on the next day.

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So what did you do this summer?

The Hill family

After wrapping up our busy school year and our family's crazy-busy sports schedule, Addison, (13, going into 8th grade), is continuing to play lots of volleyball to prepare for club tryouts and her next school team season. Hunter, (10 and getting ready to head to middle school- yikes!), has a few more baseball and football camps lined up, hopefully indoors.

We just returned from a quick Father's Day weekend in Hochatown, Ok. We squeezed in a bunch of activities in 3 short days, including hiking, kayaking, kissing camels and snuggling baby raccoons, bourbon tour, maze running and hot tubbing to mention a few!

We're now planning our annual trip to the beach next month to finally do some relaxing, as our family does love to see the ocean at least once a year. We are just going to try to enjoy every moment together and make some fun memories traveling as a family.

The Capone family

The summer started off with a bang as we had TWO baseball all-stars in the family this year! With two practices a night and separate tournaments for 4 weeks in a row, Mom and Dad were driving across S.E. Houston. We are proud of how well our boys competed and what great leaders they have become both on and off the field. We don't know how we will handle things once Nathan has his chance to shine but thankfully our family LOVES baseball!

Now that the post season is finally ended, we have some time to catch up as a family before Isaac and Asher head off to sleep away camp in July. Our summer wraps up with a mile-stone birthday by someone that will not be named. However, there will be lots of fun celebrating her (oops!) and our boys can't wait to bake her a special birthday treat (this has become one of their favorite things to do)!

The Kvale family

This summer marks a big one for the Kvale's as near the end of it our oldest of two happily heads to the University of Denver for her freshman year. Excited is not the word, ecstatic may be underestimating it. Not so much for the parents but it's all part of the process!

A weekend getaway here or there to drop a line or two proving that it's called fishing not catching, a wife's favorite for which she's gotten very good.

A hopeful visit to the cooler mountains as the heat of August hits with a special watchful eye on getting the eldest settled in the Mile High city ends the summer goals of fun!

J.K. FINANCIAL, INC.
REGISTERED INVESTMENT ADVISOR
8222 DOUGLAS AVE SUITE 590
DALLAS, TX 75225
Phone: 214-706-4300
Fax: 214-706-4262
E-mail: info@jkfinancialinc.com

Check out our Blog

www.street-cents.com

The opinions voiced in this material are for general information only and are not intended to provide specific advice or recommendations for any individual. To determine which investments may be appropriate for you, consult your financial advisor prior to investing.

Parting thoughts for you...

Welcome to our summer 2023 newsletter also known as Q3 2023 newsletter.

We hope you enjoy this newsletter and candidly let you know it was one of the toughest to write as almost all of the articles feed into each other in one way or another. Knowing life is moving faster for most, especially during the summer, we continued to allow for the pickup and put down short format articles.

Our lead article is a different look at the speed of interest rate increases and an update. We look forward to the future and both the positive and few negative effects that higher interest rates for longer will have. We then capture other effects from multiple angles in several of our other articles.

A day in the life makes its way back to our newsletter as it's been multiple years and our schedules have changed given the circumstances over the past three or four years. We hope you like it as much as many have in the past and it also gives you a peek into why we schedule visits and discussion times at certain blocks of the day.

Lastly, there are two important dates to pencil on your calendar. The TD Ameritrade Charles Schwab merger will officially occur on and over Labor Day holiday weekend. We will be sending out more information as this occurs on our blog street-cents but want to call your attention to the block on the front page that there will be correspondence that for the most part requires no action by you.

On a more fun note our holiday party returns once again to one of our favorite venues Dallas Athletic Club from 3 to 5 p.m. the Saturday before Thanksgiving where even the staff asked us last year where our group was!

Have a great summer and talk to you in the fall. JK

Dates:

July 4 - Independence Day - Capital markets closed
Sept. 4 - Labor Day - Capital markets closed
Nov. 18 - J.K. Financial, Inc. Holiday Party - Dallas
Save the date!