Goodbye Two Thousand and Twenty-Two:
Hello to Twenty-Three.
Resolutions still left to do,
The list seems longer to me.

I hope everyone had a great Holiday season. Before diving into to the outlook for 2023, I'd like to share my greatest discoveries in 2022.

Dana and I were having a conversation about fasting, as several of our friends from church have added the practice to their meditation and prayer routines. Those who know me will not be surprised to learn my first inclination was to look into the historical background of fasting as it pertains to faith.

When God selected Israel as his chosen people, he wanted them to be different; to stand out from other nations/peoples inhabiting the lands. One way God differentiated Jacob was by demanding they observe "Shabbat", or The Sabbath. Life was not easy. To survive, let alone prosper, required long hours of daily work. A group of people resting, or spending a day in worship, would have struck outsiders as strange, or different.

The procurement of food was also a daily concern, so people who fasted were giving up something for their God, something they were not guaranteed to have when the fast ended. This again would have set Jacob's twelve tribes apart from their neighbors. So when we fast today and walk by the refrigerator, are we giving up something we may not have when our fast is over?

Let me pause and make sure those reading this musing understand: I am not questioning the sincerity of those who include fasting as part of their faith walks, nor the benefits they receive. But the question kept coming back to me: Am I giving up something which may not be there when my fast has ended? Which led to the next question: What could I give up for a day that might put me at risk and, more importantly, help improve my reflection and prayer time? These were the questions and discussions I was having with myself and Dana. A few days later, she gave me the answer, although not intentionally. "Put your phone down."

My biggest find/discovery of 2022 was to be unplugged on Saturdays. On this, now my second favorite day of the week, I do not check emails, Facebook, read online news or opinions, or do anything online. I don't look at next week's weather, I don't check scores, and I don't login to the work place to check trades or markets.

One of the things I learned from my parents, as well as while watching other successful people, was the importance of differentiation. How do you make yourself different, and therefore more interesting, in your chosen profession? In today's world, information has become manna for business. And getting information first has become one way to pursue differentiation. But it's not just the procurement of data which sets folks apart. It is thinking about doing the little

things that others don’t consider, and when those ideas hit, to act immediately. Send the email etc. But now on Saturdays, I am not thinking about how to differentiate myself from my business peers. Instead I am “fasting” and trying to make myself more appealing as a husband, father, friend, and most importantly, as a representative of my faith.

So how do my Saturdays look and how tough was the transition? After finishing our quiet times, Dana and I spend the next few hours enjoying our coffee and the weekend edition of the Wall Street Journal – the print addition. You might say, “Hey, you are working, gathering information. You are not unplugged.” But I beg to differ. Reading a newspaper is a completely different experience for your brain than consuming the same information online. If you doubt this statement, read “The Shallows: What the Internet is Doing to Our Brains” by Nicholas Carr.

Next, we generally try to work out or walk, depending on the weather. The better part of the day is spent reading and writing. These hours have opened the door to another discovery: Re-reading great books. I have picked up titles I read 15-20 years ago, and thoroughly enjoyed finding new gems in the text, as well as the wonderful flashbacks brought by old underlined or highlighted sections.

How hard was the transition? The first two Saturdays brought a few challenges, hungry synapses telling me to pick up the phone, or look something up online. But those quickly faded, and now I don’t even look at my phone when passing the charging station. Full transparency: I do still watch some college football and answer the phone, especially if Cayden calls. I guess this makes me a “Mennonite,” not “Amish,” when it comes to defining “unplugged.”

It maybe all be in my head, but I truly think this discipline has made me a better thinker. As I have shared in previous letters, learning to write form poetry has helped me in so many areas. Being a better listener is one the greatest areas of improvement I’ve noticed in myself. Of course, being a better listener or thinker is easier when you have so much room to grow. ☺ But the time “unplugged” has made this patient better, and so as we head into 2023, I am considering expanding my “Mennonite” version of this discipline to include Sundays until around 4 PM, still giving me time to catch up on e-mails and markets before Monday morning.

Before discussing my outlook for 2023, let’s take a few minutes to review last year. My major allocation themes for 2022 were:

1) Be underweight equites,
2) Be underweight fixed income and keep durations short,
3) Be overweight cash and asset classes which have been non-correlated to stocks and bonds.

Looking back, these all seem both easy and obvious. But they were out of consensus when the calendar last turned. These themes helped portfolios achieve solid relative performance results. By “relative,” I mean compared to the investment returns produced by a benchmark: i.e., conservative investors might measure themselves against a portfolio of 30% stocks and 70%

bonds, while aggressive investors might use a benchmark of 70% stocks and 30% bonds. As I write this letter, a portfolio of 30% stocks and 70% bonds is down approximately 13.96%, gross of advisor fees. A conservative investor whose portfolio was down 8-10% would outperform their benchmark. For an aggressive investor, the 70/30 benchmark is down approximately 16.21% gross of advisor fees. If their portfolio was down 12.5-14%, they again would have outperformed.

But here's the thing: You can't spend relative performance. Whether you are down 6% or 9%, you are still down. So while the allocation guidance given last year helped, in most cases it did not prevent investors from being down for the year.

One more thing as we transition into 2023, which carries over from my 2022 outlook. I think it will be years before the S&P 500 sees a new high. It is my view the Federal Reserve will stay higher for longer when it comes to rates. Whether the terminal rate ends up being 4.75% or 5.25% is again, in my opinion, not as important as: 1) How long we stay there, and 2) Outside of a major shock, we are not going back to QE. (i.e., the Fed will continue to let their balance sheet shrink even after they begin to cut rates, probably in late 2023 or early 2024).

One more…one more thing. While laying out my views and opinions on the markets is a good exercise, it is not the most important investment of my time. Financial market participants should spend most of their time thinking, "If the market does X, what will I do?", versus "What will the markets do?" The information below has my take regarding the ranges of various markets, along with suggested allocation changes should we see the extremes of those ranges.

As always, the information below is given in broad strokes. Clients should consider their Goal Plan and consult with their advisor before making investment decisions.

U.S. Stocks: I believe the range for the S&P 500 will be 3550-4350. We are trading 3840 at the time of this writing. Within the U.S. market, I prefer Small Caps to Large, and in a change from previous writings, I think growth is becoming more interesting. Regarding sectors, Energy is still on the list, but on a much more limited basis; Bio-Tech remains appealing, as do certain areas of Tech and the Airlines. Given the discounts in some closed-end fund offerings, investors may want to consider these instruments as part of their equity exposure. Clients should contact their advisors for specific stock and mutual fund suggestions.

If the S&P trades near or under 3600, I would suggest suitable investors be overweight stocks relative to their risk benchmark. If the S&P trades near or over 4250, I would be underweight. Markets often overshoot, and if they do in either direction, outside of a major shock, I would stay with the plan. For example, a client with an equity benchmark of 50% (meaning having 50% in stocks) fits the allocation needs for their investment plan, they should consider being 55% if the S&P trades 3550. And if the market drops to 3200, make sure they stay at 55% (which will mean buying more) or perhaps even taking the allocation up to 57-60%. The same logic applies in reverse if the market reaches or

exceeds 4250, especially if the rally is driven by "The Ref getting back in the game" (i.e., I am wrong and the Fed starts QE (quantitative easing) again).

I've spent my time here focusing on U.S. stocks. But investors should consider international and emerging market equities as part of their equity allocation. I would use the level of the S&P as a proxy for making those decisions. It is the consensus that U.S. markets still offer the best prospects. While I can't push back on the consensus view, it does have the feel of a crowded room, and we know how those often turn out. Investors could be well-rewarded by keeping their eyes open for opportunities in markets overseas.

Fixed Income: I believe 3.40-4.20% will be the approximate range for the 10-year treasury, with the caveat being if I am going to be wrong by 50 bps (one half of a percent), I think it will be to the upside. The 10-year is 3.75% today and was 3.50% just a few trading days ago. If the Federal Reserve ends up taking us to 4.75-5.25%, I don't see the curve inverted by 200 basis points, or 2% (i.e., if Fed Funds are 5.25%, I don't think the 10-year is 3.25%).

Part of my premise is based on my outlook for inflation, which I suspect will be stubborn and sticky. I agree with the majority opinion that we have seen "peak inflation." Many of the things my partner Bret Mason and I discussed last spring have started to unfold: Declining used car prices, etc. But I don't think we will see the CPI under 3.5% during 2023, and probably even 2024.

If the 10-year trades near or under 3.40%, I would suggest investors consider reducing their duration (own bonds with shorter maturities). Conversely, should we trade towards 4.20%, I would want to own bonds with longer maturities.

Also within fixed income, High Yield debt deserves investors' attention. Currently, the spread (the amount high yield is yielding over treasuries) is around 461, meaning that High Yield bonds are paying 4.61% over treasuries. I look for this spread to range from 400 on the low side to perhaps 6.30 on the upside. If we see spreads near or under 400, investors should consider reducing exposure to high yield debt. If spreads approach 630, clients should be at their maximum high yield exposure. Remember, high yield debt should be considered as part of your equity allocation.

Alternative Investments: Given the rise in rates, these instruments (managed futures, long-short funds, etc.) are less important than they were a year ago. They still may have a place in some investor's plans, but at much lower percentages.

Other Investment Considerations:

Fixed and Structured Annuities (let them take the risk): I discussed these instruments in detail in my previous update and am happy to re-send a copy of last Fall's letter. I still think these instruments could be a fit for some clients.

Structured Notes: These are bonds issued by major investment banks (Goldman Sachs, Wells Fargo, etc.), which offer investors the chance to participate in markets with some risk control parameters. For example: A client might be able to buy a bond tied to the performance of the S&P 500. The note could have a buffer of 20%, which means if the S&P would decline 25% over the term of the note, the client would lose 5%. These buffers come with trade-offs. If you are protected against a decline in the markets, you may well give up, or be limited to what your maximum return will be. These instruments come in many different structures, far too many to discuss here. But given the increase in both interest rates and volatility, clients may want to consult with their advisor to see if any of these structures are a fit for their overall plan. Regardless of the structure, investors need to be comfortable with the financial stability of the bank issuing the note.

A year ago, I was worried. These concerns were based on my outlook for markets and what it meant for the average annual returns that investors could expect. Going into 2022, I thought the probability of a client achieving 5% (or 2.5% on a real basis) over the coming five years was extremely low. As we head into 2023, I think investors have a very good chance of meeting or exceeding those numbers over the next five years.

This letter began with the opening quatrain of a poem, a Stanza written as I looked back and forward, thinking about events of 2022, in my life and through the eyes of friends and family, as well as making resolutions for 2023.

Goodbye Two Thousand and Twenty-Two:
Hello to Twenty-Three.
Resolutions still left to do,
The list seems longer to me.

Goodbye Two Thousand and Twenty-Two:
Hello to Twenty-Three.
We lost some treasure, more than a few,
Faces we long to see.

Goodbye Two Thousand and Twenty-Two:
Hello to Twenty-Three.
Another election over and through,
Better choices a constant plea.

Goodbye Two Thousand and Twenty-Two:
Hello to Twenty-Three.
As echo chambers sell their brew,
Unplugging might be the key.

Goodbye Two Thousand and Twenty-Two:
Hello to Twenty-Three.
Grant us wisdom to know what is true,
Let us seek on bended knee.

Goodbye Two Thousand and Twenty-Two:
Hello to Twenty-Three.
May the old self pass as we put on the new,
Relying on The Truth's decree.

Goodbye Two Thousand and Twenty-Two:
Hello to Twenty-Three.
In this nation where blessings accrue,
Justice for all should be.

Goodbye Two Thousand and Twenty-Two:
Hello to Twenty-Three.
Help me listen and have a clue,
Even when I don't agree.

Goodbye Two Thousand and Twenty-Two:
Hello to Twenty-Three.
Some lofty goals to pursue,
More than enough for me.

I've taken down the Christmas Tree,
And turned the calendar too.
Hello Two Thousand Twenty-Three,
Goodbye to Twenty-two.

Thank you for investing the time to read this musing. I hope you found it helpful. May 2023 bring many blessings…and better markets… And remember: Try "Unplugged Saturdays." ☺

Respectfully,

Wally Sparks

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High-yield bonds are not suitable for all investors. The risk of default may increase due to changes in the issuer's credit quality. Price changes may occur due to changes in interest rates and the liquidity of the bond. When appropriate, these bonds should only comprise a modest portion of a portfolio.

A fixed annuity is a long-term, tax-deferred insurance contract designed for retirement. It allows you to create a fixed stream of income through a process called annuitization and also provides a fixed rate of return based on the terms of the contract. Fixed annuities have limitations. If you decide to take your money out early, you may face fees called surrender charges. Plus, if you're not yet 59½, you may also have to pay an additional 10% tax penalty on top of ordinary income taxes. You should also know that a fixed annuity contains guarantees and protections that are subject to the issuing insurance company's ability to pay for them.

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