Year-end 2022 Commentary

A Year to Forget

Calendar year 2022 provided pain to investors across almost every sector, style, and capitalization. The addiction to stimulus-spending coming out of the Covid-era was a hard habit to break, as the "all gas and no breaks" policies felt politically popular for a season. However, any student of economics could see the long-term impact of nearly 7 trillion dollars of liquidity being infused would be inflationary. The late-to-respond Federal Reserve allowed inflation out of the box to 40-year high levels, and spent the entire year hitting the brakes with tightening measures to the displeasure of equities and fixed income markets.

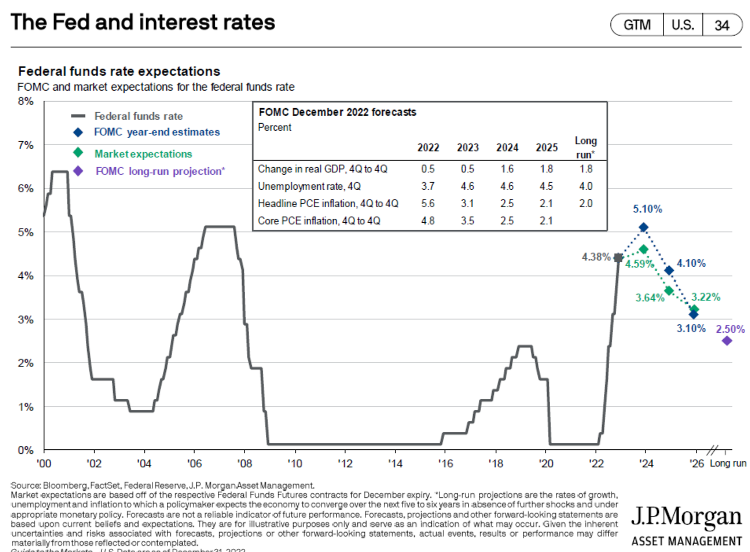
The grid below shows losses incurred across all styles and capitalizations in US equities. Following 2021, which was a year of excessive risk-taking, 2022 penalized severely high growth areas of the market, such as technology, biotech, and crypto. The valuation in these areas was stretched far beyond rational metrics, and received the most severe selling during this correction. Many of the most popular stocks from the past few years, such as Facebook (Meta), Amazon, Apple, Netflix, Google (Alphabet), Microsoft, and Tesla, saw declines from -29% to more than -70%.

	Value	Blend	Growth
Large	-7.5%	-18.1%	-29.1%
Mid	-12.0%	-17.3%	-26.7%
Small	-14.5%	-20.4%	-26.4%

Source: Factset

On the opposite end of the spectrum, the out-of-favor, boring, large-cap value stocks of the past several years saw the most resiliency with their less expensive valuations and dividends providing stability. One of the only sectors to end the year firmly in the positive column was energy. With the price of oil soaring to over $100 dollars a barrel in early 2022, energy companies made record profits after years of operating losses.

The inflation-fighting measure that saw the Federal Reserve raise the Federal Funds rate 7 times in 2022 resulted in -13% total return for the Barclay's Aggregate Bond Index for the year.



Typically, there is a negative correlation between stocks and bonds which implies that when stocks go down, the bond markets usually provide a positive return. This inverse relationship generally provides a complementary and defensive advantage to a diversified portfolio of stocks and bonds over time.

As the chart below shows, a 60/40 blend of stocks and bonds has produced a negative return 14 times over the last 72 years. Only 5 times has that negative absolute return been greater than -10%. The past calendar year

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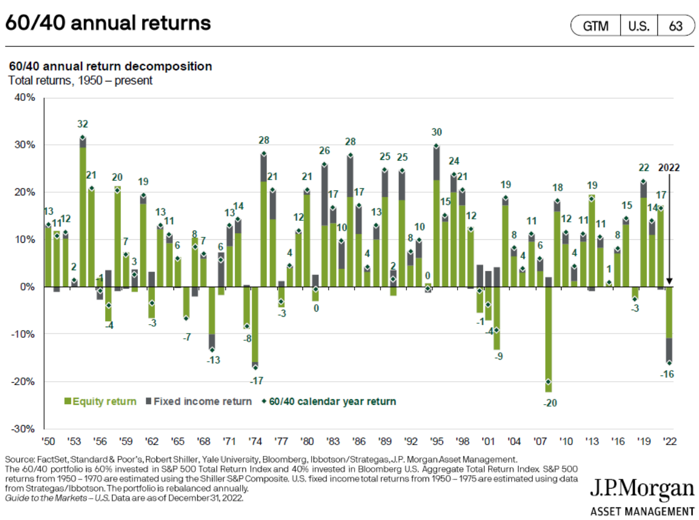
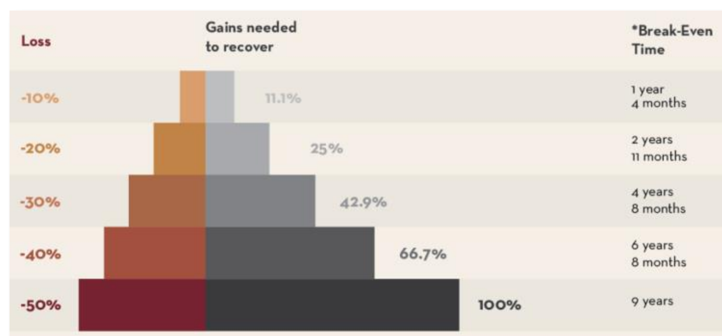
proved to be one of the worst for the 60/40 blend, with a loss of -16%.



We all agree that we have just endured a year that will be remembered as a painful one for even conservatively allocated investors.

Our team subscribes to the Warren Buffett philosophy on bear markets. He is overquoted as saying, "Rule number one, don't lose money; Rule number two, don't forget rule number one!" If you have been invested with our team for any time at all, you will appreciate our willingness to not capture the entire upside of a bull market, as we are generally underexposed to equity risks and returns. This lower exposure to equities is an effort to not capture, or participate in, all the downside moves when they occur, and they will occur.

Bear markets (-20% decline) are a part of investing that, on average, occurs every 3.7 years, typically lasts 10 months, and will, on average, take 3.3 years for investors to fully recover. When investors speak of outperforming a comparable market index, they are usually referring to outperforming with a greater positive return in a bull market. Our style is to view performance with respect to a full market cycle, and most importantly, help achieve an absolute return target to successfully meet a stated goal. To meet or exceed a particular long-term return target or index, it is often more crucial not to realize significant downside loss of capital in difficult markets. The amount needed to recover the loss of capital is shown below.



Source:www.swanglobalinvestments.com/

The most important question is: Where do we go from here, and what is our outlook?

The inflation-fighting Federal Reserve seems to be making strides in slowing down the runaway inflation that America has endured. The difficulty is that the cure of higher interest rates for the inflation plague is slowing down real estate sales, consumer spending, corporate profits, job creation, and all of the positive things that one would typically associate with a healthy, growing economy. Every inflation report has been eagerly anticipated as we have seen our Consumer Price Index (CPI), which reached a peak of over 9% this year, slide to 6.5% - still inflated, but heading in the right direction.

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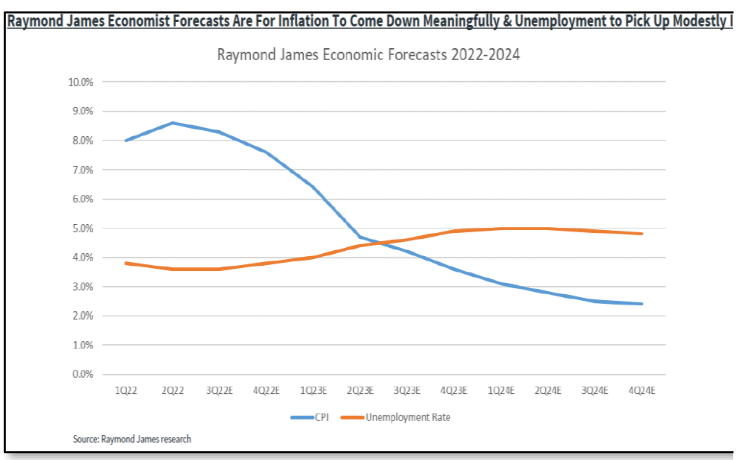
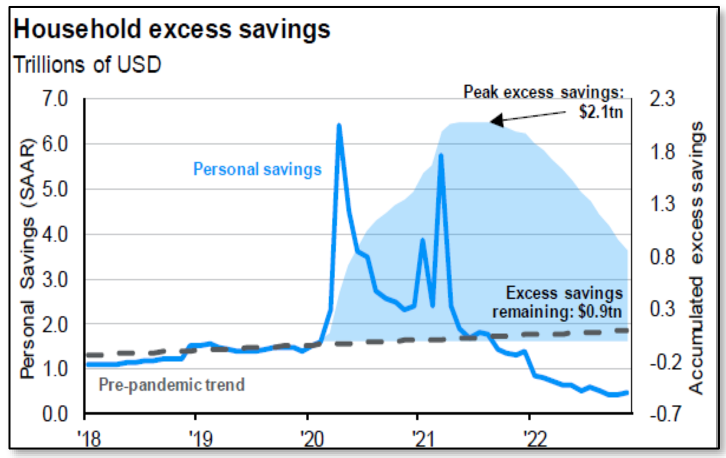
The balancing act of tapping the brakes on the economy without sending the collective passengers (consumers) through the windshield is a dangerous proposition.

The worst-case scenario would be that inflation doesn't become sufficiently tamed, but the economy slows significantly. This stagflation scenario does not seem likely, particularly now that we have a split house and senate, which should prevent more runaway stimulus spending bills (most likely gridlock, which markets prefer).

A pivot from markets focusing on inflation figures to economic indicators, like unemployment and consumer health, should become more important as the year progresses.



The savings rate of consumers swelled during Covid as restrictions and availability of goods and services prohibited spending. As the chart below shows, consumer savings has plummeted to record low levels, and will be a key component to the resiliance of the American economy.



Source: FactSet, Standard & Poor's, University of Michigan, J.P. Morgan Asset Management.
Peak is defined as the highest index value before a series of lower lows, while a trough is defined as the lowest index value before a series of higher highs. Subsequent 12-month S&P 500 returns are price returns only, which excludes dividends. Past performance is not a reliable indicator of current and future results.
Guide to the Markets – U.S. Data are as of December 31, 2022.

We believe the outlook for the first half of the year will be filled with volatility, and many retests and rallies, in the equity markets. We feel that the growth segment of the market has been oversold, and if the economy can avoid a deep recession, growth should again resume a leadership role. However, if the recession begins to take a deeper and more prolonged downturn, value/dividend equities will again outperform. The jury is still out, and we believe that balance between the two styles is prudent in our strategies as we begin the year.

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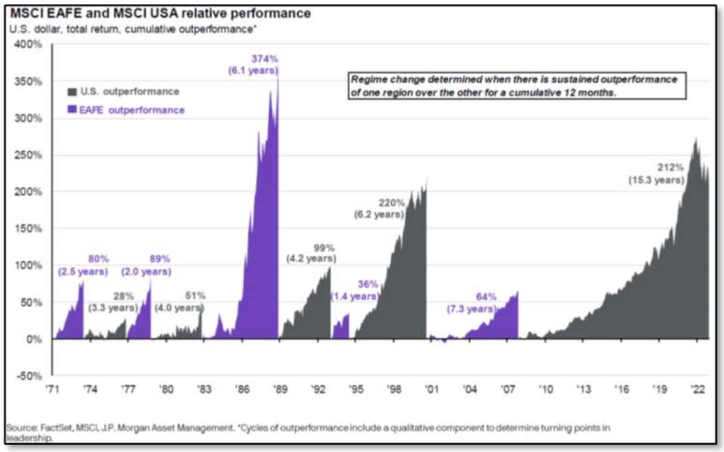

International markets have underperformed domestic equities for 15 years, and are prime for a resurgence that is long overdue. The chart above shows the historic and unusual persistance of international underperformance.

The meteoric rise in the short-term Fed Funds interest rate will continue for the near-term, as the Federal Reserve has made it clear that they will remain diligent until inflation has firmly been curtailed. The longer-term fixed income markets are strengthening as investor demand for longer-term instruments has resulted in the 10-year treasury moving from 4.5% to under 3.5%.

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All investments are subject to risk, including loss. There is no assurance that any investment strategy will be successful. Asset allocation and diversification does not ensure a profit or protect against a loss. It is important to review the investment objectives, risk tolerance, tax objectives and liquidity needs before choosing an investment style or manager.

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The information contained in this report has been obtained from sources deemed to be reliable; however, we do not guarantee the accuracy and completeness of such information.

ASSET CLASS RISK CONSIDERATIONS

Equities: Investors should be willing and able to assume the risks of equity investing. The value of a client's portfolio changes daily and can be affected by changes in interest rates, general market conditions and other political, social and economic developments, as well as specific matters relating to the companies in which the portfolio has invested. Companies paying dividends can reduce or cut payouts at any time.

Fixed Income: All fixed income securities are subject to market risk and interest rate risk. If fixed income securities are sold in the secondary market before maturity, an investor may experience a gain or loss depending on the level of interest rates, market conditions and the credit quality of the issuer. There is an inverse relationship between interest rate movements and bond prices. Generally, when interest rates rise, bond prices fall and when interest rates fall, bond prices generally rise. Please note these portfolios may be subject to state, local, and/or alternative minimum taxes. You should discuss any tax or legal matters with the appropriate professional.

International investing involves additional risks over developed countries and is greater in emerging markets. Additional information is available upon request. The S&P 500 is an unmanaged index of 500 widely held stocks. You cannot invest directly in an index.

Companies engaged in business related to a specific sector are subject to fierce competition and their products and services may be subject to rapid obsolescence. There are additional risks associated with investing in an individual sector, including limited diversification. Investing in the energy sector involves special risks, including the potential adverse effects of state and federal regulation and may not be suitable for all investors. International investing involves additional risks such as currency fluctuations, differing financial accounting standards, and possible political and economic instability. These risks are greater in emerging markets.

Forward-looking statements are subject to uncertainties that could cause actual developments and results to differ materially from the expectations expressed. Price Earnings Ratio (P/E) is the price of the stock divided by its earnings per shares

You cannot invest directly into any index and past performance doesn't guarantee future results.

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