ST. JOHN & ASSOCIATES
INTEGRATED FINANCIAL SERVICES

2022 2nd Quarter Financial & Investment Management General Commentary

Although markets may be down, remember that investing is a long-term strategy. While losses may not be over, the biggest risk may be abandoning long-term strategies based on short-term market movements. This report is to help you gain an understanding of the economics driving the markets and some financial information to help you through the rest of the year. As a firm, we are continuing to actively monitor the investment landscape in an effort to maximize the returns of our client portfolios over the long-term, while working to manage the risk-efficiency of the assets during times of market distress. If you have any questions or would like to discuss any of the material in greater detail, please give us a call. We are always here to be a resource for the benefit of our clients.

FINANCIAL PLANNING

Update to Your Financial Plan as we Reconsider Expectations

If you are a financial planning client it will be especially prudent to update your personal financial plan in view of the market selloffs and increased inflation, we've been experiencing this year. If you are a portfolio management only client and would be interest in building an initial plan or updating an earlier plan, please contact Bryan for this service.

Our plans incorporate the Brute Force Monte Carlo© technique. This technique is a random process which utilizes returns from a normal distribution based on the estimated rate of return and standard deviation of the individual asset classes and the respective correlations. The results are based on 1,000 trials of your Plan. Monte Carlo analysis helps account for volatility like we've seen lately in the markets. A Monte Carlo simulation considers a wide range of possibilities and helps us reduce uncertainty. The probability of success in our Monte Carlo calculation shows the ability to fund goals, assuming randomized returns, over the subject of the plan's lifetime. We find it useful to explain the probability of success as the number of lifetimes that a client can fund every goal (i.e., If the Monte Carlo calculation generates a result where the client meets his or her goals 750 lifetimes out of 1000, the probability of success would be 75%). We plot these along a confidence level ranging from 75% - 99%. Anything less than 75% may necessitate some adjustments to the plan to ensure a successful financial outcome.

We will be working through updates to the linked investment accounts in your plans. The linked accounts contain the funds we manage. We can populate client financial plans with those updated values easily. Linked accounts are the ones we manage on your behalf at Fidelity. It is up to the client to populate their financial plan with asset values we don't manage, since we don't have line of sight. These are non-linked accounts and typically must be manually updated. If you're a planning client we will be routinely going through the financial plans we have on file and updating your linked accounts. If you have accounts at other brokerages, banks, credit unions…etc. we would need you to update those or provide us with the information. We can certainly provide you with assistance as needed.

To have your plan updated, contact Bryan at btotri@stjjohnfinancial.com and he will provide you a fresh link to a template where you can routinely update your financial plan with those non-linked asset values.

Additionally, if you're interested in having the ability to see all of your assets and liabilities in one place, including current non-linked accounts, we have another option for you. This would automate the process and you would not have to manually update any assets we don't manage to make sure they're included in your financial plan…as they should be. This can automatically be done for you. The way to do this is through the use of an account aggregation application.

We like [Yodlee] by Envestnet. With bank-level security and compliance features it is one of the best in the industry. Chances are you may have used it in the past as more than 1,200 financial institutions and 15 of the top 20 US banks use the Yodlee platform. If you are interested, let Bryan know using the email address above. Just mention Yodlee in the subject line and he'll reach out to you.

Also make sure to review the goals in your plan. For example, we adjusted inflation expectations moderately higher so there may be a meaningful difference in plan outcomes as a result. Let us know if you have any specific concerns or want help updating your non-linked investment resources for planning purposes.

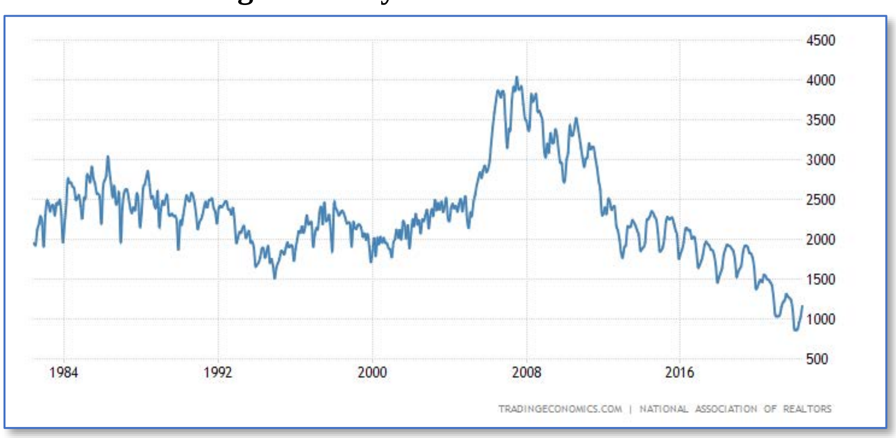
The U.S. Housing Market Is Unhealthy

The U.S. housing market has cooled as mortgage rates have surged in response to the Federal Reserve's effort to control inflation. What does that mean for buyers, sellers, and investors? First, a bit of the background story on how we got to the current housing market.

The onset of the COVID-19 pandemic, two and a half years ago, sent U.S. housing prices skyrocketing. Even now, with mortgage rates doubling since the start of the year, the median home price was up 15% year over year in May. What caused it? One major component was the work-from-home (WFH) movement. You can actually go around the country, buy something bigger for yourself and your family, and work there for the company regardless of location, if your job permits it. Because everybody traditionally buys or lives near where they work, you don't need to do that anymore. Unfortunately, that has brought unbelievable real estate price inflation to these areas that have never seen it. So, the work from home concept exported inflation from certain states into areas that didn't have the proper supply to take that kind of migration or that kind of income and buying power.

To compound that problem, we have declining inventory of unsold listings. The **National Association of Realtors** provides a monthly snapshot of inventory with its existing home sales report. Inventory from 2010 to 2019 was high enough that we didn't see major bidding wars. However, inventory has broken down to such low levels that unhealthy bidding wars are more common since 2020.

Total U.S. Housing Inventory Since 1982



Inventory is still too low. That explains why pricing is staying firm. It was an inventory shortage that was the bigger factor for home price growth. Interest rates are another factor. In previous expansions, when rates fall, you saw a reversal in demand and sales started to go up. We've experienced so much home price growth in such a short time that it won't have that really strong of an impact. But ideally, we want to keep rates from going down until we get some stabilizing because the worst thing that could happen in the next six to 12 months is that rates fall back down and it destabilizes the market and home prices just keep on rising further reducing affordability.

How Will High COLA Payouts Affect Social Security's Finances?

First, let it be said that Social Security is one of the few sources of predictable, inflation-adjusted lifetime income available to retirees. This, by itself, is a reason to maximize benefits through strategic claiming. We'll address that below in *When Should I Claim Social Security*.

The Social Security trustees are projecting an inflation rate of just 2.4% under their 75-year, intermediate-cost scenario. This year's COLA bumped benefits up by 5.9% and next year's COLA could come in at a range of between 9.8% and 11.4%!

While the final Social Security COLA won't be known for several months, estimates from The Senior Citizens League (TSCL) based on the new CPI-W data through June show that the COLA for 2023 could be 10.5%. This also depends on whether inflation runs "hot" or "cold," the organization notes:

- If inflation runs "hot" or higher than the recent average, the COLA could be even higher, at 11.4%.
- If inflation runs "cold" or lower than the recent average, the COLA could be 9.8%.

Naturally the question arises: will Social Security's finances worsen as a result of these higher payouts?

A new report by the Congressional Research Service, Social Security: Cost-of-Living Adjustments (COLAs) and the System's Projected Financial Shortfall, reminds us that inflation affects the revenue side too. As the average wage index (AWI) rises, the contribution and benefit base (CBB) also rises. If the AWI jumps, the maximum taxable wage base, currently $147,000, would go up commensurately, generating more tax revenues to fund the higher payouts. This wouldn't happen evenly as the higher COLA may precede the rise in the CBB…but would even out in the end. And remember, we're talking about a time horizon of 75 years. A temporary blip in inflation will not make that much of a difference in the long run.

Interestingly, a lower CPI projection would raise the program's costs. Under the trustees' high-cost projections, if the CPI were to rise at an annual rate of 1.8%, the trust fund would exhaust in 2031, three years earlier than with inflation running at 2.4%. This suggests that higher inflation actually helps the program, rather than hindering it.

Read the Congressional Research Report here.

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When Should I Claim Social Security?

Determining when to take Social Security is an important decision. The longer you wait to start getting your Social Security money, the more you'll get paid each month.

You can do the paperwork to start your benefit any time after your 62nd birthday. **You'll max out your benefit amount if you wait until you're 70 years old.**

But since we are dealing with individual lives and not whole populations, what matters is how long any one individual lives. Because a person claiming at 70 is giving up eight years of benefits - but then starting out at 70 with a much higher benefit - the crucial calculation is the breakeven age. How long must the individual live in order to receive more total benefits by claiming at 70?

Breakeven age is a simple concept. However, studies have shown that people tend to focus more on the eight years of zero benefits than on the much higher amount they would receive after claiming at 70.

A more useful framing of the breakeven age concept is longevity insurance. You may not think you'll live that long… but what if you do? And what about your spouse? If you die, your higher benefit will carry over to your spouse and continue to be paid for as long as he or she lives. So, we're not just talking about your life expectancy. We're talking about the life expectancy of whoever of the two of you lives the longest.

The relative benefit amounts you see on your statement that are supposedly equivalent no matter when you claim, are not really equivalent. Individuals have an edge over the actuaries through the use of two life expectancies instead of one. Plus, you are likely to live longer than the actuaries back in 1983—thought you would.

And what about those delayed retirement credits? The 8% annual DRCs were established in 1983, based on the rate of interest the actuaries assumed could be earned on the securities in the Social Security trust fund. As set forth in the 1982 OASDI Trustees report, that interest rate was 13.3% in 1981 and projected to decline to 6.6% by 2000. The 8% rate set for the maximum four years of annual DRCs seemed reasonable at the time. It could easily be covered by the growth of the investments in the trust fund.

No one needs to be reminded of what interest rates have done since the 1980's. Average 10-year treasury yields have sunk to 1.58% from a high of 13.92% in 1982. The securities in the OASDI trust fund are now yielding 2.5%, down from 13.3% in 1981. The formula that requires benefits to be increased by 8% a year in today's low interest-rate climate is like the Social Security system having to keep up the payments on a high-rate mortgage that can't be refinanced

For more details here is a good resource.

Medicare Advantage Plans: Buyer Beware

First, what is the Advantage Plan anyway? When it's time to sign up for Medicare, one of the first and most substantial decisions you face is whether to choose Original Medicare or Medicare Advantage. In 2022, 45% of Medicare beneficiaries have a Medicare Advantage plan, according to data from The Chartis Group. The decision will depend on several factors, including where you live, your current and potential health care needs and your financial situation.

Both options provide coverage for your major medical needs. But your out-of-pocket costs and choices for doctors and hospitals will depend on the program you choose. There are some good resources for helping you decide, here is a good start. Let us know if you need assistance with this decision.

Here are the issues currently with some Medicare Advantage (MA) plans.

The Subcommittee on Oversight and Investigations of the House Committee on Energy and Commerce held a hearing in June on the need for greater oversight of Medicare Advantage (MA) organizations and plans. This hearing was triggered by several government watchdog reports that show MA plans delay and deny needed care, exhibit troubling patterns of disenrollment, and cost the federal government and taxpayers more than original Medicare.

In April the HHS Office of Inspector General (OIG) found that MA plans sometimes delayed or denied services even though requests met Medicare coverage rules and would have been delivered under Original Medicare. Sometimes the MA plans claimed not to have sufficient documentation to support approval, yet reviewers found that the medical records already in the case file were sufficient to support the medical necessity of the services. Based on their samples, OIG estimates that tens of thousands of beneficiaries receive an inappropriate denial every year. Some denials are reversed on appeal, but many are not. And, of course, many people simply accept the plan's decision without filing an appeal. In the end, these practices have led to worse health outcomes as needed care is either delayed or not provided at all.

Last year the Government Accountability Office (GAO), a watchdog agency in the legislative branch, released a report showing that people in their last year of life disproportionately disenrolled from Medicare Advantage (MA) into Original Medicare. These end-of-life dis-enrollments were at ten times the rate of regular dis-enrollments, suggesting that MA plans push people off their plans when care gets more expensive. Beneficiaries who disenrolled cited barriers to getting needed care and problems accessing their preferred providers as reasons for switching coverage.

In March, the Medicare Payment Advisory Commission (MedPAC) delivered its annual report to Congress that examines Medicare's payment policies, including Medicare Advantage (MA). By MedPAC's estimates, Medicare pays four percent more for beneficiaries who are enrolled in MA than it would if those beneficiaries were covered by traditional Medicare. One reason is "upcoding" or stating that a patient is sicker than they really are. For example, the OIG flagged billions of dollars of payments to MA plans based on diagnoses that were found only on medical records and that did not lead to any treatment. Researchers have found similar results, showing that hundreds of billions of dollars may be at stake due to upcoding.

You need to know that there is a something called the one-year MA trial right. If wish to go into an MA plan when you first enroll in Medicare, you can opt out that first year. Under the MA trial right, you can drop the MA plan and buy any Medigap policy sold in the state. Or, if you started out with a Medigap policy and dropped it to go into a MA plan, you have one year to change your mind and get the same Medigap policy back. If that same policy is no longer offered, you can get any policy sold in the state.

Know what could be involved in switching to Medigap in your state. Clients who miss their one-year trial right may still be able to get a Medigap policy. Here it would pay to find a good insurance agent who specializes in Medicare policies and understands which health conditions are more troublesome and which insurers tend to have more lenient underwriting standards.

There are some good MA plans out there, primarily those in large urban areas where there is lots of competition. And much of the variability in experience has to do with a client's own health status. Clients who are and expect to stay healthy won't need to worry so much about high copayments, claim denials, or the inability to receive specialty care due to narrowing networks. The lower or no premiums may compensate for these potential problems. But like we said: Buyer beware.

A First Look at the College Savings Recovery Act

Back in June the College Savings Recovery Act was introduced in the Senate. The bill would, for the first time, allow certain individuals to rollover certain dollars within a 529 plan to a Roth IRA.

It's not yet clear whether the bill will have enough momentum to get through Congress, but it seems to have drawn a decent amount of interest from folks on both sides of the aisle. With that in mind, we thought it worth taking a few moments to give you a first look at what one future change to the retirement account rules *might* look like.

Like most things, the Devil is in the details. Here are some of the details of the proposed legislation, along with some commentary about each.

Rule: In order to qualify for the 529 plan-to-IRA rollover, the 529 plan owner must have maintained a 529 plan for at least 10 years.

Commentary: It would appear that although the owner of the 529 plan must have owned an account for at least 10 years, the beneficiary of the account can be changed during that time without triggering a new 10-year period. In general, there is a significant amount of flexibility to change the beneficiary of a 529 plan between family members.

Rule: The funds in the 529 plan could be rolled into the Roth IRA of either the owner of the 529 plan or the beneficiary of the 529 plan.

Commentary: Since it appears that the beneficiary of the 529 plan can be changed without impacting the ability to rollover the 529 plan to a Roth IRA, it would seem that a 529 plan owner would be able to make a 'last minute' change in 529 plan beneficiary to jumpstart (or supplement) an individual's retirement.

Rule: The amount that can be rolled over would be limited to the lesser of:

1. The amount of 529 plan contributions that have been in the account for at least 5 years, along with the earnings on such contributions
2. The annual Roth IRA limit, reduced by any contributions to IRAs (Traditional and Roth) made before the date of the 529 plan distribution (that is rolled into the Roth IRA)

Commentary: The wording of the rule here is notable for a couple of reasons. For starters, at a maximum, the amount that would be able to be rolled over from a 529 plan to a Roth IRA would be limited to no more than the annual contribution limit. For those 529 plan owners who have significant savings that are no longer needed for education purposes (or which are simply needed more for other purposes, such as retirement) held within such plans, shifting dollars from the 529 plan to a Roth IRA will be a gradual process, at best.

In addition, the language of the proposed legislation appears to create a timing strategy that could be used by some individuals to "stuff" Roth IRAs with "bonus" contributions. More specifically, the amount that could be rolled from the 529 plan to the Roth IRA each year would be limited to the annual contribution limit, reduced by contributions made ***earlier*** in the year to IRA and/or Roth IRA of the receiving individual. That language would sure seem to open up a loophole. In short, savers who would want to shift money from a 529 plan to a Roth IRA and make additional contributions to a Traditional IRA or Roth IRA during the same year would be able to do so, so long at the 529-to-Roth IRA rollover was made *first*, and the IRA/Roth IRA contribution for the year was made second.

Indeed, this approach could allow some forward-thinking individuals to "stuff" some extra money into Roth IRAs over the long-term. At a high level, those with available means could fund 529 plans (which have no income limits for contributions) with dollars never really intended for education. Then, after the required holding time, those dollars could be shifted over to Roth IRAs, (in addition to annual "regular" IRA/Roth contributions).

Many individuals are hesitant to contribute to 529 plans because they fear they may need those dollars for retirement, instead. The proposed 529-plan-to-Roth IRA rollover would help to mitigate that concern. Of course, regardless of whether or not the proposal becomes law, one thing will continue to remain true; there are plenty of options to get a loan for college, but no similar options for retirement.

The Auto Insurance Claim Drivers Don't Know to File

If your car is in an accident, its resale value could plummet by as much as 35% even if the damage is expertly repaired. However, there might be a way to recover that money.

If you were not at fault, you likely can obtain "diminished value" compensation from the at-fault driver's insurer and in rare cases, you may be able to obtain this from your insurer even if you were at fault.

But you have to take action. To receive diminished-value compensation:
Check state laws. In most states, you can make a diminished-value claim only if the other driver was at fault—but there are exceptions…

- You can make a claim even if you were at fault if the vehicle was insured in Georgia and/or the accident occurred in Georgia. You would make this claim under your own policy's collision coverage.
- If the other driver was at fault but uninsured or underinsured, your ability to make a claim depends on whether your policy's uninsured-motorist component covers diminished value.
- You cannot make a diminished value claim if the accident occurred in Massachusetts or Michigan, regardless of who was at fault, though Michigan does have a comparable "mini-tort" rule that could allow you to recover up to $3,000 if the other driver was at fault.

These and other relevant state law details can be found at ICAN2000-dv. com (choose "Laws" from the "Diminished Value" menu, then select the state).

Helpful: You might be able to file a diminished-value claim even if the accident occurred several years ago and/or you have sold the vehicle. The statute of limitations for claims is between three and five years, though it is one year if the accident was in Louisiana.

Put the insurer on notice. When the at fault driver's insurer contacts you about the accident, state, "I'm going to explore diminished value."

Warning: If you receive a check to cover diminished value from the insurer, do not sign or cash it until you've taken the steps below to confirm that the amount is reasonable. Some insurers send low-ball payments in hopes that these will be cashed, making it difficult for you to receive additional compensation.

Request a free estimate from a diminished-value appraiser. Reputable appraisers include Collision Claim Associates (**CollisionClaims.com**)…Wreck Check (**WreckCheck.com**) and my organization, the Insurance Consumer Advocate Network (**ICAN2000-dv.com**). If you work with a different appraiser, confirm that he/she has been doing diminished value appraisals for at least five years and has a background as an insurance adjuster or in used-car sales.

Also: If you're asked the approximate pre-accident value of your vehicle, calculate this at **NADA.com**.

Hire the appraiser to produce a full report. Do this if the free estimate suggests that the diminished value is significantly greater than the $250 to $350 you're likely to be charged for the report. After filing the report with the insurer, your appraiser will negotiate with an appraiser hired by the insurer to settle on a compensation amount.

FINANCIAL MARKETS

The Economy

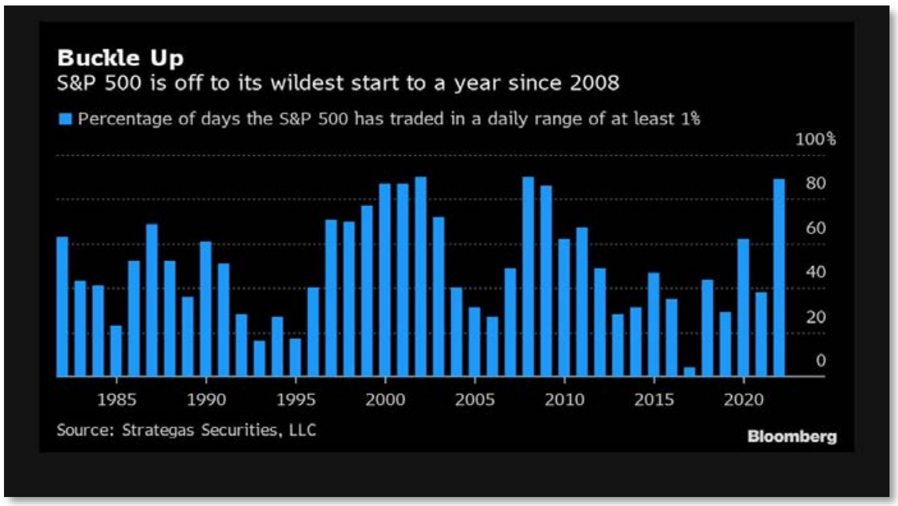
Inflation and interest rates are currently the root of all economic issues and market slowdowns. The cost of energy for heating, cooling, travel and transportation costs filter into every aspect of the economy. Additionally, materials such as wood and steel or basic components like microchips limit the availability of goods and products.

Basic rules of economics tell us that as supply decreases, even if demand stay the same, prices go up. Over the past year we have seen a decrease in the production of 1,000,000 barrels of oil per day driving up gas prices. We have seen these oil and gas prices limit shipping or driving up the transportation costs of goods and materials. This increase in costs is either absorbed by companies, which impacts earnings and operating profits, or passed on to the customer which has an impact on consumer spending as there are less dollars to spread between different purchases.

In an effort to bring down inflation levels, the FED has taken measures to raise interest rates. This has affected the cost of borrowing money for both companies as well as consumers which is priced into good, services and especially home purchases. Rising rates also negatively impacts the bond market (rates up, bond prices down).

The effect of inflation has continued to accelerate during the year resulting in economic head-winds. As we forecasted in our 2Q21 market commentary, financial markets have experienced fairly significant bouts of volatility this year. Markets continue to create a challenging environment for investors over the short-term. Consistent with our expectations, volatility remains at higher-than-normal levels based on the geo-political backdrop, path and persistence of inflation, FED policy action, the prospects of slowing growth and variants of the virus. To put this in perspective, in nearly 90% of the trading days this year, we have experienced a market move of greater than 1% in the S&P 500 (***a figure that hasn't been seen since the 2008 financial crisis***). We anticipate volatility to remain elevated in the near-term based on broader market uncertainty.

Exhibit 1: Percentage of days the S&P 500 has traded in a daily range of at least 1.0%



Below is a chart that reflects the S&P Volatility index levels showing volatility on an upward trend since early 2021moving almost completely out of the normal range early this year. Today we are still near the two-year highs.

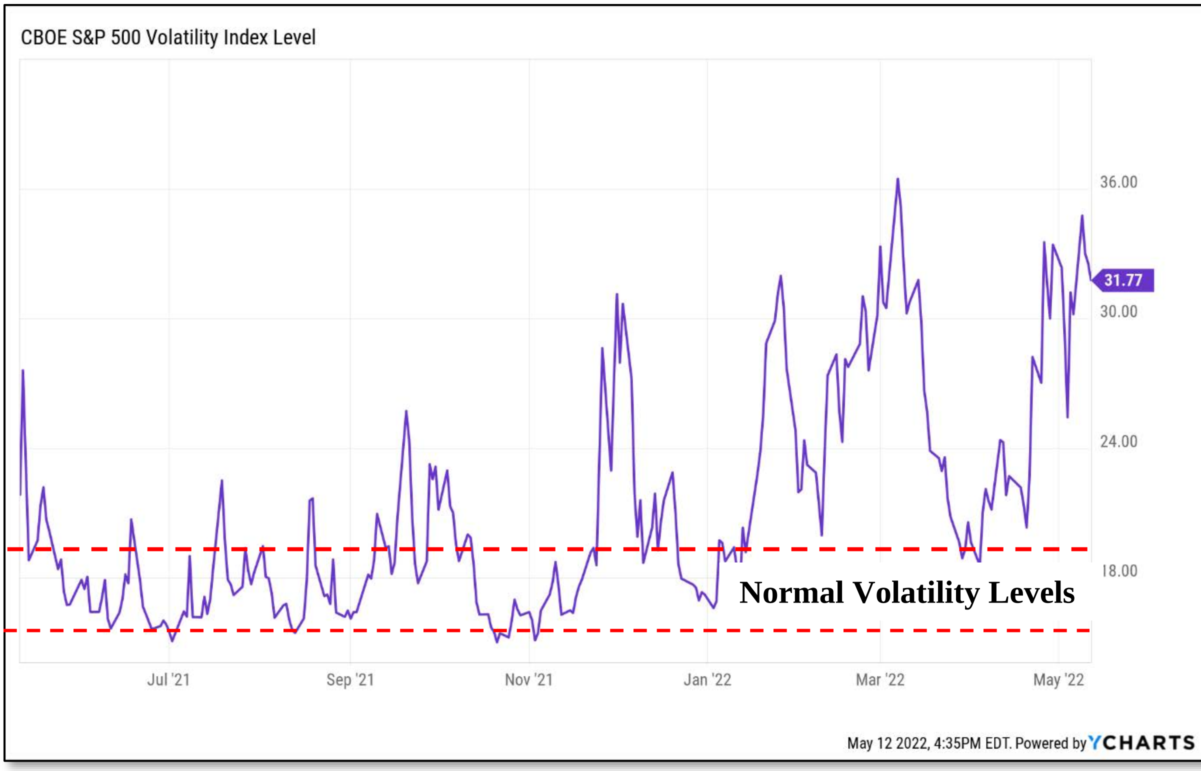


Exhibit 2: Financial markets lack stability and certainty which will continue to contribute to volatility over the near-term for risk assets.

Asset Class Performance

Most asset classes have experienced negative returns to date and it's reasonable to believe that we may be entering into a changing market regime marked by lower returns across certain asset classes over the near-term. We continue to emphasize the importance of adopting a long-term perspective because markets tend to exhibit "noise" in the short-term. As a Firm, we continue to remain disciplined in our investment approach by actively managing the risk through market cycles. This systematic approach tends to result in more optimal outcomes in performance over the long-term. The table below highlights performance across various asset and sub-asset classes.

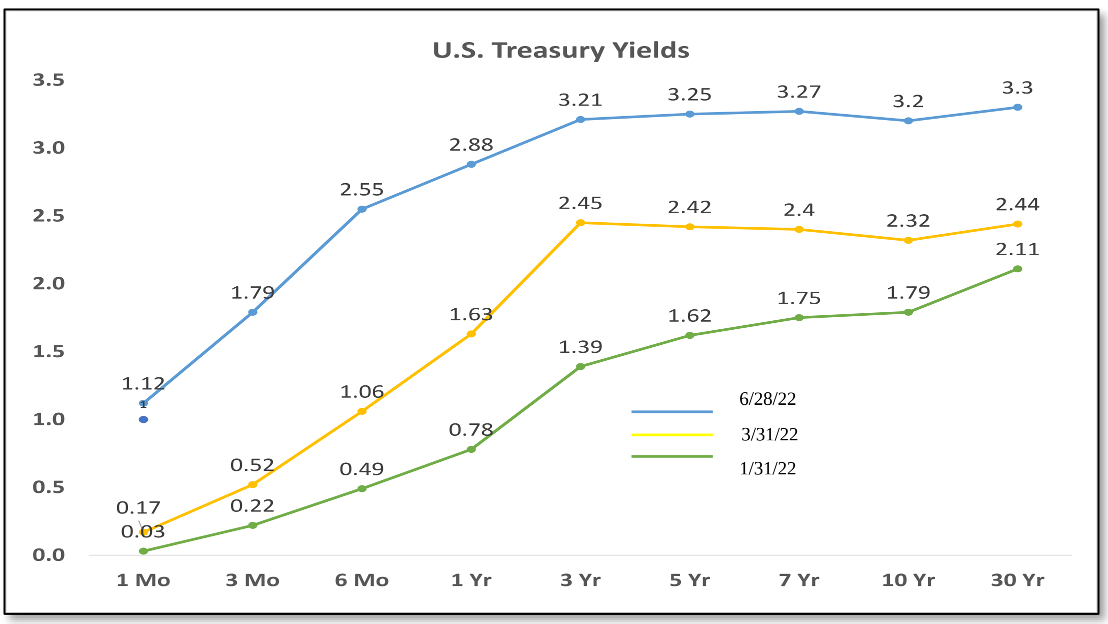
Asset Class	Sub Asset Class	YTD	1-Year	3-Year	5-Year
Fixed Income	Bloomberg US TIPS	-8.9%	-5.1%	3.0%	3.2%
Fixed Income	Bloomberg US Aggregate Bonds	-10.4%	-10.3%	-0.6%	0.9%
Fixed Income	Bloomberg Corporate High Yield	-14.2%	-12.8%	0.2%	2.1%
Equity	Bloomberg US Long Dur. Treasuries	-21.3%	-18.5%	-2.9%	0.5%
Equity	S&P 500	-20.0%	-10.6%	10.6%	11.3%
Equity	Russell Small Cap	-23.4%	-25.2%	4.2%	5.2%
Equity	MSCI International Developed	-19.6%	-17.8%	1.1%	2.2%
Equity	MSCI Emerging Markets	-17.6%	-25.3%	0.6%	2.2%
Commodities	Bloomberg Commodities	18.4%	24.3%	14.3%	8.4%

Source: Morningstar June 30, 2022

Generally, a prudent investor can rely on diversification as a powerful portfolio risk management tool; however, there have been few places to seek refuge in the current market environment. The decoupling and breakdown of cross asset class correlations between equity, credit and bond rates has negatively impacted the benefits of diversification within the construct of a traditional portfolio. To provide some perspective, it's been more than 45 years (1976) since the S&P 500 and the U.S. Aggregate Bond index were ***both*** down in excess of -10%. The only other time both indexes dropped for the year was in 1994, when the bond index declined -2.9% and the S&P 500 fell -1.5%. This illustrates the extreme and rare nature of what we have experienced as investors over the last six months. As previously covered, we continue to believe that fixed income will experience headwinds in a rising rate environment.

Interest rate impact on yields

US Treasury yields have moved sharply higher during the year based on inflation and the expectations of a more aggressive FED policy action. As of June 28, 2022, yields on the 10-year Treasury have moved 157 basis points higher on the year (that represents a 4-5 standard deviation move). It's also worth noting that the yield curve has continued to invert this year, which historically has been a precursor and indicator of an economic recession.



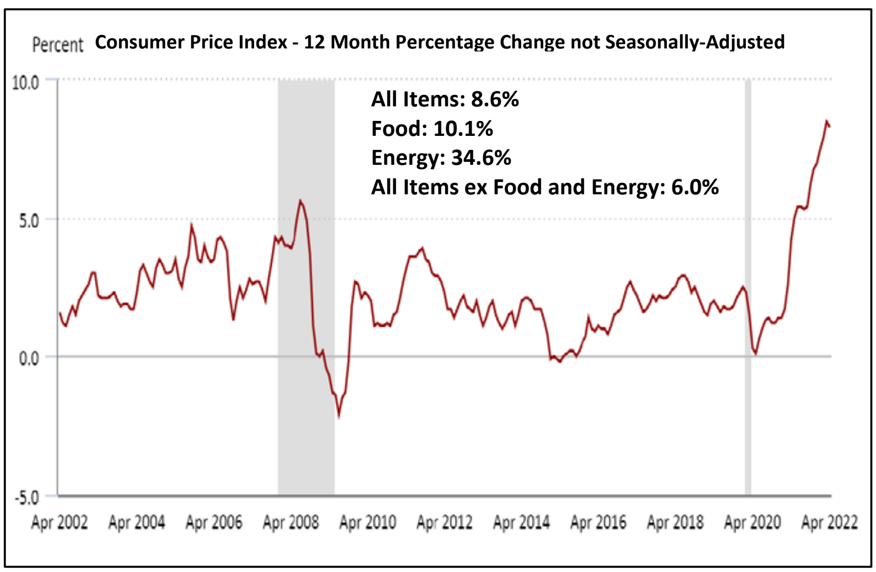
Source: US Department of Treasury

Treasuries are typically perceived as a "safe haven" or flight to safety during times of financial distress; however, they have provided no protection despite the market uncertainty and fragility. It's also important to note that the FED has initiated quantitative tightening in an effort to reduce the size of the balance sheet. This means that proceeds from maturing securities are not being re-invested which has served as a source of liquidity and support for compressing yields.

As we previously suggested, the Fed grossly miscalculated the rate and path of inflation by characterizing it as "transitory." Now the Fed is moving more aggressively in order to control and reduce inflation back to a targeted 2.0% level. Currently the Federal Funds target rate sits at 1.75% after the most recent 75 basis point hike. The FED will be challenged to hike aggressively without negatively impacting economic growth and inducing a recession. We believe the FED will continue the trend of rate hikes only to be in a position to subsequently cut rates base on slower economic growth.

Inflation

Like many of you, we look forward to the day where we don't have to address the topic of inflation. However, given the impact of inflation on each of our lives, we figured it was important enough to warrant an update. We pre-emptively began to address the prospects for inflation during the 4th quarter of 2021. Consistent with expectations, the rate of inflation has accelerated during the course of the year resulting in the FED moving into a more aggressive rate policy stance. Inflation continues to be driven by rising energy and food prices coupled with an increase in housing and rental costs. While it's hard to forecast whether inflation has peaked, the rate of increase should moderate as lower CPI numbers roll out of the calculation. In the short to intermediate term, we believe reported inflation numbers could remain at uncomfortably high levels.



- Inflation accelerated during the year based on oil prices, supply chain disruptions, previous government stimulus programs, Russia's invasion on Ukraine and China's COVID shut down policy.
- The most recent reading reflected a year-over-year increase of 8.6% for all items (the largest annual increase since December 1981).

- While some imply the current environment will be a repeat of the early 1980's inflation, it's worth identifying that the market-implied 10-year breakeven rate for inflation stood at 2.48% as of June 28, 2022.
- Additionally, higher interest rates once allowed for savings accounts to reasonably keep up with inflation. This is not the case now.

Capital Market Expectations / Assumptions

Last year we highlighted the risks with elevated valuation levels and price-to-earnings multiples. Unfortunately, our analysis proved to be right. In the spirit of managing expectations, we think it's prudent to revisit forward looking capital market expectations. The consensus across multiple financial institutions reflects a lower return expectation across various asset classes. As an example, U.S. large cap are only anticipated to generate an expected return of 7.1% annualized over the next 10-years. This is a significant reduction when compared to the 14.4% annualized total return generated by the S&P 500 over the last 10 years. We share this only to manage expectation regarding the prospects of a lower returning environment.

This highlights the importance of both active portfolio management, diversification and alternative assets as a differentiated return driver. As a Firm, we constantly source, review and implement strategies across various asset classes in an effort to enhance diversification and return optimization.

Are we in a Recession?

A recession is officially identified as 2 consecutive reductions in the GDP. Over 50% of the surveys suggest we are already in a recession. While the economic numbers have not yet confirmed a recession, the estimates are beginning to assert that the next release of GDP numbers will confirm these views.

The average length of recessions going all the way back to 1857 is generally less than 17.5 months. Recessions actually have been shorter and less severe since the days of the Buchanan administration. The long-term average includes the 1873 recession that lasted 65 months. It also includes the Great Depression, which lasted 43 months.

With the expectation that a recession may be coming, we have been bringing up the idea of how important it is to plan for expenses in the next 2 to 3 years with emergency money on hand. During a recession corporate earnings tend to fall and consumer costs tend to rise. Having personal cash on hand outside of an investment portfolio is critical to avoid untimely needs to tap into the portfolio to make up for these increased cash needs while the market is down.

Investment Markets

The first 6 months of this year have not been what almost all analysts thought at the beginning of the year, nor has it been easy. In October of last year and in January we warned of the potential for trouble because of overpriced stocks. One of Bob Farrell's 10 axioms for investing is Bull Markets are more fun than Bear Markets, and the first half of this year has confirmed that axiom. Now it is true most people did not see at the beginning of this year the likelihood of Russia invading Ukraine, but we did see very high domestic stock market valuations and some unusual financial components.

So, we are in a bear market, what happens from here?

Before we get to these comments, it is worth knowing some of the details. For the year so far through June, the S&P 500 was down 20%, the EAFE international index was down 20% and domestic small caps were down 23%. The Aggregate Bond Market was also down 10%. During this period, the value side of the equity market, which are where the majority of the dividend paying companies reside, was down only -10% for large companies, -13% for the broad domestic market and -11% internationally. Shorter duration bonds were down -3% and intermediates done only -6%. Our primary liquid alternative manager was only down -6% reflecting the defensive nature of the strategy.

With Cash still paying little and not keeping up with inflation in short or long term, there was almost nowhere to hide from this downturn. Still our portfolios for the most part outperformed the broader markets as we have been rotating to the value side seeking dividends and away from long term bonds.

Almost half of the losses for all the equity indexes listed came in June alone leading to a market collapse across the board. From a portfolio standpoint, what we see is a reasonable first 5 months and index-like returns for June. Actually, when we analyze history, we note that returns don't behave in a linear pattern. The intention is to design and construct a portfolio that captures a majority of the market up-side but provides down-side protection during times of financial distress. We believe the dividend yielding strategies will continue to perform well across a variety of market environments. We will have months when we get great relative performance and months when we do not.

Bear markets come in various forms based on duration. March 2020 was a bear market, short lived for sure, but a bear market none the less. The first bear market of this century started in March of 2000 and lasted until September of 2002. So, what will happen now? Well, we know with certainty that this bear market is already longer than the 2020 bear market. We think it will be most like the 2000-2002 bear market. So, what should you expect?

1. The market will not go straight down.

   From March of 2000 through September of 2002 the Nasdaq 100 fell 83%, but it had 16 rallies of 10% or more. We saw this phenomenon play out the week of June 20. We had just finished seven weeks in a row of negative returns and it is as if the market needed a pause. The market gain was over 6% for the week.

2. It will be longer than you think.

Bear markets certainly vary in length, but do not expect this one to last just a few months. It will be unpredictable. It is already 6 months old, and we have not seen any sign of solving the fundamental economic problems we are experiencing. The yield on the 10 Year US Treasury was 1.3% at the beginning of the year and is 3.3% today. Do you think yields are headed back to those levels?

Consider these: The price of a gallon of gas at the beginning 2021 was $2.249, at the beginning of 2022 was $3.281 and it is now $4.646. Do you think we will see gas at the January 1, prices any time soon? Wages have increased 11% through May over the same time period last year according to the US Bureau of Economic Analysis. Will these now be built into the cost of goods and services or will wages drop?

3. The market will focus on any bad news and ignore good news.

   This is the confusing part of market reactions. There will be some good news along the way, but the market will likely be resistant to price in meaningful changes until we experience some stability. So, expect good news to be discounted.

   Additionally, the market will focus on global news and likely discount information provided by individual companies. Armed with this knowledge, we expect companies to release bad news now rather than to defer until a sustainable recovery is underway.

4. The up market that will follow this period will have some and perhaps many false starts.

   This happens in every bear market, with the exception of 2020. The March 2000-September 2002 had market climbs of at least 10% 16 times. That is a correction of positive returns is more than 2 out of every 3 months.

5. The Fed holds the keys, but do not expect for precision.

   The Fed will be challenged to navigate a soft landing. They have clearly indicated intentions to hike more aggressively in order to combat inflation; however, this carries the risk of inducing an economic slowdown and a recessionary climate.

6. We need to watch the shape of the yield curve.

   The most predictable leading indicator of a Bear market (and recessions) is an inverted yield curve. The yield curve has continued to invert throughout the year with the yield on the 10-Year US Treasury at 3.01% while the yield on the 2 Year is 3.21%.

7. While this is not a strict rule, the observation of bear markets would lead one to conclude that what causes the decline will reflect the shape and duration of the decline.

   The bear market of 2020 was caused by the pandemic and lasted one month. We have been in a reduced rate environment for over 2 years. This does not mean the bear market will lasts 2 years, but will likely be longer in duration and certainly influenced by Fed policy action.

8. People will spend more money on vacations and travel this summer than they should.

We have been quarantined since the winter of 2020, and as a society we are all very tired. Yes, we are not wearing masks like we did one or two years ago, and everyone feels a need to get out, to travel. All of that is fine, but with the increase in gas, travel will come at an increased cost. Expect that to impact the economy after Labor Day, not a good economic development.

9. In most Bear markets we see opportunities that we cannot imagine at the beginning of that Bear market.

   Dislocations come in forms that are impossible to predict. In the beginning of the bear market, opportunities are hard to pull the trigger because they appear riskier. This is the importance of employing a disciplined investment strategy effectively removing behavioral finance from the decision-making process.

10. Take Bob Farrell's axiom that Bull Markets are more fun than Bear Markets to heart.

    We may not be as readily able to solve investment solutions in the short-run, but we will remain disciplined in our approach in prudently managing the risk. Markets have a way of testing the resolve, so feel free to speak with us as often as you need to. We are here to be a resource for you. We are never bothered by an extra call from you and we intend to be checking in on all of you.

The Bottoms Line

Inflation is the root of all the problems relating to the market right now. Corporate earnings, wages, consumer spending, product pricing and transportation costs are all components of market drivers and inflation sensitive.

At this point, we are at the mercy of the FED's decisions related to interest rates. In simplest terms, the FED raising interest rates eventually stems inflation. Should the FED raise rates to far or too fast it could stall the economy driving it into a deeper recession. It is difficult to get it exactly right.

The FED may have to decide at some point which is worse, more inflation or a weaker economy. Unfortunately, with the late state thinking that inflation was "transitory", they are forced to be overly aggressive which creates less room for error.

Summary Statement

We have presented in this General Commentary an overview and roadmap for investing and managing your portfolio in the near future, but portfolios are constructed for the long-term and aligned with your Personal Financial Plan or longer-term objectives. They are designed to provide stable, consistent returns over time but will not completely eliminate risk and short-term bouts of volatility. Our focus is to navigate the market landscape by actively managing our portfolios in a manner that enables our clients to realize their financial objectives.

These are truly unprecedented times in financial markets with many external factors to take into consideration. Our investment objective of striving to exceed the goals of your financial plan has not changed.

Combining high and growing dividend yielding strategies with some disruptive technology exposure is expected to contribute positively to portfolio performance over the long-term. Alternative Investment portfolios will replace bonds in providing a positive return over time, minimizing the interest rate sensitivity. Liquid and illiquid portfolios with high cash flows will produce consistent growth and income for clients needing it, and good diversification and attractive returns for all investors, regardless of the income needs. We are confident about the future because these new investment solutions will provide clients with attractive returns without increasing the risk in the overall portfolio.

Below are the returns for index categories making up the broader markets. Morningstar sourced these mutual fund returns. Returns beyond one year are annualized.

	2nd Qtr. 2022	1 Year Average	5 Year Average Return	10 Year Average
S&P 500 Growth	-20.81	-16.41	13.46	14.35
S&P 500 Value	-11.27	-4.86	8.19	10.97
S&P Midcap 400 Growth	-17.46	-20.50	6.52	10.49
S&P Midcap 400 Value	-13.49	-8.64	7.09	10.97
S&P SmallCap 600 Growth	-15.62	-19.63	7.39	11.35
S&P SmallCap 600 Value	-12.74	-13.93	6.75	11.01
DJIA	-10.78	-9.05	9.98	11.70
S&P 500	-16.10	-10.62	11.31	12.96
S&P 500 Equal Weighted	-14.36	-9.38	9.87	12.66
S&P Mid-Cap 400	-15.42	-14.64	7.02	10.90
S&P Small Cap 600	-14.11	-16.81	7.20	11.26
Russell 1000	-16.67	-13.04	11.00	12.82
Russell 2000	-17.20	-25.20	5.17	9.35
Russell 3000	-16.70	-13.87	10.60	12.57
MSCI EAFE	-14.51	-17.77	2.20	5.40
MSCI EAFE Large Growth	-16.34	-22.03	2.00	4.39
MSCI EAFE Large Value	-10.81	-10.52	0.62	3.99
MSCI Emerging Mkt	-11.45	-25.28	2.18	3.06
MSCI World	-16.19	14.34	7.67	9.51
MSCI US IMI Gold	-2.86	-5.81	13.98	2.90
DJ Real Estate	-14.46	-7.58	6.20	7.72
Bloomberg Commodities	-5.66	24.27	8.39	-0.82
Bloomberg Agg US Bond	-4.69	-10.29	0.88	1.54
Bloomberg Agg US Interim	-2.93	-7.91	0.88	1.38
Fidelity Money Market	0.11	0.12	0.95	0.55