ST. JOHN & ASSOCIATES
INTEGRATED FINANCIAL SERVICES

2022 4th Quarter Financial & Investment Management General Commentary

Commentary Background

As a Firm, we value the feedback from our most important asset – **Our Clients**. Therefore, we have adopted a slightly enhanced format of condensing our commentary into an Executive Summary which is designed to provide insights into financial markets, asset class performance, financial planning and other topical or relevant matters that are important to communicate to our clients. We are always here to be a resource for the benefit of our clients, so if you have any questions or would like to discuss any of the material in greater detail, please give us a call.

Introductory Summary

Calendar year 2022 proved to be a challenging time for financial markets with nearly all asset classes experiencing negative returns. Traditionally allocated investment portfolios did not benefit from diversification, which historically has proven as a technique for effective risk mitigation. This has truly been an unprecedented market event across asset classes as reflected by performance and numerous other meaningful measurements.

As a Firm, we continue to remain disciplined in our active approach to balance and manage risk while positioning and rebalancing the portfolios to generate attractive returns over the long-term. As we have previously indicated, perspective is essential during times like these and it is important to view investment results over a longer-term time horizon (5-10 years) in order to avoid a financial behavioral bias.

While we strive to control risk, it was difficult to avoid negative returns in 2022. Still, our portfolio models have generally outperformed the broader market by protecting capital on the down-side while capturing more of the upside over the long-term. We believe this will be key in continuing to contribute to the success of our client's financial objectives over time. Patience and market discipline are virtues in optimizing portfolio performance. Given the active investment management, we anticipate and expect our portfolio models to perform well across a variety of market environments in delivering risk-efficient returns.

Financial Market Summary

Financial markets exhibited a significant amount of volatility during 2022 with the S&P 500 experiencing more than 80% of the trading days with intra-day and day-over-day moves of greater than 1.0%. We continue to believe that volatility may be a theme throughout 2023 based on economic uncertainty and the growing probability of a Fed-induced recession. We are currently entering earnings season and there is a broader consensus that is guiding to lower earnings forecast which may not be actively priced into the market.

During 2022, the market experienced an unprecedented draw-down across asset classes. The broader global equity index (MSCI World) was down -18.14% for the year while the U.S. domestic equity index (Russell 3000) returned -19.21%. Broad equity returns were driven by multiple-compression, which generally precedes earnings declines within a business cycle.

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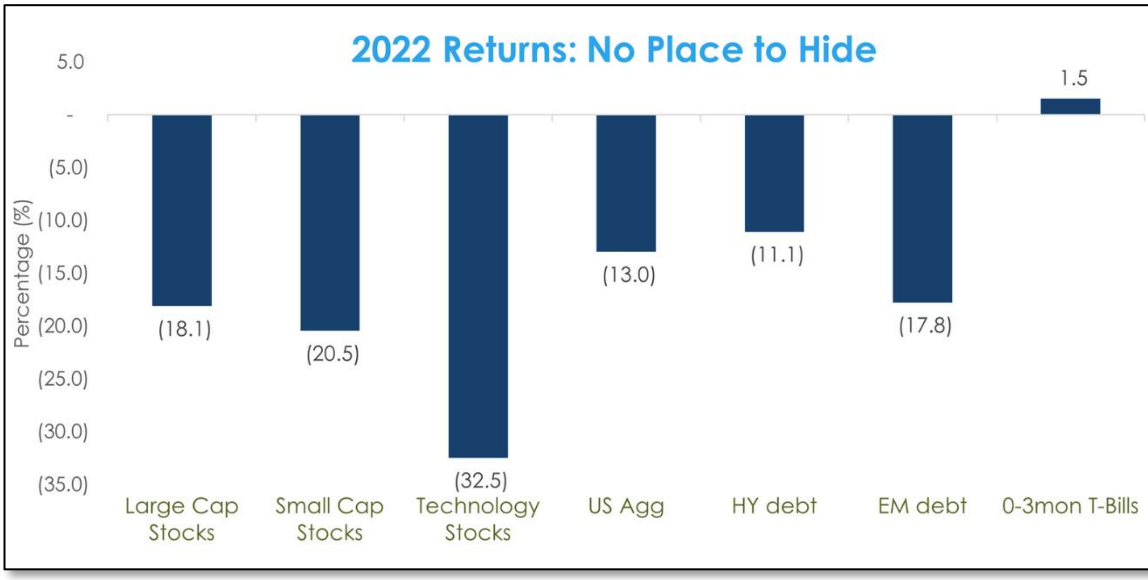
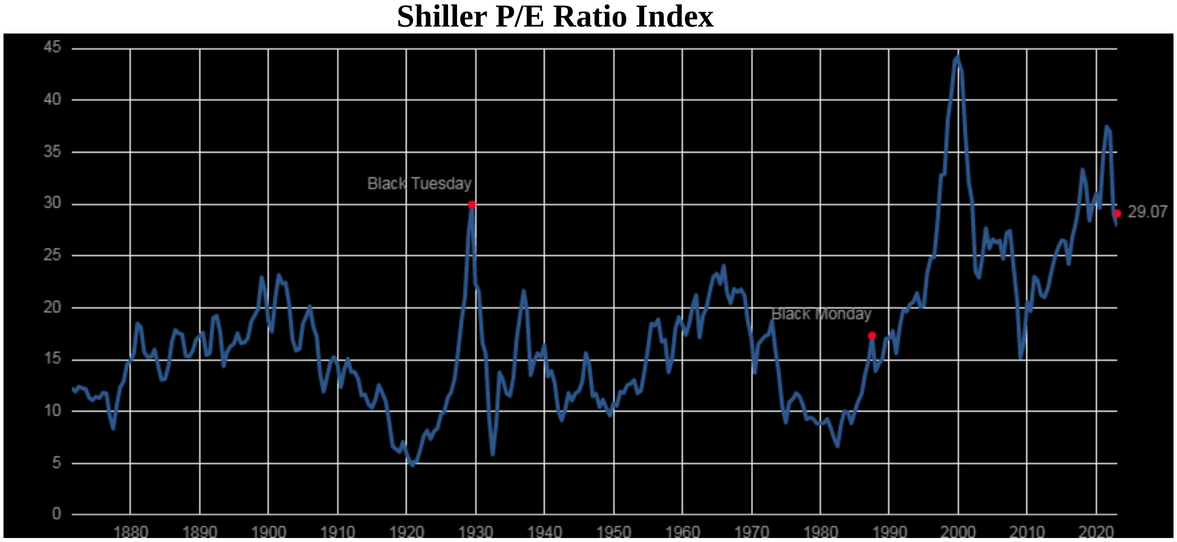
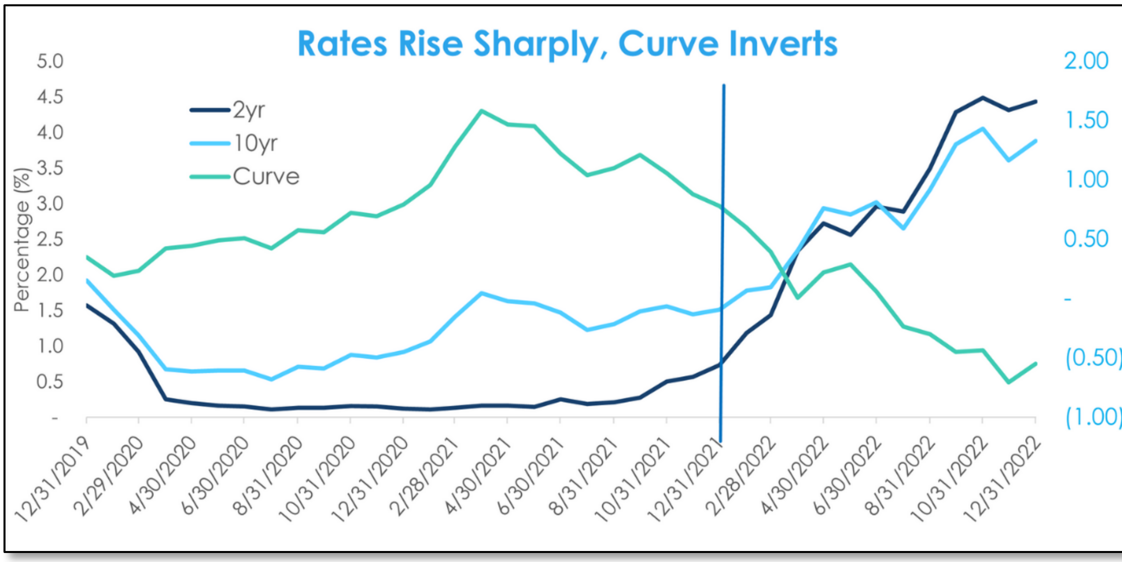


As anticipated, value-oriented equities considerably outperformed growth strategies returning -7.98% compared to -28.97%, respectively. While U.S. equity valuations, as measured by the price-to-earnings index ratio (P/E) have experienced a significant adjustment, but they are still elevated based on historical standards with a current (P/E) of 29.07. The mean and median of P/E ratio index is 17.0 and 15.91, respectively. This simply implies that valuations could be vulnerable to a further draw-down if earnings (E) compress.

Shiller P/E Ratio Index



The path of interest rates during 2022 contributed to the worst fixed income returns on record. The global fixed income benchmark, the Bloomberg Global Aggregate Index, posted a -16.25% return for the year. As we previously indicated, fixed income markets are generally challenged during a rising rate environment. The Fed has been consistent in their policy stance of continuing to raise interest rates in an effort to control inflation. It’s reasonable to expect continued volatility out of financial markets based on the expectation of slowing economic growth, path of interest rates, variants of the virus, and the continuing conflict in Ukraine.



Interest rates have experienced a significant move higher as a byproduct of inflation and Fed policy action. To put this in perspective, year-over-year changes in yields on the 10-year Treasury have gone from 1.52% as of December 30, 2021 to 3.88%. This represents a 236-basis point move, which is historic by typical market moves. Treasury yield levels have recently compressed based on softening inflation data with the 10-year yield currently at 3.46% as of January 12, 2023. As we previously communicated, the yield curve remains inverted when comparing the 2-year and 10-year Treasury yield at 4.16% and 3.46%, respectively (a historical indicator and signal of an upcoming recessionary environment.) When monitoring the implied Fed Fund Futures rate, there is increasingly a probability that the Fed will begin to moderate interest rate hikes from 75 basis points to 25 basis points and be more data dependent going forward. Still, the Fed has indicated it will not stop raising rates until it has stomped out inflation and is willing to sacrifice any and every market to accomplish the objective.

FINANCIAL PLANNING

SECURE Act 2.0

Last month, the Setting Every Community Up for Retirement Enhancement (SECURE) Act 2.0 was passed and while many elements we saw a year and a half ago remain in the final version, there are many differences. The volume of changes is huge. Tucked in the 4,155-page, $1.7 trillion spending bill are plenty of goodies, including another overhaul of the nation's retirement laws. These changes are a big deal. In our view, the SECURE Act 1.0 and 2.0 updates were long overdue. The new rules recognize that Americans are living and working longer.

The SECURE 2.0 Act contains some 90 changes to retirement savings plans which should be reviewed in depth for applicability. We've summarized 9 key takeaways.

9 key takeaways on the SECURE Act 2.0

1. **Changing the age of the required minimum distributions.** Three years ago, SECURE 1.0 increased the age for taking the required minimum distribution, or RMD, to 72 years from 70½. If you turn 72 this year, the age required for taking your RMD rises to 73 with 2.0. If you turned 72 in 2022, you'll remain on the prior schedule.

   If you turn 72 in 2023, you may delay your RMD until 2024, when you turn 73. Or you may push back your first RMD to April 1, 2025. Just be aware that you will be required to take two RMDs in 2025, one no later than April 1, and the second no later than December 31. Starting in 2033, the age for the RMD will rise to 75.

   Employees enrolled in a Roth 401(k) won't be required to take RMDs from their Roth 401(k). That begins in 2024.

2. **RMD penalty relief**. Beginning this year, the penalty for missing an RMD is reduced to 25% from 50%. And 2.0 goes one step further. If the RMD that was missed is taken in a timely manner and the IRA account holder files an updated tax return, the penalty is reduced to 10%. But let's be clear, while the penalty has been reduced, you'll still pay a penalty for missing your RMD.

3. **A shot in the arm for employer-sponsored plans**. Too many Americans do not have access to employer plans or simply don't participate. Starting in 2025, companies that set up new 401(k) or 403(b) plans will be required to automatically enroll employees at a rate between 3% and 10% of their salary.

   The new legislation also allows for automatic portability, which will encourage folks in low-balance plans to transfer their retirement account to a new employer-sponsored account rather than cash out. In order to encourage employees to sign up, employers may offer gift cards or small cash payments. Think of it as a signing bonus. Employees may opt out of the employer-sponsored plan.

4. **Increased catchup provisions**. Beginning in 2025, individuals who are 60 to 63 years old will be able to put a larger sum of their income into their retirement plans, including 401(k), 403(b) plans, SIMPLE IRA and SIMPLE 401(k).

   The Secure 2.0 Act will allow these savers to make catch-up contributions of up to $10,000 annually, or 50% more than the regular catch-up contribution amount in 2025 to their workplace plan in 2025. People who are 50 or older with wages over $145,000 during the previous year wanting to make catch-up contributions will be required to make such contributions to a Roth account in after-tax dollars.

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5. **Charitable contributions**. Starting in 2023, 2.0 allows a one-time, $50,000 distribution to charities through charitable gift annuities, charitable remainder unitrusts, and charitable remainder annuity trusts. One must be 70-½ or older to take advantage of this provision. The $50,000 limit counts toward the year's RMD.

   It also indexes an annual IRA charitable distribution limit of $100,000, known as a qualified charitable distribution, or QCD**,** beginning in 2023.

6. **Back-door student loan relief**. Starting next year, employers are allowed to match student loan payments made by their employees. The employer's match must be directed into a retirement account, but it is an added incentive to sock away funds for retirement.

7. **Disaster relief.** You may withdraw up to $22,000 penalty-free from an IRA or an employer-sponsored plan for federally declared disasters. Withdrawals can be repaid to the retirement account.

8. **Help for survivors.** Victims of abuse may need funds for various reasons, including cash to extricate themselves from a difficult situation. 2.0 allows a victim of domestic violence to withdraw the lesser of 50% of an account or $10,000 penalty-free.

9. **Rollover of 529 plans.** Starting in 2024 and subject to annual Roth contribution limits, assets in a 529 plan can be rolled into a Roth IRA, with a maximum lifetime limit of $35,000. The rollover must be in the name of the plan's beneficiary. The 529 plan must be at least 15 years old.

   In the past, families may have hesitated in fully funding 529s amid fears the plan could wind up being overfunded and withdrawals would be subject to a penalty. Though there is a $35,000 cap, the provision helps alleviate some of these concerns.

For a more detailed review **here is a section-by-section summary.**

Financial Plans

With this New Year, we've added an additional layer of analytics to our financial planning platform. Those clients who are full service with a financial planning relationship can rest easier knowing the recent round of upgrades gives us more analytical tools to help further monitor probability of plan success, client opportunities and other standards. We have an upgraded dashboard view of all of our planning client's key metrics and trends in order to further track plan success. If you are currently a financial planning client we will, during the course of this year, be reaching out to you to help us update your financial data so we can make the best use of these upgrades.

If you’re not a financial planning client and are interested in knowing more, drop an email to bryan@stjohnfinancial.com and we can start a conversation to get your questions answered.

PORTFOLIO MANAGEMENT

In our Fourth Quarter 2021 commentary, we warned of the overvalued nature of stocks, so we were not surprised by the performance. Stocks at the end of 2021 were more overvalued than they had ever been. Even today, domestic stocks are in the most expensive decile if you compare price to sales ratios going back over 120 years. In fact, if you eliminate the bottom half of the years when price-to-sales were very inexpensive and only compare the top half of price to sales ratios over the last 120 years, the price to sales ratios of the S&P 500 today are still in the most expensive decile.

It is fascinating to look at returns at the end of long bull market runs. Over the three years ending December 31, 2021, the S&P 500 doubled in value while the dividend strategy in most of our portfolios was up slightly over 60%. After last year, this dividend strategy and the S&P 500 are even for the preceding four years, a great reminder of what a core equity strategy should do. High highs and low lows are not the goal of our portfolio strategies. Consistency is the goal! Achieving client investment needs is the goal!

As a Firm, we are continuing to actively monitor the investment landscape in an effort to maximize and optimize the returns of our client’s portfolios over various market cycles. Even during times of market distress, it’s critically important to remain disciplined and invested in order to allow the assets to participate in market recovery from a portfolio optimization perspective.

We highlighted this during 2022, but it is reasonable to believe that we may be entering a challenging market regime marked by lower returns across risk assets. As a result, we are continuing to enhance our portfolio models by conducting due diligence, underwriting, and adding strategies that we believe will be instrumental in delivering returns that are diversifying and uncorrelated to broader financial markets in support of your objectives.

Expectations for returns of the broader US stock market over the next 10 years are estimated between 2% and 5% and bonds near 0%. The international stock market should be slightly higher with the weakening of the dollar. While still challenging, we believe we can deliver a higher return as we expect dividend-paying stocks to continue to lead the market while delivering cash from those dividends.

As we weave in other types of investments with the dividend stocks, we hope to capitalize on opportunities of higher interest rates with credit solutions and use volatility to our advantage through liquid alternatives.

We have a few thoughts about the portfolio investments and others about how to keep your sanity in markets like we are about to witness.

1. Do not believe buying bonds during a time of rising rates and rising yields will protect from losses. Until rates peak, there will be more volatility in the bond market than the investor will be paid for taking that risk.

2. Be confident in getting growing income from dividend strategies. Our managers have a goal of finding companies that organically grow dividends through profitability. The dividends distributed are expected to remain stable, creating a stable source of cash flow.

3. Substitute the traditional diversification from bonds to our liquid alternatives. These portfolios have returns with a high correlation to the bond market and similar volatility to bonds, but had returns significantly better than bonds last year which lost over 13%. These portfolios protect your principal, unlike bonds in the recent past and looking forward.

4. Be patient as markets work out the excesses in the system. At the end of 1972, stocks were dramatically overpriced, as they are today, and it took over ten years to work out the excesses. We have no idea if this time the workout will take ten years, but it is likely markets will be working out excesses for some time to come.

5. Do not believe the market rallies indicate the bear market is over. During bear markets it is common for rallies to fool people into believing the worst is over. Be prepared. We will know it is over looking backwards, not forward. Following an 80% rally, in 1938, the President and the Fed Chair declared the Depression was over and good times were upon us. The stock market fell over 30% and the Fed had to raise rates again.

6. Private investments may help diversification. If appropriate, private investments that will tie up the investment for a period of time, a 2-year note or a 4-year portfolio may benefit the portfolio by delivering higher stable returns to complement your liquid holdings.

7. Stay open for new ideas. Markets like the one we are in present unusually low-priced opportunities, and we need to be vigilant but patient and are constantly talking to clients about new ideas. We never know when they will arise, we just want clients to be open to all new ideas.

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.

As we previously communicated, 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 and we look forward to the continued success.

Based on modeling, we believe combining high and growing dividend yielding strategies with active management and alternative assets will create a culmination of positively contributing and optimized portfolio performance. 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 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.

	4th Qtr. 2022	**1 Year Average**	**5 Year Average Return**	**10 Year Average**
S&P 500 Growth	1.45	-29.41	10.28	13.59
S&P 500 Value	13.59	-5.22	7.58	10.86
S&P Midcap 400 Growth	8.75	-18.96	6.02	10.39
S&P Midcap 400 Value	12.75	-6.93	6.98	10.84
S&P SmallCap 600 Growth	6.98	-21.08	6.11	11.13
S&P SmallCap 600 Value	11.18	-11.04	5.38	10.33
DJIA	16.01	-6.86	8.38	12.30
S&P 500	7.56	-18.11	9.42	12.56
S&P 500 Equal Weighted	11.64	-11.45	9.11	12.40
S&P Mid-Cap 400	10.78	-13.06	6.71	10.78
S&P Small Cap 600	9.19	-16.10	5.88	10.82
Russell 1000	7.24	-19.13	9.13	12.37
Russell 2000	6.23	-20.44	4.13	9.01
Russell 3000	7.18	-19.21	8.79	12.13
MSCI EAFE	17.34	-14.45	1.54	4.67
MSCI EAFE Large Growth	15.21	-21.57	3.63	5.91
MSCI EAFE Large Value	19.99	-3.71	0.47	3.32
MSCI Emerging Mkt	9.70	-20.09	-1.40	1.44
MSCI World	9.77	18.14	6.14	8.85
MSCI US IMI Gold	14.47	-17.66	7.57	1.42
DJ Real Estate	4.44	-25.17	4.04	6.65
Bloomberg Commodities	2.22	16.09	6.44	-1.28
Bloomberg Agg US Bond	1.87	-13.01	0.02	1.06
Bloomberg Agg US Interim	1.72	-9.51	0.31	1.00
Fidelity Money Market	0.59	1.20	1.06	0.66