PORTFOLIO REVIEW

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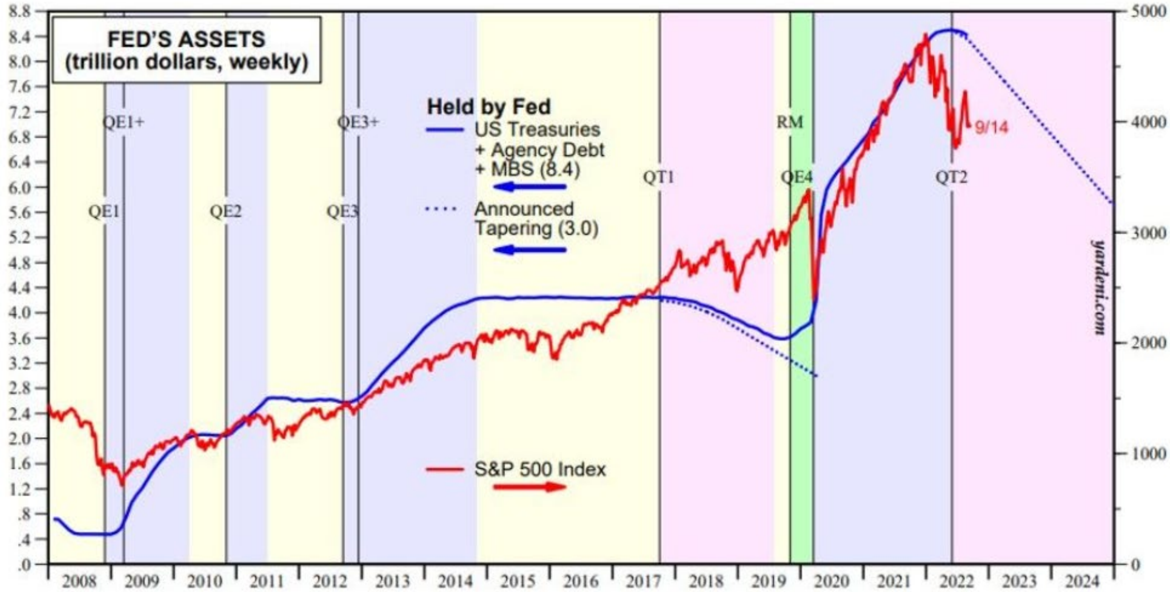
In our Q2 Portfolio Review, we discussed how even though markets had already declined significantly for the year, more pain for risk assets likely remained ahead. Seems we were at the time a minority viewpoint as markets promptly rallied in July. Nonetheless, we stayed the course with our de-risked portfolios. Markets subsequently turned down again, especially during September. For the year through September, global stocks are now down -25%.

As readers are aware, my concern has been unexpected inflation driven by the Fed being far behind in raising rates and reversing their massive quantitative easing program. The Fed has however finally grasped their error in allowing inflation to take hold. Over the past few months, the Fed has shifted focus, with Chairman Powell stating that bringing down inflation is their top priority. He has further stated that "some pain" will result and they are quite willing to "risk a recession." That is to say the Fed has now embarked on a rapid reversal of the excess liquidity in the system. Their efforts will eventually tame inflation, but will also slow the economy, perhaps more so than expected, leading to a recession in both the global economy and corporate profitability. The Fed also risks "breaking" something along the way (like a negative liquidity event). As we've said before, the Fed feels that it must now, after being behind for so long, play catch up and raise rates rapidly to bring inflation under control.

My concern now is that the Fed may be making another mistake. After easing far too much for too long, the Fed may now be reversing course too rapidly by tightening too much too quickly. That is, they went too far in one direction and are now perhaps compounding their mistake by going too far in the opposite direction. Figure 1 helps paint the picture.

Figure 1: Is the Fed Now Tightening too Fast?



Source: Yardeni.com, https://www.yardeniquicktakes.com/two-spooky-charts/

The solid blue line shows the Fed's quantitative easing path following the global pandemic, while the dotted blue line shows their projected tapering path. Notice how closely the Fed easing/tightening paths are traced by the S&P 500 index. As the old market adage goes, "don't fight the Fed." Stocks are clearly anticipating the continued Fed tightening and the negative result on the economy and corporate profits.

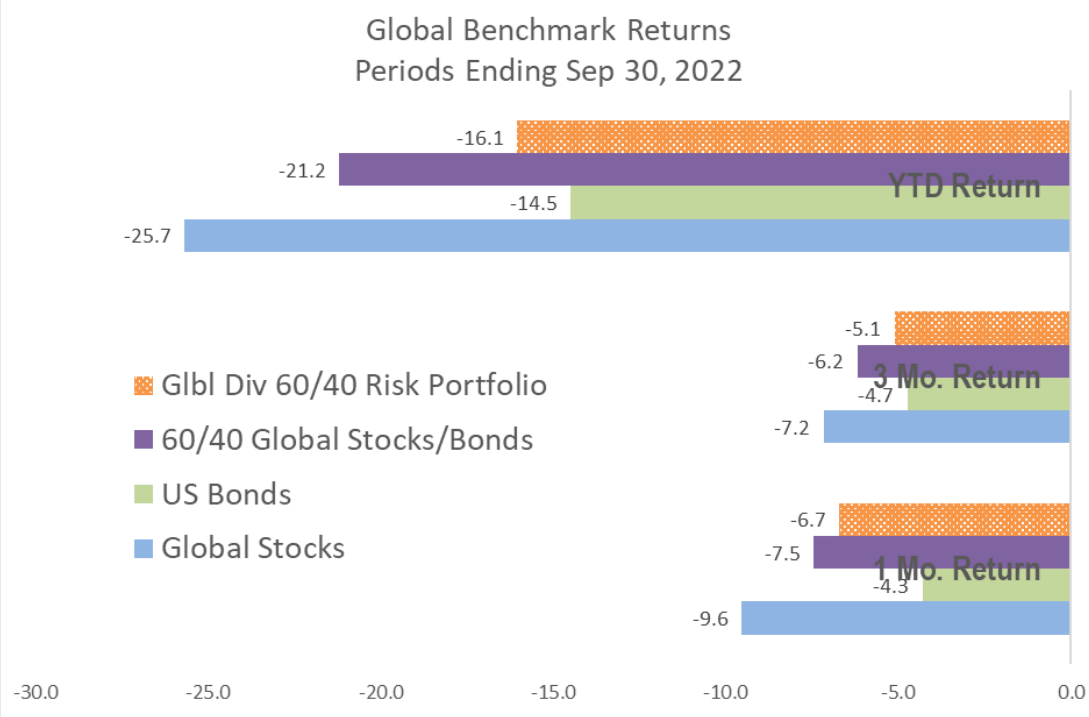
By continuing along their current projected tightening path, the Fed risks a greater than anticipated downturn in both the market and economy. With both the economy and markets already rolling over, the Fed should in my view now take its foot off the brakes a bit and allow the economy to slow more gradually. They should accept the fact that inflation is here and it will take some time to bring it down. Trying to force it down too quickly creates unnecessary downside risks to the economy and markets. I will not attempt here to discuss all the potential issues, but consider that housing is already slowing rather dramatically driven by much higher mortgage rates, hitting 7% this past week! We noted in our last report that consumer spending and business investment are slowing as well.

Though the Fed could very well change their plans, Figure 1 is where the Fed seems to be heading at the moment. We'll continue to monitor all this as this continues to unfold.

VESTEER PORTFOLIOS

To state the obvious, this year continues to be uniquely challenging for investors. As readers are aware, during 2022, we've positioned portfolios more defensively by tilting towards lower risk, higher quality stocks, while also shortening our bond duration to protect against rising rates. As Figure 2 shows, total returns are negative for both stocks and bonds for all 2022 periods (Sept, Q3, and YTD). In fact, all of the major global asset classes, with the one exception being commodities, report negative year-to-date returns with the most-risky asset classes being down the most.

Figure 2: Global Benchmark Returns



Source: Vesteer Wealth Mgt analysis using data from Morningstar. Returns beyond one year annualized.

The portfolios shown are hypothetical portfolios and do not necessarily represent any actual Vesteer portfolio or strategy. The results are hypothetical and are not an indicator of future results and do not represent returns that any investor might actually achieve. Indexes are unmanaged, do not reflect management or trading fees, and one cannot invest directly in an index. Purchases are subject to suitability. This requires a review of an investor's objective, risk tolerance, and time horizons. Investing always involves risk, whenever you invest you are at risk of loss of principal as the market fluctuates. Past performance is not indicative of future results.

In terms of Vesteer portfolios, while also in negative territory through the first nine months of the year, we have held up relatively well versus our usual market benchmark portfolio. The Global Diversified 60/40 Risk Portfolio series shown in orange, while not exactly the same, most closely represents the Vesteer portfolio approach. This global diversified portfolio is down -16% YTD versus -21% for the benchmark 60/40 global stock/bond portfolio. Thus, our global diversified portfolio has outperformed the representative global benchmark by +5% YTD (absent of any fees and expenses). While we are pleased with the relative outperformance of our diversified portfolio strategy, we fully appreciate that this has been a difficult environment in which to preserve wealth and that negative absolute performance is still painful.

Actual Vesteer client portfolios have performed similar to our global diversified benchmark besting respective benchmarks by about 4.0% YTD after subtracting advisory fees and fund expenses. On an absolute return basis, Vesteer client portfolios (net of fees and expenses) have declined YTD between -15.8% and -18.0% depending on the chosen risk profile.

During my career, I've seen many market downturns, a reality of investing too often forgotten by our industry, especially following a long bull run. The volatile reality of markets leads Vesteer's strategic client portfolio profiles (how much risk each client takes in total) to be more conservative versus our peers. Risk varies of course from client to client depending on circumstances, but in general this has been our experience. We hope that our overall approach better enables our clients to stick with their chosen portfolio mix when times get tough while also hopefully allowing the portfolio to grow when times are good.

In other words, we hope that our clients will stick with their Vesteer strategies through these tough times.[1] Success over the long haul requires one to be invested through the good times and the bad. We take seriously our responsibility to help our clients grow and preserve their wealth over the long term and continuously seek opportunities to improve our portfolios. For now, we are maintaining our defensive posture in the face of continued economic uncertainty. Our view is that eventually we will hit a bottom (hopefully this year!) and things will then finally begin to improve. In the meantime, our approach will hopefully continue to provide some downside protection until markets eventually turn in the other direction.

As always, thank you for your trust.

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[1] Research shows that as a group, investors tend to underperform the market over the long-term due to their buying after the market has gone up and selling after it has gone down. The result of the poor "market timing" behavior, investors underperform the market by a whopping 3.7% per year over the long term.

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