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MARKET REVIEW

1st QUARTER 2022

EXECUTIVE SUMMARY

- All equity and fixed income asset classes were negative for the quarter.
- Alternatives generally provided a positive earnings boost.
- Annual inflation ending February 2022 was 7.9%, led by increased energy prices.
- Federal Reserve increased rates by 0.25% and is expected to make six additional 0.25% increases in 2022.

Quarterly Market Review

1st Quarter 2022

HFG | TRUST

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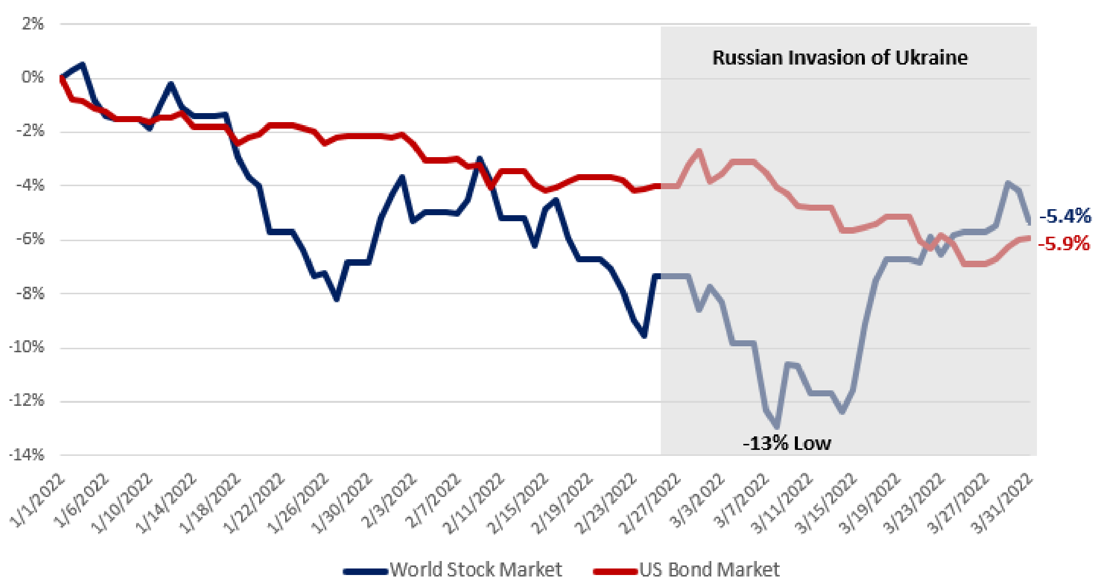
"The stock market is designed to transfer money from the active to the patient" – Warren Buffett

The beginning of 2022 had no shortage of new events to start the year as the impact of COVID-19 on the economy is finally beginning to fade. COVID headlines have been replaced by concerns surrounding the Russian invasion of Ukraine, increased inflation, and the hawkish stance taken by the Federal Reserve. We have all felt the increase of prices across the board, from purchasing food to filling up our vehicles. However, with that said, the economy continues to experience strong demand and gains in overall economic productivity.

The first quarter of the year ended modestly negative in fixed income and the stock market. The stock market experienced a low of -13% in the first week of March and ended the quarter -5.4%. The overall bond market trended down for the quarter due to bond rates increasing, which in turn pushed the overall value of bonds negative.



- Overview:
  - Q1 in Review
  - Portfolio Update
  - Economic Update
  - Is It Time to Sell?
  - World Stock Market Performance
  - Global Valuations
  - Quarterly Asset Class Market Summary
  - Long-Term Market Summary
  - World Asset Classes

Quarterly Market Review

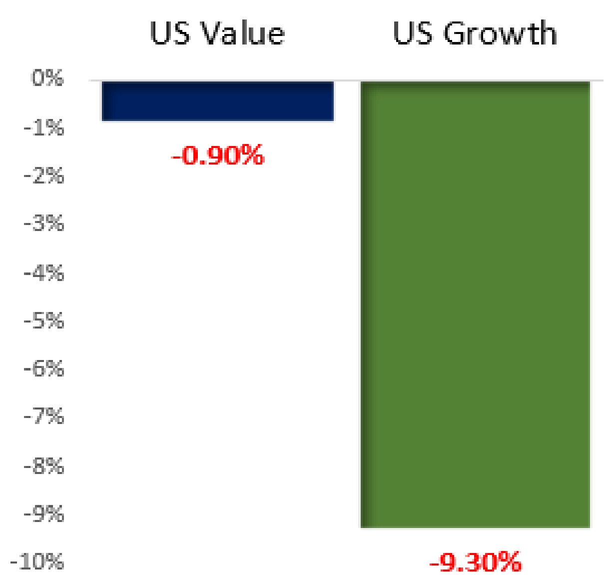
1st Quarter 2022

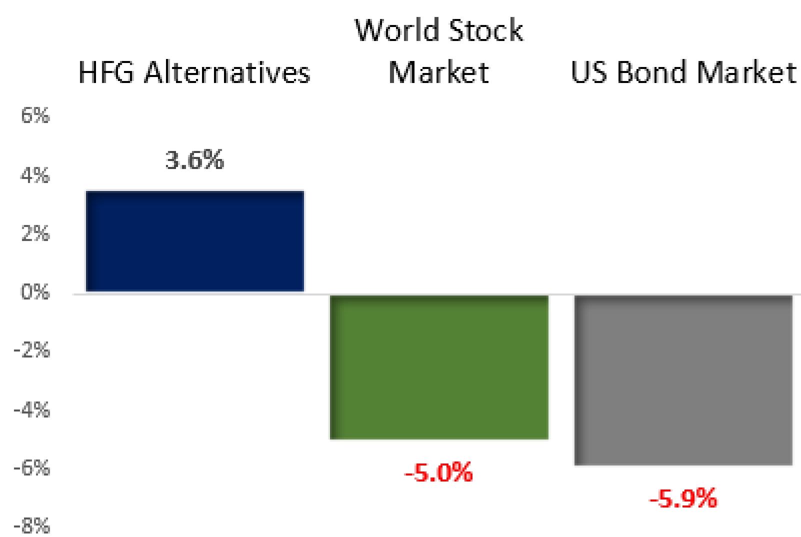
Portfolio Update:

Equities: In the first quarter of 2022, the stock market experienced a fair amount of volatility with a low of -13% and finishing the quarter down -5.4%. The heavier tilt an investor had towards "value" stocks, the less decline he or she experienced. This makes sense after years of excessive multiple expansion for "growth" companies, as they had more room to fall. For example, at the end of 12/31/2021, growth companies had an average Price-to-Earnings (P/E) of 33x, compared to value companies at 18x, or 45% less than growth companies. To say it another way, investors were paying 33 years of earnings today for a company, compared to value-focused investors paying 18 years of earnings.

Bonds: Fixed income portfolios generally provided negative returns for the quarter due to increased rates; the longer the average maturity of the bond, the larger loss experienced. The average maturity of a bond in the US is 9 years, which resulted in an average loss of -5.9%. HFG fixed income portfolios have a shorter-term tilt compared to the market, which has been favorable for clients. In addition to being shorter term, we continue to incorporate a fund with inflation protection, which provided an additional 3% boost compared to a similar fund without inflation protection.

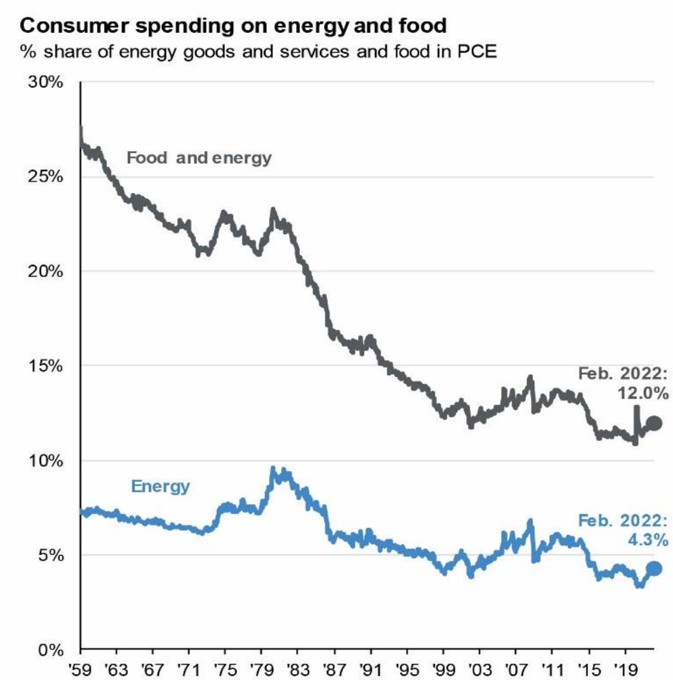
Alternatives: Alternative investments have provided strong returns that are uncorrelated to traditional markets. We've been methodical in our evaluation of incorporating alternatives into client portfolios; there are many "too good to be true" investments out there. Overall, we've have been very pleased with the incorporation of private real estate, reinsurance, and private lending on a client-by-client basis.



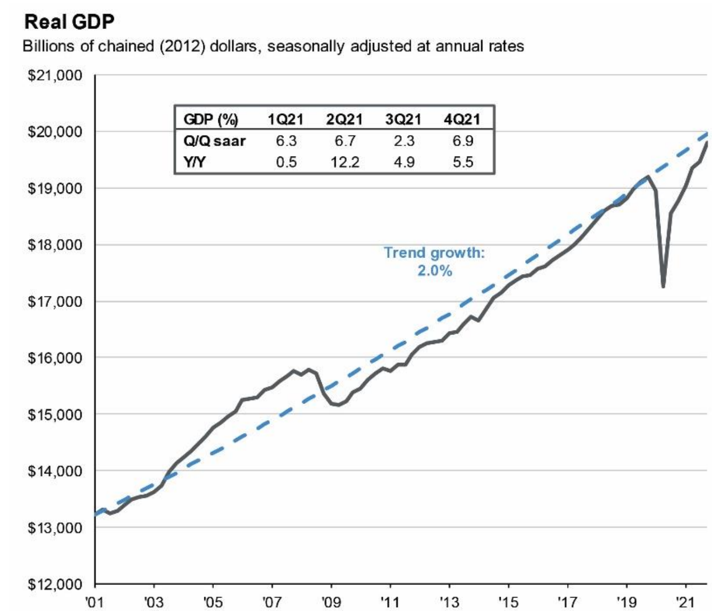


Economic

The largest disruption this year has been in energy markets due to Russia's large role in the energy sector. Higher energy prices may slow the European economy. However, it should have a smaller impact on the US economy due to strong domestic production and the fact energy consumption is a relatively small portion of consumer spending. Since the 1950s, the percentage of consumer spending on food and energy has dramatically dropped. Today, energy makes up slightly over 4% of consumer spending. A favorable difference between the energy price surge of the 1970s and now, is that in the 1970s, the US received a majority of its oil from overseas. This meant foreign companies and governments profited from the price surge. Alternatively, since the US is relatively self-sufficient in terms of energy, these higher prices, and ultimately profits, will stay within the US.



Source: BEA, J.P. Morgan Asset Management. *Guide to the Markets – U.S.* Data are as of March 31, 2022.



Source: BEA, FactSet, J.P. Morgan Asset Management. Values may not sum to 100% due to rounding. Trend growth is measured as the average annual growth rate from business cycle peak 1Q01 to business cycle peak 4Q19. *Guide to the Markets – U.S.* Data are as of March 31, 2022

Unemployment has continued to recover in Quarter 1, with the unemployment rate at 3.8%, compared to 6.8% a year earlier. As you walk around town, there appear to be "help wanted" signs at every corner. This can be seen in the data, with 5 million more job openings than unemployed workers.

As mentioned in previous commentaries, earnings have recovered exceptionally well. GDP now exceeds pre-COVID levels by over 3%. A large portion of this strong rebound has been due to productivity gains these last two years. The output per worker in the last two years has had an annual increase of 2.7%, compared to the 1.2% per year average for the first two decades of this century. Company profits are expected to persist, but most likely at a slower rate in 2022 due to increased wages, and higher interest rates.

Is It Time to Sell Stocks?

1st Quarter 2022

After touching record highs in early January, US stocks[1] have slumped, and investors have been confronted with worrisome headlines[2] in the financial press:

"Inflation Hits Fastest Clip Since '82"
—Gwynn Guilford, *Wall Street Journal*, January 13, 2022

"Economists Cut Back Growth Forecasts as Threats Pile Up"
—Harriett Torry and Anthony DeBarros, *Wall Street Journal*, January 18, 2022

"Giant Stock Swings Send Some Into Bear Territory"
—Gunjan Banerji and Peter Santilli, *Wall Street Journal*, January 18, 2022

"Markets Drop as Turbulent Trading Persists"
—Gunjan Banerji and Will Horner, *Wall Street Journal*, January 26, 2022

"Fed Set to Start Increasing Rates by Mid-March"
—Nick Timiraos, *Wall Street Journal*, January 27, 2022

Some stocks that attracted intense interest last year have fallen sharply from their previous highs, as **Exhibit 1** shows.[3]

Is rising inflation a negative for equity investors? Do large losses in a handful of popular stocks signal a downturn ahead for the broad market?

Invariably, the question behind the question is, "Should I be doing something different in my portfolio?" This is just another version of the market timing question dressed in different clothes. Should I sell stocks and wait for a more favorable outlook to buy them back? More precisely, can we find clear trading rules that will tell us when to buy or hold stocks, when to sell, when to admit our mistakes, and so on?

EXHIBIT 1

Stock Slump

Name	Ticker	Return through 12/31	Return through 1/31
Robinhood Markets Inc. Class A	HOOD	-79.1%	-83.4%
AMC Entertainment Holdings Inc. Class A	AMC	-62.5%	-77.9%
GameStop Corp. Class A	GME	-69.3%	-77.4%
Tesla Inc.	TSLA	-15.0%	-24.7%

Past performance is no guarantee of future results. Performance may increase or decrease as a result of currency fluctuations.

Source: Bloomberg.

Named securities may be held in accounts managed by Dimensional. This information should not be considered a recommendation to buy or sell a particular security.

The lure of successful trading strategies is seductive. If only we could find them, our portfolios would do so much better.

Consider Felicity Foresight. She is gifted with the ability to identify patterns in the champagne bubbles floating to the top of her glass on New Year's Eve, enabling her to predict the best performer between S&P 500 stocks and US Treasury bills over the subsequent 12 months. How would her hypothetical portfolio have performed over the past 50 years following this simple annual readjustment strategy?

1. As of January 31, the S&P 500 was down 5.17% for the year.
2. Headlines are sourced from publicly available news outlets and are provided for context, not to explain the market's behavior.
3. While these stocks were selected based on newsworthiness and the high level of attention they received in the media in 2021, their returns may not be reflective of all high-profile stocks over the period.

Is It Time to Sell Stocks?

(Continued…)

Rather well. Following a Perfect Timing strategy by investing in the best performer each year, she turned $1,000 into $1.8 million, nearly 10 times the wealth produced using a buy-and-hold strategy for the S&P 500 Index (see **Exhibit 2**).

EXHIBIT 2

Past Perfect?

Growth of $1,000, January 1972–December 2021	
Perfect Timing Strategy	$1,811,565
S&P 500 Index	$197,063
One-Month US Treasury Bills	$8,727
Perfectly Awful Timing Strategy	$949

Past performance is no guarantee of future results. Performance may increase or decrease as a result of currency fluctuations.

Source: One-Month US Treasury Bills is the IA SBBI US 30 Day TBill TR USD. S&P data © 2022 S&P Dow Jones Indices LLC, a division of S&P Global. All rights reserved. Treasury bills data provided by Ibbotson Associates via Morningstar Direct.

In USD. Data presented in the Growth of $1,000 exhibit is for illustrative purposes only and is not indicative of any investment. The examples assume that the hypothetical portfolio fully divested its holdings of stocks (or bonds) at the end of the last trading day of any year when a switch was indicated, held the other asset for the subsequent year, and performed the exercise again at year's end. The examples are hypothetical and assume reinvestment of income and no transaction costs or taxes. There is no guarantee strategies will be successful. Indices are not available for direct investment. Their performance does not reflect the expenses associated with the management of an actual portfolio.

But also consider Hapless Harry. He was never a fan of New Year's and manages to get it wrong each and every year. His Perfectly Awful strategy winds up losing money over the same 50-year period.

Motivated by the substantial payoff associated with successful timing, researchers over the years have examined a wide range of strategies based on analysis of earnings, dividends, interest rates, economic growth, investor sentiment, stock price patterns, and so on.

One colorful example, known as the Hindenburg Omen, had a brief moment of fame in 2010. Developed by a blind mathematician and former physics teacher, this stock market indicator took its name from the German airship disaster of 1937. The Omen signaled a decline only when multiple measures of 52-week high/low prices and moving averages all turned negative. This indicator had correctly foreshadowed major downturns in 1987 and 2008. When it flashed a "sell" signal on Thursday, August 12, 2010, internet chat rooms and Wall Street trading desks were buzzing the next day, Friday the 13th, with talk of a looming crash, according to the *Wall Street Journal*.[4] But no crash occurred, and the S&P 500 had its highest September return since 1939.[5]

The money management industry is highly competitive, with more stock mutual funds and ETFs available in the US than listed stocks.[6] If someone could develop a profitable timing strategy, we would expect to see some funds employing it with successful results. But a recent Morningstar report suggests investors should be wary of those claiming to do so. The report examined the results of two types of funds[7], each holding a mix of stocks and bonds:

- **Balanced**: Minimal change in allocation to stocks
- **Tactical Asset Allocation**: Periodic shifts in allocation to stocks

4. Steven Russolillo and Tomi Kilgore, " 'Hindenburg Omen' Flashes," Wall Street Journal, August 14, 2010.
5. Weston Wellington, "Hindenburg Omen Flames Out," Down to the Wire (blog), Dimensional Fund Advisors, October 8, 2010.
6. The Russell 3000 Index contains the stocks of 3,000 US companies and represented about 97% of the investable US equity market as of Dec. 31, 2021. According to the Investment Company Institute, there were 2,997 domestic equity funds and 1,032 US equity exchange-traded funds at the end of 2020.
7. Morningstar described the risk profile of the Tactical Asset allocation as generally in line with that of Morningstar's 50%–70% equity category. The narrower "balanced" category used here was a subset of Morningstar's 50%–70% category that has a fairly static mix of about 60% stocks and 40% bonds.

Is It Time to Sell Stocks?

(Continued...)

As a group, funds that sought to enhance results by opportunistically shifting assets between stocks and fixed income underperformed funds that simply held a relatively static mix (see Exhibit 3). Morningstar further pointed out that if the performance of non-surviving tactical funds were included the numbers would be even worse. Its conclusion: "The failure of tactical asset allocation funds suggests investors should not only stay away from funds that follow tactical strategies, but they should also avoid making short-term shifts between asset classes in their own portfolios."[8]

EXHIBIT 3

Scare Tactics

% Annualized Return through August 31, 2021	3 Year	5 Year	10 Year
Tactical Asset Allocation	8.36	8.38	6.18
Balanced	10.49	9.89	8.93
Tactical Underperformance	-2.13	-1.51	-2.75

Past performance, including hypothetical performance, is no guarantee of future results. Performance may increase or decrease as a result of currency fluctuations.

Source Morningstar. Morningstar defines Tactical Allocation portfolios as those that "seek to provide capital appreciation and income by actively shifting allocations across investments. These portfolios have material shifts across equity regions and bond sectors on a frequent basis. To qualify for the tactical allocation category, the fund must have minimum exposures of 10% in bonds and 20% in equity. Next, the fund must historically demonstrate material shifts in sector or regional allocations either through a gradual shift over three years or through a series of material shifts on a quarterly basis. Within a three-year period, typically the average quarterly changes between equity regions and bond sectors exceeds 15% or the difference between the maximum and minimum exposure to a single equity region or bond sector exceeds 50%."non-surviving tactical funds were included, the numbers would be even worse. Its conclusion: "The failure of tactical asset allocation funds suggests investors should not only stay away from funds that follow tactical strategies, but they should also avoid making short-term shifts between asset classes in their own portfolios."[8]

We should not be surprised by these results. Successful timing requires two correct decisions: when to pare back the allocation to stocks and when to increase it again. Watching a portfolio shrink in value during a market downturn can be discomforting. But investors seeking to avoid the pain by temporarily shifting away from their long-term strategy may wind up trading one source of anguish for another. The initial upsurge in prices from their lows often takes many investors by surprise, and they find it extraordinarily difficult to buy stocks that were available at sharply lower prices a few weeks earlier. The opportunity cost can be substantial: Over the 25-year period ending in 2021, a hypothetical $100,000 invested in the stocks that make up the Russell 3000 Index would have grown to $1,036,694.[9] But during this quarter-century, missing just the best consecutive 90-trading-day period (which ended June 22, 2020) shaved the ending wealth figure by an alarming 33%.[10]

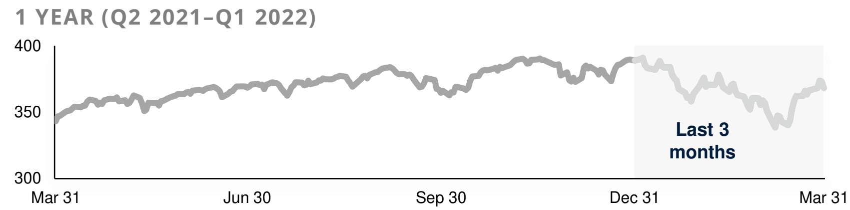
Add to this the likelihood of increased transaction costs and the potential tax consequences of a short-term trading strategy, and the odds of adding value through market timing grow even slimmer.

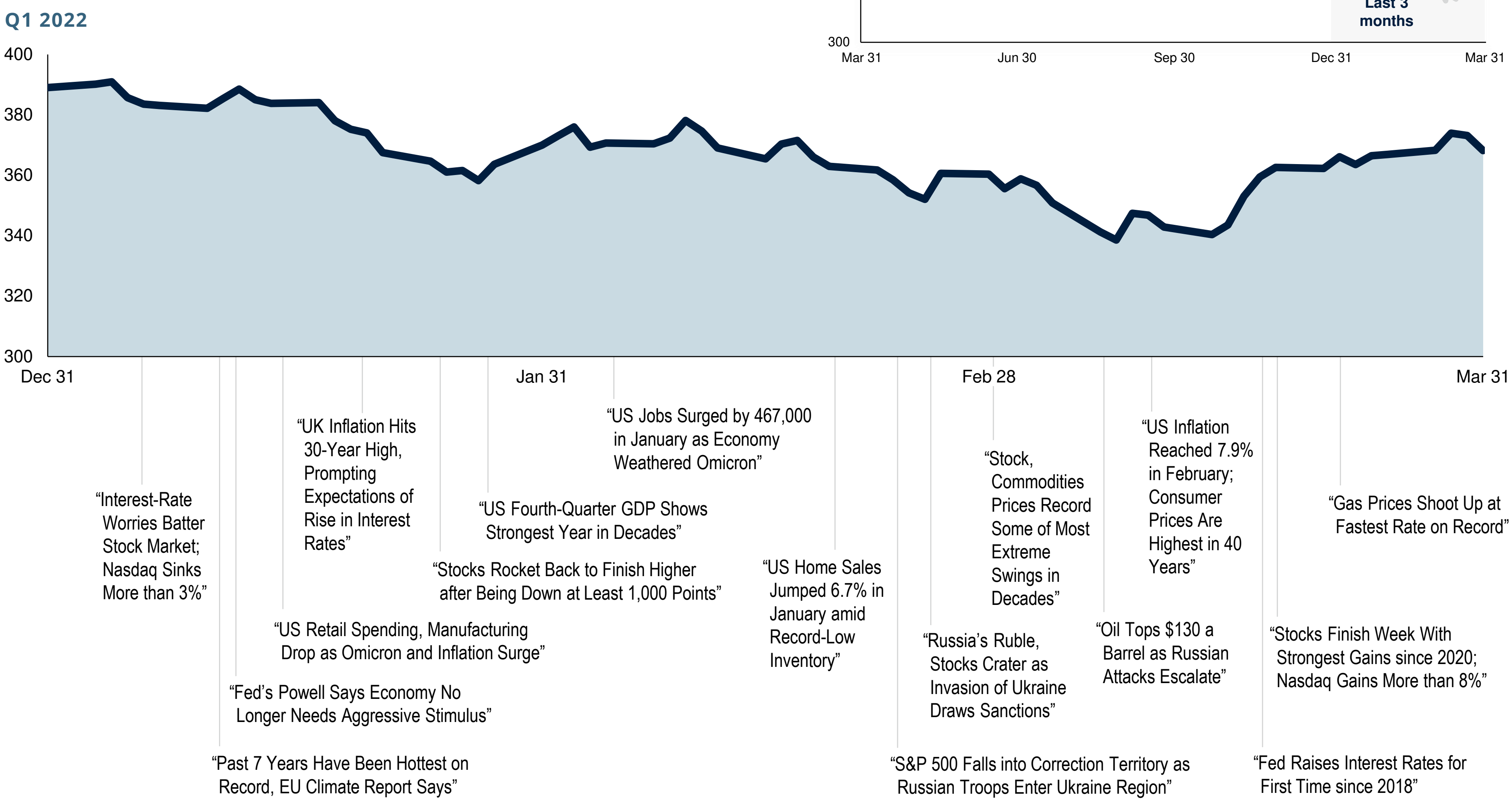
As a thoughtful financial advisor once observed, "A portfolio is like a bar of soap. The more you handle it, the less you have."

8. Amy C. Arnott, "Tactical Asset Allocation: Don't Try This at Home," Morningstar, September 20, 2021.
9. Data presented in the Growth of $100,000 example is hypothetical and assumes reinvestment of income and no transaction costs or taxes. The exhibit is presented for illustrative purposes only and is not indicative of any investment.
10. Frank Russell Company is the source and owner of the trademarks, service marks, and copyrights related to the Russell Indexes. The example of an investor missing the best consecutive 90 trading days assumes that the hypothetical portfolio fully divested its holdings at the end of the day before the 90-day period began, held cash for the period, then reinvested the entire portfolio in the Russell 3000 Index at the end of the period.

World Stock Market Performance

MSCI All Country World Index with selected headlines from Q1 2022



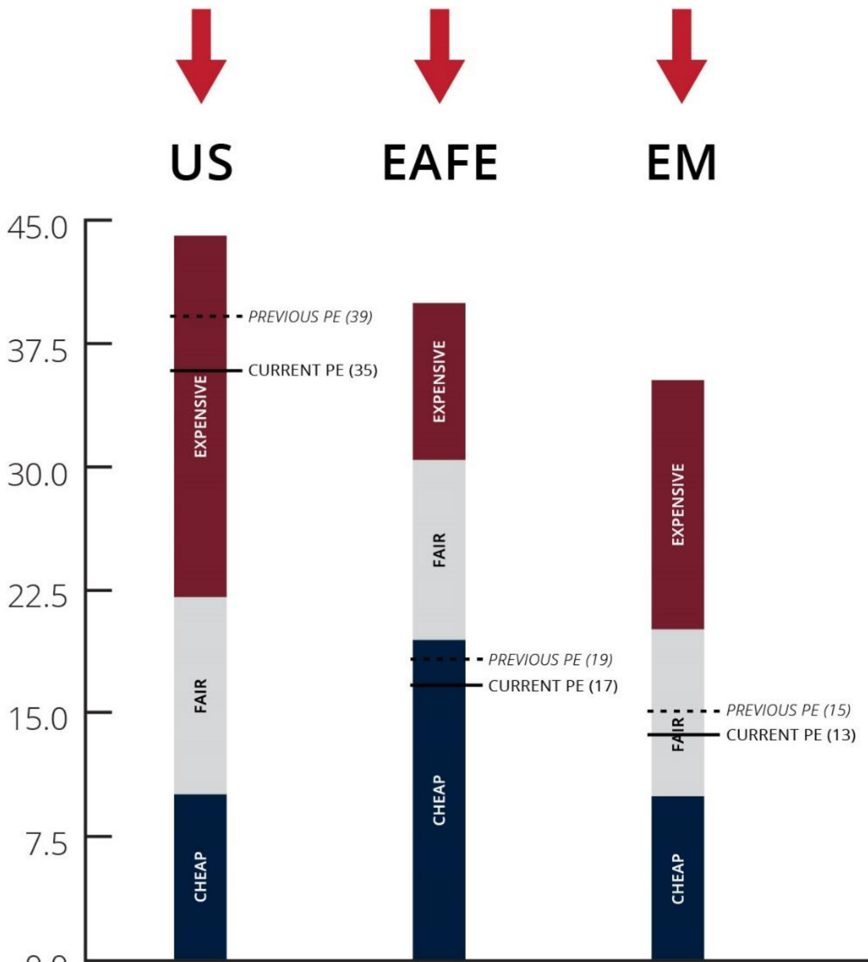


These headlines are not offered to explain market returns. Instead, they serve as a reminder that investors should view daily events from a long-term perspective and avoid making investment decisions based solely on the news.

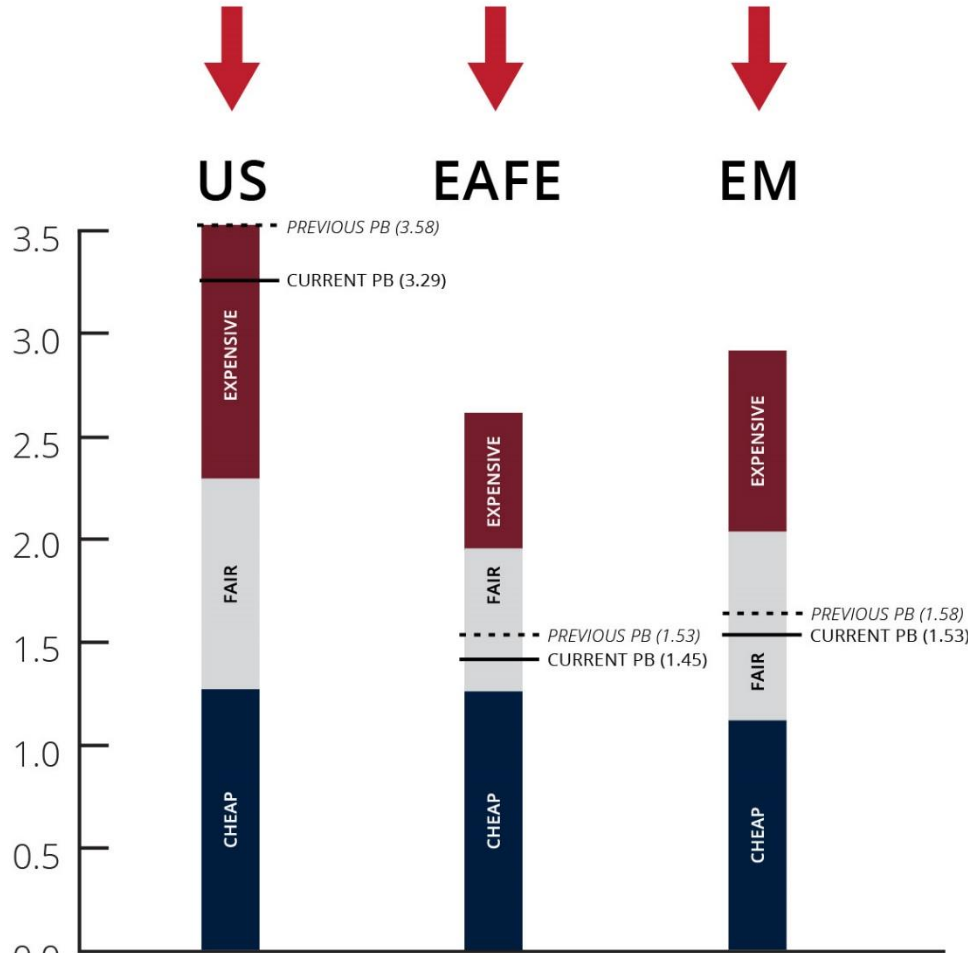
Graph Source: MSCI ACWI Index [net dividends].
It is not possible to invest directly in an index. Performance does not reflect the expenses associated with management of an actual portfolio. **Past performance is not a guarantee of future results.**

Global Valuations

What is the Investment Climate?



As of 03/31/2022



As of 03/31/2022

Cyclically Adjusted Price-to-Earnings or "CAPE" is a valuation metric, where the current market price is divided by the last ten years of average earnings (adjusted for inflation). The price you pay is what you get, and by utilizing average earnings over a longer period (10 years), we can put into perspective whether the current market price is trending toward expensive, undervalued, or fairly valued historically.

Quarterly Market Summary

Index returns

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Q1 2022	US Stock Market	International Developed Stocks	Emerging Markets Stocks	Global Real Estate	US Bond Market	Global Bond Market ex US
	STOCKS				BONDS	
	-5.28%	-4.81%	-6.97%	-3.81%	-5.93%	-4.05%
Since Jan. 2001						
Average Quarterly Return	2.4%	1.6%	2.8%	2.6%	1.0%	1.0%
Best Quarter	22.0%	25.9%	34.7%	32.3%	4.6%	4.6%
	2020 Q2	**2009 Q2**	**2009 Q2**	**2009 Q3**	**2001 Q3**	**2008 Q4**
Worst Quarter	-22.8%	-23.3%	-27.6%	-36.1%	-5.9%	-4.1%
	2008 Q4	**2020 Q1**	**2008 Q4**	**2008 Q4**	**2022 Q1**	**2022 Q1**

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Market segment (index representation) as follows: US Stock Market (Russell 3000 Index), International Developed Stocks (MSCI World ex USA Index [net dividends]), Emerging Markets (MSCI Emerging Markets Index [net dividends]), Global Real Estate (S&P Global REIT Index [net dividends]), US Bond Market (Bloomberg US Aggregate Bond Index), and Global Bond Market ex US (Bloomberg Global Aggregate ex-USD Bond Index [hedged to USD]).

Long-Term Market Summary

Index returns as of March 31, 2022

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	US Stock Market	International Developed Stocks	Emerging Markets Stocks	Global Real Estate	US Bond Market	Global Bond Market ex US
	STOCKS				BONDS	
1 Year	11.92%	3.04%	-11.37%	18.97%	-4.15%	-3.56%
5 Years	15.40%	7.14%	5.98%	7.10%	2.14%	2.25%
10 Years	14.28%	6.25%	3.36%	7.48%	2.24%	3.20%

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Market segment (index representation) as follows: US Stock Market (Russell 3000 Index), International Developed Stocks (MSCI World ex USA Index [net dividends]), Emerging Markets (MSCI Emerging Markets Index [net dividends]), Global Real Estate (S&P Global REIT Index [net dividends]), US Bond Market (Bloomberg US Aggregate Bond Index), and Global Bond Market ex US (Bloomberg Global Aggregate ex-USD Bond Index [hedged to USD]). Bloomberg data provided by Bloomberg.