

MARKET REVIEW

› 4th QUARTER 2022

▶ EXECUTIVE SUMMARY

- › Equity and fixed income asset classes produced positive returns for the quarter.
- › Inflation peaked in June at 9.1% (year-over-year) but slowed to 7.1% in November.
- › The Federal Reserve finished the year increasing rates twice in Q4, resulting in a total of seven rate hikes, totaling 4.25% in 2022.

Quarterly Market Review

4th Quarter 2022



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“After a stock market decline, people may perceive more risk than before when, in fact, the decline may have taken some of the risk out of the market” – Robert Shiller, Yale University Finance Professor

Every January, it’s typical to reflect on market data from the past year. You will see the results in your own quarterly reports, as well as across the usual flurry of broad market analyses. Even when the results aren’t preferable — which has certainly been the case for 2022 — we look at them anyway. It’s good to keep an eye on your annual investment returns, as they are one consideration among many that guide your financial plan.

2022 was the year of volatility. Interest rate hikes at an unprecedented pace by the Federal Reserve, higher than anticipated inflation, and Russia’s war in Ukraine all contributed to recession fears going into 2023, which in turn pushed the equity and bond markets lower for the year. However, at the time of this writing, calmer seas appear to lie ahead economically; inflation is decreasing, the Federal Reserve appears to be nearing the end of its tightening cycle, and much of the weakness of a possible recession has already been priced into current market valuations. This optimism was reflected in a Santa Clause rally in the fourth quarter, with a return of 10% for the global stock market.

■ Overview:

- › Q4 in Review
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- › Stock Market Performance
- › Global Valuations
- › Quarterly Asset Class Market Summary
- › Long-Term Market Summary
- › World Asset Classes



QMR – Portfolio & Market Review

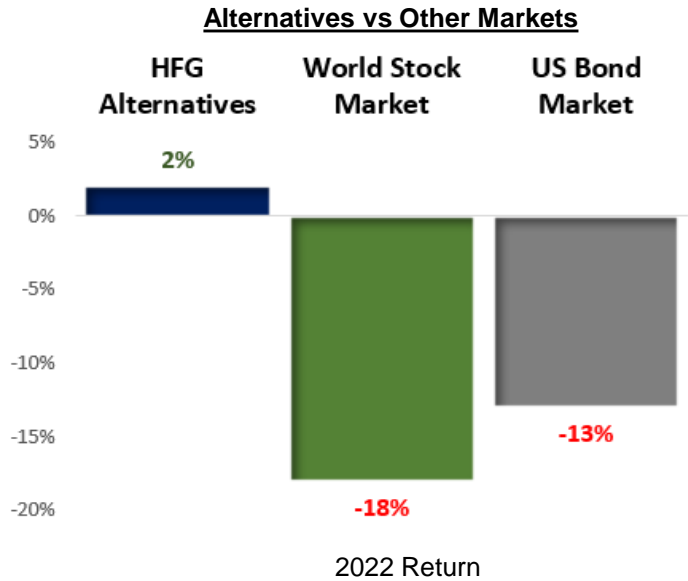
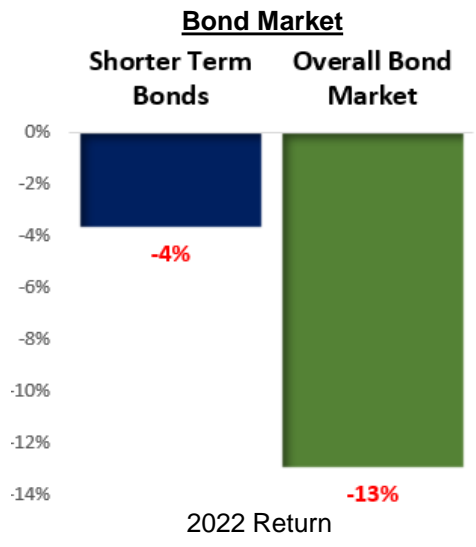
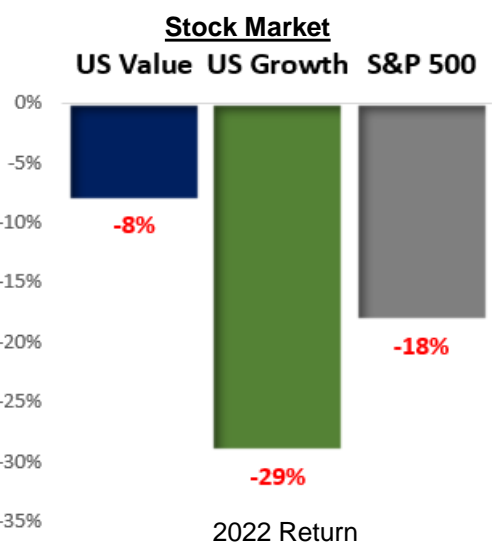
4th Quarter 2022

Stocks - Over previous market reviews, we’ve harped on the seemingly disjointed returns and valuations of growth stocks – the saying, “growth at any price” comes to mind. 2022 brought some sense to the market with the collapse of growth stocks and their exceptional over-valuation compared to value stocks. The preference to overweight undervalued companies paid off well for our investors in 2022 with value companies outperforming growth by 21% for the year and 10% in Q4 alone. Going into 2023, we continue to tilt towards lower valued companies with an average Price-to-Earnings Ratio in the HFG stock portfolio being 42% less than an average company in the S&P 500.

Fixed Income - Bonds have traditionally been the ballast of a portfolio. Many investors began questioning this in 2022, with bonds declining in tandem with the greater stock market. The shorter average maturity of a bond an investor had in their portfolio, the more insulated the bond portfolio was from losses. The US bond market has an average maturity of 9 years, while an HFG bond portfolio is closer to a 3- to 4-year average maturity, in addition to incorporating inflation-protected bonds which have provided additional return. In 2022, the overall bond market was down -13% for the year and up 1.9% in Q4, while shorter term bonds were down -4% in 2022, and up 0.9% in Q4.

After years of bond yields in the 1-2% range, bond portfolio yields are attractive with yields at +5-6%. We’ve been taking advantage of these increased rates for individual clients and business owners with excess cash. Most businesses have cyclical cash flow where they sit on large amounts of cash for a few months (or even most of the year). For example, in agriculture, higher expenses tend to occur during springtime and harvest. In this case, we’ve been investing in short-term Treasury bonds (generally 4-5% yield) that mature before a project or harvest commences in order to enhance returns on idle cash.

Alternative Investments - In a year where stocks and bonds struggled, alternative investments were a bright spot for portfolios, especially in the private markets. Private real estate was up 7% and private lending was up 6-9% for the year. Our investment in catastrophe bonds (reinsurance) bounced back in Q4 after a 12% loss due to Hurricane Ian to finish the year down -3.4%. Due to the losses attributed to Hurricane Ian, the reinsurance industry sector wide has been increasing their rates by roughly 75% from renewal rates one year ago – thus providing attractive current yields.

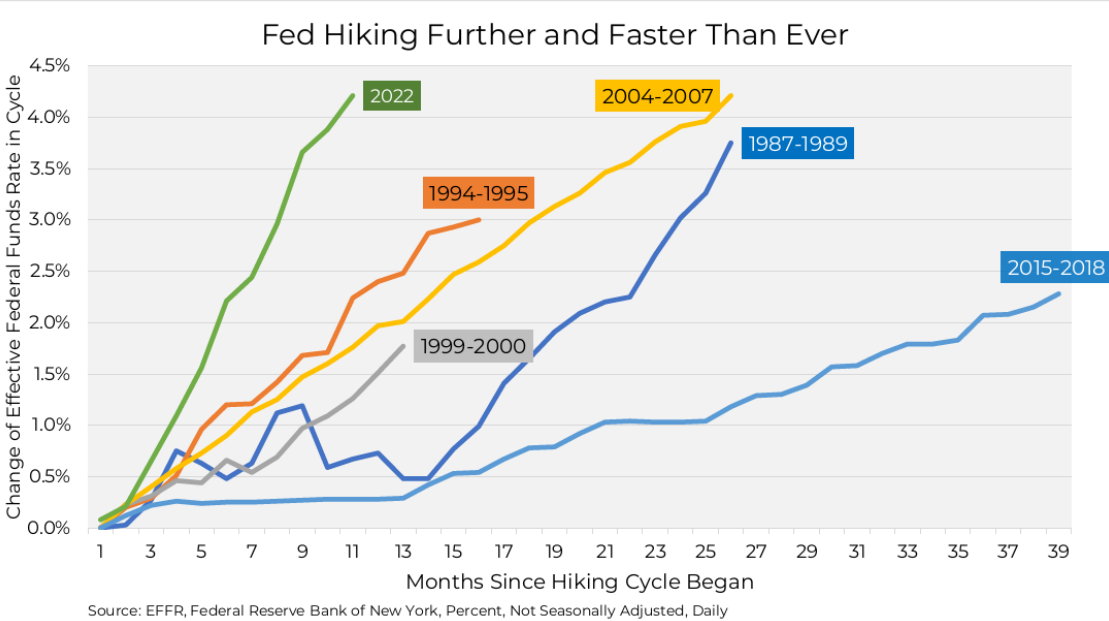


QMR – Economic Update

4th Quarter 2022

Rates / Inflation – Everyone has felt the effects of lingering inflation and the Federal Reserve increasing rates from effectively 0% to 4.25% in 2022. To the right is a graph that illustrates the magnitude and swiftness of the interest rate hikes this year for the Federal Reserve compared to historical rate hikes. One might agree that the Fed was late to the game in increasing rates, but this action has provided convincing signs inflation is sustainably decreasing. Inflation peaked in June at 9.1% (year-over-year), while most recently, consumer prices only rose 0.1% (month-over-month) in November and 0.2% if food and energy are excluded. The major hotspots of inflation from earlier in 2022 have softened, including energy prices that skyrocketed in the first half of 2022 after Russia invaded of Ukraine.

Recession Fears – The threat of recession is on everyone’s mind – however, there are different shades of gray as all recessions are not created equal. The National Bureau of Economic Research (NBER) identifies phases of the business cycle using a bevy of indicators, such as consumption, income data, employment rates, and gross domestic product growth. None of these measures have been consistently dominant in the determination of economic conditions, and certainly past US recessions have come in all shapes and sizes. Recessions are therefore named retroactively, with the benefit of hindsight. Since the market is forward looking, it may have already hit its bottom before the recession is even announced. For example, on the chart to the right for the recessions of 1980, 1991, 2001, and 2020 the market bottom was months before the recession was even announced.



Global Strategic NextGen OCIO, 2022 Year in Review

Recession Announcement & Market Lows

Peak Market Month	Recession Announcement Month	US Market Low Month	Months from Announcement to Market Low
Jan-80	Jun-80	Mar-80	(3)
Jul-81	Jan-82	Jul-82	6
Jul-90	Apr-91	Oct-90	(6)
Mar-01	Nov-01	Sep-01	(2)
Dec-07	Dec-08	Feb-09	2
Feb-20	Jun-20	Mar-20	(3)

QMR – Economic Update

4th Quarter 2022

With the public service announcement on the previous page that we can't time the market, we'll take a swing digesting current economic conditions and what it may mean going forward, which will most certainly be partly or entirely wrong.

Going into 2023, there is growing economic data that we will slip into an official recession. The US consumer has mostly been unscathed, but increased interest rates have adversely affected trade, business investment, and home-building. Higher inflation, leading to increased prices for every day goods has put financial pressure on consumers where the current savings rate is 2.4%, compared to 4.7% at the beginning of 2022. However, an 8.7% Cost-of-Living Adjustment (COLA) for Social Security recipients has helped ease some of the spending sting, as should some of the provisions within the newly enacted SECURE 2.0 Act of 2022. Early indication is this should not be a severe recession if we do slip into one. This is primarily driven by relatively strong labor market and consumer earnings. As of November, there are still 1.72 open jobs per unemployed individual, and an exceptionally low unemployment rate of 3.7%.

A strong US dollar may pose some headwinds for exports, although we've seen signs of softening in Q4 of 2022. From May 2021 until October of 2022, the US dollar, compared to international currencies, increased in value by 25% - meaning a buyer not in US dollars would have had to pay 25% more in just that short span to buy a good denominated in USD. However, from the highs in October 2022 until the end of the year, the US dollar has declined in value 8.6%; giving some reprieve to US exporters and providing a boost in returns for US investors with international stock allocations.

The U.S. dollar

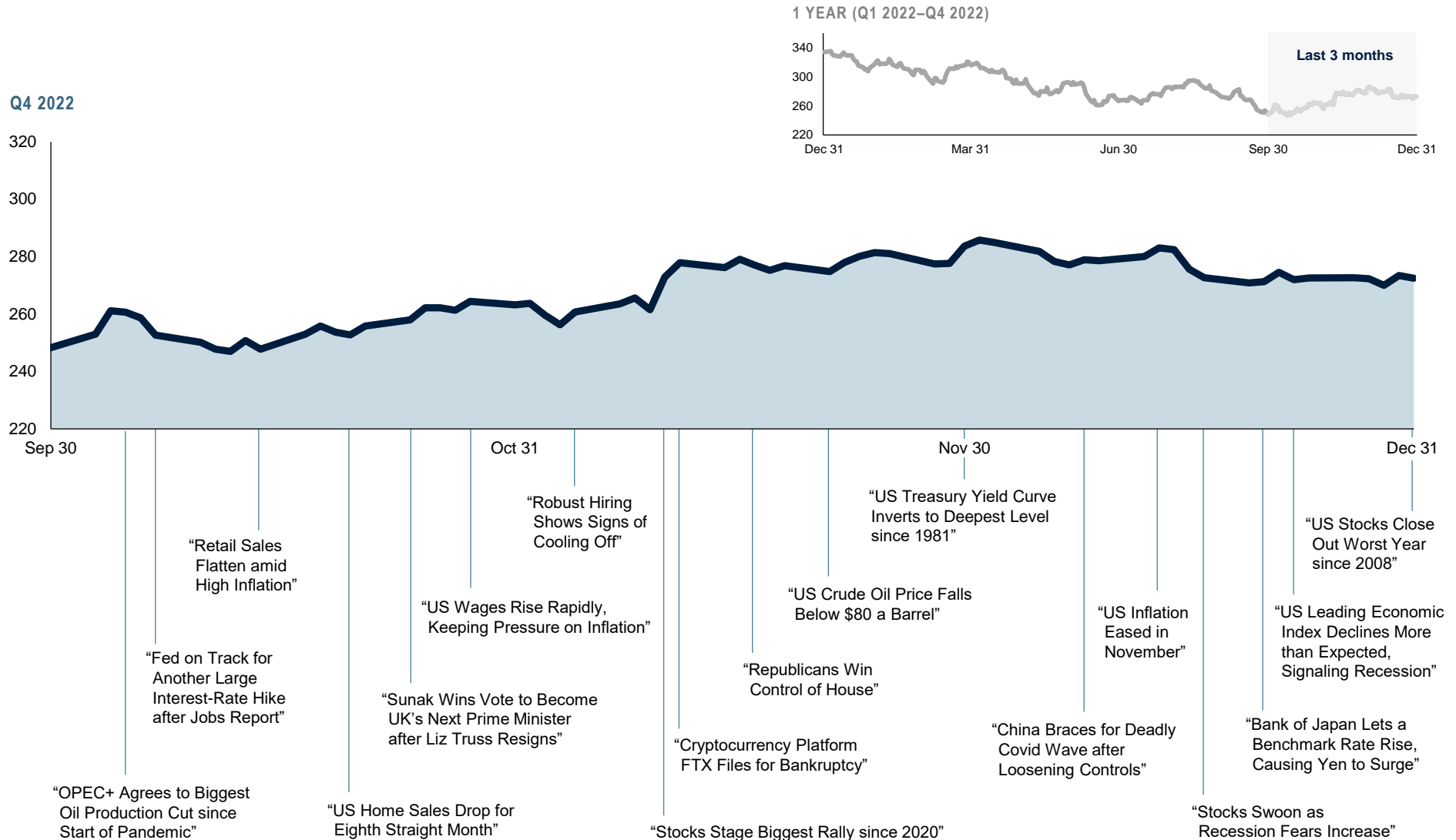
U.S. Dollar Index



JP Morgan, Q4 Guide to the Markets

World Stock Market Performance

MSCI All Country World Index with selected headlines from Q4 2022



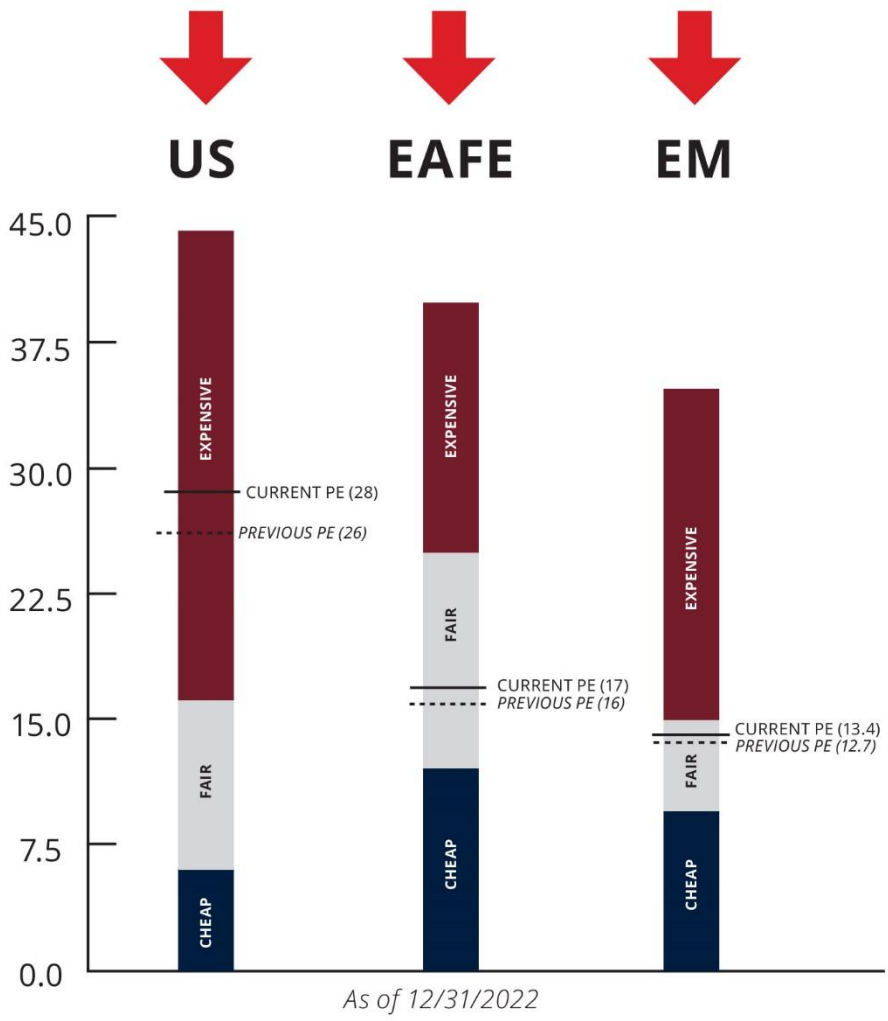
These headlines are not offered to explain market returns. Instead, they serve as a reminder that investors should view daily events from a long-term perspective and avoid making investment decisions based solely on the news.

Graph Source: MSCI ACWI Index (net dividends). MSCI data © MSCI 2023, all rights reserved. Index level based at 100 starting January 2001. 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.**

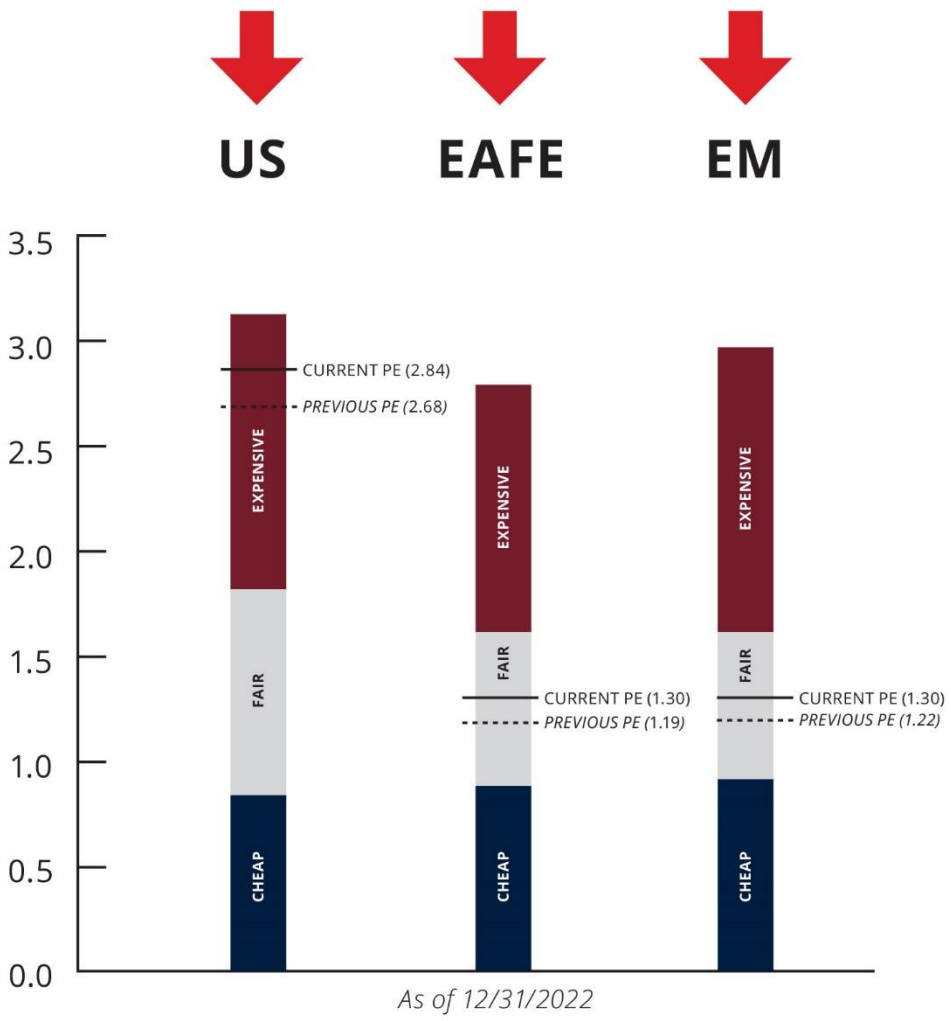
Global Valuations

What is the Investment Climate?

Price-to-Earnings (CAPE)



Price-to-Book Value



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


















	US Stock Market	International Developed Stocks	Emerging Markets Stocks	Global Real Estate	US Bond Market	Global Bond Market ex US
Q4 2022	STOCKS				BONDS	
	7.18%	16.18%	9.70%	6.88%	1.87%	0.18%
						
Since Jan. 2001						
Average Quarterly Return	2.1%	1.5%	2.5%	2.2%	0.9%	0.9%
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

Past performance is not a guarantee of future results. Indices are not available for direct investment. Index performance does not reflect the expenses associated with the management of an actual portfolio.

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]). S&P data © 2023 S&P Dow Jones Indices LLC, a division of S&P Global. All rights reserved. Frank Russell Company is the source and owner of the trademarks, service marks, and copyrights related to the Russell Indexes. MSCI data © MSCI 2023, all rights reserved. Bloomberg data provided by Bloomberg.

Long-Term Market Summary

Index returns as of December 31, 2022

	US Stock Market	International Developed Stocks	Emerging Markets Stocks	Global Real Estate	US Bond Market	Global Bond Market ex US
1 Year	STOCKS				BONDS	
	-19.21%	-14.29%	-20.09%	-24.36%	-13.01%	-9.76%
						
5 Years						
	8.79%	1.79%	-1.40%	0.92%	0.02%	0.52%
						
10 Years						
	12.13%	4.59%	1.44%	3.88%	1.06%	2.10%
						

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