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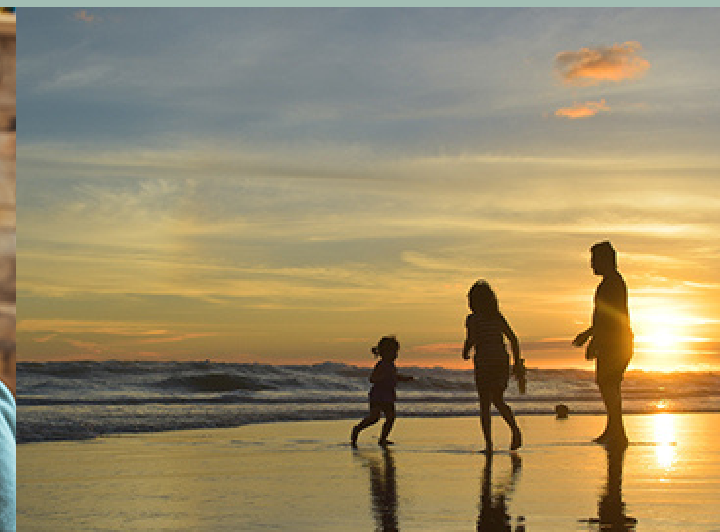
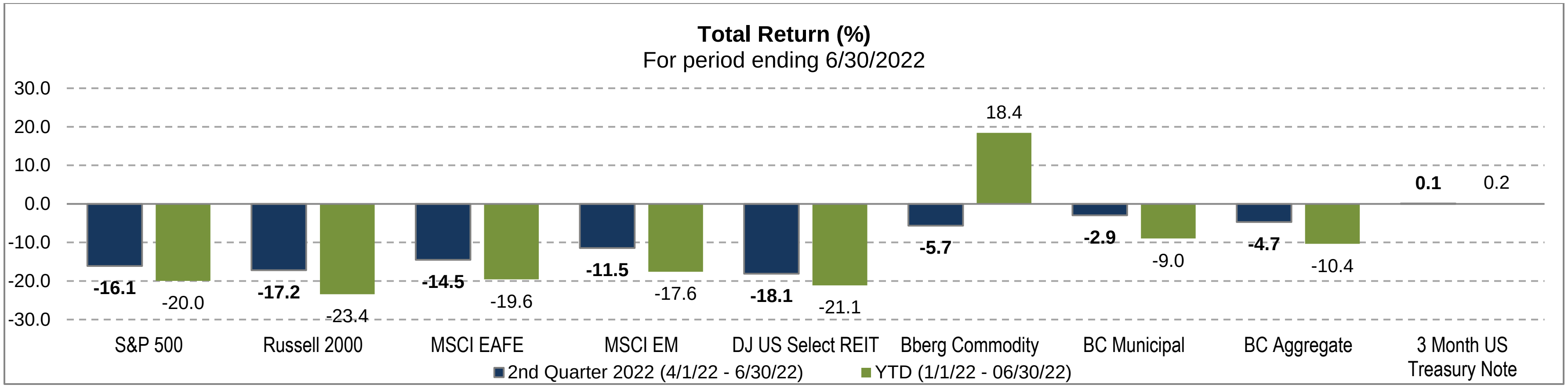


Bad Markets Don't Last Forever: Keeping Perspective Amid Market Volatility

Schneider Downs Wealth Management Advisors, LP

Q2 2022 Market Commentary



As I sit down to write this quarterly letter over the 4th of July holiday weekend, it struck me that an event that happens once a year, honoring the same event every year (Independence Day!), is still so incredibly important to my life and to our country. The reason the 4th of July holiday resonates with us is that once a year we are reminded of the bravery of the 56 delegates at the Second Continental Congress who signed the Declaration of Independence[1] at great risk to them and their families and thus gave birth to a nation. More simply put, it resonates with us because it provides us with ***perspective*** (the hot dogs[2], barbeque, cheeseburgers, adult beverages, and fireworks help too!). More to come on this idea of perspective and how it can help us as investors get through the difficult times that we currently find ourselves in later in this letter.

When the books closed on the first half of 2022, we as investors found ourselves off to the worst six months in the equity market (as measured by the S&P 500) since 1970[3] and global bonds off to the worst start on record (Deutsche Bank estimates it's the worst first half for bonds since 1788 – we are going to go ahead and take their word for it)[4]. To put it bluntly; capital markets have provided little safe harbor for investors. The traditional ballast of portfolios, high-quality bonds, were staggered amid higher inflation that caused global central banks to raise interest rates rapidly. As illustrated by the green bars, the difference between large U.S. stocks, small U.S. stocks, international stocks, emerging market stocks, and publicly traded real estate were negligible, with all down double digits (most declining 20%). The level and rate of change inflation (increasing) has caused global central banking authorities to tighten monetary conditions,[5] which in turn has caused equity prices to re-rate downward. While there have been a few signs that inflation is slowly beginning to moderate[6], capital markets remain firmly in transition as markets deal with a global central banking regime that is no longer synchronized in accommodative monetary policy.

Now back to the lessons of the 4th of July and the fundamental underpinning of ***perspective***. Every 4th of July, my family of four heads up to Conneaut, Ohio, to spend time at a cottage on Lake Erie with my wife's family[7]. Cell service is spotty at best, the house is structured in a way that

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[1] https://education.nationalgeographic.org/resource/signing-declaration-independence
[2] While controversial amongst team members, I believe that the only acceptable condiments on a hot dog are yellow mustard, onions, and relish/pickle.
[3] https://www.barrons.com/articles/stock-market-sp500-1970-outlook-51656620380
[4] https://www.reuters.com/markets/rates-bonds/brutal-first-half-puts-bonds-line-worst-year-decades-2022-06-30/
[5] Global central banks have raised interest rates, reduced and/or eliminated their bond purchasing program, and allowing bonds to roll of their balance sheets without reinvesting.
[6] https://www.bloomberg.com/news/videos/2022-06-30/prasad-signs-of-inflation-easing-video
[7] Britt, she is a saint for putting up with me.

forces us to be outside, and the view of the sunset over Lake Erie is among the most beautiful in the world. In other words, it is the perfect place to take a deep breath and try and get some perspective. It also happens to be a 50-minute drive from where I grew up[8] and from the cemetery where my mother is buried. My mom passed away on Valentine's Day in 2004 after a 9 ½ year battle with breast cancer; she was the epitome of strength and grace amidst incredibly trying circumstances. She also gave the best advice, so naturally I went to visit her over the holiday weekend to hopefully draw some inspiration for this letter. As I laid fresh mulch, planted flowers, and read her an LA Times article about my twin brother,[9] something struck me in the form of a series of numbers. 11, 5, 15, 5, -37, 26, 15, 2, 16, 32, 13, 1, 12, 22, -4, 31, 18, 31. This time series stumped everyone I asked, and I wouldn't expect any of you to know it either. It is the calendar year total returns of the S&P 500 since my mother passed away; the S&P has increased at an annualized rate of ~8.9% and increased by a staggering ~377% on a cumulative return basis since my mom left us on a cold Saturday morning in 2004[10]. Tough times don't last, and markets don't stay down forever; a healthy dose of ***perspective*** is the precise antidote to the volatility that is ubiquitous in capital markets today. A mother always knows best – thank you once again, Mom, for being the source of my perspective.

At a macro level there was little, outside of commodities, that gave investors even a modicum of reprieve during the first six months of 2022. However, SDWMA portfolios had a few bright spots that helped weather the storm. Our portfolios were bolstered by an overweight to real assets (infrastructure, farmland, timberland, high-quality commercial real estate) and an underweight to traditional fixed (specifically we were underweight duration/interest rate sensitivity). Starting in 2016, the investment team, in conjunction with SDMWA advisors, began to build out real asset exposure in client portfolios. The underlying thesis was that real assets gave client portfolios multiple ways to win whereas core fixed income relied on the price/yield relationship; for those that may not remember, a bond is like a seesaw, when yields go up, prices go down (and vice versa). For 40 years, a secularly declining interest rate environment (bond yields down, prices up) gave investors an enormous tailwind to the traditional portfolio mix of stocks and bonds. SDWMA's view was that this was not sustainable after almost 15 years of accommodative monetary policy, with the COVID era stimulus and rescue packages serving as the crescendo. With interest rates likely to go up and inflation, in our view, likely to be stickier than consensus estimates, we increased our exposure to real assets during 2020 and 2021. In a market that saw most equity indices enter bear markets territory (down 20% from a previous market high), our real asset strategies delivered positive total returns for the first half of 2022[11]. Carving out a meaningful piece of fixed income and allocating it toward real assets created a new ballast for our client portfolios. In addition to our real asset exposure, defensive value strategies delivered strong relative performance, declining significantly less than the broad stock indices (e.g. S&P 500). Combining real asset exposure, an underweight to traditional fixed income, and exposure to defensive value strategies, there were rays of sunshine in an otherwise dreary first half of 2022.

Even with the exposure mentioned above, our portfolios were not immune to the significant drawdowns shown in the chart at the top of this letter. Our broadly diversified portfolios had exposure to developed international and emerging markets, U.S. small- and mid-cap equities, as well as growth-oriented strategies, that were particularly challenged amid higher inflation/interest rates. Growth stocks, like the so called FAANG stocks (Facebook, Apple, Amazon, Netflix and Google), were the previous market stalwarts generating significant returns over the past decade. However, as interest rates rose and their businesses proved to be less resilient to inflationary pressures, their stock prices came under pressure. The FAANG stocks

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[8] Shout out to Perry, Ohio

[9] https://www.latimes.com/sports/chargers/story/2022-07-02/chargers-coach-brandon-staley-at-wimbledon

[10] Returns generated by Morningstar Direct and represent performance from February 16, 2004 through June 30th of 2022.

[11] Represent total returns of Versus Multi-Manager Real Estate Income (+3.79%) and Versus Capital Real Assets (+1.19%) from 1/1/22 through 6/30/2022. Returns generated from Morningstar Direct and represent an investor holding the client for the entire time period and reinvesting dividends. Not all clients hold Versus strategies due to client specific limitations.

came into 2022 representing almost 30% of the S&P 500. All of the FAANG stocks have struggled, with Netflix declining over 70%, Facebook (now Meta) declining 50%, and Apple generating the best return declining *only* 23%. Despite our decision to have exposure to defensive value strategies inside the U.S. equity complex that performed admirably in the first half of 2022, we still were not able to avoid all of the drawdowns experienced by broad U.S. stocks. In addition to the struggles over the broad U.S. equity indices, a much stronger than anticipated U.S. Dollar combined with Russia's invasion of Ukraine, hurt our international and emerging market allocations, which had a quality growth bias. While we retain our conviction in both having exposure to international and emerging market stocks and our quality growth strategies, we nevertheless have to acknowledge that they have struggled year to date.

Looking ahead to the second half of this year, we take solace in the fact that there is little to no correlation between 1st half calendar year returns and 2nd half calendar year returns. Valuations in domestic small- and medium-sized companies are priced at valuations we last saw at the depths of the Great Financial Crisis in 2008-2009[12]. International and emerging markets are showing historically attractive valuations, and with the prospect of China loosening monetary conditions[13] over the next several months, emerging markets in particular could get a catalyst to jumpstart returns in 2022. The benchmark U.S. 10-Year Treasury Bill Yield has fallen from a high of almost 3.5% in early June to approximately 2.8% in early July, which has helped traditional fixed income gain back some of the losses incurred year to date. Our baseline expectation for the next six months is that inflation is likely to remain elevated but will moderate over time. Volatility in capital markets is likely to remain as well, as long as inflation remains above trend. Despite the current levels of inflation and volatility, if investors are willing to take an intermediate to longer term outlook, there are places to allocate capital that are likely to generate attractive returns. In order to generate those returns, it will require a healthy dose of ***perspective*** – something that we endeavor to help provide you in the conversations we intend to have with you in the days, weeks, and months ahead.

If you have any questions or concerns, please reach out to your investment relationship manager to review your portfolio. We construct each of your portfolios to meet your short and long-term goals. For many of you, this means generating a stream of cash to fund your retirement needs. While this downturn may feel like the wind has been sucked out of your sails, keep in mind that within our portfolio construction we have many levers to pull to help you navigate through volatile markets. The history of securities markets, while never repeating themselves the same way through any cycle, has shown us again and again that downturns forecast and reflect economic and monetary conditions. The breeze of change in either or both will ultimately lead to better days. As always, we appreciate your continued trust and confidence as we navigate through the challenges markets have put before us.

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[12] https://www.yardeni.com/pub/peacockfeval.pdf
[13] https://www.bloomberg.com/news/articles/2022-06-10/china-factory-inflation-moderates-as-commodity-prices-cool