Second Quarter 2022

Market Recap
Performance Review
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Market Recap

Managing investment portfolios during 2022, particularly so Q2, has been among the most challenging of my 33-year career. All major markets, indexes, industrial sectors, and investment styles ended Q2 deeply in negative territory. Stocks, as measured by the S&P 500® Index, had the worst first-half of a year going back 50+ years. Neither bonds nor holding cash itself provided relief.

By the close of Q2, the S&P 500® was down more than 20% from its January 3rd all-time high, the steepest plunge for the first half of any year since 1970. The tech-heavy Nasdaq was hit especially hard, at the end of Q2 sitting more than 31% below its November 22nd all-time high.

Bonds, as measured by the Bloomberg U.S. Aggregate bond index, finished Q2 down more than 10% year-to-date. The once-trusty 60/40 portfolio, after expenses and management fees, finished Q2 with losses of nearly -17% year-to-date. That -17% loss ranks as the third worst period performance, behind two Depression-era downturns, 1931 and 1937, when 60/40 portfolio losses topped 20%.

> I know it when I see it
>
> - Potter Stewart -

With U.S. inflation running in the high single digits, selling investments and holding cash was, and remains, a losing strategy on a real return basis. Even the crypto space – despite laughably being promoted for years as "the ultimate hedge" – saw staggering losses. Bitcoin's price fell from about $45,000 to slightly above $19,000; a -57% quarterly decline. There was, simply put, nowhere to hide.

The energy sector, the lone bright spot for the year, was up nearly 70% at the start of June. Despite not typically maintaining investments in the energy space, I was using tactical trading strategies in the space to hedge against further erosion in our most sensitive long-term core positions and to add incremental positive return.

But when business and consumer confidence buckled during the first week of June – following guidance warnings from retailer Target and chip-maker Intel, coupled with a hotter-than-expected May CPI release – the energy complex turned sharply lower. Investors realized that, to contain inflation, the U.S. Federal must move more aggressively to raise interest rates. The hope that the Fed could engineer a "soft landing" for the U.S. economy faded quickly, and the consensus probability of a global recession increased to greater than 50/50.

With a consensus call now for a global slowdown, and therefore demand destruction, energy prices quickly collapsed nearly 25%. The one space in markets that provided some respite from the storm finally roll over. Our activity thereafter shifted to actions available to us to reduce portfolio responsiveness should bad news continue.

Performance Review

Lake Jericho managed and advised portfolios are typically invested in some variation of either one of two strategies - either (1) a concentrated individual stock strategy heavily biased towards U.S. large-company technology, health care, and consumer-focused stocks, or (2) a global-macro strategy broadly diversified by asset type, sector, and geography that is executed via exchange traded funds (ETF).

Within the individual stock strategy, macro factors can overwhelm individual stock selection and performance in the short run or for extended cycles. I regularly reinforce with clients that when growth-oriented strategies and/or market momentum stumble, Lake Jericho managed all-stock portfolios will experience those negative effects more deeply than typical U.S. equity indexes. Q2 is no exception, continuing the trend of performance divergence that began during 2021.

Within the global-macro strategy, I actively manage macro positioning, geographic diversification or concentration, asset types, sector allocations, and other performance factors. Additionally, these portfolios represent risk profiles that are not appropriately benchmarked against an all-equity index. Here too, these decisions all have meaningful impact upon returns and can cause our performance for any single quarter or for extended cycles to deviate from appropriate indexes. Performance must be measured versus similarly diversified benchmarks.

We provide the bulleted benchmark returns immediately below to demonstrate how each decision impacts returns. I then provide the iShares (by Blackrock) Core Allocation ETF Portfolio Series benchmarks within the tabled data at the end of this *Outlook*, for a proper, relative performance comparison against independent, objective, balanced, globally diversified strategies managed to standardized risk profiles.

- The Dow Jones Industrial Average finished Q2 with a loss of -10.92%, for a year-to-date loss of -14.70%, and a one-year loss of -9.58%. The DJIA is a price-weighted measure of the performance of 30 "blue-chip" U.S. companies.
- The S&P 500® Index, a broadly diversified, committee selected index of 500 large U.S. companies, finished Q2 with a loss of -16.20%, for a year-to-date loss of -20.10%, and a one-year loss of -11.01%.
- The technology and consumer-cyclical heavy Nasdaq Composite Index finished Q2 with a loss of -22.28%, its worst quarterly outing since 2008. The year-to-date loss was -29.23%, for a one-year loss of -23.43%.
- Small- and mid-sized companies, as measured by the Russell 2500™ Index, finished Q2 with a loss of -16.98%, a year-to-date loss of -21.81%, and a one-year loss of -21.00%.
- International developed markets, as measured by the MSCI World (ex-USA) Investable Market Index, finished Q2 with a loss of -14.94%, for a year-to-date loss of -19.24%, and a one-year loss of -17.29%.
- International emerging markets, as measured by the MSCI Emerging Markets Investable Market Index, lead their developed markets counterparts with a Q2 loss of -12.10%, for a year-to-date loss of -17.94%. Emerging markets continue to lag significantly on a one-year basis with a loss of -24.75%.
- The Bloomberg Barclays U.S. Aggregate Bond Index, a measure of the performance of the U.S. investment grade bond market, finished Q2 with a loss of -4.69%, for a year-to-date loss of -10.35%, and a one-year loss of -10.29%. Should interest rates continue to move higher, bond performance for traditionally managed strategies will generally continue to be negative.

Near-term Outlook

It has been a rough start to 2022. Capital destruction stands at more than $9 trillion globally, exceeding the financial crisis of 2008. Well into the third year of adjusting to life with Covid, every aspect of the global economy continues to struggle with the transition to our new reality.

Inflation continues to run near double-digits around the globe. The primary drivers during 2022 have been rising energy and food costs, affecting everything from production, distribution, to consumption. Food inflation, already pressured by accelerating climate change, has been made worse by Russia's invasion of Ukraine. And China's continuing zero-Covid policy continues to restrict goods manufacturing and delivery on a global scale.

Although there are only so many things that central banks can do, it is now obvious that they have been too slow to act. They are well behind in normalizing interest rate policy. Here in the U.S., because our Fed will be forced to take bigger steps with each rate increase, and likely increase for longer, the recession conversation has evolved from "will there be a recession", to "when will the recession begin", to speculating "are we in a recession already?".

The results of the most recent poll of confidence among small business by the National Federation of Independent Businesses found confidence was the worst in the 48-year history of the survey. Meanwhile, the University of Michigan's consumer sentiment reading showed consumer sentiment falling to the lowest level ever recorded.

As is the case with most historical recessions, it will come about more as a self-fulfilling prophecy by consumer and business belt-tightening than as the result of central bank action. At what point does sentiment turn so universally negative that it becomes a bullish indicator? As in 1964, when U.S. Supreme Court Associate Justice Potter Stewart, when trying to explain pornography or to define obscenity, said "I shall not today attempt further to define the kinds of material…but I know it when I see it…". Well, I can't point to a reliable indicator, but I am confident that I am looking at it.

The anticipation of a global slowdown in demand has already caused energy prices to decline by about 25%. Commodity prices have fallen, generally, double digits. As of this writing, gas prices in the U.S. have fallen for 36 consecutive days. When examining the futures market for energy, food and raw materials prices to come – oil, wheat, copper, gold – all are showing signs of continued declines into the fall. And if price inflation eases, the need for interest rates to increase then eases. And when pressure lessens on rates, stock and bond returns normalize.

That does not imply that markets have bottomed or that volatility is behind us. What is does mean, however, is that markets are doing much of the work on behalf of central banks around the world. As consumers and businesses tighten their own belts, inflation pressures will soften. But we are walking a tightrope.

It is possible that such belt-tightening becomes overdone, and corporate earnings start to decline. If that happens, there will be another leg lower in this downturn. However, if the rate of inflation does start to fall, and central banks are not forced to move as far, as fast, and if corporate earnings don't soften dramatically, we might yet manage a soft economic landing. But time is running out.

Generally, I moved portfolios to more defensive positioning during Q2. I plan to maintain this positioning throughout the summer, or until I see a softer CPI print. Should we reach a point in the macro environment where significant strategic change is necessary, should CPI continue to increase or corporate earnings take a downturn, I will comment in more detail at that time. However, I do believe that we are closer to the end of this cycle than we to the beginning.

As always, I am available to discuss anything within this Outlook, or your own specific portfolio performance questions. And if there are any changes in your personal/financial situation that we have not already discussed, we need to schedule a more in-depth review.

Until then, be well. And thank you for your continued trust and support.

A.J. Walker, CFA CFP® CIMA®
Founder, President, and CEO
Lake Jericho, LLC

The iShares Core Allocation ETF Portfolio Benchmark Series

Total Return Comparisons For Comparable Risk and Allocation Profiles

All Periods Ending June 30, 2022

Core Allocation Portfolio (Ticker)	Q2 2022	Year-to-date	1 Year Total Return	3 Year Total Return	5 Year Total Return
Conservative (AOK)	-8.00%	-13.15%	-11.73%	3.85%	14.60%
Moderate (AOM)	-8.98%	-14.03%	-12.11%	6.29%	18.21%
Growth (AOR)	-10.92%	-15.78%	-12.91%	11.05%	25.44%
Aggressive (AOA)	-12.90%	-17.57%	-13.77%	15.57%	32.45%

The iShares Core Allocation ETF Portfolio series is designed to meet the needs of investors who would like to maintain fixed target levels of exposure through a portfolio diversified across domestic, international, and emerging market equities, bonds, and other instruments. The Core Conservative Allocation Strategy seeks approximately 30% exposure to global equity markets. The Core Moderate Allocation Strategy seeks approximately 40% exposure to global equity markets. The Core Growth Allocation Strategy seeks approximately 60% exposure to global equity markets. The Core Aggressive Allocation Strategy seeks approximately 80% exposure to global equity markets. Presented here is the iShares Core Allocation ETF Portfolio Benchmark NAV total return performance as reported by iShares, constructed with no investment advisor fees, and with no transaction costs, while Lake Jericho portfolio performance is actual performance, net of all fees, including investment management, administration, and transaction expenses.

For any portfolio with an inception date within the current quarter, or within the current year-to-date, that observation period data will not be directly comparable to the iShares Portfolio Benchmark data above due to start-date differences. Nonetheless, your individual portfolio performance data is presented here for informational purposes. For direct comparison based upon exact portfolio inception dates, please access the custom reporting features within the Portfolio Analyst tool in your client portal.