Fourth Quarter 2022

Market Recap, Near-term Outlook, and Performance Review

Market Recap

Q4 2022 closed with refreshingly positive results, despite one final downturn in December amidst bleak market sentiment. Both sentiment and the resulting negative positioning were a bit disconnected from fundamentals as the year ended, so 2023 shot out of the gate to a solid start. Nonetheless, we have a long distance yet to run if we are to fully close the gap left from 2022.

As measured by the Russell 3000 Index, a portfolio of 3,000 U.S. company stocks and a proxy for the *complete* U.S. stock universe, U.S. stocks finished Q4 with a gain of +7.18%. Impressive, but still leaving U.S. stocks with a 2022 annual loss of -19.21%. The tech-heavy growth component of the Russell 3000 Index finished Q4 with a modest gain of +2.31%, for a 2022 annual loss of -28.97%. The cyclical-oriented value component finished Q4 +12.42% higher, %, for a 2022 annual loss of -7.98%.

Bonds, as measured by the Bloomberg U.S. Aggregate (AGG) index, finished Q4 on the positive side after four consecutive quarters of negative returns. The AGG finished +1.87% higher, for a 2022 annual loss of -13.01% — the second year in a row of negative annual returns. The average "classic" 60/40 stocks-bonds portfolio fell 22% in 2022, the largest loss since 1931. Investing 60% of one's portfolio in stocks and 40% in bonds is supposed to protect against both assets falling at the same time. But that did not happen in 2022 as inflation and rising interest rates hammered both asset classes.

International stocks experienced a strong Q4 reversal as well, and outperformed the U.S. in total for 2022. As measured by the MSCI ACWI Index, an index composed of large and mid-sized companies in both developed and emerging markets, international stocks climbed +9.88% during Q4, for a 2022 annual loss of -17.96%.

Sector return differentials were dramatic during 2022. Sectors in which we focus — Communications Services (-37.65% annual loss), Technology (-27.72% annual loss), and Healthcare Tech & Devices (-20.17% annual loss) — had exceptionally weak results that negatively impacted portfolio performance. Meanwhile, the Energy Sector ended 2022 with a jaw-dropping +64.42% annual gain, but doing so amidst great volatility.

Volatility, the pattern and size of returns, and the timing of either starting a new portfolio or of significant additions or withdrawals from existing portfolios had tremendous second-derivative impact upon portfolios during 2022. I rarely wade into the topic of volatility as the math starts to get complex. But, as a simple exercise, starting with $100, losing 10% on day one, then gaining 10% on day two, you do not end day two with $100, you have $99. Run that pattern for 10 more two-day cycles, you end with $90. While headlines make you feel that you are standing in place, the ground around you is falling away.

In investing, the path of returns can matter more than the destination. 2022 was filled with head fakes; sharp drops followed by large rebounds that would invariably fail again. Lucy had the football, and I was Charlie Brown. Repeatedly. Our process seeks to lean into those rebounds to recover ground lost during downturns. We were caught on the wrong side of that trade multiple times in 2022. Volatility, and its power to erode portfolio, significantly undermined performance.

Near-term Outlook

The gut-punch of a one-year drop of 22% in one of the most widely used ways average investors organize their portfolios, the 60/40 split, is hardly overcome by assurances that market history is on our side. During a down year, it is understandable to question our process, one that admittedly will get beat down more than average. Especially so after such a particularly tough year, certainly a statistical outlier. But our long-term performance results remain comparatively resilient. Markets will rebound, and we will retake our leadership position.

The key market inputs that I am watching most closely in 2023 are the same I have focused on since mid-year 2022; inflation, interest rates, corporate earnings, and recession signals.

- For the first time in nearly three years, inflation has fallen on a monthly-over-month basis. The just-released CPI report from the Bureau of Labor Statistics showed that prices decreased by 0.1% in December. The last time prices were lower than the previous month was May 2020. This closely watched inflation gauge also showed that year-over-year prices continued to cool, slowing to 6.5%, from 7.1% in November, the smallest annual increase since May 2021. Stripping out food and energy prices, which tend to be more volatile, core CPI came in at 5.7%, down from November's 6.0% annual rate and up 0.3% from the month before.

- As inflation continues to abate, there is less pressure on the Federal Reserve to continue its aggressive pattern of interest rate hikes. Expectations are now for one more small rate increase in February, followed by an extended pause. The level of interest rates sets the discount rate used in formulas to value stocks and bonds. The lower the level of interest rates, the higher the current value calculation of future earnings, therefore the higher that stock and bond prices will go.

- Corporate earnings season will be in full swing by the end of this coming week. Big banks, airlines, and several closely watched names like Netflix have already released results. Company-level results have supported my view that both companies and consumers are holding up far better than feared. But market expectations continue to come down. FactSet noted that earnings for S&P 500® companies are expected to fall 3.9% during this Q4 earnings report season. This would set up the benchmark index for its first aggregate drop in profits since the third quarter of 2020. Still, far better an environment than the 20%+ drop in earnings some have projected.

  At first glance, a reduction in corporate profits — the ultimate long-term driver of stock prices — would seem an obvious negative for the stock market this year. Yet, not only are stocks more likely to rise than fall when earnings are falling, but in years the market is down it is also more likely than not corporate earnings are rising. This seems counterintuitive, but it makes sense when we remind ourselves that markets are forward looking. Markets will price in earnings declines well before they happen, as with 2022. By the time earnings declines materialize, such as now, stocks are already moving higher in anticipation of the next earnings upcycle.

- Increasingly so, I am an outlier in the will there or won't there be a recession in the U.S. debate. I remain in the "no" camp. The labor market remains historically strong. That props up consumer strength. Consumer spending drives corporate revenue. After a few years of pandemic-induced bloat, many companies are downsizing, but that has yet to impact much of anything negatively. Jobs opportunities elsewhere are abundant, as they have been for many years. As wage-pressures decline because of some slack working its way into the jobs market, that further reduces inflation pressures. Reduced inflation pressures mean a pausing, if not reversing, Federal Reserve. I wholly believe that the "soft landing" scenario remains realistic so long as the Fed *does* pause soon.

All inputs point to a positive environment for stocks heading into 2023. Despite some missteps in 2022, I did not abandon our core positioning. And that global growth oriented positioning is absolutely best suited for what is likely to be a positive year for markets and a healthy rebound.

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.

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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.

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 Q4 with a gain of +16.01%, for a 2022 annual loss of -6.86%. The DJIA is a price-weighted measure of the performance of 30 "blue-chip" U.S. companies, so labeled for a history such as this during volatile market environments.
- The S&P 500® Index, a broadly diversified, committee selected index of 500 large U.S. companies, finished Q4 with a gain of +7.56%, for a 2022 annual loss of -18.11%.
- The technology and consumer-cyclical heavy Nasdaq Composite Index finished Q4 with a loss of -0.76%, for a 2022 annual loss of -32.54%.
- Small- and mid-sized companies, as measured by the Russell 2500™ Index, finished Q4 with a gain of +7.43%, for a 2022 annual loss of -18.37%.
- International developed markets, as measured by the MSCI World (ex-USA) Investable Market Index, finished Q4 with a gain of +16.26%, for a 2022 annual loss of -13.82%.
- International emerging markets, as measured by the MSCI Emerging Markets Investable Market Index, trailed their developed markets counterparts with a Q4 gain of +9.60%, for a 2022 annual loss of -19.46%.
- The Bloomberg Barclays U.S. Aggregate Bond Index, a measure of the performance of the U.S. investment grade bond market, finished Q4 with a gain of +1.87%, for a 2022 annual loss of -13.01%.

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The iShares Core Allocation ETF Portfolio Benchmark Series

Total Return Comparisons versus Comparable Risk and Allocation Profiles

All Periods Ending December 31, 2022

Core Allocation Portfolio (Ticker)	Q4 2022*	1 Year Total Return*	3 Year Total Return	5 Year Total Return
Conservative (AOK)	4.24%	-14.03%	-1.48%	8.85%
Moderate (AOM)	5.11%	-14.46%	0.70%	11.79%
Growth (AOR)	6.94%	-15.30%	5.05%	17.68%
Aggressive (AOA)	8.83%	-16.21%	9.15%	23.35%

* For any portfolio with an inception date within the current quarter, or within the current year, 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 the Client Portal.

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.