Second Quarter 2022 Review

GLOBAL EQUITY AND INTERNATIONAL STRATEGIES

To say that the first half of 2022 has been a tumultuous start to the year for investors is an understatement. In the first six months of 2022 the S&P 500 declined by 20.6% while the Tech-heavy Nasdaq index fell by nearly 30%. To put things in perspective, the S&P 500 had its worst first half in more than 50 years. The last time the market suffered these types of losses was in 1970 when the S&P 500 lost 21% in the first half of that year. This happened during a period of high inflation that the current environment has been compared with. The challenging market conditions during the first half of the year were a global phenomenon with several market indices falling between 15-20% across Europe, Developed Asia, and the Emerging Markets.

The reasons for the weakness in global stock markets are well known and include persistent inflation, ongoing supply chain disruptions, the war in Ukraine, and a more hawkish tone from the U.S Federal Reserve and other central banks around the world.

Portfolio Review:

Portfolio activity was busy during the first half of 2022. Given higher than expected inflation and the war in Ukraine, we repositioned our Global & International portfolios to make them more defensive. As part of this initiative, we reduced our exposure to cyclical sectors such as Technology, Banking, and Consumer Discretionary. Companies in these sectors are more sensitive to economic downturns and their earnings are more vulnerable to significant downgrades, so we believed it was prudent to lighten up in these areas. Some of the specific stocks that were sold include JPMorgan, Taiwan Semiconductor, Facebook, HDFC Bank, Adidas, and Silicon Valley Bank. A portion of the funds from these sales were redeployed into the Consumer Staples and Healthcare sectors. These sectors are a good place to find defensive companies that have more stable free cash flow generation, and they are less susceptible to large earnings downgrades. Some of the stocks we have been buying include Johnson & Johnson, Nestle, GlaxoSmithKline, Diageo, and AstraZeneca.

Outlook for the Second Half of 2022 and our thoughts on recessions:

As we think about the back half of 2022, we remain cautious, although we do acknowledge that some of the risks are now priced into the market. Stubborn inflation, rising interest rates, and the war in Ukraine give us some reasons to remain concerned. Overall, we believe that the risk of a recession has risen significantly compared to where things stood at the beginning of 2022.

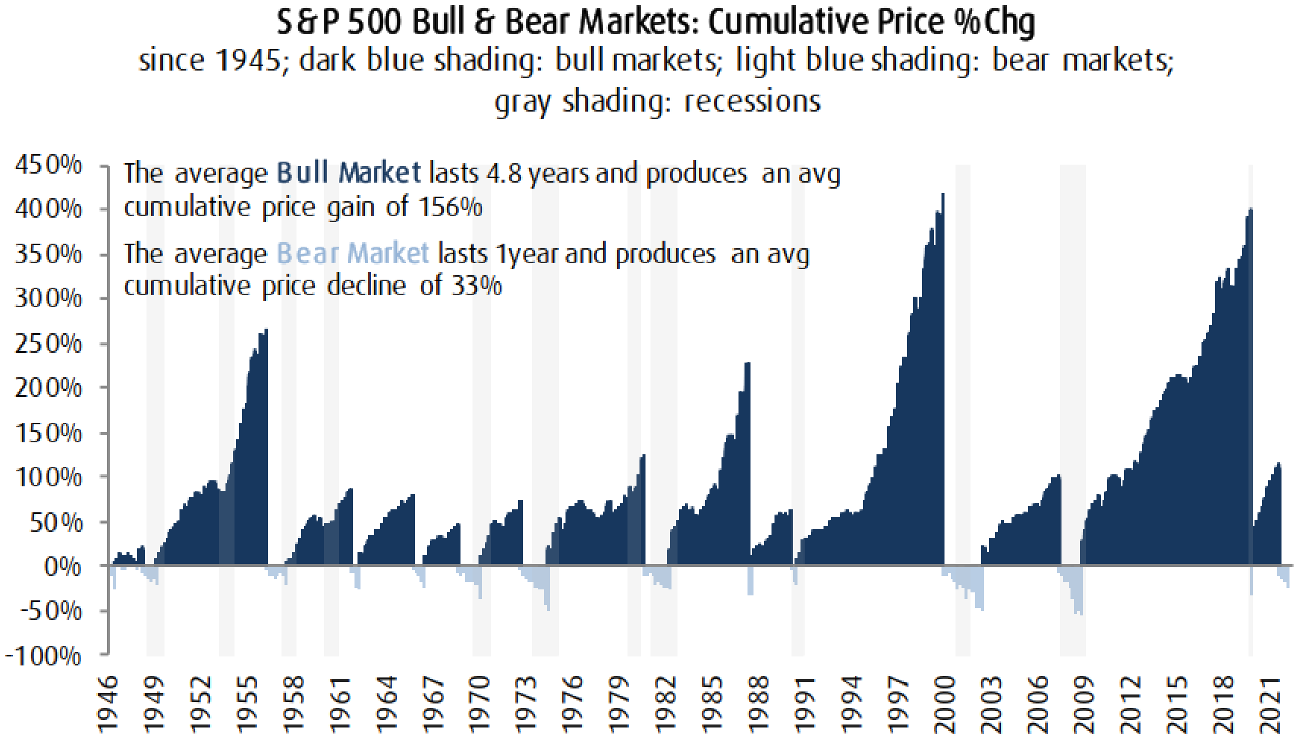
Given the fears surrounding a recession, a look back at historical stock market performance during past recessions might offer some perspective. One of the key conclusions when one looks back previous recessions is that the economy is not the stock market. Stocks have generated positive returns on average, during economic downturns. The S&P 500 has surprisingly risen an average of 1% during all recession periods going back to the 1940's. That's because stock markets usually reach a peak before the start of recessions and typically bottom out before recessions reach their conclusion. In other words, the worst is usually over for stocks before the worst is over for the economy. The chart that follows does a good job of illustrating this point. The data in the chart highlights returns for the S&P 500 in the 6 months leading up to the recession, the returns during the actual recession itself, and the returns in the 1, 3, 5, and 10 years that follow from the end of the recession. For long-term oriented investors, it's important to consider the columns to the far right in the chart below…the returns 3, 5, and 10 years after the recession.

S&P 500 returns before, during, and 1, 3, 5, and 10 years following the end of the recession:

Recession	6 Months Prior	During the Recession	One Year	Three Years	Five Years	Ten Years
Nov 1948-Oct 1949	9.83%	4.12%	31.48%	87.98%	171.33%	497.04%
July 1953- May 1954	-6.46%	27.57%	35.92%	83.74%	144.81%	294.38%
Aug 1957- April 1938	9.28%	-6.51%	37.31%	66.35%	89.72%	211.33%
April 160-Feb 1961	-1.01%	18.40%	13.61%	35.06%	68.41%	111.33%
Dec 1969 - Nov 1970	-7.78%	-3.45%	11.24%	20.63%	25.16%	145.87%
Nov 1973- Mar 1975	2.86%	-17.90%	28.32%	21.99%	55.33%	252.40%
Jan 1980 - July 1980	7.67%	16.14%	12.92%	55.89%	100.89%	345.64%
July 1981 - Nov 1982	-1.02%	14.66%	25.40%	67.24%	103.23%	350.51%
July 1990 - Mar 1991	3.09%	7.64%	11.04%	29.84%	98.21%	284.66%
Mar 2001 - Nov 2001	-17.84%	-7.18%	-16.51%	8.44%	34.33%	33.16%
Dec 2007 - June 2009	-2.33%	-35.46%	14.43%	57.70%	136.98%	294.17%
Mar 2020- April 2020	1.92%	-1.12%	45.98%	???	???	???
Average Cumulative Return			**20.90%**	**48.60%**	**93.50%**	**256.40%**

Instead of worrying about a recession that is just around the corner, investors should consider the possibility that we are already in a recession. First quarter 2022 US GDP was -1.6%. According to the Federal Reserve Bank of Atlanta's GDP Now forecasting model, US GDP growth for Q2 2022 is estimated to be -2.1%. Economic recessions are defined as 2 consecutive quarters of negative GDP growth, so based on the latest data that is available, it is possible that we are already in a recession.

The S&P 500 Index entered a bear market on Monday June 13, 2022. Bear markets are defined as a 20% decline from recent highs. As seen in the chart below, the average bear market decline of the last 75 years was approximately 33%.



Based on where the S&P 500 was trading at the end of the second quarter, there could be further downside of 11-12% if the current bear market proves to be an average bear market. For long-term investors, this downside risk should be viewed in the context of the long-term returns that have been generated following recessions. Over the last 70 years the average 1, 3, 5, and 10-year forward cumulative returns for the S&P 500 following a recession are +20.9%, +48.6%, +93.5% and +256.4%, respectively (as seen in first chart).

So how should investors position their portfolios in light of all the uncertainties that exist today? We believe it's about striking the right balance. Given the current backdrop of inflation and war, we have tweaked our portfolios to give them more of a defensive tilt and we have also raised some cash. Given the steep year-to-date decline, the S&P 500 was within 11-12% of the average bear market return of -33% as of the end of the second quarter. Given this backdrop, we don't believe that now is the time to completely abandon equities. We are maintaining exposure to equities but we are doing so in a more conservative manner with some cash on hand. Given the weakness in global equity markets, we are preparing a list of stocks so we are ready to deploy our cash opportunistically when we feel the time is right. We remain confident in the long-term outlook for the businesses we own and we are satisfied that our portfolios hold the types of companies that can weather the storms of inflation and possible recession.

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