



Brighton Jones®

Q4 2022
Investment Update



Q4 2022 Investment Update

Contents

Historical Expansions/Contractions

2022 Portfolio Component Performance

Q4 Portfolio Component Performance

2022 Performance by Morningstar Equity Style

Brighton Jones Equity Exposure

2022 Range of Returns for S&P 500 Constituents

What it takes to recover

Inflation Trends

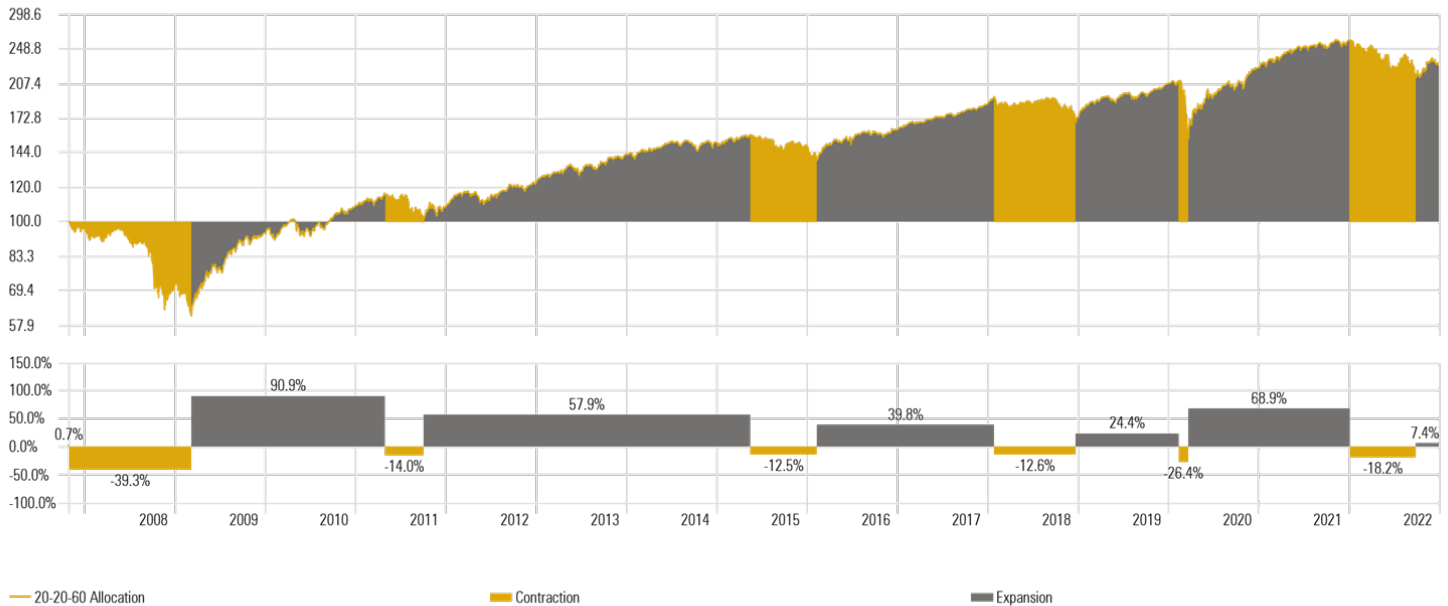
Calibrating Portfolio Positioning

Expansions and Contractions: 60% Equity Portfolio

Investment Growth

Time Period: 10/31/2007 to 12/31/2022

Define drawdown as decline by 10% or more



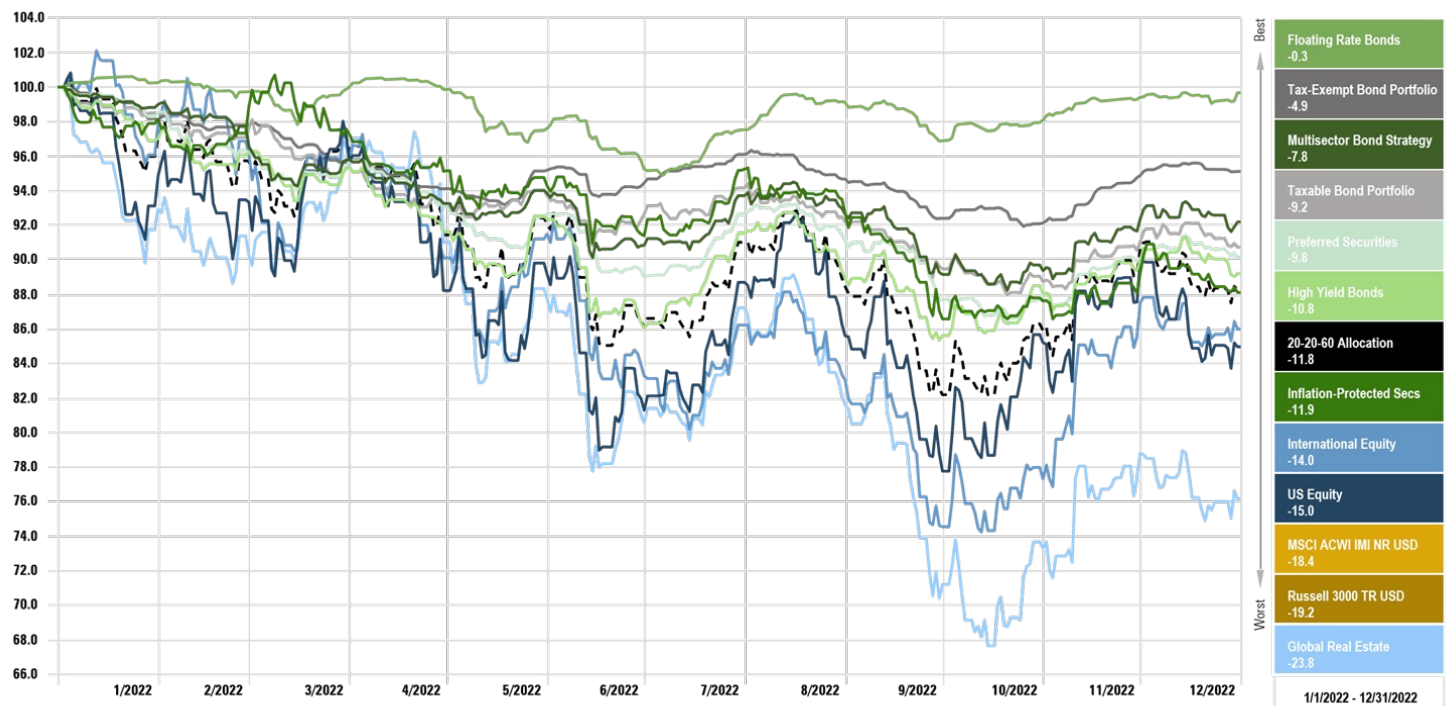
This chart shows the growth of a moderate risk portfolio—with a 60% weighting to stocks—since the peak of the market before the global financial crisis. The bottom half of the page shows the length and magnitude of expansionary and contractionary periods during the 15 years shown.

Key Takeaways:

- Scary headlines were unrelenting throughout 2022. The US Aggregate Bond Market suffered its largest drawdown in history, the US Stock Market suffered its worst calendar year return since the Global Financial Crisis, year-over-year inflation reached levels not seen since the 1970s, and would-be home buyers are contending with mortgage rates that are now double where they started the year.
- Against this backdrop, investors might perceive the volatility we experienced this year to be higher than normal. But this is the 6th time in the past 15 years a diversified portfolio has experienced a drawdown of 10% or more. If there's one thing that's always important to remember, it's that volatility is a normal part of investing. And despite these temporary setbacks, capital markets have a long history of rewarding investors for the capital they supply. While down markets are always difficult to endure in real time, zooming out and looking at the long-term growth of a portfolio makes it easy to see there was nothing remarkable about what broadly diversified investors experienced in 2022—we've been here before and have managed through challenging times again and again. We do not believe this time will be any different.
- We noted at the end of last quarter that it's moments like this where attractive investment opportunities start to show up. We cited that US treasury notes are yielding 4% and riskier bond market segments are yielding 6-8%. Moreover, if equity markets take three years to recover from the ~25% year-to-date decline as of the end of Q3, investors would earn about 10% per year on average during the recovery period. Indeed, without any notable or concrete catalysts to speak of during the fourth quarter, both fixed income and equity markets posted strong returns in the final three months of the year, driving portfolios more than 7% higher. A typical 60% equity portfolio ended the year down approximately 12%.

Data Disclosures: Moderate Risk Portfolio: 10% Short-Term Bonds, 10% Intermediate-Term Bonds, 4% Inflation-Protected Bonds, 4% Multisector Bonds, 4% Floating Rate Bonds, 4% High Yield Bonds, 4% Preferred Securities, 34.5% US Stocks, 18% International Stocks, 4.5% Global Real Estate, 3% Master Limited Partnerships. The foregoing information is provided for discussion purposes only and should not be relied upon as indicating any expected or projected returns. Hypothetical back-tested performance does not represent actual performance, trading costs or the impact of taxes and should not be interpreted as an indication of such performance. Data source: Morningstar Direct.

2022 Performance by Portfolio Component



This chart shows full-year performance for the core market segments within our portfolios, segmented by quarters.

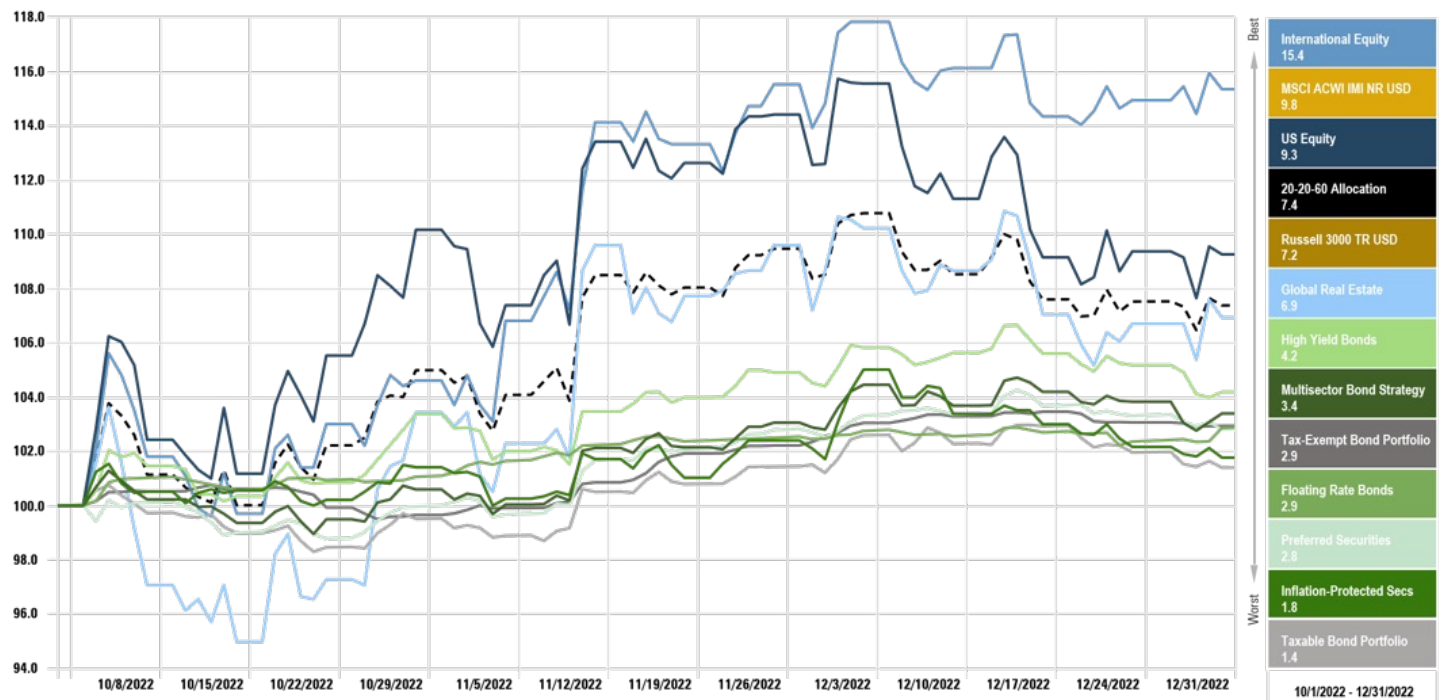
Key Takeaways:

- In the first quarter, equity markets suffered a 10% correction but recovered sharply in the last two weeks of the period—despite Russia invading Ukraine and the Fed's first interest rate hike in March.
- The relief was short-lived as both equity and fixed income markets trended lower throughout Q2, with stocks briefly falling into bear market territory (defined as a decline of 20% or more).
- Q3 was a tale of two halves. Equity markets initially rallied 13% off their June lows; but firmer-than-expected inflation readings laid the groundwork for the Federal Reserve to aggressively hike interest rates at a rate that far exceeded expectations, triggering a renewed selloff in equity and fixed income markets. At the end of Q3, the US Aggregate Bond Market was down 14.6% and the MSCI All Country World Stock Market Index was down 25.7%, which turned out to be the lows in both market segments for the year.
- The Federal Reserve met twice during the fourth quarter, hiking interest rates by 75 basis points in November and 50 basis points in December. Still, fixed income and equity markets rallied sharply, helping portfolios to trim losses as the year closed out.
- What may come as a surprise to many is that international stocks outperformed domestic stocks for the year. With the war between Ukraine and Russia creating uncertainty across Europe and China's strict COVID policies shutting down the world's largest economy outside the US, this is not an outcome many expected.
- Brighton Jones portfolios outperformed basic index strategies with comparable weightings to equity and fixed income, owing to strong outperformance of our global equity managers and broader diversification among fixed income market segments with less duration risk (a measure of sensitivity to changes in interest rates) than the US Aggregate Bond Market Index.
- The outperformance of our global equity allocation can be attributed to our exposure to index-like investment strategies that overweight stocks with low price-to-book ratios (i.e. value stocks) and companies with high profitability. In the current environment, growth stocks and unprofitable companies have declined most from recent highs.

Note: the foregoing information does not reflect the potential impact of client-specific personalization e.g. the exclusion of certain sectors or companies.

Data Disclosures: Taxable Bond Portfolio: 50% Vanguard Short-Term Bond Index + 50% Vanguard Total Bond Market. Tax-Exempt Bond Portfolio: 50% Vanguard Limited-Term Tax-Exempt + 50% Vanguard Intermediate-Term Tax-Exempt. Inflation-Protected Bonds: Vanguard Inflation-Protected Securities. Multisector Bond Strategy: PIMCO Income. Floating Rate Bonds: Fidelity Floating Rate. High Yield Bonds: PIMCO High Yield. Preferred Securities: Nuveen Preferred Securities. US Equity: DFA Core Equity I. International Equity: DFA World ex US Core Equity. Global Real Estate: DFA Global Real Estate. Data source: Morningstar Direct.

Q4 Performance by Portfolio Component



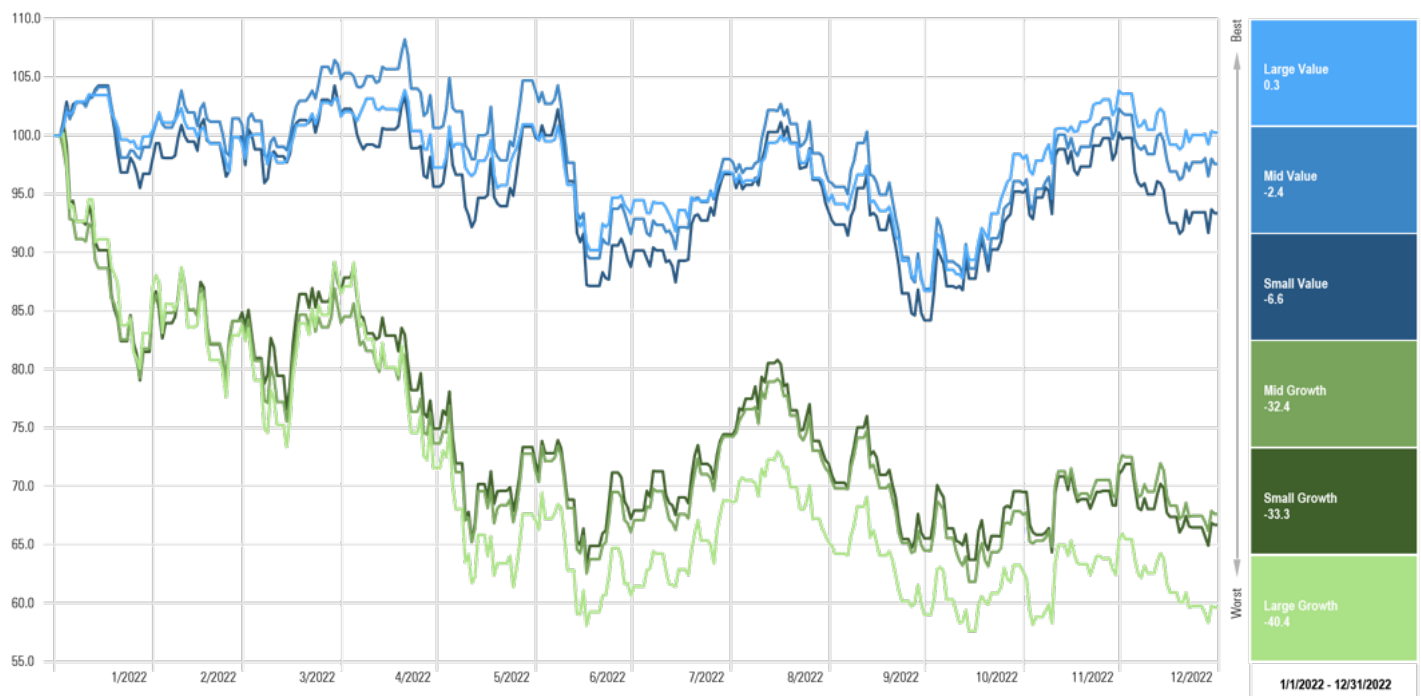
This chart shows Q4-2022 performance for the core market segments within our portfolios.

Key Takeaways:

- Zooming in on the fourth quarter, every asset class posted positive performance, with international stocks leading the way.
- Our US equity portfolio added to its year-to-date outperformance over the Russell 3000 Index during the fourth quarter. As noted on the previous slide, this can be attributed to our exposure to index-like investment strategies that overweight stocks with low price-to-book ratios (i.e. value stocks) and companies with high profitability. Even as domestic equity markets climbed higher throughout the quarter, many large cap growth stocks (an area we are structurally underweight) did not participate and ended the year at or near lows.
- There was not a concrete catalyst that sparked the fourth quarter rebound. This observation highlights the importance of staying invested in times like these. By the time happier headlines dominate the news cycle, markets are likely to be much higher.

Data Disclosures: Taxable Bond Portfolio: 50% Vanguard Short-Term Bond Index + 50% Vanguard Total Bond Market. Tax-Exempt Bond Portfolio: 50% Vanguard Limited-Term Tax-Exempt + 50% Vanguard Intermediate-Term Tax Exempt. Inflation-Protected Bonds: Vanguard Inflation-Protected Securities. Multisector Bond Strategy: PIMCO Income. Floating Rate Bonds: Fidelity Floating Rate. High Yield Bonds: PIMCO High Yield. Preferred Securities: Nuveen Preferred Securities. US Equity: DFA Core Equity I. International Equity: DFA World ex US Core Equity. Global Real Estate: DFA Global Real Estate. Data source: Morningstar Direct.

2022 Performance by Morningstar Style Box



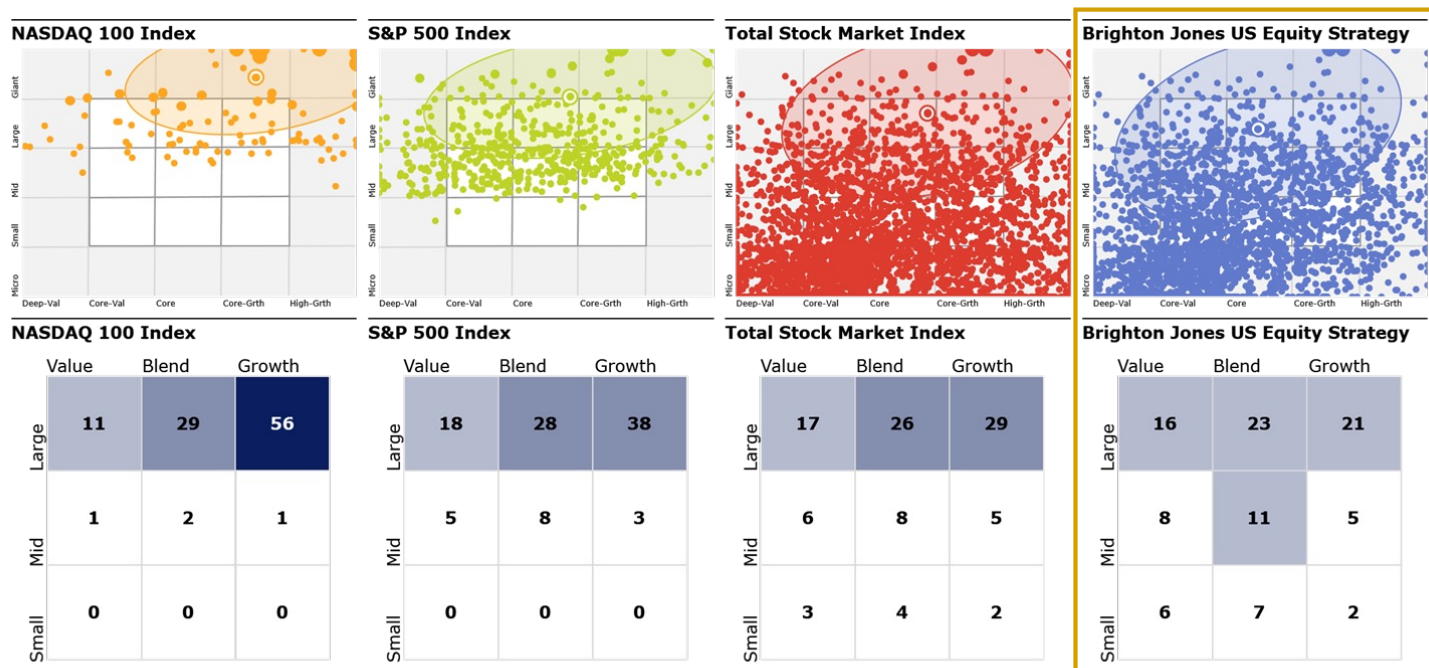
This chart shows the performance of Morningstar Style Box Indexes.

Key Takeaways:

- In a reversal of fortune from previous years, value stocks outperformed growth stocks significantly.
- Our core equity strategies outperformed materially in 2022 owing to a structural overweight to value stocks.

Data Disclosures: Source: Morningstar Direct.

Brighton Jones Equity Exposure



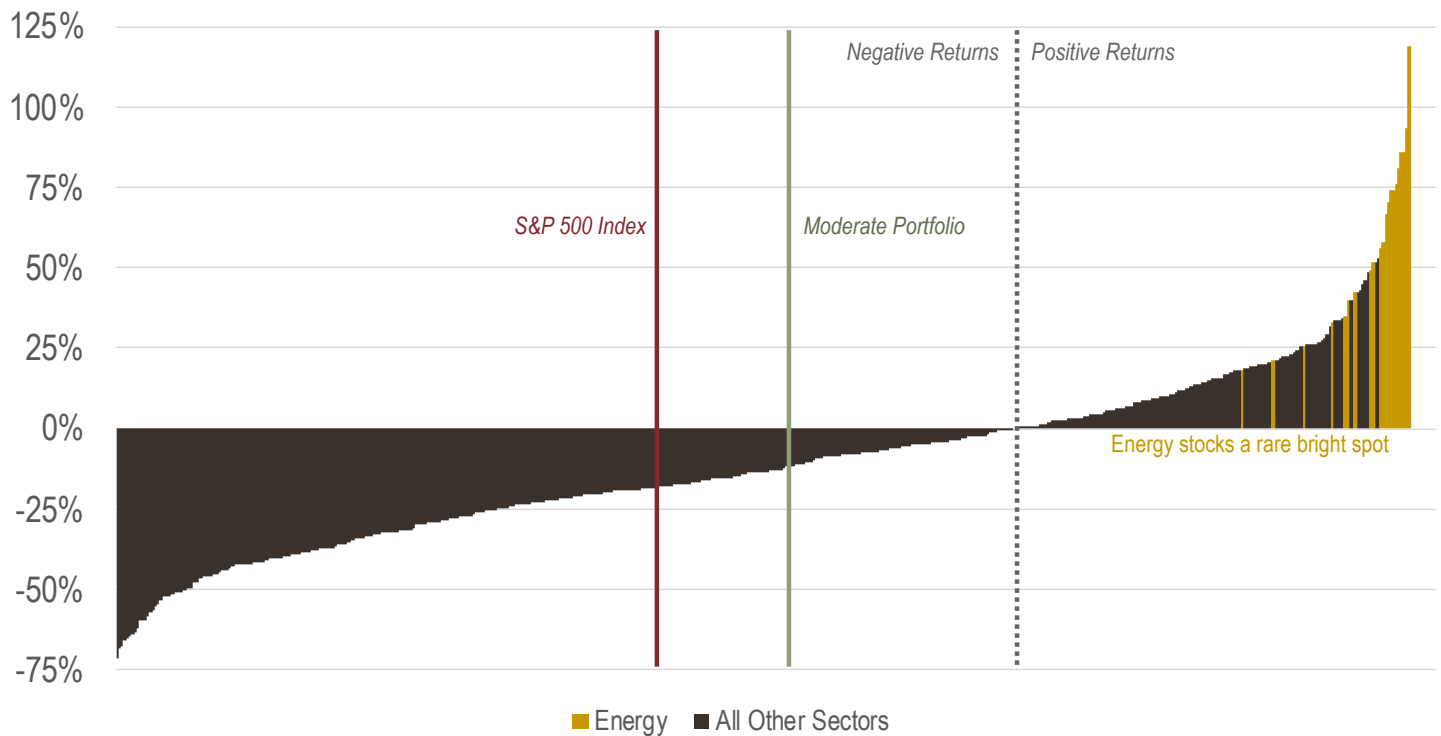
This chart illustrates how our exposure to equity style boxes (right) compared to popular indexes at the start of 2022.

Key Takeaways:

- Certain indexes like the NASDAQ 100 and S&P 500 have heavy exposure to large cap growth stocks.
- And, looking under the hood, these indexes also have high exposure to just a small handful of companies. For example, about 40% of the NASDAQ was concentrated in Apple, Amazon, Microsoft, Google, Facebook/Meta, and Tesla at the start of the year.
- The equity exposure in a Brighton Jones portfolio is more broadly distributed among the style boxes, with a material underweight to Large Cap Growth Stocks relative to the S&P 500.
- The last two years have been favorable as we've seen value stocks come back in favor.

Data Disclosures: Source: Morningstar Direct.

S&P 500 Index: Dispersion of Returns



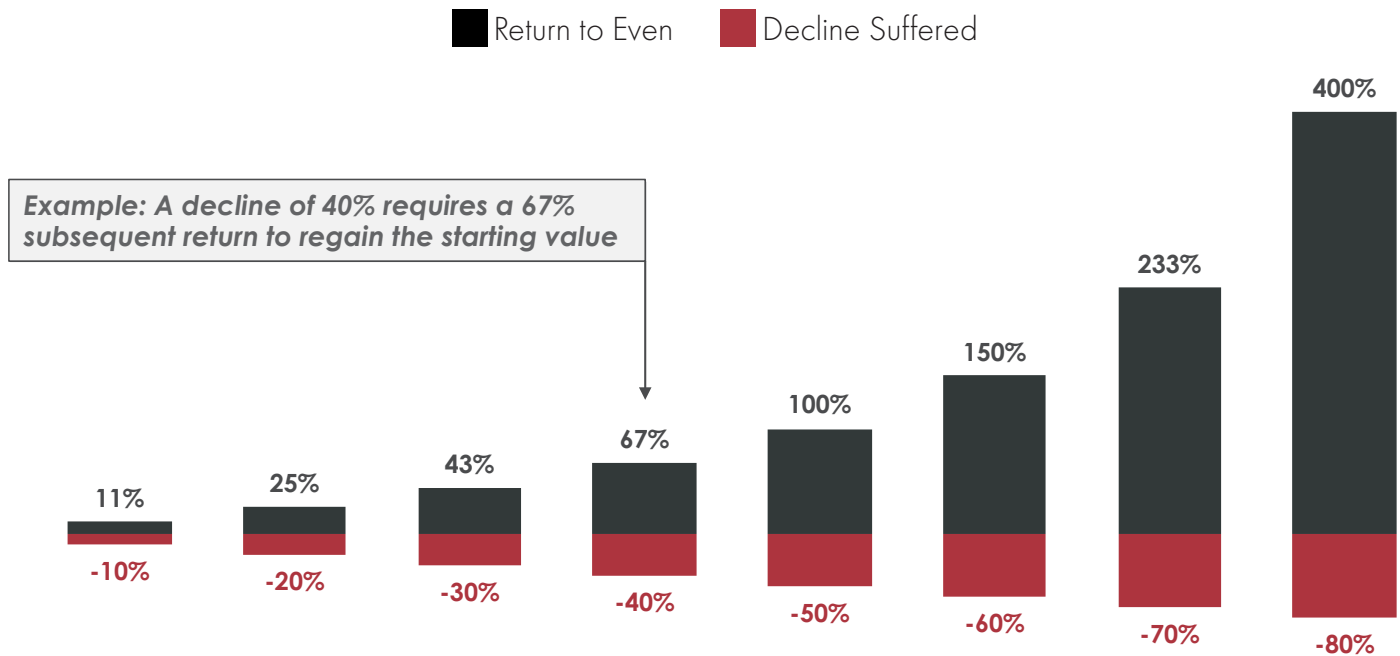
This bar chart sorts individual stock returns of S&P 500 companies from low to high. The visual allows you to see the range of returns among S&P 500 constituents as well as the proportion of companies that fell above or below a certain return threshold. For reference, we indicate where the returns of a Moderate Portfolio and the S&P 500 Index fall inside the range of individual company returns. We also highlight the energy sector in yellow to illustrate the high concentration of these companies at the top of the performance rankings.

Key Takeaways:

- Diversification cannot be expected to protect investors against periods of negative returns—down years are inevitable. But what diversification is quite successful at doing is protecting investors against outcomes that are extremely difficult to recover from.
- As a group, large cap growth stocks were down 40% in 2022; and two of the largest companies within that group (Tesla, Meta) declined 65%.
- Whereas the road to recovery for some concentrated stock pickers might be a long one, investors who follow reasonable guidelines of diversifying among and within asset classes are well positioned for what the future holds.

Data Disclosures: Moderate Risk Portfolio: 5% Short-Term Bonds, 5% Intermediate-Term Bonds, 4% Inflation-Protected Bonds, 4% Multisector Bonds, 4% Floating Rate Bonds, 4% High Yield Bonds, 4% Preferred Securities, 34.5% US Stocks, 18% International Stocks, 4.5% Global Real Estate, 3% Master Limited Partnerships. Data source: Morningstar Direct.

What it Takes to Recover



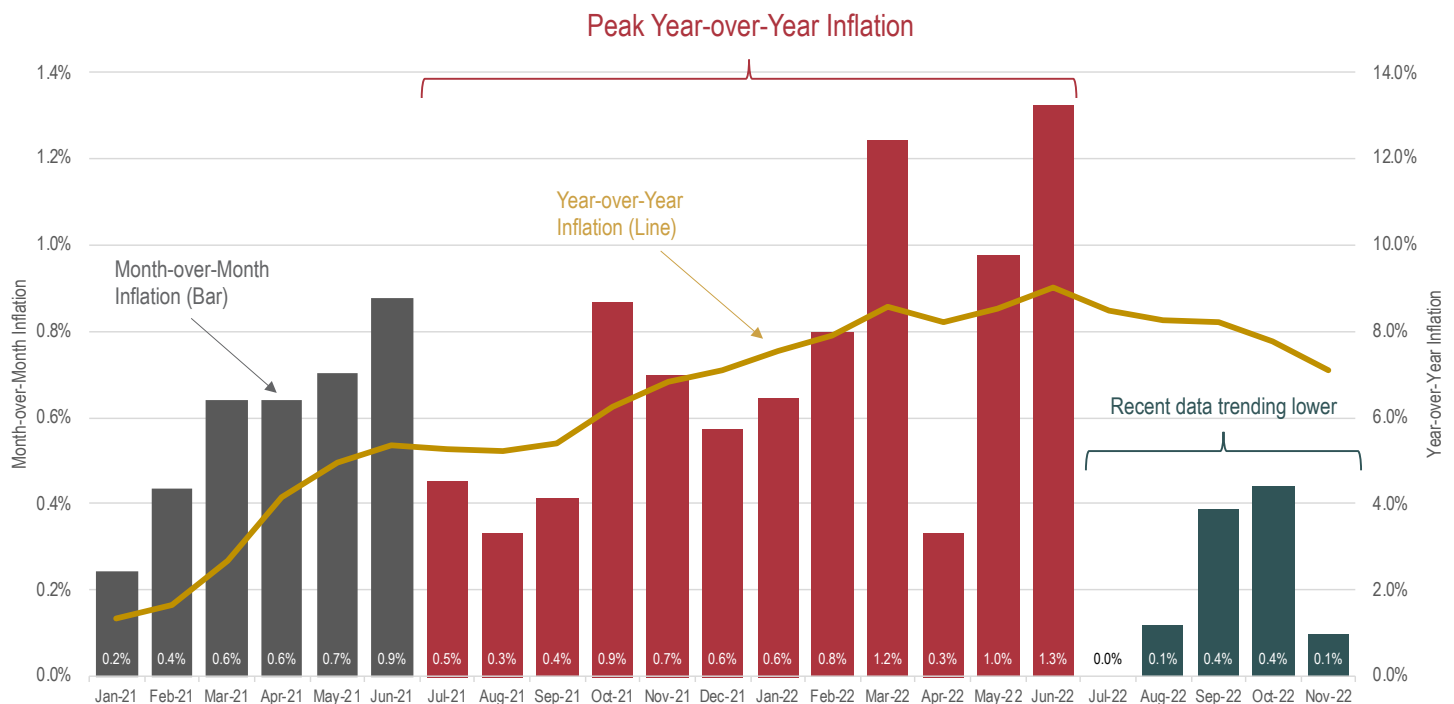
Bonds → Diversified Portfolios → Stock Market Indexes → Niche Themes → Single Stocks / Crypto

Building on the previous slide, this diagram shows the return an investor needs to “get back to even” on a position or portfolio for a given decline. For example, a position or portfolio that declines 40% needs a 67% subsequent return to fully recover.

Key Takeaways:

- Historically, diversified portfolios owned by disciplined investors have weathered a great deal of uncertainty en route to earning attractive long-term returns.
- In our view, chasing niche themes and picking individual stocks introduces considerable risk that often goes uncompensated.
- Over the past year, investors have seen crypto currencies collapse; once-hot stocks like Zoom, DocuSign, Netflix, Robinhood (and many more) have fallen by more than 80%; and niche themes like IPOs, Cloud Computing, Work from Home (and many more) have also declined considerably more than the total stock market.
- The road to recovery for risky behavior can be much longer and uncertain than a broadly diversified investment strategy.

Inflation Trends



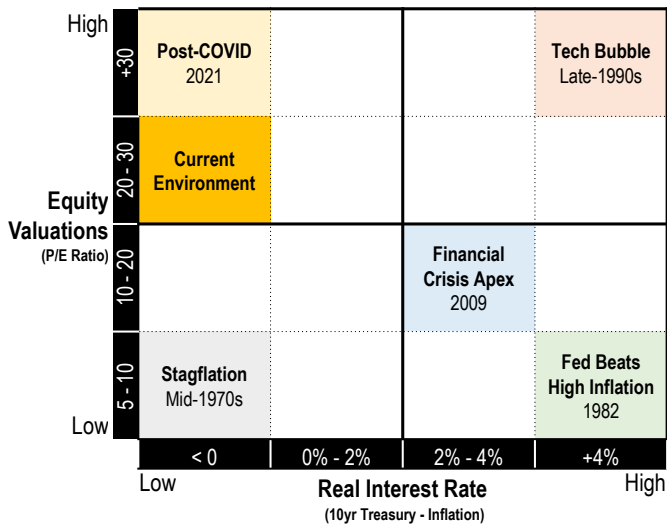
This chart shows month-over-month inflation (bars, left axis) and year-over-year inflation (line, right axis).

Key Takeaways:

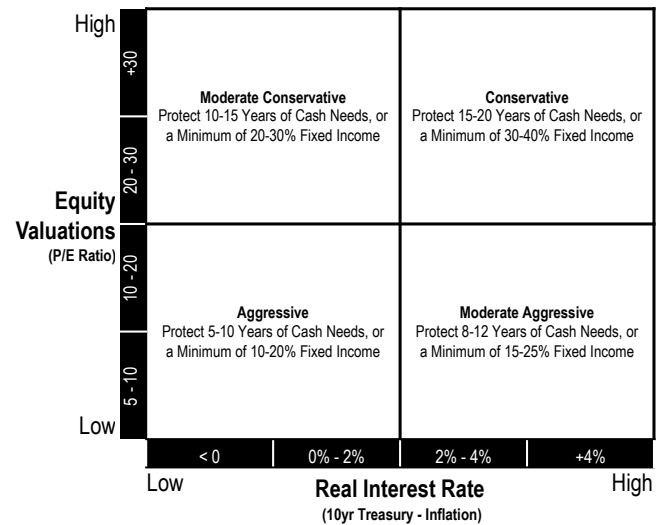
- Elevated inflation has been an ongoing concern for consumers and a key driver of investment returns across fixed income and equity markets. Consumers and investors alike are anxiously monitoring inflation trends and hoping for signs that price pressures are beginning to ease.
- Headlines typically focus on year-over-year inflation but looking at monthly inflation readings can reveal potential trends sooner. In identifying emerging trends, it's helpful to visualize the annual inflation rate as a 12-month moving window, where each month the oldest number drops off and is replaced by a newly revealed number.
- Shaded in red are the twelve monthly inflation readings included in the highest year-over-year inflation rate of 9%. The annual inflation rate started to decline in the summer as the twelve-month window shifted to the right, with a monthly reading of 0.5% from July-21 being replaced by a new monthly reading of zero in July-22.
- Many economists have predicted that inflation will continue to come down through June of 2023. This isn't because they have a crystal ball and know what the future inflation readings will be. They are simply looking at the data and can see that large readings in excess of 1% will start to drop out of the twelve-month moving window starting in March. Hence, predictions saying that inflation will come down is more or less a guess that the monthly numbers dropping out of the twelve-month moving window will be replaced by smaller numbers.
- Should the prevailing trend of lower inflation readings continue, investors are likely to feel a sense of relief and hope that the Federal Reserve will pause in hiking interest rates.

Calibrating Portfolio Positioning

Benchmarking the Investment Environment



Calibrating Risk for the Environment



With large movements in fixed income and equity markets, clients might be wondering what we look for when considering adjustments to our investment strategy. The diagram on the left illustrates how we characterize the investment environment using a quadrant chart with inflation-adjusted treasury yields on the horizontal axis and equity valuations on the vertical axis. Along each axis, we denote the break-points used for segmentation; and within each quadrant we identify at least one period that stands out as having historical significance. We then calibrate our allocation positioning according to the quadrant chart on the right. When equity valuations are low (bottom half), we want increased exposure to stocks, all else equal. When real interest rates are high (right half), we want increased exposure to bonds, all else equal. Importantly, we consider allocation adjustments when there are changes in the relative attractiveness of fixed income and equity market segments. For the past several years, the investment environment has fallen in the upper left quadrant, which is indicative of low prospective returns. One of our key investment principles states that when high returns aren't in prospect, we don't want to invest as if they are. Hence, we have maintained a "moderate conservative" posture towards risk.

Key Takeaways:

- Despite rising interest rates and declining equity valuations throughout 2022, we have not categorically shifted into a different investment environment.
- Nominal interest rates have increased dramatically but real interest rates remain negative adjusted for inflation. Equity valuations have retreated significantly from a year ago, but do not represent the type generational buying opportunity seen in 1982 and 2009.
- While the forward-looking return environment has improved since the start of the 2022, the relative attractiveness of fixed income vs. equities has not materially changed. Hence, we believe our current portfolio positioning has us appropriately balanced for the time being.
- Of course, we will consider adjustments as warranted by a changing investment environment; but we do not want to make changes just for the sake of making changes.

Brighton
Jones®

Contact Us at www.BrightonJones.com