Brighton Jones®

Q1 2023
Investment Update

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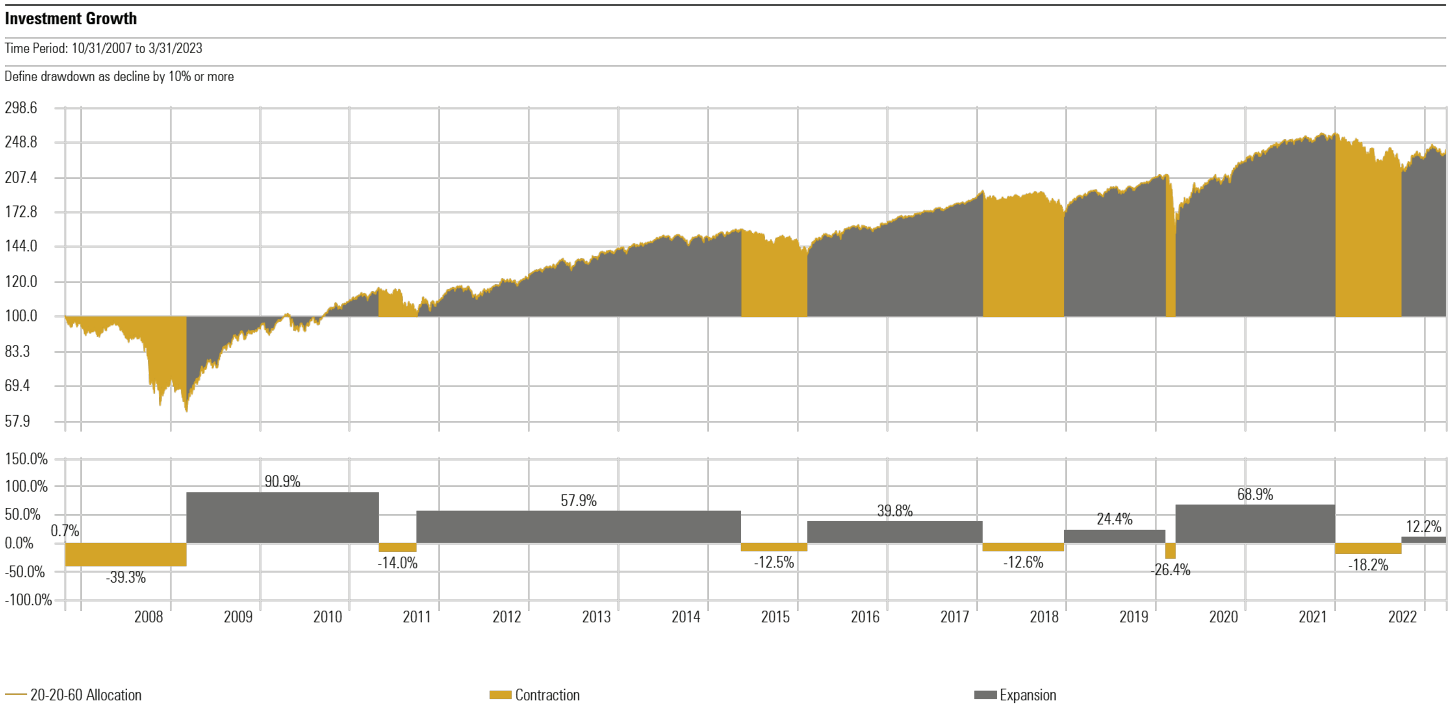
Contents

Expansions and Contractions: 60% Equity Portfolio



About this Chart: This chart shows the growth of a moderate risk portfolio—with a 60% weighting to stocks—since the peak of the market before the 2008 global financial crisis. The bottom half of the page shows the length and magnitude of expansionary and contractionary periods during the fifteen years shown.

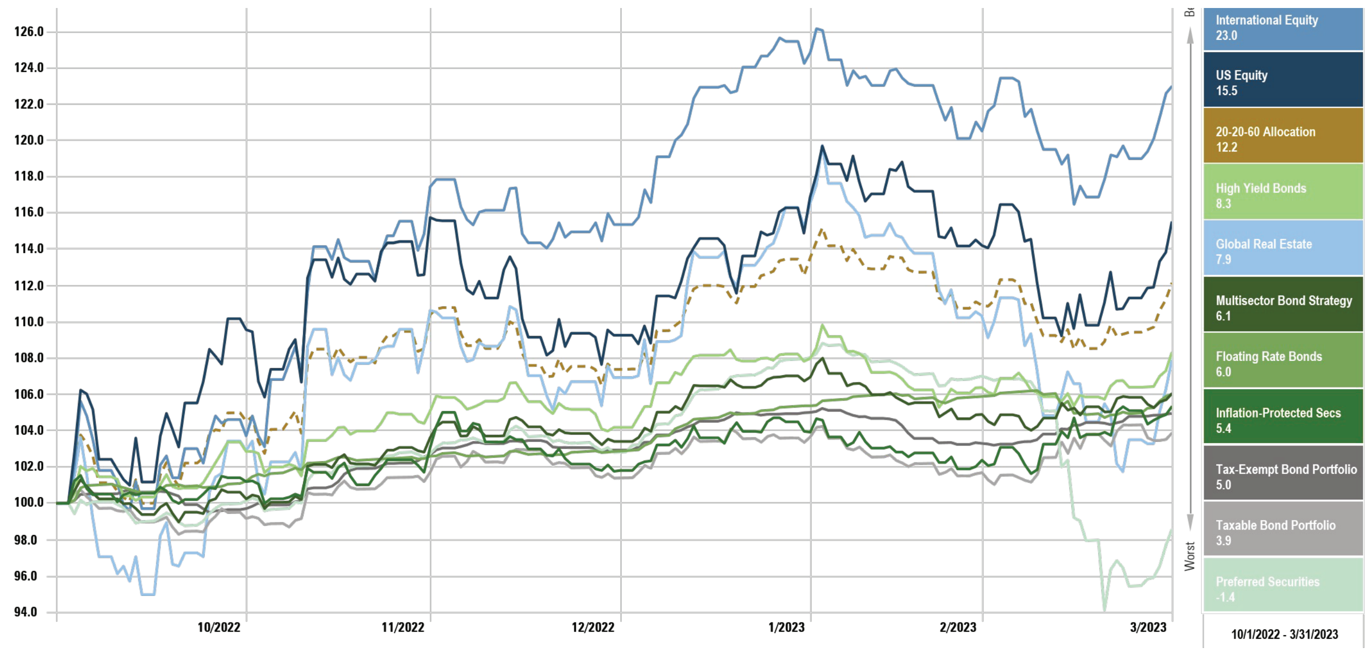
Key Takeaways:

- Over the past fifteen years, a diversified portfolio has experienced a drawdown of 10% or more on six occasions. If the recent low on September 30 holds, last year's peak-to-trough decline of roughly 18% over 269 days (9 months) will have closely matched the average experience of the five previous episodes, which saw an average peak-to-trough decline of roughly 20% over 258 days.

- Without any notable or concrete catalysts to speak of at the time, diversified portfolios found a bottom on September 30, and have rallied more than 12% over the past six months. This serves as reminder that capital markets will never send an "all clear" signal for us to invest near the bottom, and if we wait for one to appear, chances are markets will be much higher. Indeed, the recent gains have coincided with continued interest rate hikes, firmer-than-hoped-for inflation readings, and a regional banking panic.

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.*

Component Performance: Tracking the Recovery



About this Chart: This chart shows performance for the core market segments within our portfolios since September 30, 2022—the low point for a diversified portfolio in the current market cycle.

Key Takeaways:

- On September 30, the target range for the Federal Funds Rate was 3.00% to 3.25%. In the four interest rate policy meetings that have taken place since, the Federal Reserve has increased the range to 4.75% to 5.00%. Despite continued interest rate hikes, fixed income markets have rallied sharply over the past six months.

- While diversified portfolios reached a low on September 30, the US Aggregate Bond Market Index did not reach its low until October 24. The US Aggregate Bond Market Index returned 7.6% from its low to the end of Q1-2023. This once again shows that fixed income markets typically find a bottom before the Federal Reserve is done raising interest rates and, similar to equity markets, it can be a costly mistake to sell bonds after a price decline hoping to sidestep further declines.

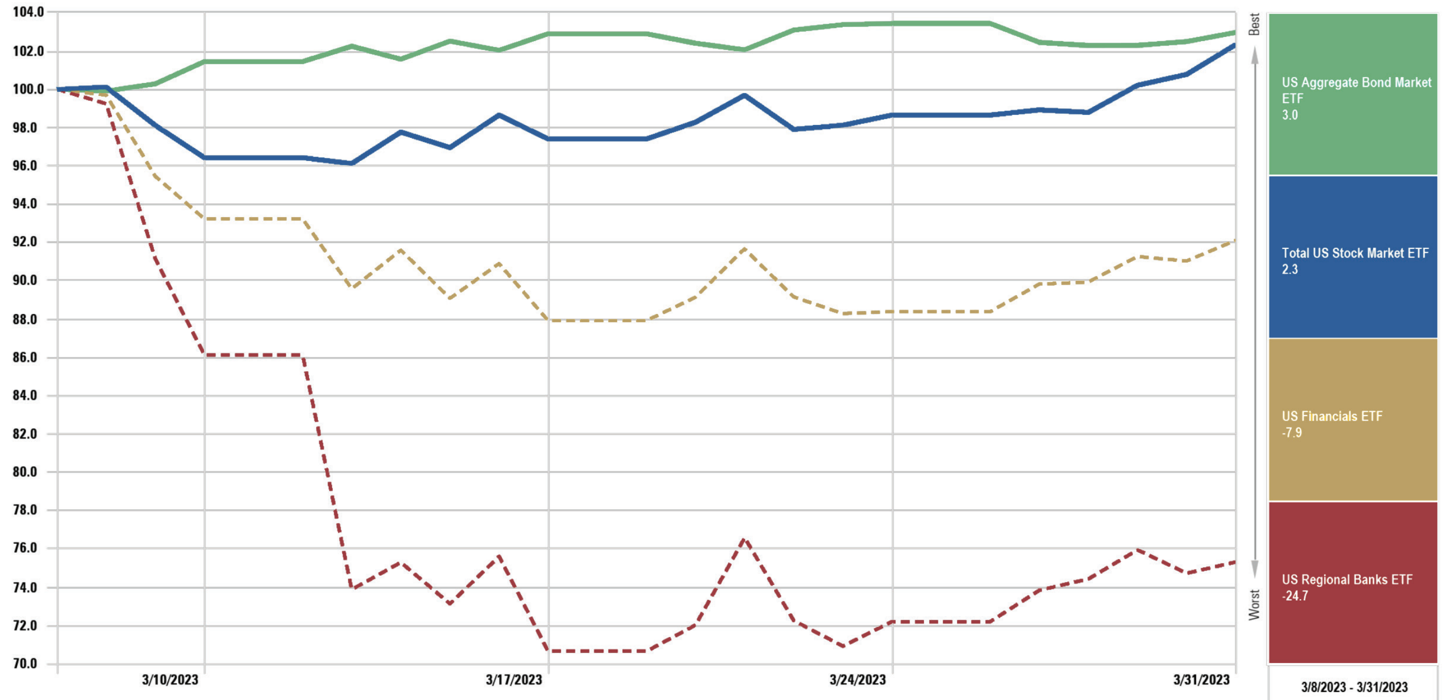
- With the war between Ukraine and Russia creating uncertainty across Europe and China's strict COVID policies shutting down the world's largest economy outside the US throughout much of 2022, many clients have been nervous about their international equity exposure. In our recent performance reviews with clients, it has come as a surprise to many that international markets outperformed the US market last year and have outperformed considerably—by 7.5%—over the past two quarters.

- One of our investment principles states that price—not quality—is the primary determinant of risk. One interpretation of this statement is that few opportunities are so inherently bad that they cannot become a good investment if bought cheap enough. The combination of depressed expectations and low relative valuations for international markets help explain what can sometimes feel like a disconnect between financial markets, economic performance, and current news headlines.

- The lone exception to an otherwise solid performance scorecard are Preferred Stocks. Preferred Stocks had rallied sharply along side high yield bonds (up more than 8%) but gave up the gains from the initial rebound during the regional banking scare (financial institutions are among the largest issuers of preferred equity). However, as the asset class experienced indiscriminate selling pressure, preferred stock yields jumped into the high single-digits. As of quarter-end, the selling pressure appears to have abated, and the market segment has started to recover.

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 US Core Equity I. International Equity: DFA World ex US Core Equity. Global Real Estate: DFA Global Real Estate. Data source: Morningstar Direct.*

Muted Reaction to the Regional Bank Scare



About this Chart: This chart shows the performance exchange-traded funds representing the US Aggregate Bond Market, US Total Stock Market, US Financial Sector, and US Regional Banks since March 8, the date Silicon Valley Bank revealed they liquidated approximately $20 billion of treasury and mortgage-backed securities at nearly a $2 billion loss and would seek to raise additional capital.

Key Takeaways:

- As we often say, successfully timing markets requires investors to be right twice—you have to know when to move to cash at the right time, and you have to reinvest before markets recover and push higher beyond the point at which you sold. What played out as the regional banking scare unfolded is likely to have tripped up even the most seasoned traders.

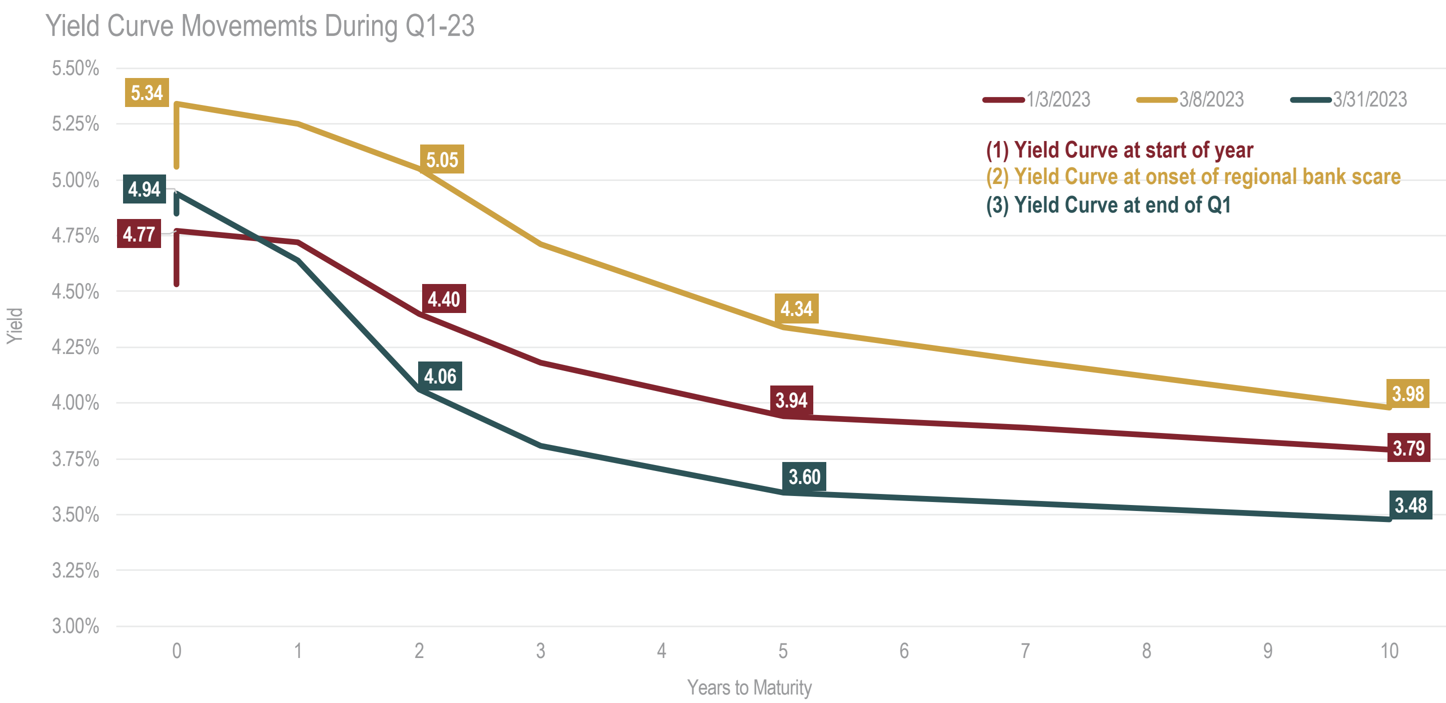
- While regional banks were punished with nearly a 30% decline and the rest of the financial sector was dragged as much as 12% lower in a 10-day period, the US Stock Market suffered only a moderate decline before pushing higher to close out the quarter.

- As of quarter-end, the US Stock Market was 2.3% higher from its March 8th level. The US Bond Market performed even better—up 3%.

- In retrospect, knowing how stock and bond markets performed, a well-reasoned explanation is that investors welcomed the apparent challenges in the banking sector because it likely means the Federal Reserve will end its interest rate hikes sooner than previously expected. Indeed, market-reasoning can be a convoluted exercise. That's why it's so hard to successfully outperform by timing markets and picking individual stocks. Conventional thinking—such as selling stocks at the onset of a potential regional bank run—is likely to land investors in trouble more often than not.

Data Disclosures: *Source: Morningstar Direct.*

Yield Curve Evolution



About this Chart: This chart shows US Treasury Yield Curve on three selected dates: (1) the beginning of the year, (2) at the onset of the regional bank scare, and (3) the end of Q1.

Key Takeaways:

- In the first two months of the year, inflation readings came in firmer than the Federal Reserve wanted to see. This initially caused interest rates across the yield curve to move higher as investors discounted the possibility that the Federal Reserve would need to raise interest rates higher than previously expected.

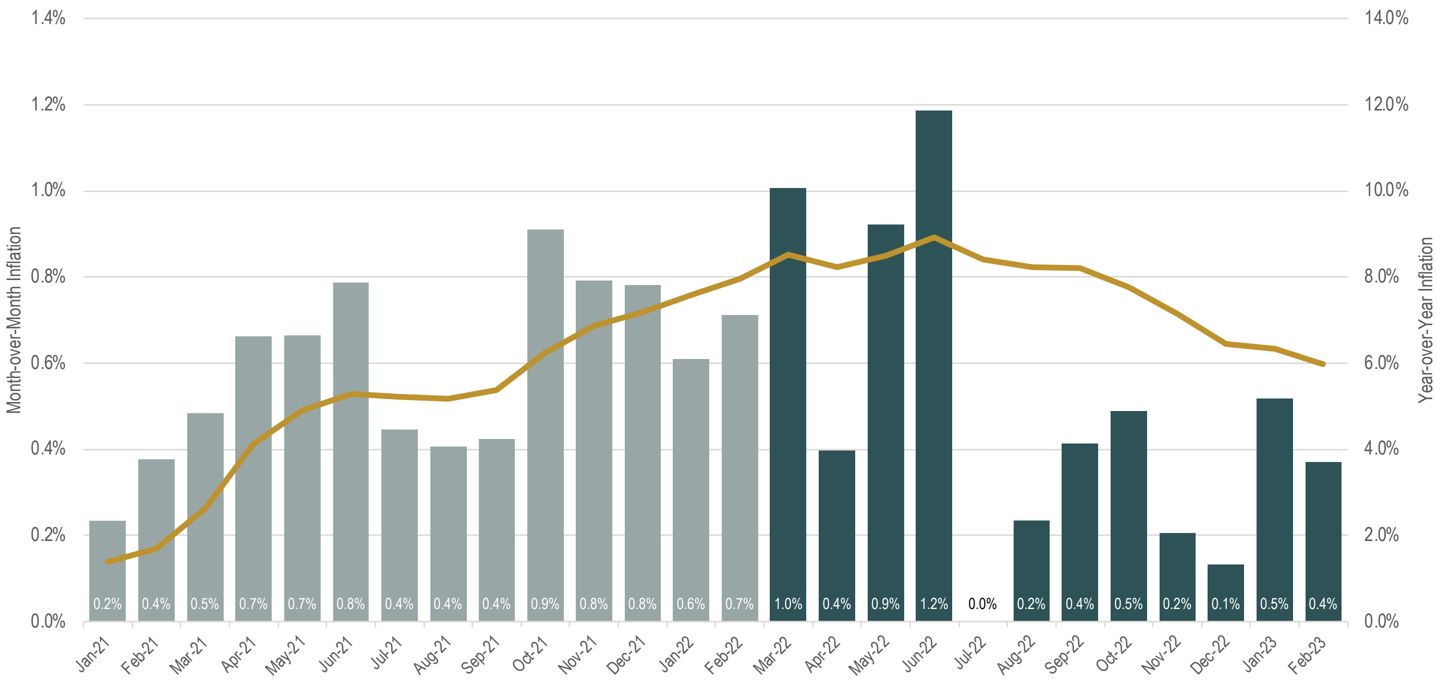
- Interest rates then plummeted amid concerns of the regional bank turmoil. In a matter of days, yields on 2-Year Treasuries dropped from a rate of about 5% to as low as 3.6% (on an intra-day basis) before stabilizing closer to 4%.

- Believing that the FDIC, US Treasury Department, and Federal Reserve took the necessary actions to prevent the problems at a select number of banks from spreading more broadly, the Federal Reserve followed through with another interest rate hike on March 22. Yields on short-term Treasury bills moved higher in lockstep with the rate hike but yields on longer-term Treasuries held roughly constant at lower levels.

- As of quarter-end market participants were pricing in about a 50% probability that the Federal Reserve is done raising interest rates and a 50% probability that there will be one more 25 basis point hike at the next meeting on May 3rd.

Data Disclosures: *Source: Federal Reserve of St. Louis.*

Inflation Trends



About this Chart: This chart shows month-over-month inflation (bars, left axis) and year-over-year inflation (line, right axis). Bars shaded in dark blue represent the most recent 12-month period, over which inflation averaged 6%.

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 will continue to ease (from a peak year-over-year inflation rate of 9% registered June 2022).

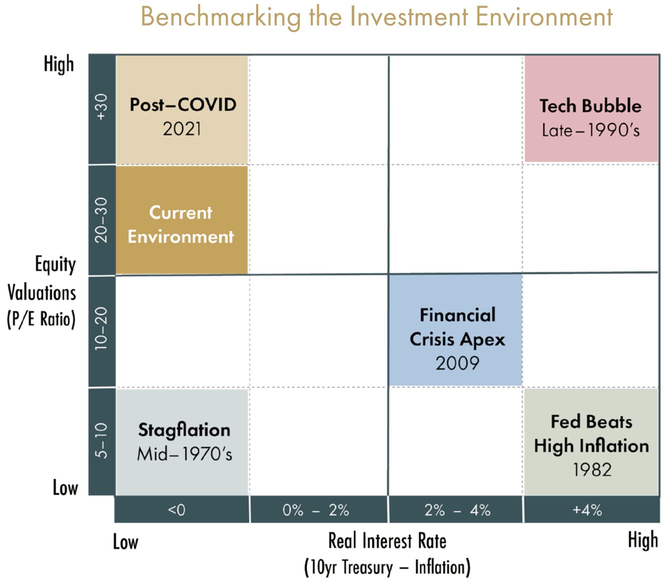
- Headlines typically focus on year-over-year inflation but looking at monthly inflation readings can reveal potential trends sooner. In identifying emerging trends, it's helpful to visualize the annual inflation rate as a 12-month moving window, where each month the oldest number drops off and is replaced by a newly revealed number.

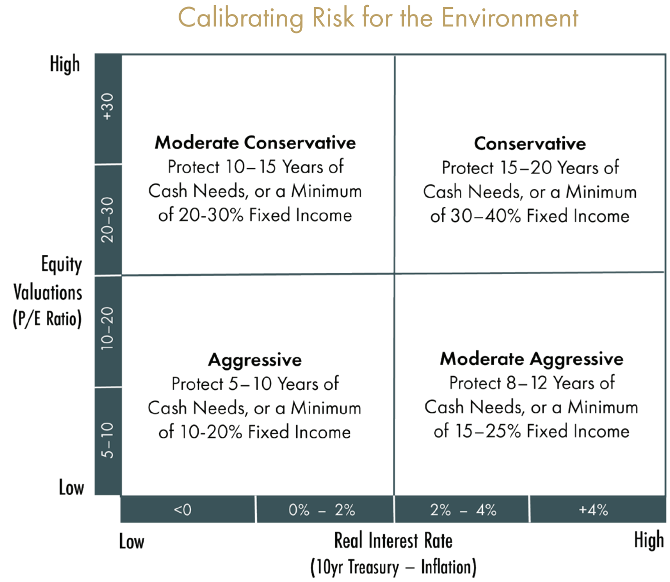
- Many economists have predicted that inflation will continue to come down through June of 2023. This isn't because they have a crystal ball and know what the future inflation readings will be. They are simply looking at the data and can see that a stretch of large readings in excess of 1% will start 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.

- For example, if inflation averages 0.4% per month over the next four months, the annual inflation rate would drop from 6% to 4% for the June reading. If inflation instead averages 0.3% per month, the annual rate will drop to about 3.6%. Note: this is a hypothetical exercise, not a prediction of upcoming inflation readings.

Data Disclosures: *Source: U.S. Bureau of Labor Statistics*

Calibrating Portfolio Positioning





About this Chart: Historical stock market data reveals there is a strong inverse relationship between starting equity valuations and future equity returns over an intermediate time frame of 10-15 years. When starting valuations are low, future returns tend to be above average, and vice versa. Historical bond market data reveals a strong positive relationship between current yields and future fixed income returns. For example, an investor who buys a 5-year bond yielding 4% can expect to earn very close to 4% per year over the term of the bond (the only unknown component to the nominal return of a fixed income security held to maturity is the future interest rate at which income is assumed to be reinvested).

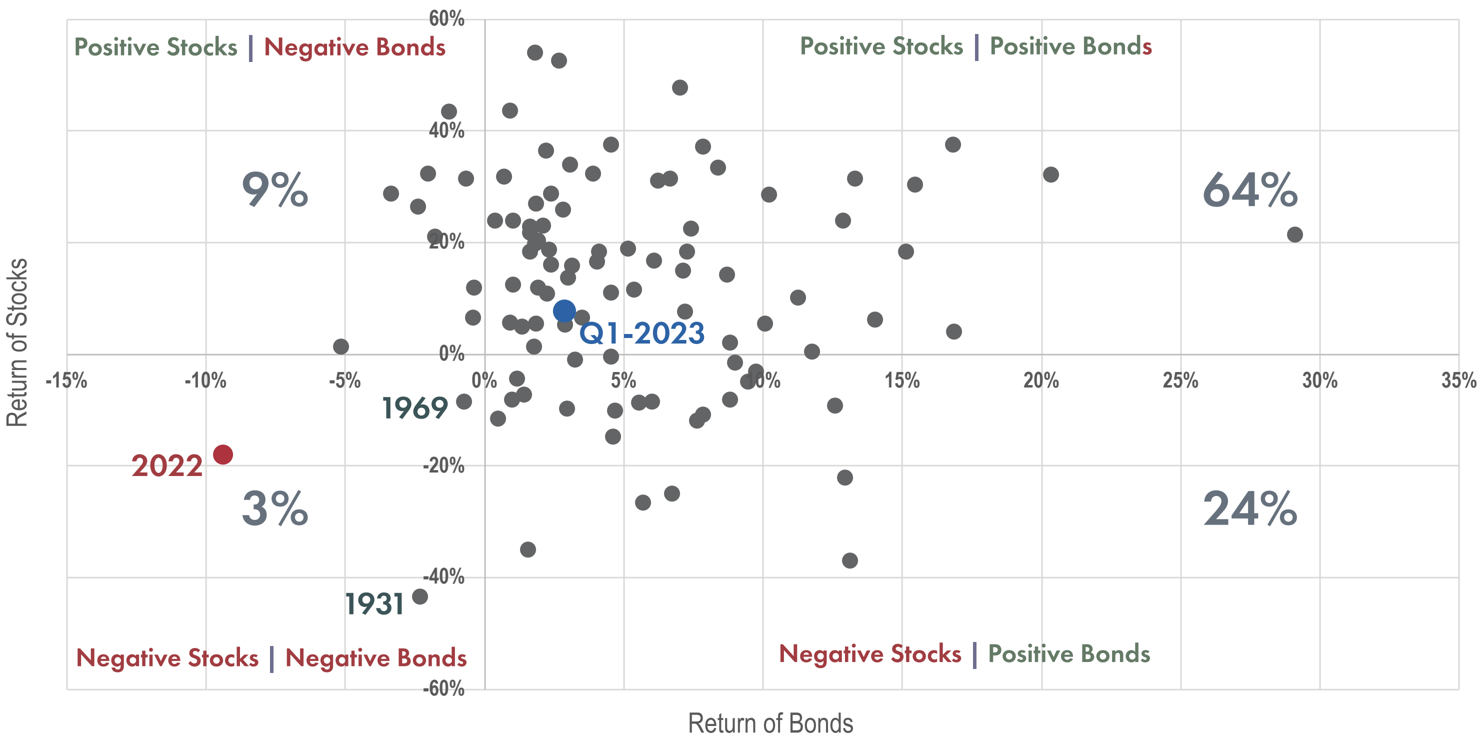
Using this information, we benchmark the current investment environment by deriving absolute return expectations for fixed income and equity markets in isolation as well as relative return expectations between the two asset types (since asset classes are competing against each other for our dollars via expected returns). This exercise helps us determine our portfolio positioning (i.e. the percentage weights of fixed income and equity securities) when equity valuations are high/low and real (inflation-adjusted) interest rates are high/low.

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 breakpoints 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. With large movements in fixed income and equity markets, clients might be wondering what we look for when considering adjustments to our investment strategy.

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 from a year ago, but do not represent the type of generational buying opportunity seen in 1982 and 2009.
- While the forward-looking return environment has improved since the start of 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.

Calendar Year Returns: Stocks vs. Bonds (01/1926 – 03/2023)



About this Chart: This chart plots the calendar year returns of 5-year Treasury Bonds on the horizontal axis against the calendar year returns of the S&P 500 Index on the vertical axis since 1926. This visual offers an easy way for investors to assess the probability of earning positive or negative calendar year returns for fixed income and equity securities in isolation or jointly together (of course, past performance may not be a reliable indicator of future results). For example, to calculate the probability of earning a positive return in fixed income, we can add the two quadrants on the right-hand side together (24% + 64% = 88%); and if we want to identify the probability of earning a positive return in both fixed income and equities, we can just look to the upper right quadrant (64%).

Key Takeaways:

- In 2022, both fixed income and equity markets posted negative returns. This outcome has historically been extremely rare and occurred only twice before last year since 1926.
- As humans, we often extrapolate recent trends. For example, many investors feared a repeat of 2022 with further losses in both fixed income and equity markets throughout 2023.
- Using history as our guide, a repeat of 2022 appears unlikely.
- Through the first quarter of 2023, we are off to a good start with positive returns in both fixed income and equity markets.

Data Disclosures: *Data source: Dimensional Returns 2.0.*

Contact Us at www.BrightonJones.com