Brighton Jones®

Q3 2023
Investment Update

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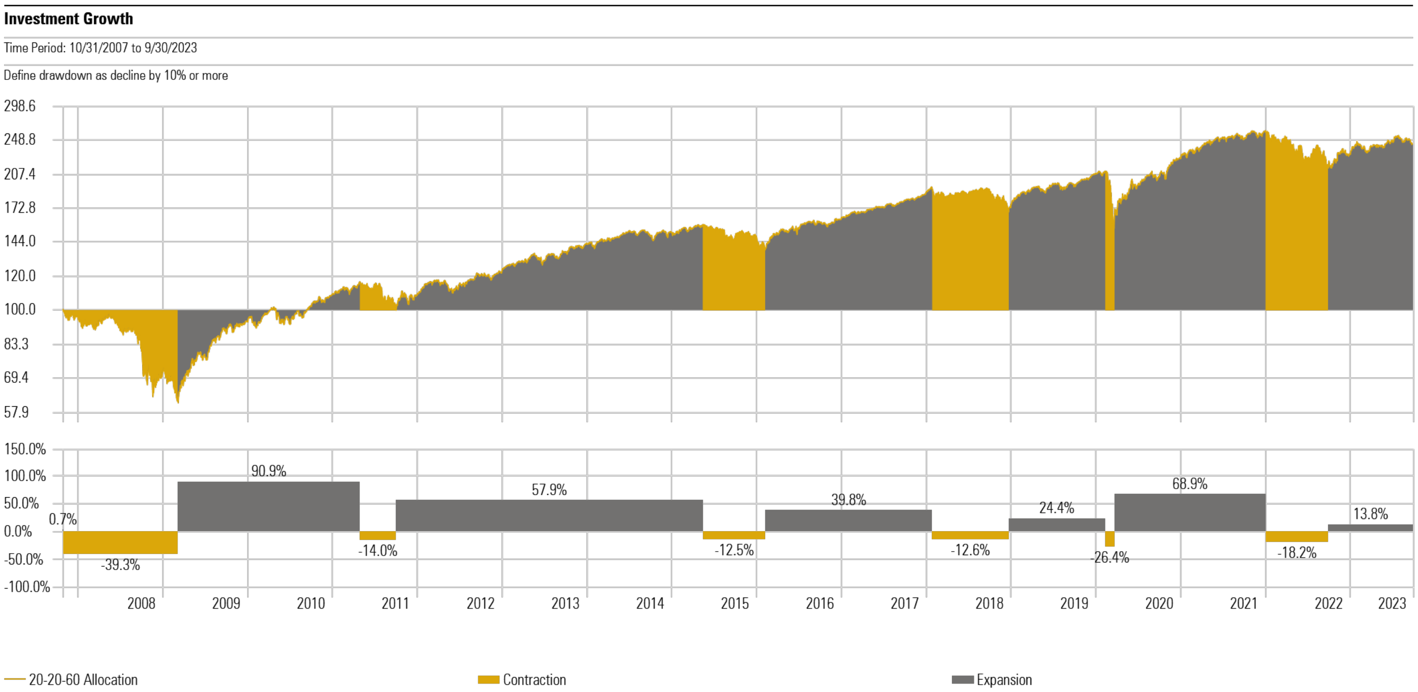
Contents

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 [approximate] fifteen years shown.

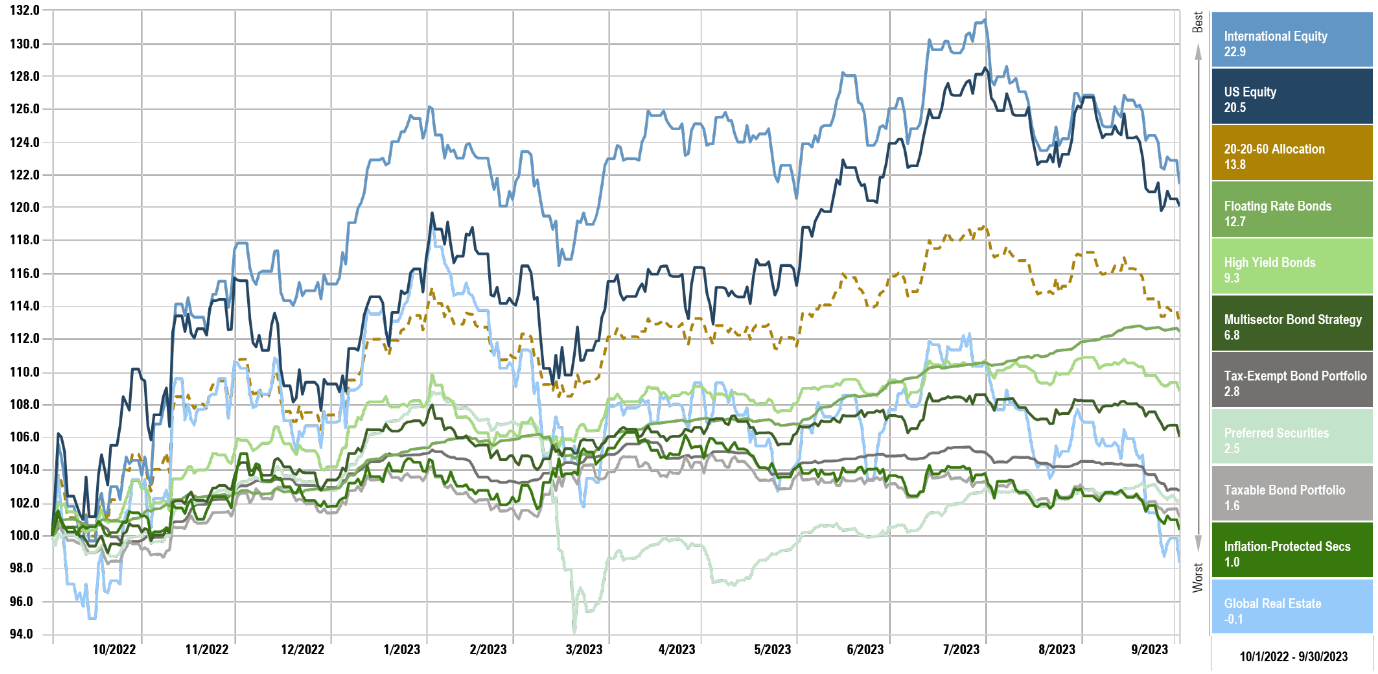
Key Takeaways:

- Over the past fifteen years, a diversified portfolio has experienced a drawdown of 10% or more on six occasions. Last year's peak-to-trough decline of roughly 18% over 269 days (9 months) closely matched the average experience of the five previous episodes, which saw an average peak-to-trough decline of roughly 20% over 258 days. Having found a bottom on September 30th of last year, diversified portfolios have been in recovery mode for the past year with a total return of nearly 14%.

- It is worth noting that there were not any notable or concrete catalysts that marked the beginning of the recovery phase last September. 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 climb higher as we keep waiting. Indeed, the recent gains have coincided with continued interest rate hikes, firmer-than-hoped-for inflation readings, a regional banking panic, fears the US might default on its debt obligations with congress fighting over the debt limit, and ongoing disagreements in congress that may lead to a government shutdown.

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 of 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:

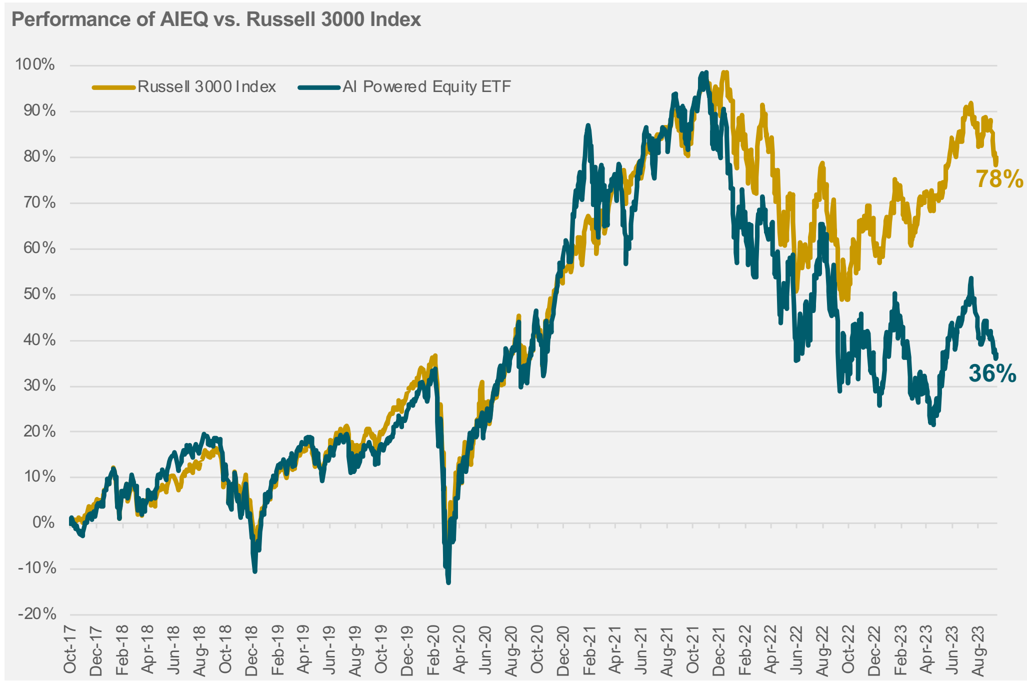
- Investor sentiment was decidedly negative this time last year. The Federal Reserve had aggressively hiked interest rates from the zero bound to 3.25% and indicated additional hikes would be necessary to bring down inflation, which registered 8.2% on a year-over-year basis last September. In turn, many economists and investors believed it to be a foregone conclusion that a recession would hit by mid-year 2023.

- Had a time traveler told you last September that the Federal Reserve would go on to increase interest rates to 5.25%, mortgage rates would touch 8%, a regional banking crisis would take down established institutions like Silicon Valley Bank and First Republic, yet we did not see a recession and home prices even ticked higher...would you believe them? Moreover, would you believe the time traveler if they told you global equities would surge more than 20% higher along side positive performance from much of the fixed income market despite continued interest rate hikes?

- While investors often focus on the surprises that lead to sharp declines (e.g. stickier inflation, higher interest rates), it is important to keep in mind the opposite side of that equation—all the times we are surprised with better-than-expected market outcomes, even when the headlines leave us with plenty to be concerned about.

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.*

Can Artificial Intelligence Pick Winning Stocks?



About AIEQ®

AIEQ is an artificial intelligence powered ETF that utilizes IBM Watson to equal a team of 1,000 research analysts, traders and quants working around the clock.

- The is the first actively managed ETF to fully utilize AI as a method for stock selection.
- It analyzes millions of data points across news, social media, industry and analyst reports, financial statements on over 6,000 U.S. companies, technical, macro, market data and more.
- It also harnesses the power of IBM Watson for machine learning, sentiment and natural language processing.
- Previously only available to hedge funds and professional trading firms, this method of stock selection is now accessible as a prepackaged solution in an ETF.

Investment Process

AIEQ applies AI technology to build predictive models on 6,000 U.S. companies. Each company has four underlying deep learning models: a Financial, News and Information, Management, and Macro model. Each of these four models have many underlying signals as depicted. The models identify approximately 30 to 200 companies with the greatest potential over the next twelve month for appreciation.

About this Chart: In November of 2022 the artificial intelligence company OpenAI released to the public a free version of its AI-powered chatbot, ChatGPT. The program reached one million downloads in just five days, shattering comparable milestones set by other popular applications, including Twitter, Facebook, Spotify, Instagram, Netflix, etc. The release of ChatGPT provided individuals and companies around the world with the ability to experience the power of artificial intelligence firsthand like never before. As various AI applications were shown to pass legal exams, draft business plans, produce travel itineraries, summarize lengthy text documents, and much more, many curious observers started to wonder if the technology could be used to pick winning stocks.

While the use of artificial intelligence in everyday life has broadened to a wider audience with the release of ChatGPT, the investment world has been using various forms of algorithm trading, machine learning, and artificial intelligence for decades. To that end, the use of computers to collect and synthesize information faster and more accurately is not a new phenomenon to financial institutions seeking a winning edge in a fiercely competitive marketplace.

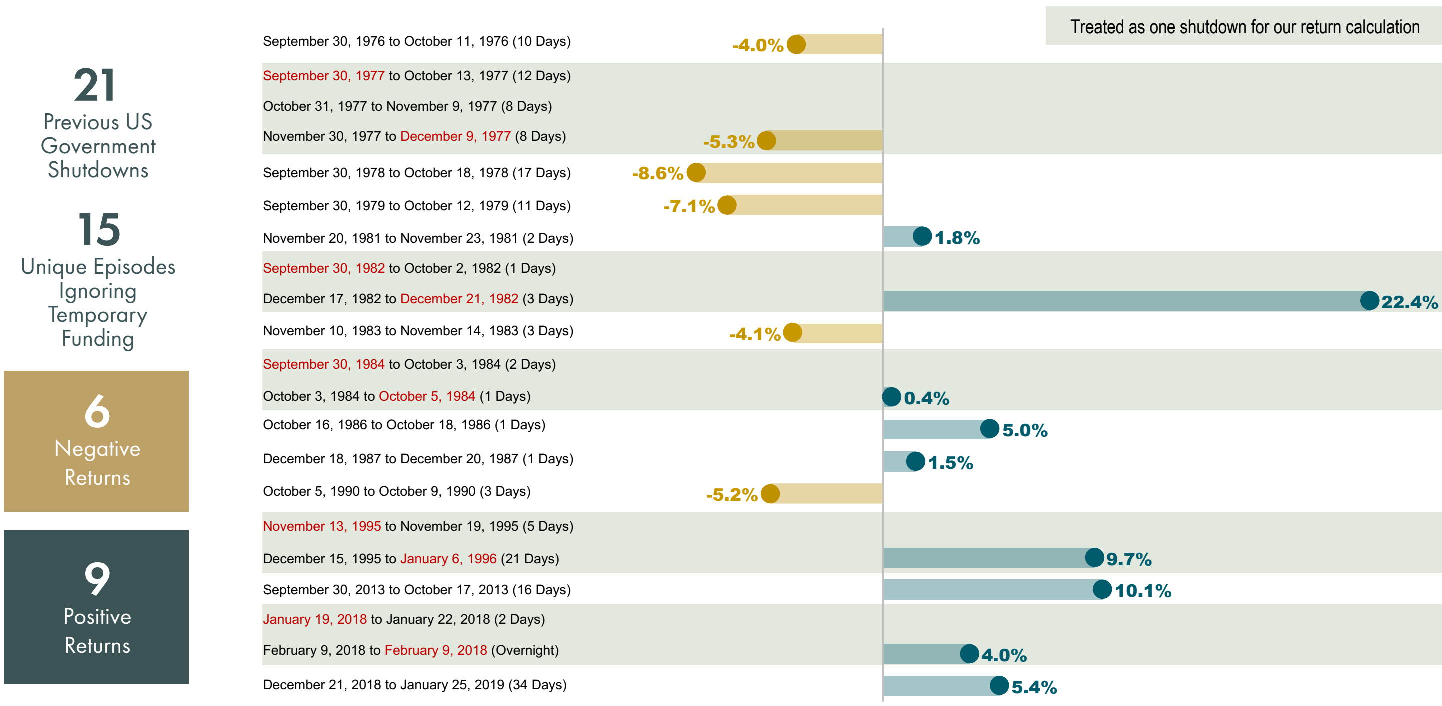
This slide compares the performance of the broad US equity market index (Russell 3000) to an Artificial Intelligence powered fund that was launched in 2017 (the longest publicly available track record of a fund still operating today that explicitly uses artificial intelligence to pick stocks). While the strategy and process description of the fund might sound alluring, the investment results are not—the AI-powered fund provided a cumulative return of 36% compared to 78% for the broad market index (since the inception date of the AI-powered fund).

Key Takeaways:

- There will always be a “newer, better, and faster” way to gather and synthesize information. It started with computers, improved with the internet, and continues with machine learning and artificial intelligence. If none of these previous breakthroughs created a sustainable advantage for picking stocks and outperforming the market, why will the latest iteration?
- Artificial Intelligence is a tool, just like the internet, that every individual and company can use to their benefit to create some efficiencies and potentially uncover some opportunities. But if everyone has access to this tool, is it really a differentiator that can provide an investor with a useful and sustainable advantage over all other investors?
- In our view, having tens of thousands of AI-applications working independently from one another to process all forms of information is only going to make financial markets more efficient, not less.
- While Artificial Intelligence has the potential to profoundly impact our everyday lives, the fiercely competitive nature of financial markets is likely to prevent any single AI-based investment strategy from maintaining a sustainable edge over all others trying to do the same.

Data Disclosures: *Source: Morningstar Direct.*

S&P 500 Return from 30 Days before to 30 Days after a Government Shutdown



About this Chart: Some clients have asked whether we should reposition portfolios ahead of a potential government shutdown. This slide identifies dates of previous government shutdowns and shows the price return of the S&P 500 Index spanning 30 days before each shutdown started to 30 days after each shutdown ended. In cases where temporary funding agreements briefly restored government operations before shutting down again, we calculated the return from 30 days before the first shutdown to 30 days after the last shutdown.

Key Takeaways:

- While news headlines might paint a scary picture of the potential ramifications of a government shutdown, history reveals no clear relationship between shutdowns and stock market returns. From an investment standpoint, this isn't a high conviction event that should influence changes to one's portfolio or investment strategy.

- It's also worth clarifying what happens during a government shutdown:

    - A shutdown occurs when the federal government suspends services deemed non-essential because a new law to fund discretionary spending programs was not approved ahead of a fiscal year deadline.

    - When agreement on a new funding bill is not reached, Congress may pass a "continuing resolution" that extends previous funding levels to keep the government fully operating.

    - Importantly, the current negotiations to keep the government fully operational are different from the debate over whether to raise the debt ceiling that took place earlier this year. In the case of the debt ceiling talks, the biggest risk was a potential U.S. default if lawmakers did not raise the debt ceiling.

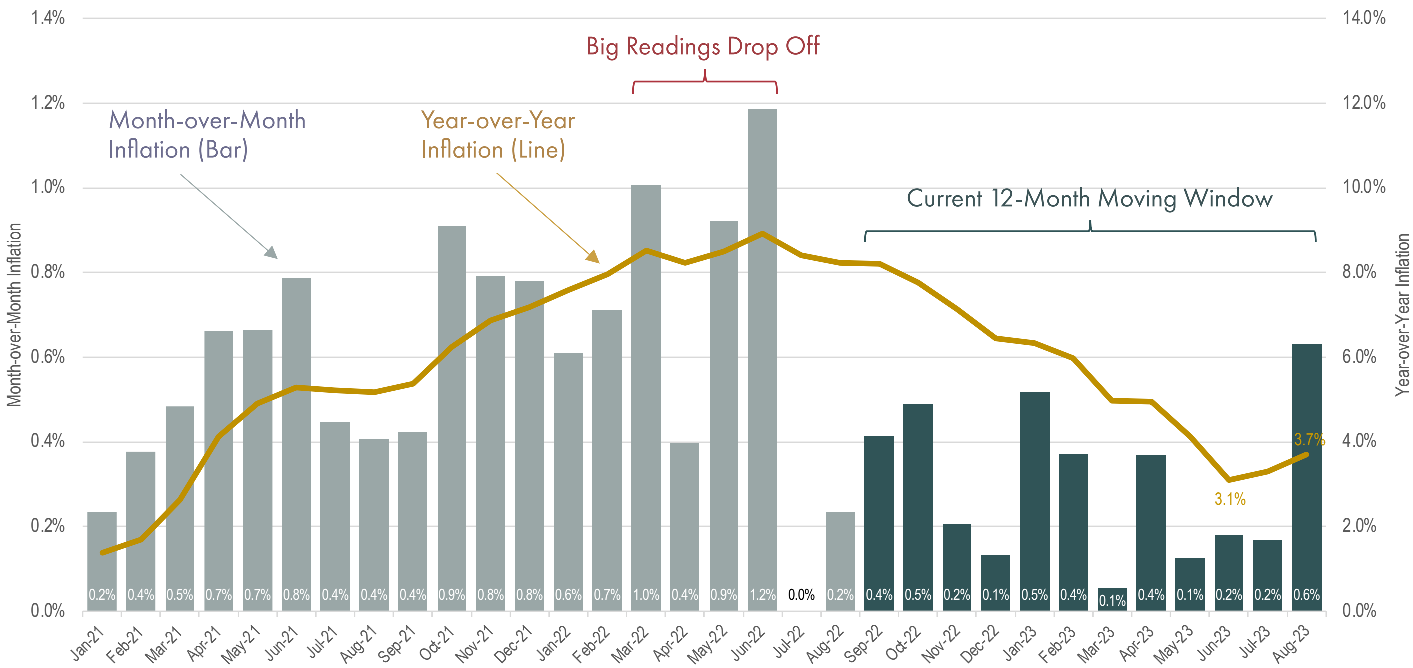
    - Past government shutdowns paused nonessential activities in various government departments—for example, national parks and museums have closed. Critical federal government functions such as ongoing Social Security benefits, air traffic controllers, and the Postal Service generally were not affected.

    - Federal government shutdowns don't affect state and local government functions that are not dependent on federal funding.

- Note: we assessed return calculations in more ways than one. For example, we also calculated market returns only during the period in which the government was closed. These variations of return calculations do not change the overarching conclusion: government shutdowns are not a tradeable event.

Data Disclosures: *Source: Morningstar Direct*

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 3.7%, down from 4.1% as of our last quarterly update.

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.

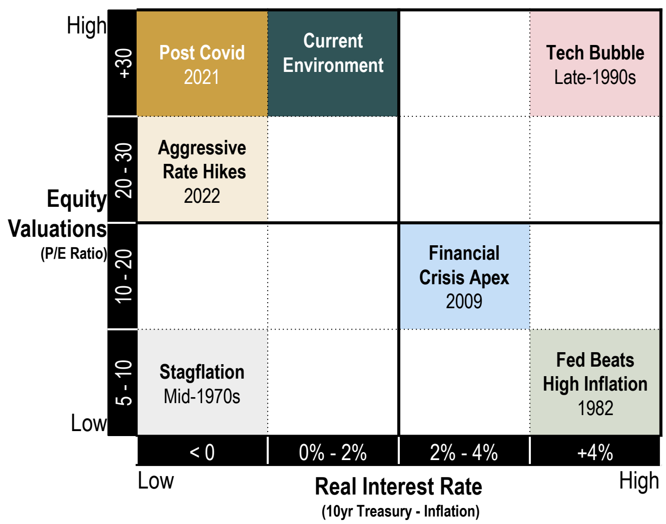
- Many economists predicted earlier this year that inflation would decline at a rapid pace through June of 2023. This isn't because they have a crystal ball and knew what the future inflation readings would be. They simply looked at the data and could see that a stretch of large readings in excess of 1% would drop out of the twelve-month moving window starting in March. Hence, predictions saying that inflation would come down was more or less a guess that the monthly numbers dropping out of the twelve-month moving window would be replaced by smaller numbers. Indeed, that is exactly what happened.

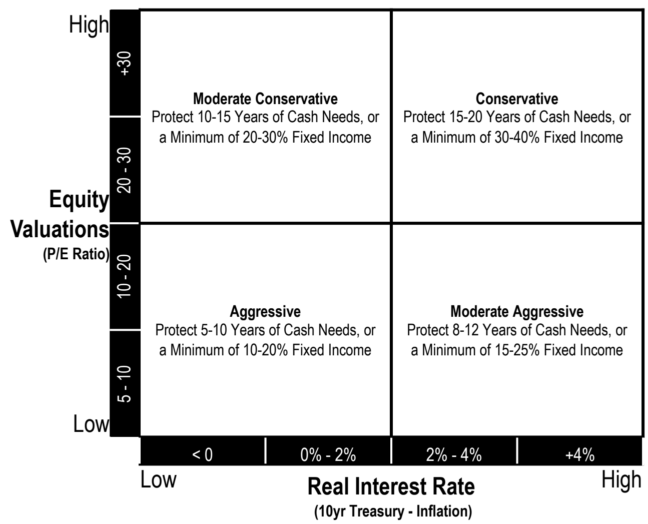
- Looking ahead, it appears the easy wins for the Federal Reserve are over. Getting inflation to fall from the mid-3% range to the low-2% range may prove harder than the drop from last year's peak of 9%.

- It is worth noting that the shelter/housing category represents about 35% of the consumer price index and its most recent year-over-year reading was 7.3%. However, it is widely acknowledged by economists that this component can have a 12-18 month lag, especially around sharp turning points. If the current reading of 7.3% for shelter (which is believed to be based on stale information) was swapped with real time indicators from Zillow, Redfin, and others (e.g. asking rents), year-over-year inflation would register closer to about 1.5% to 2.0%. But this does not change the fact that the consumer price index, as it is officially calculated, will be slow to reflect quickly moderating inflation for asking rents (which real time estimates put at close to 0% year-over-year).

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 5% can expect to earn very close to 5% 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.

Key Takeaways:

- For the past several years, the investment environment has fallen in the upper left quadrant of our framework. With large movements in fixed income and equity markets, clients might be wondering what we look for when considering adjustments to our investment strategy.
- It is worth emphasizing that allocation adjustments are warranted only when we see large shifts in the relative attractiveness among asset classes as opposed to changes in the absolute expected returns of each asset class in isolation.
- With interest rates moving higher and equity valuations moderating since early 2022, we have not categorically shifted into a different investment environment such that a material allocation adjustment would be warranted.
- While we welcome fixed income yields that are considerably more attractive than they have been over the past decade, ~5% treasury yields are on par with their long-term average over the past 100 years. In other words, we have seen a return to normal fixed income yields, but not generationally high yields.
- While aggregate valuations for capitalization-weighted indexes such as the S&P 500 and Russell 3000 remain elevated (although down from the peak), a select few mega cap growth companies (e.g. Nvidia, Tesla) are driving this. Beneath the surface level valuation measurements, there remains healthy return prospects for fundamentally-weighted indexes that overweight companies considered to have low relative prices (i.e. value stocks), high profitability, and lower market capitalizations (i.e. mid and small cap stocks). In other words, we are more constructive on the return potential of our equity portfolio than indexes such as the S&P 500 for the next decade.
- On balance, we continue to believe a moderate conservative stance towards risk in our portfolio positioning is appropriate.

Contact Us at www.BrightonJones.com