TRIVANT

CUSTOM PORTFOLIO GROUP, LLC

July 2022

Quarterly Insights

EXECUTIVE SUMMARY

Stocks And Bonds Down In Q2

In the Second Quarter, the domestic S&P 500 Index was down 16.10% and performed in line with all major regions. There were no bright spots. Energy (-6.13%) was a Q2 sector out-performer as oil prices remained high. The market reached “bear market” status on June 13, falling more than 20% from its peak on January 3. To combat high annual inflation (8.6% in May), the Fed raised its target rate by 0.50% on May 8 and a further 0.75% on June 15, bringing its current target rate to 1.50%. It is destined to go much higher. In Q2, the Bloomberg US Aggregate Bond Total Return USD Index fell 4.69%. Year-to-date, the Index is down 10.35%.

Opportunities Are Greatest Off The Bottom

The big question is whether the Fed can simultaneously raise interest rates and avoid putting the US into a recession. Given the rise of rates likely needed to bring inflation down to the Fed’s 2% target, we do not think so. Having said this, we look ahead with optimism regarding the markets. A recession is a positive forward market indicator.

In most cases, the S&P 500 Index hits a high 7 months before the start of a recession and bottoms out four months before the end of a recession. Then it bounces off the bottom. We believe we are entering or already in a recession. Assuming a current recession that will linger through year-end, we theorize a market bounce around September/October.

The key is to be positioned for the bounce. While all stocks do well, smaller companies (small cap stocks) have historically out-performed three and 12 months off the bottom.

Second Quarter 2022

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Deliberate Investing For Your Peace Of Mind

We Believe We Are Entering A Recession

It is an understatement to say that 2022 has been a challenging time in both the stock and bond markets. We know this is a difficult time to be an investor and appreciate your confidence in having us navigate the tough waters. Amidst the multitude of negative headlines, remember that the market is a forward indicator. It moves up the most at the times when it seemingly makes the least sense.

US inflation (8.6% in May) is exceedingly beyond the Fed inflation target of 2%. Causes include the Russian invasion of Ukraine (rising oil prices) and the COVID shutdown in China (supply chain issues). Consequently the Fed has initiated a series of rate hikes to combat inflation. In Q2 the Fed raised its target rate from 0.25% to 1.50% through two hikes. The rate is destined to go higher going forward. Will inflation subside? We think substantially lower inflation is a longshot in the short term but probable in the long term.

"The Committee's commitment to restoring price stability - which is necessary for sustaining a strong labor market - is unconditional". (June 17 Fed report to Congress)

The big question is whether the Fed can simultaneously raise interest rates and avoid putting the US into a recession (achieve a "soft landing"). Given the rise of rates likely needed to tame inflation, we do not think so.

A Recession Is A Positive Forward Market Indicator

Since 1945 there have been 13 recessions (source: National Bureau of Economic Research). Technically defined as two consecutive quarters of GDP decline and loosely defined as a temporary period of economic decline, there have been three recessions in the 21st century (2001, 2008 and 2020). We believe another one is on the way if not already here. How do stocks perform when the economy is faced with a recession? Surprisingly well. The S&P 500 Index rose an average of 1% during all recession periods since 1945 (source: CFRA). Markets usually top out before the start of recessions and bottom out before their conclusion. Put another way, the worst is over for stocks before it is over for the rest of the economy. In almost every case, the S&P 500 Index hits a high 7 months before the start of a recession and bottoms out four months before the end of a recession. Then it bounces off the bottom. If we assume we are in a recession right now that will linger through year-end, past history indicates the market should have hit a high at 2021 year-end (which it did) and we can theorize a market bounce around September/October. The key is to be positioned for the bounce.

Stock Market Returns During Recession Years

Markets typically bottom out and rebound months before the end of a recession.

Recession Year	Recession Year Returns (S&P 500)	Following Year Returns (S&P 500)
1945	30.3%	-11.9%
1949	10.3%	21.8%
1953	-6.6%	45.0%
1957	-14.3%	38.1%
1960	-3.0%	23.1%
1970	0.1%	10.8%
1974	-29.7%	31.5%
1980	25.8%	-9.7%
1982	14.8%	17.3%
1990	-6.6%	26.3%
2001	-13.0%	-23.4%
2008	-38.5%	23.5%
2020	16.3%	26.9%

Source: CFRA Research

Opportunities Are Greatest Off The Bottom

The out-sized returns come off the bottom of a market, and it is critical to be positioned to take advantage. While we cannot time portfolio moves perfectly, it is important to be in the market versus out of the market.

Market Opportunities Off The Bottom - S&P 500 (Large Cap) Vs. Russell 2000 (Small Cap)*

Bottom (Month)	Period	S&P 500 3 Months Later	S&P 500 12 Months Later	Russell 2000 3 Months Later	Russell 2000 12 Months Later
March 2020	Covid Lockdown	17.05%	47.43%	25.00%	92.57%
Dec. 2018	Fed Taper Tantrum	9.22%	23.74%	14.18%	23.72%
March 2009	Great Financial Crisis	22.32%	52.16%	20.23%	60.53%
Feb. 2002	Tech Wreck	11.82%	36.60%	22.32%	62.42%
	Last 4 (Average):	**15.10%**	**39.98%**	**20.43%**	**59.81%**
Jan. 1990	Iraq War	5.98%	25.97%	-	-
Dec. 1987	Black Monday	10.25%	14.73%	-	-
July 1982	Volcker Breaks Inflation	21.30%	52.65%	-	-
Dec. 1974	End of Gold Standard/ Oil Embargo	24.91%	32.25%	-	-
July 1970	Nifty Fifty	11.42%	30.74%	-	-
Jan. 1962	Kennedy Slide/ Flash Crash	15.83%	30.02%	-	-
	Last 10 (Average):	**15.01%**	**34.63%**		

* End of Month Data

Small Cap Out-Performs Large Cap Off The Bottom

We have successfully navigated many market cycles. As we adjust the portfolio in anticipation of out-sized market opportunities (style rotation), we recognize smaller companies (small cap stocks) have historically out-performed three and 12 months off the bottom. Consequently, we anticipate purchasing some small cap stocks at a time where you may not feel comfortable with the market. We want to be ahead of the curve.

Many Managers Cannot Buy Small Cap Stocks - We Are Not One Of Them!

Size is not an advantage in portfolio management. The very large managers are precluded from buying small cap companies, which is a huge handicap coming off a market bottom. Imagine a $200 billion asset manager with a diversified portfolio of 50 stocks. The average individual stock position would be $4 billion.

Further imagine a public company with a market cap of $40 billion, a level many would consider well above a small cap company. Owning $4 billion of a total available $40 billion of outstanding stock would give the very large manager a 10% ownership of the company. For many reasons including market liquidity and SEC compliance, holding a $40 billion market cap company is precluded (as is holding any company below this size). The average market cap of the Russell 2000 is $3 billion. TriVant can buy companies with any market cap.

We Manage Millions, Not Billions

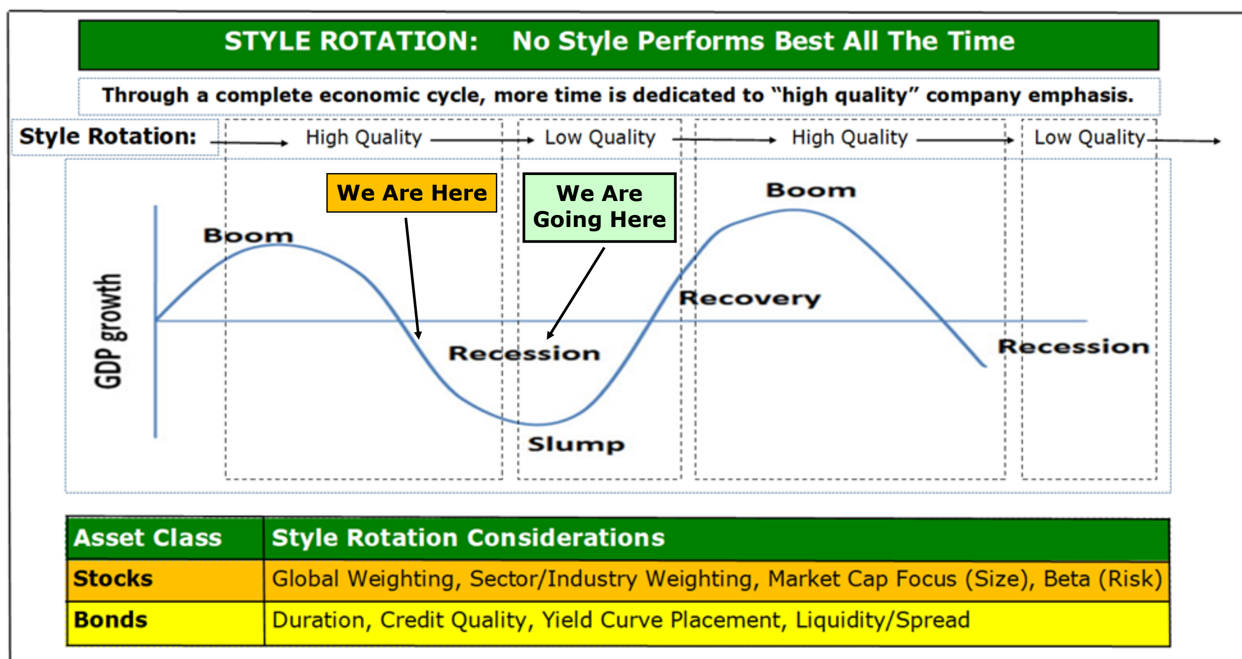
Style Rotation Dictates Soon-Increased Emphasis Towards "Low Quality" Companies

We view the investment markets through the prism of Style Rotation. This framework suggests that different "styles" of companies out-perform during points in the economic cycle. Our goal as your portfolio manager is to adjust accordingly as styles go in and out of favor. This is not a perfect exercise. A complete cycle can last in the range of five years or longer.

As the economic recovery becomes more entrenched and matures, we rotate towards companies with stronger balance sheets (lower levels of borrowing) and more "secular" earnings. These "high quality" companies are less dependent on the economy for their sales growth. In a point of the cycle where it is harder to achieve sales growth, high quality companies tend to lead in a mature market and a downturn.

As a recession approaches or is current (the situation we believe we face right now), we look ahead to the transition from "high quality" to "low quality" companies and plan accordingly.

After a recession and at the beginning of a new expansion, we believe "low quality" companies with cyclical earnings and leveraged balance sheets (high levels of borrowing) tend to lead. These companies are tied to the economy and often remain cheap due to the large stock price declines during the recession.



Asset Class	Style Rotation Considerations
Stocks	Global Weighting, Sector/Industry Weighting, Market Cap Focus (Size), Beta (Risk)
Bonds	Duration, Credit Quality, Yield Curve Placement, Liquidity/Spread

It Is Best To Take Gradual Steps: There May Be Some Suckers' Rallies Along The Way

When we shift emphasis on company quality, we are not operating a "binary switch". It is not a situation where we suddenly go "all in" and rotate everything from "high quality" to "low quality". First, we do not know with certainty when the market will bottom. Second, we always want some "high quality" companies. Third, we will likely have tax considerations in the taxable accounts (unrealized gains). Fourth, we will likely see some "suckers' rallies" as we approach the market bottom. These are the times where the market goes up a lot and investors get "suckered" into thinking we already hit the bottom, only to see the market fall back very quickly. Risk control is paramount in portfolio management - we always ask "what if we are wrong".

All Major Regions Down In Q2

In the Second Quarter, the domestic S&P 500 Index was down 16.10% and performed in line with all major regions. There were no bright spots. Energy (-6.13%) was a Q2 sector out-performer as oil prices remained high due to the Russia/Ukraine crisis - it is also the lone positive sector so far in 2022 (+29.54%).

Equity Index Performance

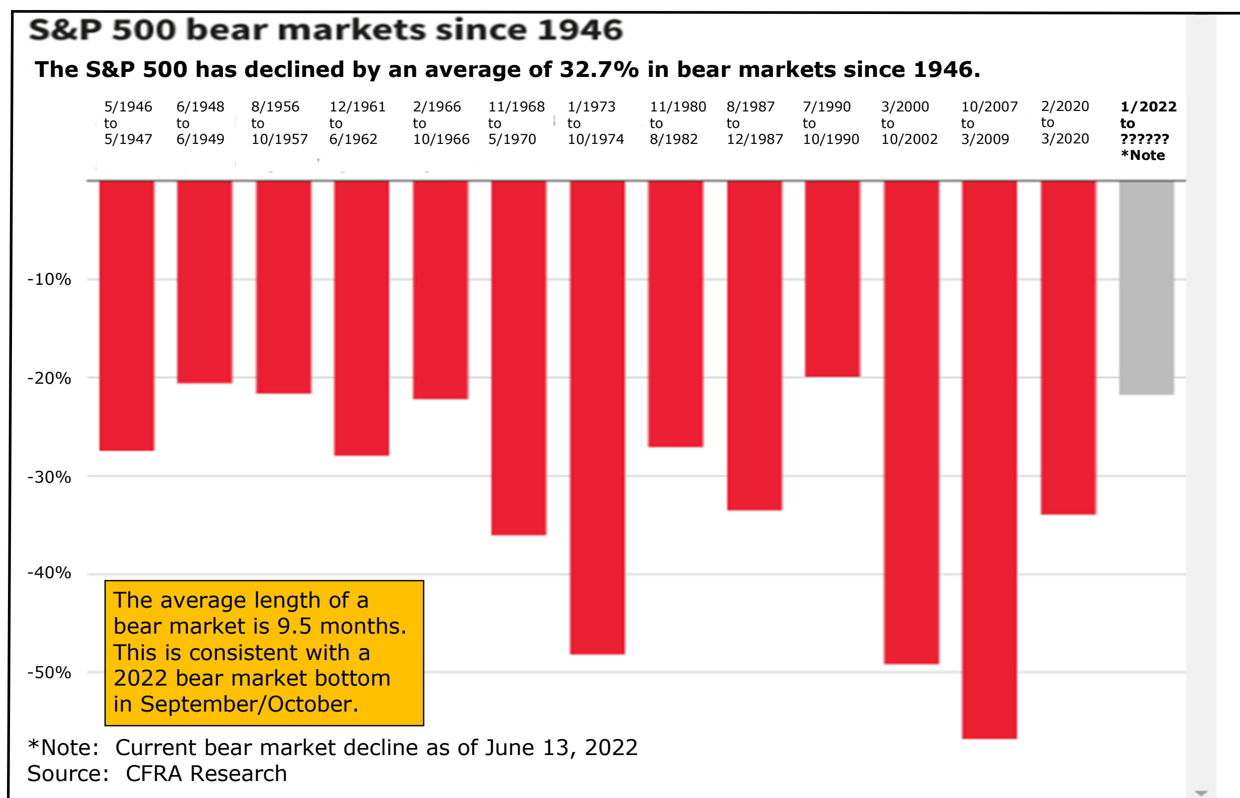
Index	Q2 2022	2022 YTD
S&P 500 (Domestic)	**(16.10%)**	**(19.96%)**
MSCI EAFE (Foreign) *	**(14.51%)**	**(19.57%)**
MSCI Emerging Markets	**(11.45%)**	**(17.63%)**
MSCI EMU (European Monetary Union)	**(15.86%)**	**(25.23%)**
MSCI Japan	**(14.63%)**	**(20.27%)**

* Europe, Australia and the Far East

We Entered A Bear Market: Many Good Companies Are Now On Sale

The S&P 500 Index peaked on January 3 and had fallen by 21.82% on June 13, thereby reaching "bear market" status (a market that has fallen more than 20% from its peak). Bear markets are normal, occurring roughly 15% of the time. Can this market fall further? Maybe.

We look at the market through the windshield versus the rearview mirror. Many good companies have been beaten down hard and are now on sale. While we know our timing will not be perfect, we see tremendous potential buying opportunities in the framework of Style Rotation. Watch for upcoming transactions.



Bonds Fall Further In Q2

The Bloomberg US Aggregate Bond Total Return USD Index (AGG), a broad-based representation of bond performance, fell 4.69% in the Second Quarter, following a 5.93% fall in Q1 (the largest quarterly decline since 1980). Year-to-date, the Index is down 10.35%. To combat high inflation, the Fed raised its target rate by 0.50% on May 8 and a further 0.75% on June 15. More rate hikes are expected.

Key US Interest Rates	March 31, 2022	June 30, 2022	Change
Federal Reserve Board Funds Target Rate	0.25% - 0.50%	1.50% - 1.75%	+ 125 basis points
2-Year Treasury (Constant Maturity)	2.28%	2.92%	+ 64 basis points
5-Year Treasury (Constant Maturity)	2.42%	3.01%	+ 59 basis points
10-Year Treasury (Constant Maturity)	2.32%	2.98%	+ 66 basis points

For The First Time In 45 Years, A 60/40 Portfolio Is Ineffective In A Down Market

A basic tenet of a target asset allocation of 60% stocks / 40% bonds is to insulate the portfolio from a down stock market. If stocks go down, we expect bonds to go up, remain flat, or go down much less. In the last 45 years, a 60/40 portfolio has provided effective loss protection in every down market - except so far this year. What is different in 2022? Stocks and bonds are simultaneously down a lot, which is very unusual.

The Effectiveness Of A 60/40 Portfolio* In A Down Stock Market

Year	SP 500 Return	60/40 Return		Year	SP 500 Return	60/40 Return		Year	SP 500 Return	60/40 Return	
1977	**(11.5)**	**(3.0)**	Effective	**1994**	**(1.5)**	**(0.4)**	Effective	**2011**	**0.0**	**4.4**	Effective
1978	1.1	4.5		1995	34.1	29.9		2012	13.4	11.3	
1979	12.3	11.9		1996	20.3	15.2		2013	29.6	18.6	
1980	25.8	20.1		1997	31.0	23.9		2014	11.4	10.6	
1981	**(9.7)**	**(0.3)**	Effective	1998	26.7	20.6		**2015**	**(0.7)**	**1.1**	Effective
1982	14.8	25.3		1999	19.6	12.3		2016	9.5	8.2	
1983	17.3	16.7		**2000**	**(10.1)**	**(0.8)**	Effective	2017	19.4	14.5	
1984	1.4	9.7		**2001**	**(13.0)**	**(3.8)**	Effective	**2018**	**(6.2)**	**(2.6)**	Effective
1985	26.3	27.6		**2002**	**(23.4)**	**(9.2)**	Effective	2019	28.9	22.4	
1986	14.6	17.2		2003	26.4	18.8		2020	16.2	14.0	
1987	2.0	4.6		2004	9.0	8.3		2021	26.9	13.8	
1988	12.4	13.1		2005	3.0	3.9		**2022 YTD**	**(20.0)**	**(16.1)**	Not Effective
1989	27.3	24.8		2006	13.6	11.2					
1990	**(6.6)**	**1.7**	Effective	2007	3.6	6.1					
1991	26.3	24.7		**2008**	**(38.5)**	**(20.1)**	Effective				
1992	4.5	7.5		2009	23.5	18.2					
1993	7.1	9.9		2010	12.8	11.7					

* A 60/40 Portfolio is weighted 60% of the S&P 500 Index and 40% of the AGG; Data Source: Compound, Macrotrends

Reports Of The Death Of The 60/40 Portfolio Are Greatly Exaggerated

Looking back at down stock markets over the last 45 years, 11 out of 12 "effective" outcomes with a 60/40 portfolio is a great track record. Bond yields are now rising quickly and becoming increasingly attractive. There are numerous media reports signaling the death of the 60/40 portfolio. We disagree. Ignore them!

Strategies In A Market Downturn: Roth Conversions & Tax-Loss Selling

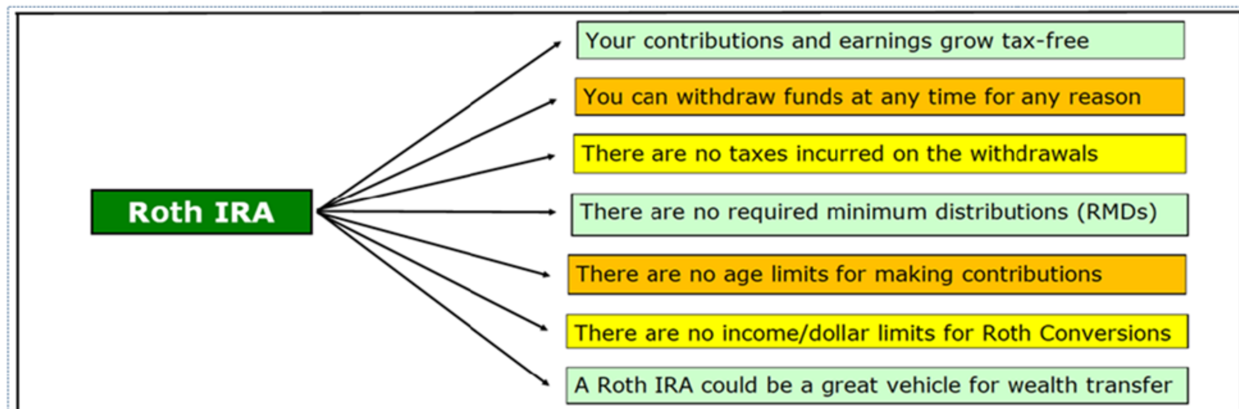
There are two potentially beneficial strategies in a market downturn: Roth conversions in tax-deferred accounts and tax-loss selling in taxable accounts. While we are not tax professionals, please contact us to discuss the potential merits of a Roth conversion for your specific situation. We regularly monitor realized gains and potential tax-loss selling in your taxable accounts.

Roth Conversions (Tax-Deferred Accounts)

One of the primary benefits of a Roth IRA is that you don't pay income tax when you withdraw funds. With a Regular IRA you pay income tax when you withdraw funds. This is one of the reasons why a Roth IRA is the best type of account from a tax efficiency standpoint. A Roth Conversion is the action of converting traditional IRA assets into Roth IRA assets. This is not a tax dodge - you will pay taxes on the conversion - but the conversion is potentially good long-term financial planning.

It makes even more sense to consider this strategy in a down market. When the market is down, it is likely your Regular IRA value has also gone down. Paying taxes on a lower dollar amount of assets being converted means you will have a lower tax bill. The strategy pays off if the market subsequently recovers. You have paid less taxes to move subsequently-appreciated assets into the most tax-advantaged account.

Keep these points in mind when considering a conversion. First, if it is a new Roth IRA account, there is a five-year rule that locks you into waiting five years before making withdrawals (or else you face a 10% penalty). Second, you need to monitor your adjusted gross income (AGI) as a conversion may increase your AGI, which in turn can increase both your tax rate and cause your Medicare premiums to change.



Tax-Loss Selling (Taxable Accounts)

Tax-loss selling is when we try to reduce realized capital gains in a taxable account by realizing losses with stocks whose price is (currently) below acquisition cost. We tax-loss sell when feasible, usually as we approach year-end, in an effort to be as tax-efficient as possible. The recent downturn has increased the unrealized losses with some stocks in the portfolio. In instances where we want to sell a "down" stock for portfolio strategy reasons, it is potentially advantageous to realize the loss now versus waiting until Q4.

We made relatively few portfolio adjustments in Q2 other than rebalancing amidst a volatile market. The rationale for the moves we did make included an increased Consumer Discretionary exposure and selling a couple of disappointing stocks to take the losses (tax-loss selling).

We bought Ulta Beauty Inc (symbol: ULTA; $22 billion market cap), the largest specialized beauty retailer in the US. With more than 1,300 stores and a partnership with Target, the firm offers makeup, fragrances, skin care products, hair care products, and bath and body items. Despite being a consumer discretionary company, ULTA is well-positioned to achieve growth because its products are not luxury goods. Rather, its products are a necessity at a price point that is attractive to the masses. Given its strategic alignment with Target, we believe ULTA has the potential to double its market share.

We sold Schneider Electric SE ADR (symbol: SBGSY; $66 billion market cap), whose leading specialty industrial machinery products span from ground-level equipment to top-level analytics and execution software. We also sold Unity Software (symbol: U; $13 billion market cap), a leading software provider to the gaming industry. Both companies did not perform to expectations and we wanted to realize the capital losses.

Looking ahead to the "bounce off the bottom" (the early stage of the next bull market), we will lower the average market cap of the portfolio by acquiring "small cap" companies - as previously discussed, we expect small cap to out-perform off the bottom. We also expect "value" stocks to lead "growth" stocks and anticipate overweighting these sectors: Consumer Discretionary, Energy, Financials, Industrials, Materials, and Technology. Underweight sectors may include Consumer Staples, Health Care and Utilities. Finally, we may raise foreign exposure as foreign valuations have become increasingly attractive.

We will continue to closely monitor the market and adjust your portfolio as needed. Please feel free to contact us anytime to discuss questions or comments you may have. We will keep you informed of portfolio progress.

Respectfully submitted,

TRIVANT

CUSTOM PORTFOLIO GROUP, LLC

Disclaimer

The information presented herein is intended for informational purposes only. All views are subject to change based on updated indicators. The recommendations made in this publication are made without regard to individual suitability. Investors should consider their own needs and objectives before making any investment decision.

Commentary in this review reflects our portfolio strategy. Many of our clients have different objectives and circumstances which are reflected in unique portfolio considerations. Please note that accounts may not contain all elements of the strategy discussed here. Additionally, individual client customizations and start dates may preclude certain elements of this strategy from being implemented.

Past performance is no guarantee of future results. A risk of loss is involved with investments in stock markets.