TRIVANT

CUSTOM PORTFOLIO GROUP, LLC

July 2023

Quarterly Insights

EXECUTIVE SUMMARY

Stocks Up And Bonds Down In Q2

In the Second Quarter, the domestic S&P 500 Index was up 8.74% and out-performed all major regions. All global regions were positive. China was down 9.71% as its economic growth continues to be challenged. Technology (+18.65%), Communication Services (+15.16%) and Consumer Discretionary (+17.30%) were the leading Q2 sectors and drove all Q2 returns. By far, these are the sector leaders year-to-date. To combat high annual inflation (4.0% in May), the Fed raised its target rate by 0.25% on May 3, bringing its current target rate to 5.25%. More rate hikes are possible. In Q2, the Bloomberg US Aggregate Bond Total Return USD Index (AGG) fell 0.84%.

2023: A Year Of Transition

At the beginning of 2023, we cited conditions pointing to a "transition year" for stocks that included more rate hikes, quantitative tightening (QT), inflationary pressures, above-average market valuation, and earnings expectations that may be too high. The "year of transition" also defines the US economy. Its future is bright and full of opportunities. Here are four unheralded positive economic developments:

1. Dramatically Expanded US Manufacturing In "21st Century Industries"
2. Beneficial Interest Rates For Individual Investors
3. The US Economic Recovery Is Fastest Among Comparable Advanced Economies
4. Out-Sized Earnings Gains For Low-Income Workers

Second Quarter 2023

In This Issue

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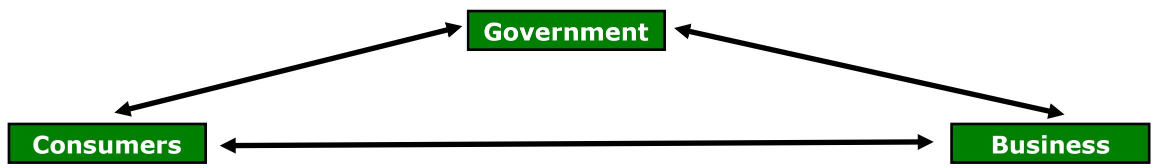
The Times They Are A-Changin'

At the beginning of the year, we cited conditions pointing to a "transition year" for stocks that included more rate hikes, quantitative tightening (QT), inflationary pressures, above-average market valuation, and earnings expectations that may be too high. While these conditions remain relevant, the "year of transition" also defines the US economy. Its future is bright and full of opportunities.

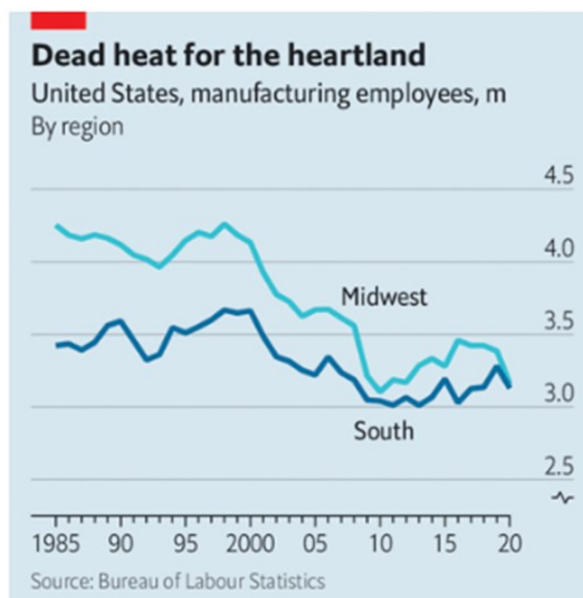
US economic prosperity necessitates a healthy interplay between government, business and consumers.



These three pillars are driving a long-term economic transition. Here are four positive developments:

1. The South Is Fast Becoming America's Industrial Heartland

Here is an example where the Government is working closely with Business to drive economic prosperity. The industrial policies from the Biden administration - incentives and rules to boost the production of "21st century industries" such as semiconductors, renewable energy and electric vehicles (EVs) - have spearheaded a surge of investment, much of it in the South (a region running from Texas to Virginia). The number of manufacturing workers is now the same in the South as the Midwest - a considerable shift from the past.



Let's highlight the battery industry. The Inflation Reduction Act's manufacturing tax credit for battery cells is $35 per kWh. For a 30 GWh EV battery factory, that could add up to roughly $1 billion in annual subsidies. Expansion includes 30 GWh factories being built in Indiana (1,700 jobs), North Carolina (2,100 jobs) and South Carolina (1,200 jobs). Ford Motor just received a $9.2 billion federal loan to build three EV battery factories in Kentucky and Tennessee (7,500 jobs). In 2019, the projected US battery manufacturing capacity was 220 GWh by 2029. With the government push, there is now 931 GWh in planned capacity for EV battery cells in 2030. There are 50 new projects, $56 billion in planned investments, and over 38,000 new jobs.

2. Higher Interest Rates Benefit Individual Investors

Here is an example where Government policy is helping Consumers. Starting in early 2022, the Fed has dramatically raised interest rates to combat inflation. Further rate hikes are possible. At this time, Fed Chairman Jerome Powell is signaling two more quarter point hikes by year end.

We view higher interest rates as good news for individual investors and anyone holding cash. Higher rates allow for better portfolio positioning regarding disciplined asset allocation, risk control, and meeting income needs. As your portfolio manager, we seek safe income-producing assets that provide adequate income. The lower the yield environment, the tougher they are to find. At this time, a short-term risk free Treasury is yielding over 5%. Less than two years ago, the yield on a short-term risk free Treasury was under 1%.

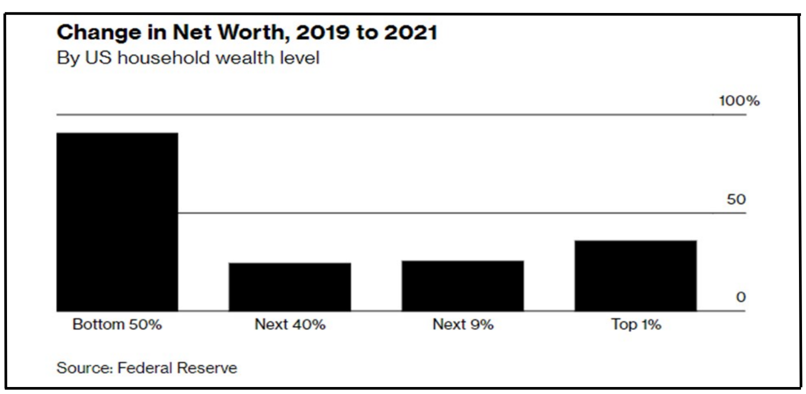
3. The US Economic Recovery Is Fastest Among Comparable Advanced G7 Economies

Here is an example where post-pandemic Government initiatives are helping both Business and Consumers. Per a news release from the U.S. Department Of The Treasury on June 5, 2023:

- The size of the U.S. economy is now over 5% above its 2019 level
- The U.S. economic recovery has been stronger relative to other economies
- Core inflation in the U.S. is now lower than in many major advanced economies
- The U.S. labor market recovery has been exceptionally strong

4. Earnings Growth Favors Low-Income Workers

Here is another example where the Government has helped Consumers. From February 2020 to September 2022, average income for the lowest-earning 50% of Americans increased by more than 10%, faster than all groups except for the top 1% (source: Realtime Inequity economists). The improvement is a result of trillions of dollars in Covid-19 relief and a strong labor market that remains hottest for the lowest income workers. America's inequality problem improved for the first time in a generation. The collective wealth of the bottom 50% of households has nearly doubled in two years, great news for an economy 70% tied to Consumers.



Stocks Rise In Q2

In the Second Quarter, the domestic S&P 500 Index was up 8.74% and out-performed all major regions. All global regions were positive. China was down 9.71% as its economic growth continues to be challenged. Technology (+18.65%), Communication Services (+15.16%) and Consumer Discretionary (+17.30%) were the leading Q2 sectors, as was the case in Q1. By far, these are the sector leaders year-to-date.

Equity Index Performance

Index	Q2 2023	2023 YTD
S&P 500 (Domestic)	**8.74%**	**16.89%**
MSCI EAFE (Foreign) *	**2.95%**	**11.67%**
MSCI Emerging Markets	**0.90%**	**4.89%**
MSCI EMU (European Monetary Union)	**3.17%**	**17.66%**
MSCI Japan	**6.42%**	**13.00%**

* Europe, Australia and the Far East

The AI Hype May Be Overblown

While the market rose in Q2 to follow a rise in Q1, it has not been a broad rally - the "Magnificent 7", seven of the largest technology growth stocks active in artificial intelligence (AI), catapulted due to AI excitement and are attributable to more than 100% of the S&P 500 return year-to-date. The other 493 S&P 500 stocks have a collective negative 2.41% return year to date. We have what we consider a reasonable exposure to AI in the portfolio with four of the seven "Magnificent 7" stocks. Of the three "Magnificent 7" stocks we do not have,

- One stock more than doubled in six months with negative revenue growth
- One stock more than doubled in six months with negative net income growth
- One stock almost tripled in six months where its market capitalization is over 100 times its net income

"Caveat Emptor": we are skeptical of AI hype that lacks concrete data and regulatory clarifications. When something looks too good to be true, it usually is. The over-valued companies tend to correct over time.

While we are excited about the longer-term positive U.S. economic transition, we currently maintain a defensive component in the portfolio because:

1. Fed Chairman Jerome Powell recently signaled two more rate hikes for this year. Annual inflation has come down to 4.0% for the 12 months ending in May, but that is still twice the Fed's preferred 2% target.

2. Banks are not anxious to lend. Tougher loan access could slow the economy. It is interesting to see the rise of private lending in these conditions.

3. There is a chance of a mild recession. The 10-year Treasury yield fell even further below the 2-year rate in Q2. An inverted yield curve is an historical indicator of a recession.

4. Above-average market valuation - the historical Price/Earnings ratio of the S&P 500 Index is 15.99 and the current P/E ratio is 22.22.

5. Earnings expectations may be too high (must fully factor in recession risk, inflation, Fed rate hikes).

Bonds Fall In Q2

The Bloomberg US Aggregate Bond Total Return USD Index (AGG), a broad-based representation of bond performance, fell 0.84% in the Second Quarter. Year to date, the index is up 2.09%. To combat high inflation, the Fed further raised its target rate by 0.25% on May 3 but paused on June 14. Chairman Jerome Powell recently stated two more rate hikes are possible this year.

Key US Interest Rates	June 30, 2023	March 31, 2023	Change
Federal Reserve Board Funds Target Rate	5.00% - 5.25%	4.75% - 5.00%	+ 25 basis points
2-Year Treasury (Constant Maturity)	4.87%	4.06%	+ 81 basis points
5-Year Treasury (Constant Maturity)	4.13%	3.60%	+ 53 basis points
10-Year Treasury (Constant Maturity)	3.81%	3.48%	+ 33 basis points

Series I Savings Bonds Are No Longer A Screaming Deal: Our Suggested Redemption Strategy

Recall that Series I Savings Bonds, issued and backed by the US government, can present a unique opportunity to earn a meaningful risk-free rate of return. The bonds are issued with a base (fixed) interest rate and a semi-annual adjustment for inflation. Back in October 2022, when annual inflation was 8.3%, we advised that Series I Savings Bonds were a "screaming deal" because their annual return was 9.62%:

<u>BACK IN OCTOBER 2022: For Bonds Issued from May 2022 Through October 2022</u>

Base Rate: 0%; Semi-Annual Adjusted Inflation Rate: 4.81% (annual rate of 9.62%);
Total Annual Return (Combined Rate): 9.62%

Annual inflation has now fallen to 4.0%. Consequently, the Series I Bonds are now paying a lot less than in October 2022 when inflation was 8.3%, whether purchased now or previously. **<u>Short-term risk-free US Treasury bills, with a yield over 5%, are more attractive.</u>** Here are the new (lower) rates for the I Bonds:

<u>NEW RATE: For Bonds Issued Effective May 2023</u>

Base Rate: 0.9%; Semi-Annual Adjusted Inflation Rate: 1.70% (annual rate of 3.40%);
Total Annual Return (Combined Rate): 4.30%

<u>NEW RATE: For Bonds Issued From November 1, 2022 Through May 1, 2023</u>

Base Rate: 0.4%; Semi-Annual Adjusted Inflation Rate: 1.70% (annual rate of 3.40%);
Total Annual Return (Combined Rate): 3.80%

<u>NEW RATE: For Bonds Issued From January 1, 2021 Through October 31, 2022</u>

Base Rate: 0.0%; Semi-Annual Adjusted Inflation Rate: 1.70% (annual rate of 3.40%);
Total Annual Return (Combined Rate): 3.40%

CONCLUSIONS

1. Do not buy Series I bonds going forward - short-term risk free US Treasury bills now offer a better yield.
2. For most scenarios, redeem your previously-purchased Series I bonds and replace them with short-term US Treasury bills. Since there is a three-month interest penalty for early redemptions (holding the bonds less than 5 years), we suggest that you minimize the penalty by taking the new lower rate for three months prior to selling. The rationale is to take the opportunity to "lose the lower interest months".

Please contact us to help you assess the optimal date for your bond redemption.

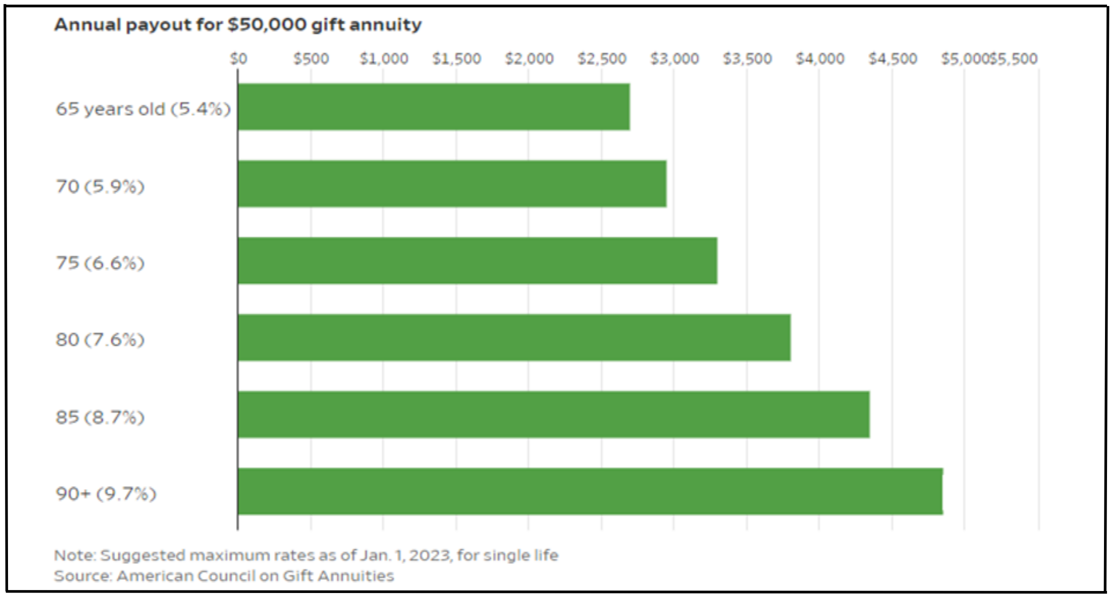
3. For some scenarios, a different sell strategy may be optimal (we are here to help guide you).

New Rule: Charitable Gift Annuity Up To $50,000 Can Be Made From An IRA Account

As of January 1, retirees age 70.5 years or older can donate up to $50,000 from their IRA account to fund a gift annuity through an eligible charitable organization. What is a charitable gift annuity? It is a contract between a donor and a charity, whereby the donor transfers cash to the charity in exchange for a tax deduction and a lifetime stream of annual income from the charity. While charities have offered gift annuities for years, the donations previously could not be made directly from retirement accounts.

Here is how it works. When a gift is made, the gift itself is tax deductible and counts towards the required minimum distribution (RMD), the annual withdrawal Americans 73 years and older must make from their IRAs. Normally these withdrawals are taxed as income, but when directed to an eligible charity, they are tax-free. In exchange for the gift, the charity makes fixed annual tax-free payments to the donor. Any funds left over when the donor passes go to the charity.

How is the amount of annual payments (usually paid monthly or quarterly) determined? Actuarial tables.



CASE STUDY

Paula Williams is 80 years old and wants to support her alma mater university. She decides to fund a charitable gift annuity for $50,000 from her IRA account. The following takes place:

- Paula donates $50,000 from her IRA to her university
- A charitable gift annuity contract is established between Paula and the university
- The university will pay Paula a fixed tax-free annual amount for the rest of her life:
  $50,000 * 7.6% = $3,800
- Paula's $50,000 donation from her IRA will count towards her required minimum distribution (RMD)
- Paula's $50,000 donation component of her RMD will not be taxed
- Paula's $50,000 donation is tax deductible

We made several portfolio adjustments in Q2 because we remain cautious about the market and wanted to rotate to Health Care and Consumer Staples (defensive sectors). Being disciplined is the key to successful long-term investing.

In Health Care, we bought

- Sanofi SA (symbol: SNY: $142 billion market cap), a company based in France that features three operating segments (Pharmaceuticals, Consumer Healthcare, and Vaccines)
- AstraZeneca PL (symbol: AZN; $228 billion market cap), a U.K. based global pharmaceutical company that focuses on oncology, rare diseases, and biopharmaceuticals
- Thermo Fisher Scientific Inc. (symbol: TMO; $210 billion market cap), a U.S. based company with four operating segments: Life Sciences Solutions, Analytical Instruments, Specialty Diagnostics, Lab Services

In Consumer Staples, we bought Walmart Inc (symbol: WMT; $400 billion market cap), the largest US retailer.

We sold two banks facing declining net interest margins and profit pressures from tough lending conditions: Citigroup (symbol: C; $91 billion market cap) and US Bancorp (symbol: USB; $48 billion market cap). We also sold Simon Property Group Inc. (symbol: SPG; $36 billion market cap), the largest mall real estate investment trust (REIT) in the US, to take profits. Other sales included Qualcomm Inc, Nutrien, and Woodside Energy.

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