


QUARTERLY NEWSLETTER

DO THE OPPOSITE

2Q • 2022

 **Chart 1. Index Performance as of 03.31.2022**



INDEX PERFORMANCE

Returns as of 03.31.2022

S&P 500 (SPX)	-4.60%
Dow Jones Indus. Avg (INDU)	-4.10%
Bloomberg 1K Growth	-8.91%
Bloomberg 1K Value	1.58%
Bloomberg Developed Ex North America & Mid Cap	-5.56%
Bloomberg World Index	-5.61%
U.S. Corp High Yield	-4.83%
Alerian MLP	18.72%

Chart & Performance Numbers Source: Bloomberg as of 03.31.2022

On the mega hit show Seinfeld, George Costanza, after many years of bad decisions, has an epiphany as he decides to try and do the opposite of his instincts given that his instincts have failed him again and again. And, it works. He gets a date and a job with the New York Yankees.

Jerry Seinfeld: If every instinct you have is wrong, then the opposite would have to be right.

George Costanza: Yes, I will do the opposite. I used to sit here and do nothing, and regret it for the rest of the day, so now I will do the opposite, and I will do something!

George Costanza: [He goes over to the woman] Excuse me, I couldn't help but notice that you were looking in my direction.

Victoria: Oh, yes I was. You just ordered the same exact lunch as me.

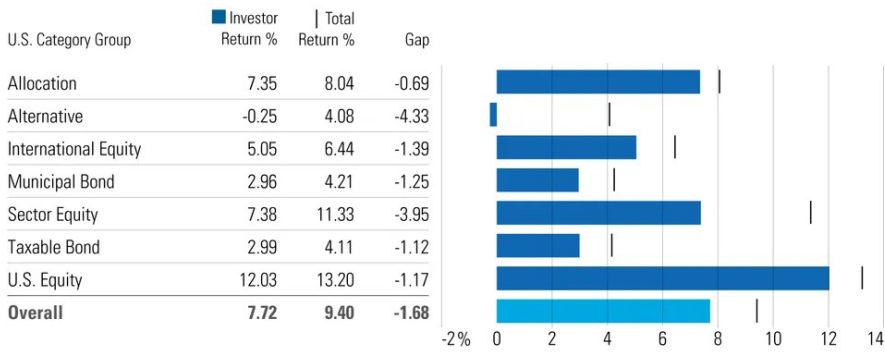
George Costanza: [Takes a deep breath] My name is George. I'm unemployed and I live with my parents.

Victoria: I'm Victoria. Hi.

While this scenario is purely fictional, we use it to highlight a theme during periods of volatility such as what we experienced during the first quarter of 2022. Doing the opposite with investing is not quite as simple as George's choice, but it does help illustrate that if one can control their emotions, they will therefore be apt to make higher quality, less *emotional* decisions. Although it is overused, the idea of staying the course, or what highly successful portfolio manager Bill Miller calls "time arbitrage," is indeed a highly valuable idea. There are many studies that have shown most individual investors buy high and sell low, and therefore fail to realize market index returns.

In Morningstar's annual "Mind the Gap" study which studies dollar-weighted returns, they found that "investors earned about 7.7% per year on the average dollar they invested in mutual funds and exchange-traded funds over the 10 years ended Dec. 31, 2020." This was about 1.68 percentage points less than the total returns their fund investments generated over that span (Chart 2). This shortfall, or "gap," stems from inopportunistically timed purchases and sales of fund shares, which cost investors nearly one-sixth the return they would have earned if they had simply bought and held.


 **Chart 2.** The Gap by U.S. Category Group (10-Year Returns)

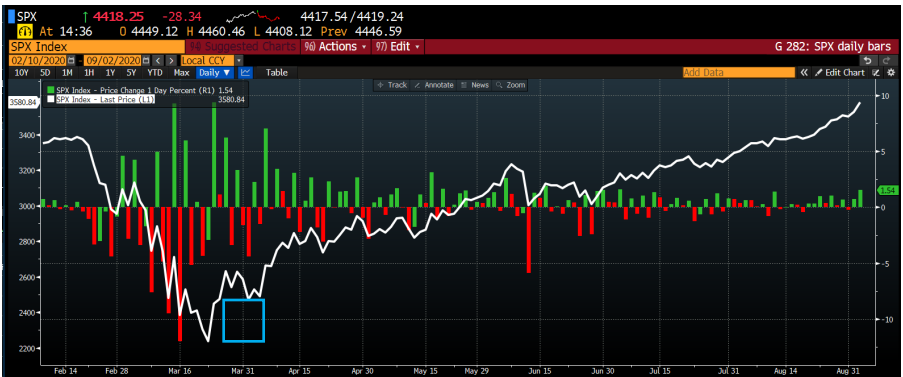


Source: Morningstar as of 12.31.2020

This brings us back to portfolio management and analysis. Level Four Capital Management (LFCM) believes that the most important edge we can possess is a behavioral edge. Most of this edge comes from having a repeatable investment process that is proven along with the investment professionals to implement it. By conducting our own extensive research on each name in a portfolio, we have a unique perspective of making decisions based on the long-term intrinsic value of the business. Therefore, this gives us the confidence to step back from the headlines and emotions of the day, and stick to our process even when markets are uncertain.

Chart 3 shows the daily returns of the S&P 500 from February 10, 2020 through September 20, 2020, which was the most volatile period during the COVID-19 crisis. In our opinion, this shows the futility of trading the news. As illustrated in the chart, most of the largest days up (red) or down (green) are close together and in a tight range. In fact, most of the largest down days are followed by up days. For an additional perspective, these are some of the largest moves in the last 10 years. If you attempted to trade on the news and sold on the big down days, you probably would have missed the up days as well. Doing the opposite, like George Costanza, and selling on the up days would have been better since those were followed by down, and mostly outsized, down days. Indeed, it is hard to believe anyone could have pulled off the timing of such trades.

 **Chart 3.** Daily S&P 500 Returns - 2/10/20 - 9/20/20

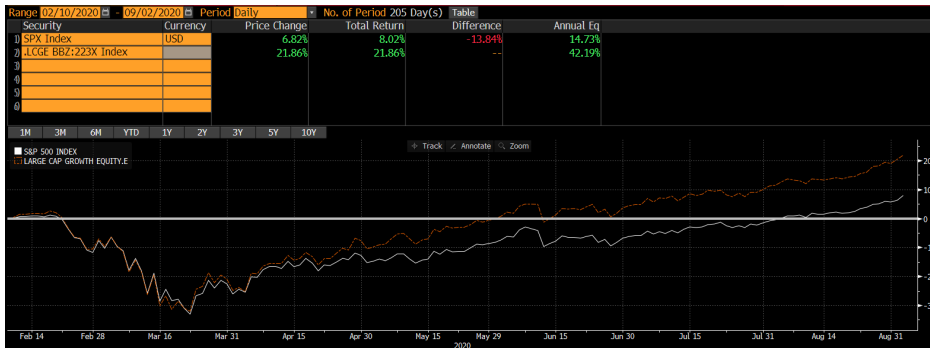


Source: Bloomberg as of 03.31.2022

Further reviewing Chart 3, the white line is the price of the S&P 500 which represents the path for those who rode out the storm and stayed the course. We realize there was plenty going on during that time and there is hindsight in the observation, but beyond riding out the volatility, we propose the idea of **enhanced dollar cost averaging**. Dollar cost averaging is the act of adding to your investment on a regular basis to take market timing out of your investment strategy. We believe this approach is much better than letting fear drive your portfolio returns. Enhanced dollar cost averaging is buying during the storm or as the market is correcting; even if you buy halfway down, your compounded returns are much better over time. After all, investing is generally a long-term prospect and your strategy should match your time horizon.

For example, we do this for you in the LFCM equity portfolios. During the COVID-19 correction, we acted as buyers by deploying excess cash in the portfolios during an otherwise scary time in the market. Our team stepped in and took advantage of the heightened volatility to buy names that met our investment discipline, but were otherwise too expensive prior to the correction. We use these periods as an opportunity to utilize cash and sell underperformers to buy cheaper more attractive long-term ideas. Using the LFCM U.S. Large Cap Growth portfolio

 **Chart 4.** LFCM U.S. Large Cap Growth Portfolio



Source: Bloomberg as of 03.31.2022

as an example, you can see the results of this strategy in Chart 4 to the left. The portfolio began to trail the market at the bottom as a result of *buying* on the way down as we added beta (market risk) to the portfolio, but when the market bottomed, we outperformed significantly over the next few months.

In the current market environment, with elevated levels of economic volatility and strife, we are indeed seeing some very concerning headlines such as Russia invading Ukraine, historic inflation, and rising interest rates. Unfortunately, we can likely expect more and the news could get worse before it gets better. As investors, we all should be concerned and diligent during these types of events but know that the LFCM team is watching these headlines closely and looking for ways to take advantage of any long-term opportunities that may arise. As time always tells, whatever we are currently experiencing, including low or high prices, negative or positive returns, it will change.

INTERNATIONAL PERSPECTIVE

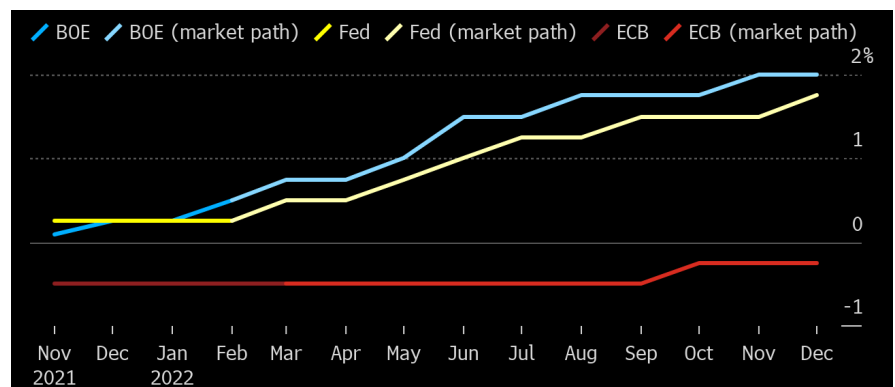
2022 was supposed to be the year of normalization, following a transition year marked by easy monetary policy, favorable economic data comparison, and high inflation. However, the Russian invasion of Ukraine and the surge of COVID-19 infections in China disrupted recovery efforts and caused hawkish reactions from policy makers. As a result, the IMF downgraded its global growth outlook from 4.4% to 3.6% to adjust for macroeconomic headwinds. Looking at data, there is a clear dichotomy between consumption-driven economies and export-driven economies. We selected three countries/provinces in each category to illustrate the contrast.

STATE OF CONSUMPTION-DRIVEN ECONOMIES

Looking abroad to the United Kingdom, the economy is heavily dependent on consumption, as it represents approximately 64% of GDP. The job market remains robust with the unemployment rate at 3.8%, which is the lowest level since December 2019. The Services PMI improved in the first quarter from 54.10 to 62.60. The strong economic backdrop emboldened Bank of England (Chart 5) to shift its focus on fighting inflation as consumer prices reached a multi-year high. The benchmark interest rate now stands at 0.75%, following three consecutive rate hikes. British stocks advanced 1.78% in the first quarter, as the Ukraine invasion by Russia and rising inflation dampened growth expectations.

India is another consumption-driven economy, as it represents close to 60% of GDP. The impact of the war and inflation can be seen in the surge in import prices as energy prices spiked. According to data from the oil ministry, India's oil bill will be over \$100B in the fiscal year ending March 31st. Services PMI rose steadily in the first quarter amid strong demand and increasing wages. The Reserve Bank of India has been reticent to tighten monetary policy because of geopolitical uncertainty and COVID-19. In its April World Economic Outlook release, the IMF revised down its growth estimate for India from 9% to 8.2%. Near-term headwinds have been heavily discounted by markets as the Nifty 50 index, a gauge of Indian most liquid stocks, only gained 0.64% in the first quarter.

 **Chart 5.** BOE is on a faster tightening path than its major peers

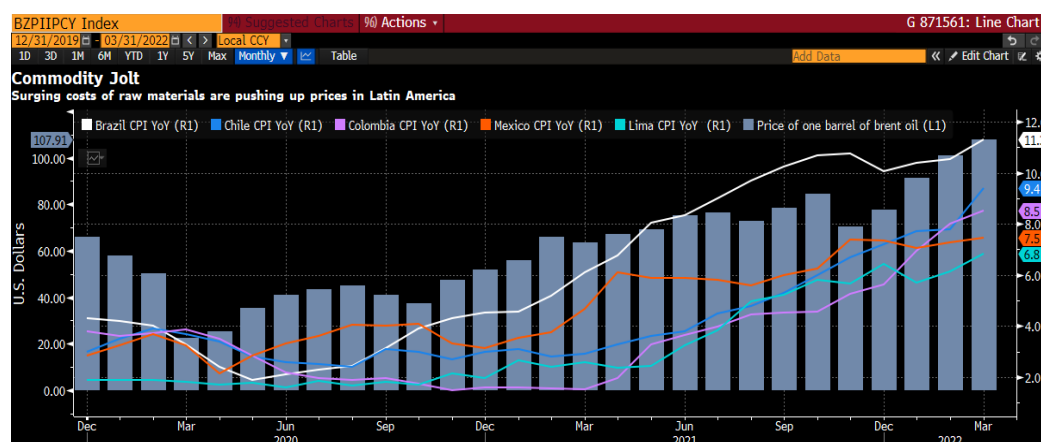


Source: Bloomberg as of 03.31.2022

Last but not least, Brazil largely depends on consumers to drive economic output as consumption represents 64% of GDP. Rising prices has been at the forefront of political debates as President Jair Bolsonaro tries to appease voters ahead of presidential elections later this year. In fact, headline CPI has been above Latin American peers in the last six months, prompting the Central Bank to aggressively raise the benchmark interest rate (Chart 6 below). The strong labor market was not derailed by monetary policy tightening as unemployment rate declined to 11.2% in March, the lowest level since March 2016. The IMF upgraded its growth outlook for Brazil from 0.3% to 0.8%, thus making the case that Brazilian economy is more resilient than expected to exogenous shocks. Brazilian stocks advanced 14.48% in the first quarter, boosted by commodity stocks.



Chart 6. Fed vs. Market



Source: Bloomberg as of 03.31.2022

Overall, the picture painted by these consumption-driven economies is that the cost of inflation is partially offset by a strong consumer and labor market. The unprecedented fiscal and monetary policy stimulus deployed during the Pandemic currently act as a shock absorber amid the war-fueled inflation. However, exports-driven economies may face different challenges.

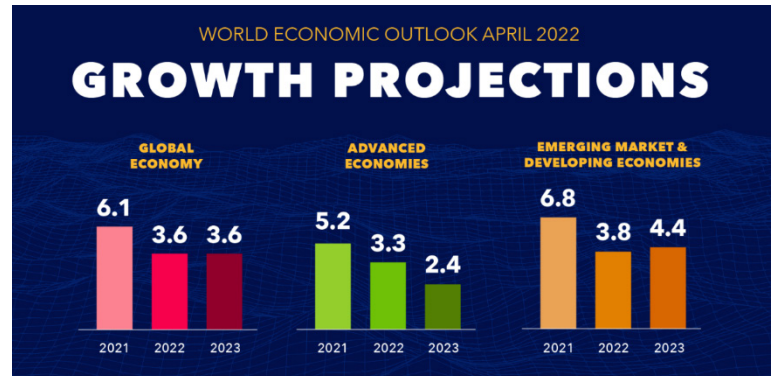
STATE OF EXPORT-DRIVEN ECONOMIES

South Korea is often referenced as a bellwether for the global economy due to its export-driven economy. Like many large exporters, the country faces supply chain challenges due to raw material shortages, COVID-19 disruption and the Russia/Ukraine war. As a result, exports growth were choppy in the first quarter and roughly flat month-over-month, although it grew 18% year-over-year. This relative softness is further highlighted in the Manufacturing PMI number that declined from 53.8 to 51.2. Despite supply chain issues, policy maker remained focus on keeping inflation under control. Indeed, Bank of Korea raised its key rate by 25bps to 1.25% in the first quarter in response to rising prices. The IMF projects 2.5% real GDP growth in 2022 and 2.9% in 2023, which is in line with growth rates seen in the last decade. Korean stocks declined 7.39% in the first quarter, reflecting investors' angst on the global economy.

The second export-driven economy that we picked is Taiwan, known for being a manufacturing hub for semiconductors and many consumer products. Like South Korea, Taiwan experienced a slight decline in production in the first quarter due to supply chain woes. Manufacturing PMI slightly declined from 58.8 in February to 57.8 in March. The Taiwanese dollar depreciated over 3.6% in the first quarter versus the U.S. dollar and whether this currency depreciation will be a net positive for exports remains to be seen. Month-over-month exports declined following the Russian invasion, but remained elevated year-over-year with 21% growth. The IMF projects 3.2% real GDP growth in 2022 and 2.9% in 2023. Taiwanese stocks declined 2.88% in the first quarter, as uncertainty surrounding China's involvement in the Russia/Ukraine conflict obscured the growth outlook.

Finally, Hong Kong is another typical export-driven economy, with one of the world's busiest ports. Hong Kong faced a difficult quarter with a surge in COVID-19 cases that affected production and caused shipping delays. Manufacturing PMI contracted from 48.9 in January to 42.0 in March, the lowest reading since April 2020. The IMF projects 0.5% growth in 2022 and 4.9% growth next year. The latest year-over-year export data published by Hong Kong authorities shows 0.9% growth in February, down from 18.4% growth in January. The Hang Seng index declined 5.99% in the first quarter, as industrials dropped 13.87%.

 **Chart 7.** World Economic Growth Projections



Source: International Monetary Fund as of 03.31.2022

In sum, export-driven economies seem to experience supply-driven headwinds that could cause a slight slowdown in near-term growth. The question remains how long can consumption-driven economies absorb the cost of disruption? With monetary policy normalizing in many countries, a reasonable assumption is that their runway is getting thinner and thinner. Exports-driven economies are more than ever incentivized to find a solution to capitalize on strong demand.

ASSET ALLOCATION VIEW

IS THE 60/40 PORTFOLIO DEAD?

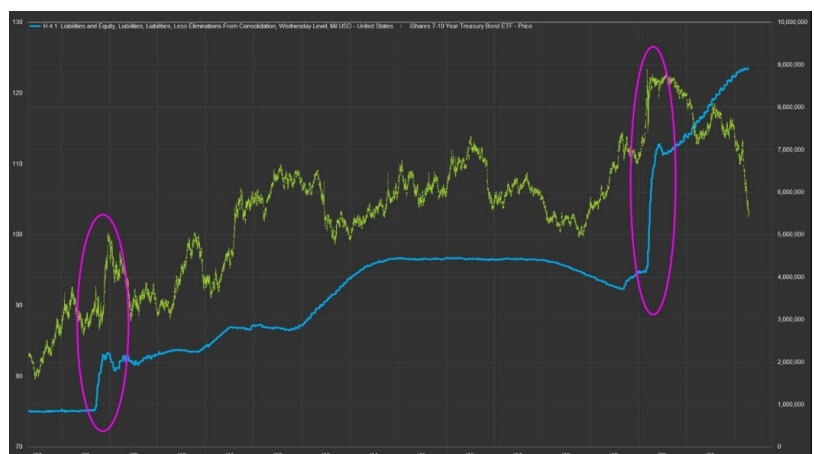
The investment markets entered 2022 facing a number of challenges which has led to lower performance of stocks and bonds, the primary asset classes in many portfolios, and the asset classes represented in the traditional 60/40 portfolio. The main goal of a 60% stock, 40% bond allocation is to capture the long-term performance of equities, while reducing the overall portfolio volatility by including bonds which typically have lower volatility than stocks, and also have a low to negative correlation (moving in the same direction at the same time) to stocks.

It has been said the most dangerous words in investing are "it's different this time" because most of the time it really isn't. So, is it actually different this time? We would propose the answer to this question is yes...and no.

WHAT'S DIFFERENT?


In response to the Pandemic-generated recession and associated economic distress, the Federal Reserve (Fed) instituted a number of actions to enhance liquidity in the markets and to support the U.S. government's massive fiscal stimulus packages. The result of these actions was a flood of liquidity as the Fed increased its balance sheet from around \$4 trillion to \$9 trillion, and cut short-term interest rates to zero. This \$5 trillion increase in liquidity supported financial markets in 2020, with the aggregate bond index retuning approximately 7.5%, while the S&P 500 gained 18.73%. In 2020, a 60/40 portfolio would have returned approximately 14%, as represented by 60% exposure to the S&P 500 and 40% exposure to the Bloomberg Barclays Agg. As inflation rose in 2021, bonds were challenged and lost 1.54%, while stocks returned 28.75%. Again the 60/40 portfolio provided a healthy

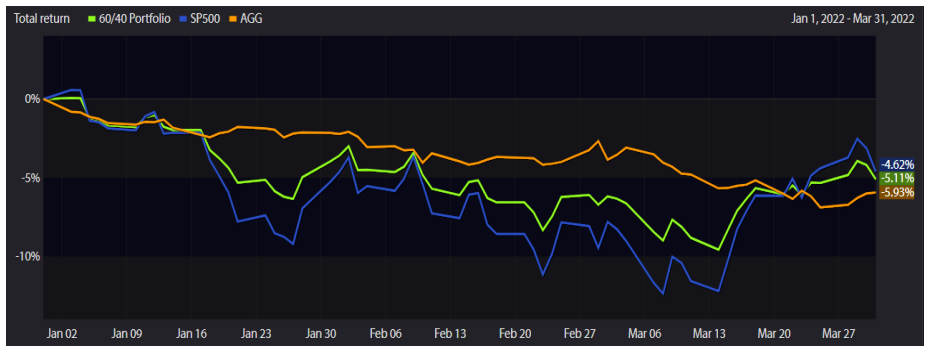
 **Chart 8.** Bond Prices and Fed QE Cycles



Source: FactSet as of 03.31.2022

return of over 17%. In the first quarter of 2022, as the Fed began to raise rates and outlined a plan to shrink their balance sheet, both stocks and bonds exhibited a negative return. On the following page, Chart 8 illustrates bond price reactions to Fed balance sheet actions. Note that in the circled areas that as the Fed increased their balance sheet, bond prices rose, but then declined after the initial Fed action.

 **Chart 9. 60/40 Model and Component 1Q22 Returns**




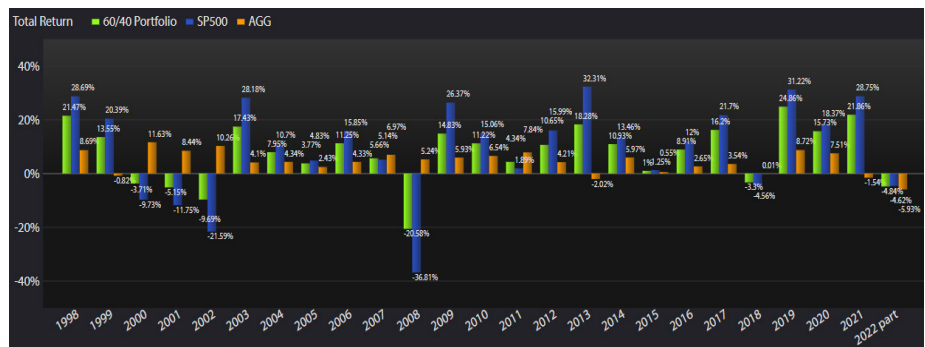
Source: Kwanti as of 03.31.2022

Equities are also positively impacted by a rising Fed balance sheet. However, the opposite is also true; as the Fed indicates a reduction of liquidity, stock and bond prices can be adversely affected as has occurred in the first quarter of 2022 which is represented in Chart 9.

WHAT'S THE SAME?

As can be seen in Chart 10, during the past 25 years, a 60/40 portfolio has never had a year where both the stock and bond allocation generated negative returns in the same year. In fact, if viewed on a quarterly basis, there have only been six quarters out of the last 100 quarters where both allocations in a 60/40 portfolio have been negative in the same quarter. During this time frame, a 60/40 portfolio has returned on average about 8%.

 **Chart 10. 25-Year Stock, Bond, and 60/40 Model Returns**



Source: Kwanti as of 03.31.2022

WHAT'S THE CONCLUSION?

Over time, markets will change, the economy will change, Fed actions will change, but diversification works. We may see times such as this most recent quarter where stocks and bonds both suffer negative returns, however over the long-term, both asset classes provide positive returns while reducing volatility from each other. Long live the 60/40!

Current asset allocation positioning:

The first quarter of 2022 reflected a response of financial markets to increased inflation, increased federal funds rate, and expected quantitative tightening. Passage of additional fiscal stimulus seems unlikely. We are closely watching the effects of these changes while staying macro aware of ongoing economic activity and government policy.

In accordance with this view, we currently see the following indications for asset allocation:

General Allocation – In the first quarter, markets declined with our equity benchmark down 5.43% while our fixed income benchmark declined, 5.93%. In the fixed income markets, interest rate spreads widened slightly but remain compressed. We recommend a quality core of equity focusing on companies with strong balance sheets and strong cash flows and a good balance between growth and value. For fixed income, we recommend a mix of core, multisector, and floating rate/inflation protected allocations. As the Fed tightens

monetary policy to combat persistent inflation, we believe volatility in the fixed income markets may increase, both in terms of overall interest rates and spreads. We also believe equities may see lower returns and higher volatility than has been seen in the recent past. Accordingly, we support an allocation to non-correlated alternative assets in mixed equity/fixed income models. We are closely monitoring the rate of changes in monetary policy the Fed will implement. We remain vigilant regarding our indicators and will modify overall allocations as these indicators and the market environment dictate.

Equity Allocation – We continue to monitor financial conditions and market returns to determine our optimal equity asset allocation. Relative to benchmarks, we are currently equal weight equities relative to our benchmark. We are neutral U.S. equities versus international, though we note that international equities are priced more favorably than U.S. equities. In the event of a resolution of the Russian/Ukrainian conflict, we see opportunities in Europe.

We are constructive regarding select small/mid-cap equities, and are particularly watching small cap value closely. We continue to emphasize high quality and high cash flow equities as those type of companies should emerge from the current crisis in the most favorable condition to take advantage of the recovering economy. We see opportunity in emerging markets, but are cautious regarding China due to increased involvement of their government in respect to capital markets.

Fixed Income Allocation – We believe fixed income going forward will continue to be challenging. In response to current inflations, the Fed has initiated a series of proposed rate hikes in the federal funds rate and indicated future quantitative tightening. The effects of these actions have pressured interest rates higher across the yield curve. As rates rise the outlook for core fixed income may improve, however we remain cautious regarding duration and spreads as a strong tail risk exists for rates to continue higher. Longer term, rates may simply respond to changes in the economy, the existing debt level, and increased future debt needed to fund Social Security and Medicare as more Boomers retire. All of this indicates a more tactical approach of fixed income management. We continue to monitor and interest rate movements and spreads closely and will adjust positioning in accordance with the evolving economic and interest rate environment. Liquid alternatives have been helpful in reducing portfolio volatility and improving risk adjusted returns. We continue to evaluate alternatives as an option to reduce portfolio volatility and as an alternative to a portion of a traditional fixed income allocation.

As always, we are working hard on "best ideas" to take full advantage of any over index moves. We believe that our focus in all of our portfolios is on quality and value, and they are positioned even better in an inflationary environment. Inflation and uncertainty usually leads to more dispersion in returns and more focus on picking high quality and well-run companies at great prices, versus long-term intrinsic value.

Thank You,
Level Four Capital Management Team

IMPORTANT INFORMATION

The opinions articulated in this document are for general information only. This information is not intended to provide specific advice or recommendations for any individual. The economic forecasts set forth above may not develop as predicted and there can be no guarantee that strategies promoted will be successful. All performance referenced is historical and is no guarantee of future results. No strategy including asset allocation assures success or protects against loss. All indices are unmanaged and may not be invested into directly.

Stock investing involves risk including loss of principal. Value investments can perform differently from the markets as a whole. They can remain undervalued by the market for long periods of time.

International and emerging market investing involves special risks such as currency fluctuation and political instability and may not be suitable for all investors.

The Standard & Poor's 500 index is a market capitalization weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries. The Dow Jones Industrial Average (DJIA) is a price-weighted average of 30 significant stocks traded on the New York Stock Exchange (NYSE) and the NASDAQ.

The Dow Jones Industrial Average (DJIA) is a price-weighted average of 30 significant stocks traded on the New York Stock Exchange (NYSE) and the NASDAQ. Price-weighted means stocks with higher share prices are given a greater weight in the index. The DJIA is a stock market index that shows how 30 large, publicly owned companies based in the United States have traded during a standard trading session in the stock market. The value of the Dow is not a weighted arithmetic mean and does not represent its component companies' market capitalization, but rather the sum of the price of one share of stock for each component company.

The Bloomberg US 1000 Value and Growth Indices (B1000V & B1000G) are screened from the Bloomberg US 1000 Index (B1000) and are constructed based on a linear combination of risk factors. The four factors are: 1) Earnings Yield, 2) Valuation, 3) Dividend Yield and 4) Growth. The factors are equally weighted when forming a composite signal where Growth is considered to be a negative indicator and thus flipped to be a negative. The Indices are market-capitalization-weighted. The current price is used to calculate the price-based ratios. For detailed information, review the index methodology document.

Bloomberg Developed Markets ex N. America Large & Mid Cap Price Return Index is a float market-cap-weighted equity benchmark that covers 85% market cap of the measured market.

Bloomberg World Large & Mid Cap Price Return Index is a float market-cap-weighted equity benchmark that covers 85% market cap of the measured market.

The Bloomberg Barclays US Corporate High Yield Bond Index measures the USD-denominated, high yield, fixed-rate corporate bond market. Securities are classified as high yield if the middle rating of Moody's, Fitch and S&P is Ba1/BB+/BB+ or below. Bonds from issuers with an emerging markets country of risk, based on Barclays EM country definition, are excluded.

The Alerian MLP Index is the leading gauge of energy Master Limited Partnerships (MLPs). The capped, float-adjusted, capitalization-weighted index, whose constituents represent approximately 85% of total float-adjusted market capitalization, is disseminated real-time on a price-return basis (AMZ) and on a total-return basis (AMZX).

DISCLOSURE

Investment advisory services offered through Level Four Advisory Services, LLC, an SEC-registered investment advisor. Asset management services offered through Level Four Capital Management, LLC an SEC-registered investment advisor. Level Four Advisory Services, LLC and Level Four Capital Management, LLC are related entities and subsidiaries of Level Four Group, LLC.