Quarterly Commentary

July 2022

RWA Roberts Wealth Advisors

In This Issue:

A Change of Momentum

Veteran investors have long understood there is not return opportunity without taking some level of risk. Risk manifests itself in volatility around a long-term trend on both the upside and the downside. Thus far, 2022 has been a stark reminder of that downside volatility across nearly all asset classes. The stock market saw an acceleration of decline from first quarter's weakness and fell 16.1% in the 2nd quarter alone. The bond market also continued its decline in the quarter, with the Barclay's aggregate falling 4.7%. The housing market, traditionally a laggard on the downside, also showed signs of weakness, as higher mortgage rates and nervous buyers cooled what had been an extremely hot housing market.

U.S. companies have largely executed well, announcing revenue and earnings growth in line with their guidance, but investors shifted their focus to the remainder of 2022 and the inflation fears that threaten to upset economic growth. Inflation numbers remain alarmingly elevated at 8.6% forcing the hand of the Federal Reserve to take a more aggressive stance at curbing the pressure.

Jerome Powell, chairman of the Federal Open Market Committee (FOMC), signaled the committee's willingness to move aggressively as they unwind their actions during the pandemic. Prior to 2020, FOMC governors were deliberating how quickly to reduce the bond purchases done over the previous 10-years in response to the financial crisis. The quantitative easing (QE) programs expanded the FOMC balance sheet from $900 billion in assets to over $4.4 trillion by 2018. When the pandemic hit in the Spring of 2020, a policy pivot was made to provide liquidity to the markets, and the FOMC Balance Sheet expanded by an additional $4.5 trillion in the ensuing 18 months. As inflation now grows at levels not seen since the 1980s, the debate rages amongst market participants as to whether current inflation is a result of exogenous events or a function of the extended period of FOMC's actions that left a global economy awash in liquidity. While the FOMC governors fire their initial salvos in their battle against inflation, investors spent the quarter exiting investments of all kinds, choosing to watch from the sideline.

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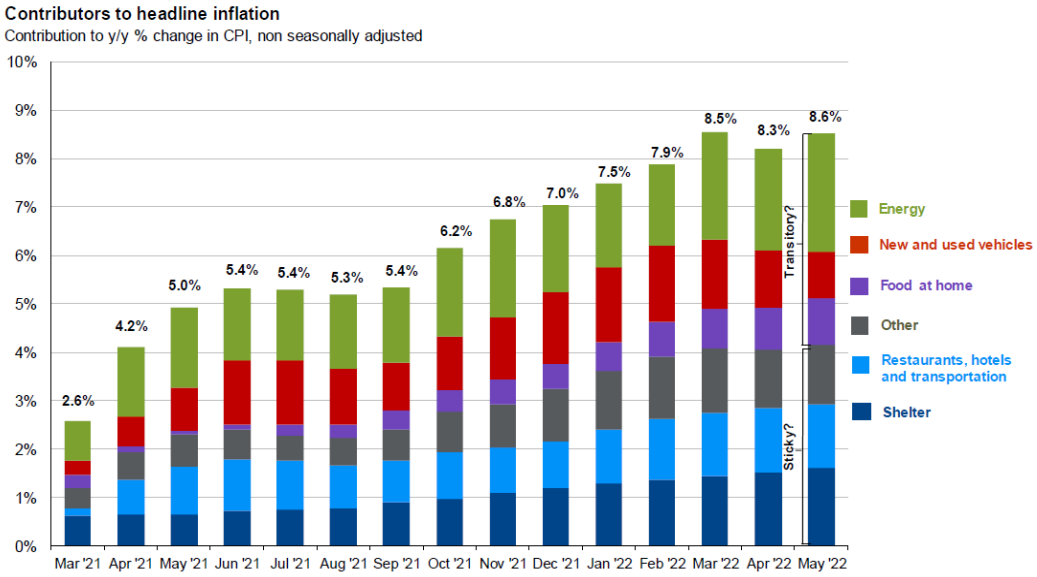
This inflation conundrum is not isolated to the U.S. central bank. The response to the 2008 financial crisis was a coordinated global monetary action amongst the central banks across the world to infuse liquidity into the global economy and maintain low interest rates. This unprecedented action gave way to a global "easy money policy" that resulted in stabilization, recovery and ultimate appreciation of growth assets led by the technology sector of the U.S. stock market. The pandemic extended those actions, requiring an even greater adjustment to return to levels that predated the financial crisis. The time for reversal has come and with it comes the uncertainty of how the global economy will fare as the central banks tighten.

Central banks have two major tools at their disposal in the fight against inflation. They can raise rates, which increases borrowing costs and encourages savings, or they can reduce the FOMC balance sheet by selling bonds, effectively pulling money out of the economy. The FOMC is utilizing both of those tools. Thus far in 2022, the FOMC has increased their target Fed Funds rate three times, up to 1.75%. In March, the FOMC enacted the second of these tools by ending its monthly bond purchases. This strategic shift eliminated what had been an injection of $120 billion monthly into the bond market. The FOMC has formed a plan to start reducing positions in Treasury securities, agency debt, and agency mortgage-backed securities by $47.5 billion per month initially, stepping up to $95 billion monthly by September. The process of the Fed "unwinding" its balance sheet is commonly referred to as quantitative tightening (QT).

Fed Chairman Jerome Powell stated, "Inflation is much too high, and we understand the hardship it is causing. We're moving expeditiously to bring it back down." While much has been written about inflation, it is interesting to look at the components of the headline inflationary number. There has been a noticeable increase in all the major categories of the Consumer Price Index (CPI), with a particularly large contribution from energy, new and used automobile pricing, and food consumed at home. Those three categories contributed nearly half of the 8.6% increase in the May reading. While the expectation is for pressures to persist, there may be some easing in all three of those measures. This relief could come from an increase in non-Russian oil production, the ending of shutdowns and restrictions due to Covid-19, and/or the increased utility of global shipping routes.



Source: JP Morgan

It goes to reason that the same type of investments that benefit the greatest from central banks' easy money policy would suffer the most with a change in policy. That, in fact, has played out with U.S. growth stocks facing their largest declines since the end of 2021. The return differential between growth and value stocks has been quite dramatic. One characteristic of a growth company is that much of its value can be attributed to the opportunity it has to deliver revenue in the future. During an environment of elevated interest rates, the discount rate is also higher, reducing the current value of future success. While the same opportunity for future revenues may still exist for those companies, the value in today's dollars is reduced. Though relative returns have been much better for their value counterparts, this has largely been a function of the energy sector's outperformance. The price of a barrel of oil has spiked significantly as the western world has moved to eliminate Russian imports in support of Ukraine. The high prices have yet to result in a corresponding reduction in demand as the post-pandemic consumer has jumped back into their cars and onto airplanes, refusing to cancel plans that often have already been delayed due to the pandemic. Value stocks have performed better but have still seen their values decline by double digits across all market capitalizations.

The market narrative has shifted from how to best support a fragile pandemic era economy to combatting the ramifications of that same support. Our investment portfolios must shift in response to that. The "growth at any cost" mantra that resulted in elevated valuations of companies with attractive stories, will be replaced by time tested valuation metrics that identify well managed companies able to deliver value to shareholders. Companies poised to deliver strong cash flows with protectable margins stand to perform best in the current environment. There will continue to be upward pressure on interest rates, that argues a bond portfolio of short-term high-quality bonds will position investors to enjoy improved income, while protecting their principal investments. Participating in market sell offs is not enjoyable; however, this investment environment is not unprecedented. Patient investors focused on identifying opportunities will stand to benefit most.

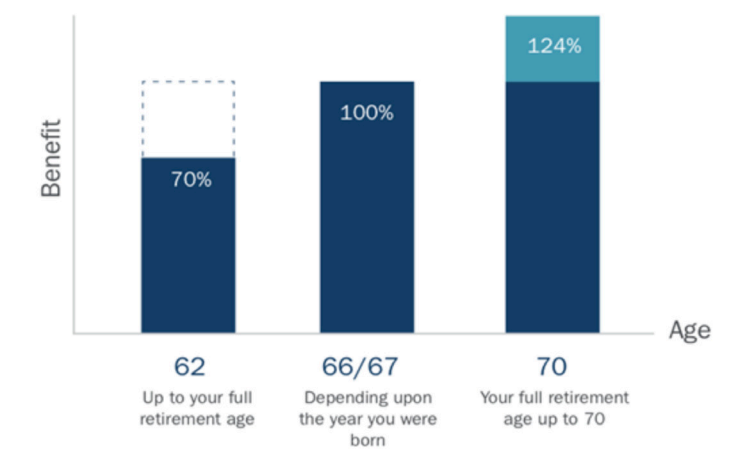
Year To Date Returns

	Value	Blend	Growth
large	-11.4%	-20.0%	-27.6%
mid	-14.0%	-19.5%	-24.9%
small	-14.2%	-18.9%	-23.7%

Source: YCharts

Finessing your Retirement Timeline: When to Take Social Security Benefits

Nearly all participants in the U.S. workforce have paid into the Social Security system. Social Security benefits are available as early as 62 years old and are guaranteed for life. Payments can be deferred to as late as 70 years old, with a higher monthly payment.



Source: ameriprise.com

Finding your Social Security "sweet spot" can be complicated and is different for every individual. Many factors should be considered, such as, cash needs, marital status, and employment status, but the most telling consideration, and the factor hardest to predict, is life expectancy. The decision to collect Social Security benefits should be made with the longevity of your own life in mind, and in many cases, your spouse's life too. Estimating your life expectancy may feel glum, but making an educated guess is critical. For men turning 65 in 2022, the average life expectancy is 84.1 years old. For women turning 65 this year, the average life expectancy is 86.7 years. Couples who are married tend to live longer, with a strong likelihood that at least one spouse will live until age 90. Social Security benefits are calculated with these life expectancies in mind. If you anticipate you will outlive the average life expectancy, it is better to delay collecting Social Security, but if you have reason to believe you won't, better to enjoy those benefits while you can.

The amount of your benefit depends on when you file to collect your benefits. If you wait until full retirement age (66/67 years depending on date of birth), you are entitled to receive 100% of the benefit. Filing at the earliest age of 62 will reduce the total benefit by 30%. Each year you delay after reaching full retirement age, the benefit is increased by 8%, maxing out at the age of 70. Married couples should consider a coordinated split approach where the spouse with historically lower earnings files earlier and the higher earner delays until age 70, if possible. This maximizes the higher benefit amount while realizing a portion of the total benefit for longer. There are specific benefit eligibility rules for surviving and divorced spouses. RWA can provide guidance on these qualifications if applicable to you.

Retirement Age Milestones

50 Eligible for catch-up contributions to retirement accounts

59½ Eligible for penalty-free withdrawals from retirement accounts

62 Eligible for reduced Social Security benefits

65 Eligible to sign up for Medicare

66/67 FRA (full retirement age)

70 Maximum delayed retirement age

Regardless of your current age, it's never too early to establish your my Social Security account at www.ssa.gov/myaccount. From here, you can access your Social Security statement, which lists your annual earnings from the time you started contributing to Social Security and what your benefit will be at certain ages.

Don't forget! At age 65, you qualify for Medicare coverage (Part A - Hospital and Part B - Medical). If you are already taking Social Security at this point, you will be automatically enrolled in Part A and can choose to elect Part B, which has monthly premiums. If not, you will need to manually enroll through your my Social Security account. The window to sign up begins 3 months before you turn 65 and ends 3 months after.

If you are approaching any of these important listed milestones and would like to discuss your options or need help navigating the system, feel free to reach out to us. As always, a little bit of planning at the right time can have a meaningful impact on your retirement income.

Portfolio Activity

The equity markets accelerated on the downside in the second quarter. Even though companies reported strong earnings and revenue growth, cautious guidance and the threat of higher interest rates suppressed valuations. Much of the portfolio activity was tactical in nature, implementing trades to reduce potential tax exposure while positioning the portfolio for a time when the market stabilizes.

We exited a position in Kellogg (K). Cost inflation in the food industry is expected to rise double digits in 2022 with those costs accelerating in the second half of the year. Kellogg, a company already with low operating margins, will be challenged to maintain profitability. In addition to the cost of raw materials, the company has been managing labor issues that further pressure its fragile cost structure. Late in the quarter, the company announced a plan to split into three companies, a move with questionable motivation. Despite the pressures, the stock traded at the higher end of its valuation range which prompted the decision to exit.

We also exited a disappointing investment in Envestnet (ENV). Envestnet has benefited from the growth of the investment management industry, providing both technology solutions and a platform of managed solutions for a growing number of advisors. The company was actively seeking an acquirer and had multiple suitors expressing interest. The combination of a decline in asset values and higher borrowing costs reduced the probability of a deal being consummated. Envestnet will be tasked with rebuilding business momentum, with the initial implications being increased spending and lower margins. Rather than wait for the turnaround, we realized a loss and moved on.

We initiated a position in Generac (GNRC) which we feature in this quarter's featured stock profile. Generac is the market leader in back up power generation systems, while also making significant inroads into the rapidly growing clean energy solutions market. We anticipate Generac will benefit from the transition to alternative energy production for both the commercial and residential markets. Additionally, the increasing frequency of power disruptions from weather and fire related events promises to increase demand for Generac's backup solutions.

Index Performance	Q2	YTD
Dow Jones Industrial	-10.78%	-14.44%
Standard & Poor's 500	-16.10%	-19.96%
MSCI EAFE (International)	-14.51%	-19.57%
Russell 2000 (Small Company)	-17.20%	-23.43%
MSCI ACWI (Global Stock)	-15.66%	-20.18%
Barclays Intermediate Term Bond	-1.14%	-4.55%
Barclays Municipal Bond	-2.94%	-8.98%
Barclays Short Term Bond	-4.96%	-10.35%

In many taxable accounts, we doubled our holding in PayPal (PYPL). The stock has not performed anywhere near expectations, despite our confidence that their market share in the digital payments space and increased interest payments will lead to growth in the company stock. We doubled the position as a strategy to recognize the loss once the holding period exceeds 31 days.

Additionally, there were corporate actions that impacted several of the portfolio investment positions. AT&T (T) completed its spin-off of Warner Brothers Discovery. Longer term we are more interested in maintaining our exposure to the wireless business of AT&T which contributes nearly 2/3 of the revenues. Emerson Electric completed its investment in Aspen Technology (AZPN), which resulted in a cash payment to Aspen shareholders while maintaining a position in the stock. The increased distribution of Aspen solutions to the industrial clients of Emerson expands the company's addressable market.

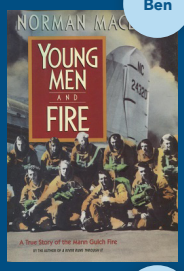
TOP 10
U.S. HOLDINGS

- Microsoft
- Apple
- Amazon
- Alphabet
- Illumina
- Disney
- First Republic Bank
- Qualcomm
- Salesforce
- Medtronic

Staff Summer Picks

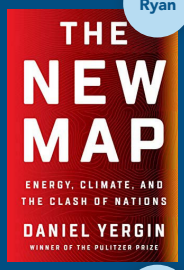
Young Men and Fire, by Norman Maclean: Young Men and Fire is about the true events that took place on August 5, 1949, when a crew of fifteen of the U.S. Forest Service's elite airborne firefighters, the Smokejumpers, stepped into the sky above a remote forest fire in the Montana wilderness. Two hours after their jump, all but three of the men were dead or mortally burned. Haunted by these deaths for forty years, Norman Maclean puts together the scattered pieces of the Mann Gulch tragedy in *Young Men and Fire*.

Ben



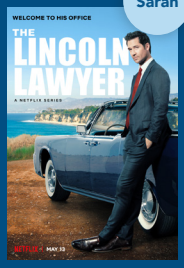
The New Map, by Daniel Yergin: In light of the war in Ukraine and the spike in global energy prices, this book has become even more insightful as it looks at some of the major global energy relationships and how they have changed over the years and where they are likely headed. It focuses on the Big 3: the United States, Saudi Arabia, and Russia, and looks at how the U.S.'s rise to become the number one global oil producer today has changed the traditional energy balance in the world and how the energy transition fits into the story going forward.

Ryan



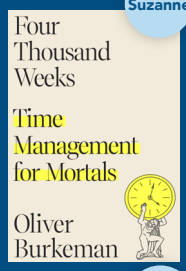
Lincoln Lawyer [2022, Netflix] A legal drama series based on the novel by Michael Connelly. This series is the perfect blend of detail and drama, an enjoyable show for all adults in the household.

Sarah



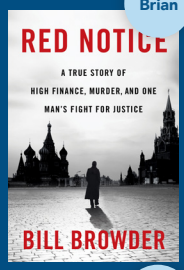
Four Thousand Weeks: Time Management for Mortals, by Oliver Burkeman: "The average human lifespan is absurdly, insultingly brief. Assuming you live to be eighty, you have just over four thousand weeks." This self-help book does a powerful job of putting time into perspective against the reader's own mortality. It provides a meaningful approach to determine what is important and how to prioritize your time. An important read for anyone who, like me, gets a thrill from checking off all the items on the to-do list.

Suzanne



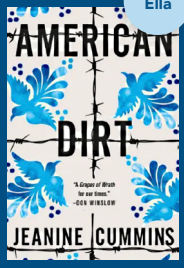
Red Notice: A True Story of High Finance, Murder, and One Man's Fight for Justice, by Bill Browder: A compelling autobiography by the American-born financier and founder of Hermitage Capital, which was once the largest foreign portfolio investor in Russia. The story provides a fascinating perspective into the interworking of the Russian investment markets.

Brian



American Dirt, by Jeanne Cummins: A riveting tale that follows a middle-class Mexican woman and her young son as they narrowly escape cartel-violence in their efforts to flee Mexico for America. A contentious, social-justice thriller, American Dirt is a suspenseful story about bravery, the subtleties of a mother and son relationship, and a relentless journey from Acapulco to America.

Ella



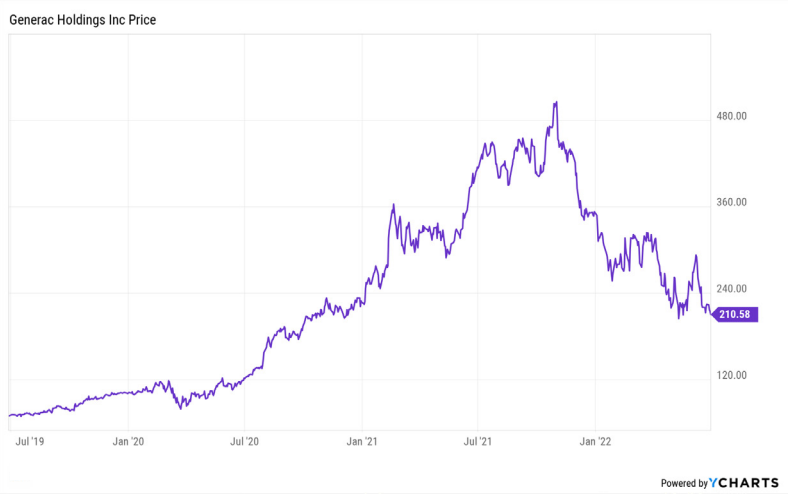
Featured Stock: Generac (GNRC)

Generac is a leading energy technology solutions company that provides back up energy and power generation systems to residential, commercial & industrial end markets with the widest selection of products in the marketplace. The company is the largest player in the home standby generator market. For the last decade, Generac has coined the industry's largest distribution network with a 75% share of the entire U.S. market. Currently, less than 5% of homes in the U.S. have a standby generator. This represents a massive growth opportunity for the company as an increase in severe weather incidents, combined with an aging electric grid, drive increased power outage activity across the country.

In addition, Generac is a key supplier of backup power systems to the telecommunications market in the U.S., situating itself nicely to benefit from emerging global telecom opportunities. With the impending deployment of 5G technology on the horizon, the need for continuous supply of power to network sites has never been more critical. As the number of "connected" devices continues to increase and wireless networks become critical infrastructure in the U.S., network reliability is essential. Hence, highly resilient cell tower sites across the network require reliable backup power sources on site. Generac will benefit from this demand as they hold a 50% share of the telecommunications backup power market and have existing, longstanding relationships with top-tier wireless providers and cell tower companies.

In recent years, Generac's business model has made significant investments to optimize both energy consumption and production. Generac's focus on distributed energy resources (DERs) and the establishment of Virtual Power Plants (VPPs), a grid stability program for product owners, has secured the company as a leader in the market for clean energy storage.

As the traditional, centralized electric grid evolves over time and we risk increased power outages, a more decarbonized, digitized, and decentralized grid infrastructure will be required to combat future demand. Generac's energy technology solutions are uniquely and strategically positioned to participate in this next-generation grid transformation.



The Streaming Wars

Topic Spotlight

The average household in the U.S. subscribes to four streaming services. As most American consumers, in the wake of the pandemic, demanded bigger content libraries and availability on multiple devices, a new reliance on over-the-top (OTT) streaming services emerged. As investors now consider viewing habits in a post pandemic environment, companies like Disney and Netflix, have seen a considerable decline in their stock prices. A transition in the way viewers consume content is likely to continue creating opportunity and challenges for industry participants.

From May 2021 through May 2022, the total share of TV and film consumed via streaming in the U.S. rose from nearly 26% to 32% with traditional broadcast and cable TV bearing the brunt of the decline. Broadcast and cable TV now make up less than 25% and 30% of total screen time, respectively. As broadcast TV loses popularity, legacy entertainment providers are engaged in a "streaming war" to establish the dominant streaming platform.

Streaming is a broad category with several large players. Its major sub-segments are known as SVOD, AVOD, and TVOD. SVOD, or subscription video on-demand, is a service where users pay a recurring fee for access to premium content, whether that be licensed or original. AVOD, or ad-supported video on-demand, includes streaming that is either partly or completely subsidized by advertising revenue and is thus discounted or free for the viewer. TVOD, or transactional video on-demand, is the legacy option of the group, providing pay-per-view programming that remains popular in certain arenas, notably sporting events.

Popular SVOD platforms like Netflix, Disney+, and HBO Max are some of the first names that come to mind when we think of streaming. AVOD platforms, like YouTube TV and Roku, are garnering increased attention. Consumers have been attracted to AVOD platforms because of the lower price point and an advertising load that is significantly lower than traditional TV. The platform has been popular as a fast way to attract and grow users with a goal of a transition to subscription revenues. The prevalence of smart TVs with preloaded AVOD apps has aided growth in this space, as 87% of U.S., households now own at least one internet-connected TV device.

Advertisers have been supportive of the AVOD model because less ad clutter results in higher awareness of each ad by the viewers. For example, in April of this year, it was estimated that NBCU's Peacock had less than five minutes of ads each hour, Hulu had less than ten minutes, and HBO Max had less than four minutes. Compare these measures to traditional television which could have up to fifteen minutes of advertising content per hour. Moreover, AVOD platforms can generate better responsiveness due to their ability to target advertisement to specific viewer demographics while traditional TV advertisements tend to be broader based.

AVOD's recent success has allowed its platforms to become the highest revenue generating sub-segment of the OTT universe, generating 51% of total revenues from AVOD compared to 40% from SVOD. Traditional TV has suffered a decline of 15% in paid subscribers since 2015 a trend that is expected to continue. AVOD platforms are positioned to benefit from the reduction in linear TV consumption as their service fills the void between linear and subscription models (on-demand, but free/less expensive) and may be more likely to convert those who find value in the linear model.

Over the last few months, a number of headlines have been generated in this space with many of the larger streaming platforms at least considering, if not committing, to rolling out ad-supported iterations of their platforms. We believe this trend is likely to continue and the current inflationary environment may add even further weight behind a lower cost alternative to both SVOD and traditional programming. However, the market is likely to remain in flux as dozens of providers vie for their slice of the estimated $19B in AVOD revenues this year, more than double the number from 2020.