Quarterly Commentary

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ROBERTS WEALTH ADVISORS

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Rate Increases Impact Market Returns

After a hopeful rally off the stock market lows in October, the momentum fizzled as fears of an imminent recession emerged. The S&P 500 ended the year with a total return of -18.11%. That annual return hid the stark contrast between the growth heavy Nasdaq Index return of -32.54 % and the more value-oriented Dow Jones Index's return of -6.86%. To put it mildly, it was a terrible year for stock investors.

The Federal Open Market Committee (FOMC), fearful of out-of-control inflationary pressures on the heels of fifteen years of accommodative monetary policy, looked to slam the brakes by raising their Target Funds rate from 0.25% to 4.50% over the course of the year. As the FOMC orchestrated their steady stream of rate hikes, bond yields jumped in anticipation of future committee actions. The Bloomberg U.S. Aggregate Bond Index, a useful representation of bond issuances in the U.S., fell over 13.0%, as bond prices reacted to a higher rate environment.

Shrewd readers of the RWA Quarterly Commentary will observe that those calendar year numbers represent an improvement over the year-to-date levels of the end of the third quarter. For the fourth quarter, the S&P 500 was up 7.56% and the Bloomberg U.S. Aggregate Bond Index improved by 1.87%.

Our outlook on the coming year focuses on many of the same themes we highlighted a year ago. There has been some deterioration over the past twelve months of some important economic indicators, but the stock market has largely reacted to the fears of what might still be on the horizon. Detailed below are a few of the indicators that bear close watching.

Inflation measures have started to improve but remain a focus of the FOMC. A key inflation measure, the U.S. Core Personal Consumption Expenditures (core PCE), improved to a 4.68% in November, the lowest measure in over a year. This level, however, remains elevated relative to the long-term average of 3.23%. The FOMC spooked market participants earlier in the year by stating their desire to raise interest rates until they exceed the level of inflation. With a Fed Funds rate of 4.50% and the core PCE at 4.68%, the two measures are converging toward that objective.

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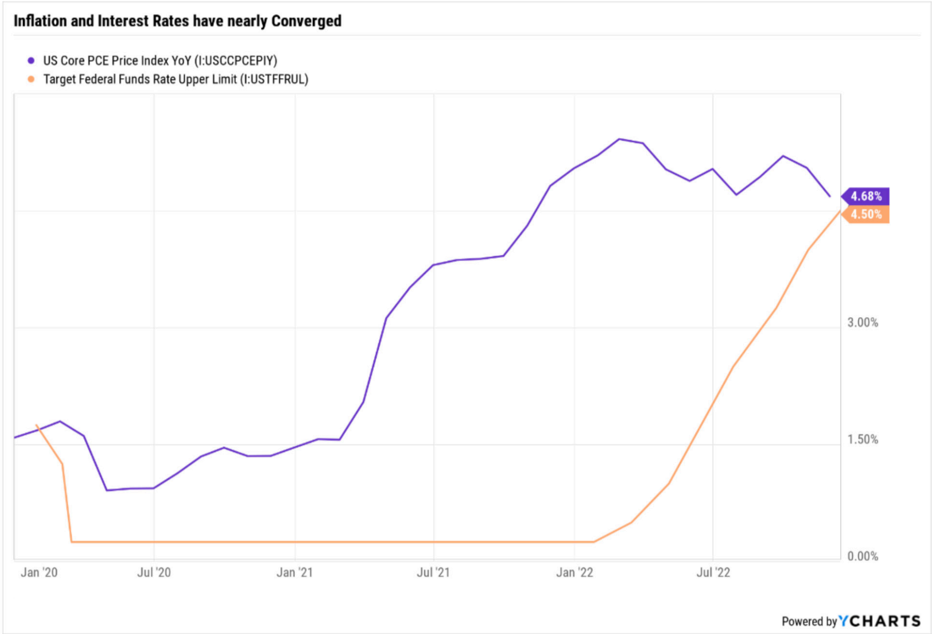


In fact, the FOMC reduced the pace of rate increases in their most recent meeting, a signal that they may be nearing the end of their rate hikes. This would set the stage for positive bond market returns for investors. Those returns would come from increased portfolio income as investors reap the benefit of higher interest rates on their bond portfolios.

An economic recession in the U.S. is widely expected. A recent survey of professional forecasters by the Federal Reserve Bank of Philadelphia indicated the likelihood of an economic downturn in the next four quarters to be nearly 50%. The last time the survey had such an elevated measure was the third quarter of 2009, coinciding with the best buying opportunity for stocks in the last 20 years as the economy recovered from the financial crisis. Our point is not to discredit forecasters, but instead to highlight that the stock market historically anticipates economic downturns and falls in advance of the economy. The 20% declines across the investment markets have already priced in a recession in 2023. If that recession is mild or does not materialize, the stock market will respond positively.

The U.S. consumer remains in good shape. Stock market investors are transitioning their pessimism from the negative impacts of higher inflation to the potential for an economic recession. There are clear signs of economic decline by some measure of economic activity, but the largest contributor to economic output, the consumer, shows little sign of weakness. The U.S. unemployment rate now stands at 3.70%, an improvement, albeit a small 0.30% one, over the same measure from January of 2022. U.S. workers have seen their wages increase by more than 5.0% over the year. Most importantly, as prognosticators predict a reversal of both of those measures, is those same consumers have taken advantage of the low interest rates of the last fifteen years to reduce their monthly obligations to service debt, cushioning them from the impact of leaner economic times. According to J.P. Morgan, debt payments as a percentage of disposable income now measures 9.5%, well below the 13.7% measure prior to the financial crisis of 2007-2008. The consumer represents nearly 70% of the U.S. economy; their resiliency will help keep any looming economic downturn a mild one.

Similar to consumers, corporations have positioned themselves for worsening economic conditions. The forward Price to Earnings (P/E) ratio of the S&P 500 is at its 25-year historical average of 16.8x earnings. In 2022, corporate revenues increased by nearly 10%, but profit margins were impacted by the inflation of input costs and earnings suffered. Corporate managers have adjusted their expense structures and guided analysts with a cautionary tone. An abatement of inflationary pressure would lead to stable or expanding profit margins, setting the stage for earnings to exceed expectations.

Attractive investment themes remain in place. As valuations contracted, many stocks had dramatic declines in the last twelve months. The more speculative the investment, the more dramatic the reduction in value often was. The ballyhooed FAANG (Facebook, Apple, Amazon, Netflix, Google) stocks that enjoyed meteoric increases in the five years prior to 2022 were not spared. Facebook (now Meta) and Netflix both saw their value decline by over 50% in the year. Apple proved to be the best of the group falling 'only' 30% in the year. Though the stock prices adjusted, the business opportunity for growth remains intact for each of those companies. In fact, with the lone exception of Meta, each of those companies had solid revenue growth in the last year.

An investment theme we are pursuing includes the reshoring of manufacturing capabilities. The pandemic exposed a strategic weakness in the U.S. economy's manufacturing capabilities. The early stages highlighted a need for, and a scarcity of, personal protective equipment (PPE) for healthcare workers. This issue was exacerbated by the fact most PPE production was done overseas in geographies that faced similar needs. A spike in demand for semiconductors (a critical component of many finished goods) further revealed how tenuous our supply chain could be to geopolitical risks, shipping efficiency, and labor shortages. Significant investment will need to be made to address more localized manufacturing capacity, providing opportunities for suppliers of capital equipment, automation solutions, as well as transportation solutions.

Calendar year 2022 marked the transition from an extremely accommodative FOMC monetary policy, made necessary by the onset of the COVID-19 pandemic, back to the traditional FOMC focus on their dual mandate of stable prices and employment. While we do not discount the possibility of a recession in the coming year, we believe the investment markets have anticipated an economic slowdown and have adjusted in response. Stock valuations provide a more attractive entry point for companies that retain an opportunity to participate in the spending of a stable consumer base and evolving demands of the U.S. economy.

SECURE 2.0

President Biden signed the SECURE 2.0 Act into law on December 29th, 2022, as part of the $1.7 trillion Consolidated Appropriations Act of 2023 passed by Congress just before the Christmas holiday. This legislation builds upon the original SECURE Act (Setting Every Community Up for Retirement Enhancement), enacted in January of 2020. SECURE 2.0 provides a lineup of changes intended to bolster the retirement system for Americans. Highlighted below is a list of new rules that could be most impactful to you.

Changes to RMDs (Required Minimum Distributions). The age retirement account owners are required to take distributions is currently 72; but starting January 1, 2023, it will increase to 73. This age will increase again to 75 starting in 2033. In addition, beginning in 2023, the once steep 50% penalty for failure to take an RMD will be reduced to 25% and further reduced to 10%, if corrected in a timely manner. RMDs for plan Roth accounts (Roth 401ks and 403bs) will be eliminated in 2024.

Changes to catch-up contributions and employer matching. The $1,000 catch-up contribution to IRAs for people 50+ has been stagnant for 15 years. Starting in 2024, it will be indexed for inflation, meaning it could increase each year based on cost-of-living adjustments (COLA).

Starting in 2025, individuals aged 60 through 63 can make a super charged catch-up contribution up to $10,000 per year (indexed for inflation). Catch-up contributions for a 50+ individual to a plan will be given Roth treatment (i.e., not pretax) unless the individual earned $145,000 or less in the prior year.

Effective immediately, employers can now offer their employees matching contributions and non-elective contributions to Roth accounts. Prior to this, all matching contributions were made on a pre-tax basis, and remember, starting in 2024 Roth plan accounts will no longer require minimum distributions.

Expanded Qualified Charitable Distributions (QCDs). Starting in 2024, the current QCD limit of $100,000 will be indexed for inflation and individuals of RMD age (73) are allowed a one-time $50,000 QCD to a charitable gift annuity, charitable remainder unitrust (CRUT), or a charitable remainder annuity trust (CRAT).

529 to Roth IRA Transfers. Effective in 2024, 529 account assets can be rolled over into a Roth IRA account if the 529 account has been held for 15 years. The transfer can only be made to a Roth IRA in the name of the 529 plan beneficiary, not the owner. The transfer amount per year is limited to no more than the annual IRA contribution limit for that year and is reduced by an actual IRA contribution made with a lifetime maximum transfer of $35,000. Contributions and earnings made in the last 5 years cannot be transferred to Roth.

Student Loan Debt. Beginning in 2024, employer retirement plans can treat student loan payments as elective deferrals for matching purposes. Effectively, the employee can make payments toward their student loan debt and the employer can match the debt payment as if it was a 401k contribution.

SECURE 2.0 is far-reaching, containing dozens more provisions that can be confusing to dissect. Whether you are approaching retirement or already enjoying it, please reach out to us if interested in learning more about how this legislation might impact your personal financial situation.

Portfolio Activity

Account activity in the fourth quarter was centered around adding to positions which provide long-term opportunities for appreciation while exiting positions we feel are more susceptible to short-term risks. In aggregate, we were net buyers of both stocks and bonds in client portfolios as we look to take advantage of attractive entry points following the broad market declines over the year.

Index Performance	Q4	YTD
Dow Jones Industrial	16.01%	-6.86%
Standard & Poor's 500	7.56%	-18.11%
Nasdaq Composite	-0.79%	-32.54%
MSCI EAFE (International)	17.34%	-14.45%
Russell 2000 (Small Company)	6.23%	-20.44%
MSCI ACWI (Global Stock)	9.76%	-18.36%
Barclays Intermediate Term Bond	1.87%	-13.01%
Barclays Municipal Bond	4.10%	-8.53%
Barclays Short Term Bond	1.20%	-5.50%

Our bond purchases focused on short-term U.S. Treasury positions and high-quality corporate bonds. The investment yield on a 1-year U.S. Treasury Note climbed in conjunction with the FOMC during the year, with yields now above 4.5%. Bond purchases in the quarter locked in these elevated rates while reducing the sensitivity to future upward movement in interest rates. We expect interest income to be significantly higher from portfolios in the coming year as these purchases start to generate additional cash flow.

In our stock portfolios, we exited some positions that had disappointing performance in the current year. Generac (GNRC), the focus of our stock spotlight in the July 2022 Quarterly Commentary, was sold in late November at a loss. The company was part of an alternative energy-themed investment, as it participates in solar solutions for both residential and commercial applications. We believe the opportunity remains for Generac, but a dispute with their largest distributor proved to be a more significant event than a normal business interruption; we moved to the sideline until it becomes resolved.

Two positions that enjoyed significant growth during the period of restricted travel in the last three years were Docusign (DOCU) and Chewy (CHWY). There was sharp acceleration of adoption for Docusign's electronic signature solutions across all industries, though that growth slowed, and a significant valuation contraction followed. We exited Docusign while adding to our Adobe (ADBE) position, which has similar capabilities as part of a larger suite of products.

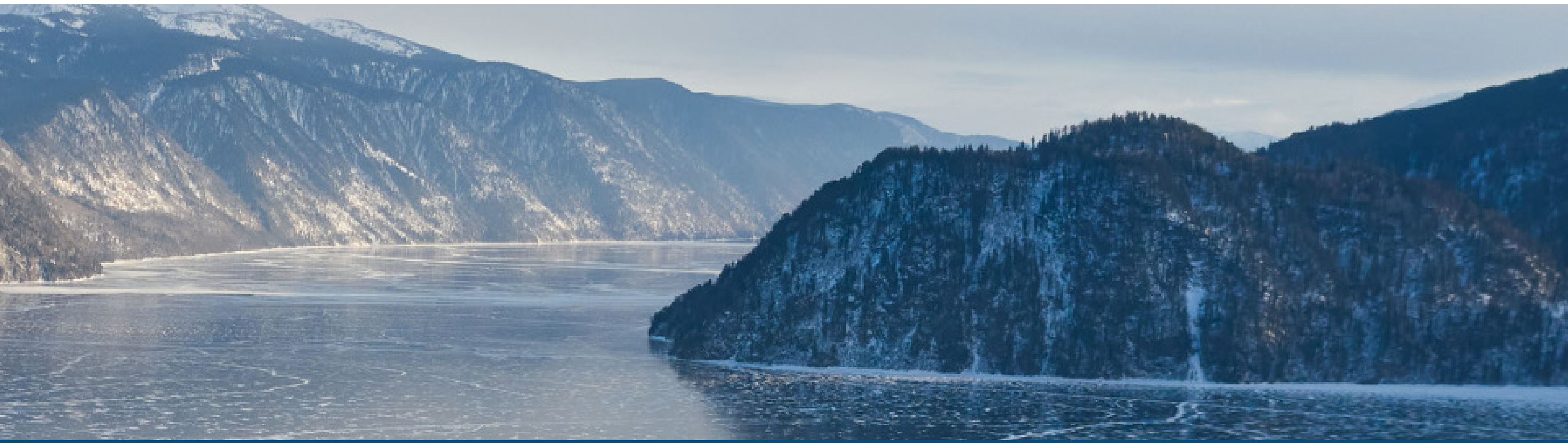
Similar to Docusign, Chewy was a darling of the pandemic as an online retailer of household pet supplies. Also like Docusign, Chewy's valuation outstripped its ability to support it with business fundamentals. We continue to feel Chewy can make the most of the opportunity and popularity within the growing household pet segment but will look for an entry point more appropriate to that opportunity. We redeployed the proceeds from the Chewy sale by increasing our position in Zoetis (ZTS), a pharmaceutical company focused exclusively on animals.

Additionally, we increased our position in American Tower (AMT), an owner and operator of more than 220,000 cell towers. The company leases space on towers to the major mobile service providers, providing a consistent stream of income for its shareholders. American Tower is poised to monetize the increase in demand for expanded mobile services like video streaming on the developing 5G mobile network.

Though returns largely disappointed across all economic sectors, we continue to find opportunities to position our equity and fixed-income portfolios to provide tax-efficient, long-term returns.

TOP 10
U.S. HOLDINGS

- **Apple**
- **Microsoft**
- **Alphabet**
- **Amazon**
- **J.P. Morgan**
- **Trane Technologies**
- **Procter & Gamble**
- **Thermo Fisher**
- **Cisco Systems**
- **Visa**



2023 Quick Tax Facts

The IRS released notably higher tax brackets and contribution limits for 2023 to account for higher inflation.

401k Contribution Limits	
Elective Deferral	$22,500
Catch-Up Contribution 50+	$7,500
HSA Contribution Limits	
Health Savings Account – Individual	$3,850
Health Savings Account – Family	$7,750
HSA Catch-Up Contribution 55+	$1,000
Annual Gift Exclusion	$17,000 *per recipient*
Estate and Gift Tax Exemption	$12,920,000 *per person*
Estate and Gift Tax Rate	40%

	Tax Rate	Single	Married Filing Jointly
Ordinary Income	10%	Up to $11,000	Up to $22,000
	12%	$11,001- $44,725	$22,001- $89,450
	22%	$44,726- $95,357	$89,451-$190,750
	24%	$95,376- $182,100	$190,751- $364,200
	32%	$182,101- $231,250	$364,201- $462,500
	35%	$231,251- $578,125	$462,501- $693,750
	37%	$578,126 or more	$693,751 or more
Capital Gains & Dividends	0%	$44,625	$89,250
	15%	$492,300	$553,850
Standard Deduction		$13,850	$27,700

Featured Stock: JPMorgan Chase & Co (JPM)

JPMorgan Chase is one of the world's largest banks and one of the most complex financial institutions in the U.S., with nearly $4 trillion in total assets. The bank's offerings span the financial spectrum from consumer and community banking, corporate and investment banking, commercial and middle market banking, and asset and wealth management. Its services are currently offered in more than 60 countries, supported by nearly 250,000 employees.

JPMorgan is not a new name to our portfolio, but it is one that we decided to increase our exposure to over the last few months. The company's fortress balance sheet, historical strength during periods of market and economic turmoil, and firm leadership (under the hand of the longest-serving, major U.S. bank CEO, Jamie Dimon) are all ingredients for a company we want to own, rain or shine. Additionally, we believe that after a tough year for financial stocks, the sector, in general, is poised to perform well, and JPMorgan could outperform the group.

The U.S. Federal Reserve is partly to thank for our optimism, with the central bank raising its benchmark Federal Funds Rate at one of the fastest paces in its history (0.25% to 4.50% in nine months). Those rate rises flow directly through to banks' net interest margins (NIMs), which is the interest profit banks keep after interest expenses are paid out. Those margins are on pace for their best growth in 40 years in 2023, and banks with a higher degree of deposits are likely to benefit even more from NIMs. JPMorgan has the highest value of deposits in the U.S., and we believe that its emphasis on technology and breadth of its offerings will lead to a sustained advantage that will directly benefit its interest margins.

We also believe that general bank profitability will return to focus next year as banks layered on expenses during the first two years of the pandemic. Investments in technology, headcount, and physical infrastructure are likely to begin tapering off next year, which implies that incremental margins on new revenue streams should generate higher profitability than the last two years. Additionally, JPMorgan has been in the forefront of technology spending within the sector, after committing an elevated ~$12 billion this year, more than double what it spent in 2019. Future technology spending is likely to continue but should slow from current levels, and automation and machine learning should begin to allow further growth without additional headcount, which has historically been approximately 50% of total bank industry costs.

Finally, after a year where large bank earnings are estimated to have declined 26% on average, 2023 is likely to see a reversal in those earnings as profitability sets in and the year-over-year comparisons become easier. Additionally, data over the last four decades has shown that positive earnings growth vs. the prior year has often led (~74% of the time) to positive stock returns, and industry estimates expect the major banks to grow their earnings around 6% next year. In the event that there is an economic decline next year, JPMorgan has been ahead of the group in preparing for adversity. That should benefit the company in the case of a down market and could be a dramatic uplift if the economy turns out to be stronger than many economists are forecasting. Thus, we believe that banks, in general, are likely to perform well next year, and JPMorgan is the best positioned to weather all markets.

FTX & the Implications for Cryptocurrency

Topic Spotlight

FTX was one of the largest cryptocurrency exchanges in the world a few months ago but has since been reduced to rubble amid its November 11th bankruptcy filing. The firm was valued at $32 billion earlier this year and had an estimated 1.2 million registered users who exchanged crypto tokens like Bitcoin and thousands of others on its platform. Now, however, most platform users (large traders and crypto fans alike) are still in the dark over whether they'll ever see their money again.

So, what exactly led to the crash of FTX? FTX was officially split into two main parts – FTX, the crypto exchange itself, and Alameda Research, the company's own trading arm. The story began to unravel on November 2nd when an article on CoinDesk's website suggested that much of the equity in the Alameda business came from a token that FTX created and not an independently valued asset. Further pressure came days later when a Wall Street Journal article accused Alameda Research of using FTX's customer deposits as funding for its trading bets.

The death knell came on November 9th when FTX's competitor, Binance, reversed its plans to acquire FTX, citing issues "beyond our control or ability to help." That revelation led to a run on FTX with customers trying to withdraw billions of dollars from the exchange, FTX halting withdrawals in response, and the company declaring bankruptcy two days later. Since then, further details about the drastic mismanagement of the company have slowly come out, including FTX's lack of system controls and little record-keeping evidence. Additionally, FTX's interim CEO has publicly stated that it is unlikely FTX customers will be made fully whole, but U.S. customers stand a better chance of reclaiming some assets than international ones.

Based on the news flow thus far, it appears that FTX was a classic case of embezzlement that involved taking money from others and using it for their own purposes. And while the situation is still being resolved, FTX's founder and CEO, Sam Bankman-Fried (SBF), has currently been charged with at least five separate crimes, including wire fraud, conspiracy to commit money laundering, and conspiracy to defraud the United States. If SBF were to be convicted on all current counts, the total maximum sentence would amount to over 100 years in prison.

The crypto markets have already had a tough year – the price of Bitcoin is down more than 60% from the start of the year and more than 75% from its peak in late 2021. With such a high-profile bankruptcy and a wave of smaller bankruptcies in FTX's wake, the question then becomes, "What happens next to crypto?" Or, as some have asked time and time again, "Is crypto dead?" We believe the answer to that question is no, but we have also avoided investment in cryptocurrency since its creation.

Since FTX's collapse was driven not by a failure in the technology itself but by a lack of oversight and regulation, we believe that crypto is likely to move into a new phase where custody and trading becomes centralized on institutional platforms like banks and exchanges. Those platforms generally have higher regulatory burdens and would be less likely to fall victim to situations like FTX, while the actual management of the assets would remain independent and decentralized as originally intended. In that way, crypto may not remain as revolutionary as once intended, but it would become safer, more liquid, and potentially much more transparent. An increase of controls and regulation will establish credibility and allow for the long-term viability of digital currencies.

RWA Roberts Wealth Advisors