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FROM THE DESK OF

KEN SOUTH

Our team adheres to a set of principles designed to provide an exemplary client experience.

We believe the trust of our clients is earned over time and remains our most important asset.

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We take great pride in the professional quality of our work. Exceptional client service that is proactive, thoughtful, and customized.

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Competitive investment returns with a focus on risk management.

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Sophisticated financial planning — an essential pillar in the development of your customized investment strategy.

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We believe in continuous improvement. As our clients' needs change, we learn and adapt.

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We stress teamwork in everything we do and remain accountable for our responsibilities.

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Integrity and honesty are at the heart of our business. Integrity: we do what we say we're going to do, full disclosure and no surprises.

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Honesty means we give it to you straight, even if means having a difficult conversation

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We regularly receive confidential information as part of our normal client relationship. It is our responsibility to protect against the unauthorized disclosure of this information.

March 16, 2022

The Market Seems to be Losing Velocity on the Downside

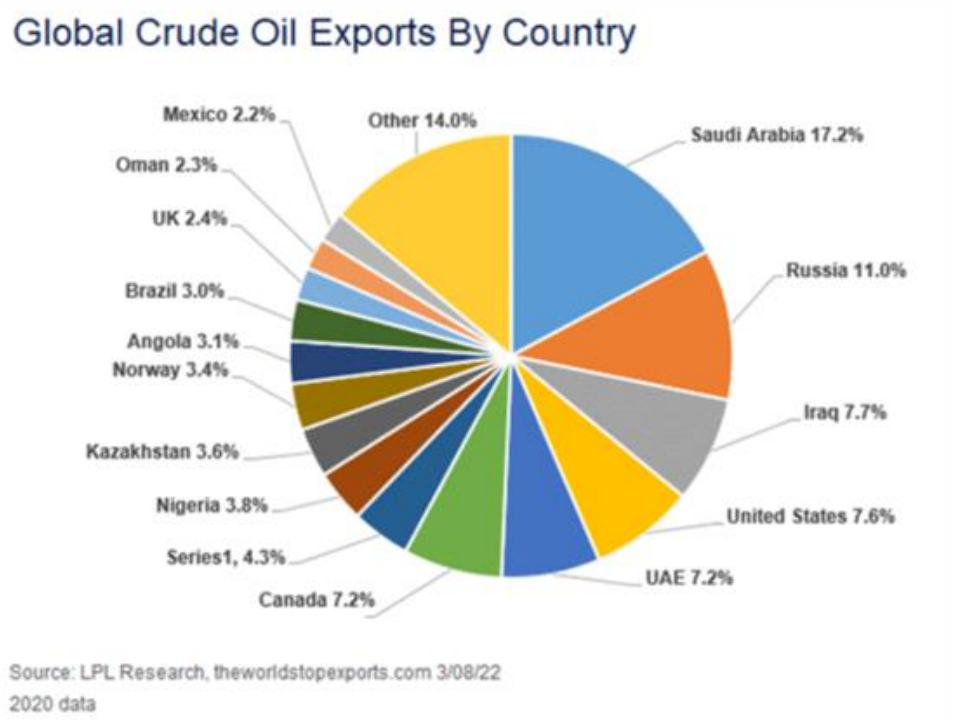
Vladimir Putin's diabolical invasion of Ukraine has succeeded in turning Russia into a rogue state, and with his nuclear threats, he is playing an insanely dangerous game. The nations of Europe have placed themselves in a difficult situation by becoming 40% dependent on imported Russian natural gas. Meanwhile, investors have concerns about Russia's five million daily barrels of oil exports in a tight oil market. In the event a new nuclear deal is struck with Iran, 1.3 million daily barrels of oil would be added to the global supply. This reality is not only upsetting but frustrating.

In the first week of Biden's presidency, he decreased our domestic production capabilities, forcing us to go from being a profitable exporter to a necessary importer of petroleum products to meet our domestic needs. Now, we are going to deal with unstable governments in Iran and Venezuela to make up the difference.

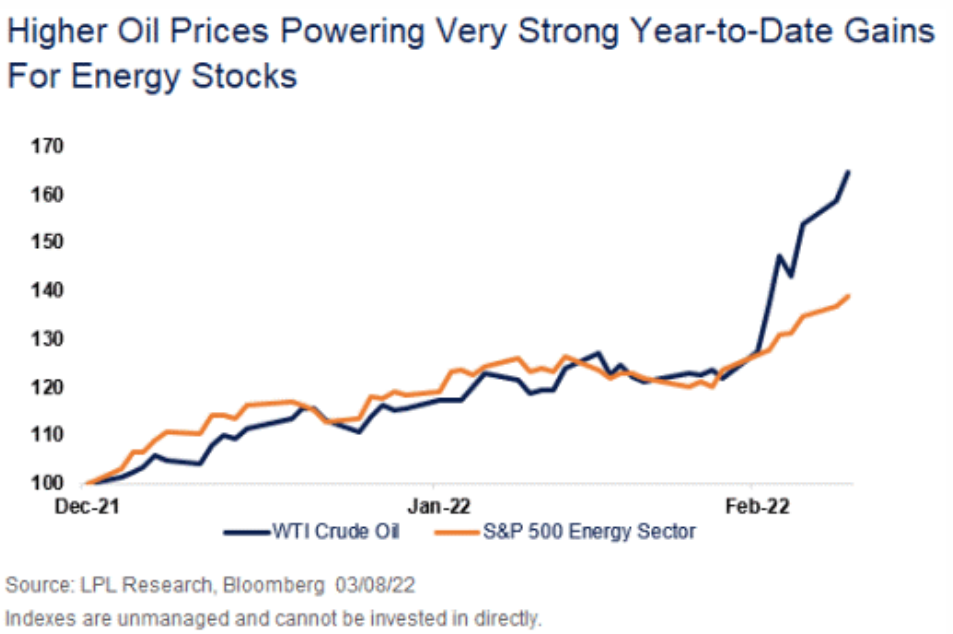
Simultaneously, it's to no surprise that oil prices would go up given that Russia is being shut down from international trade and they are the third-largest producer of oil. Seems to me like there wasn't a tremendous amount of thought put into the decision to stifle US production not long ago.

Below are two charts that paint a more vivid picture of what is happening in the Oil industry.

1. Global Crude Oil Breakdown



2. What energy stocks seem to be doing collectively vs. Oil prices in general



On top of this issue mentioned above, the market's decline is becoming quite tiresome as well. There was an interesting article in the *New York Times* by Jeff Sommer this past weekend, "When You Think About Investing, Don't Think About News." I get the title, quite a novel concept, but let's be serious. Where is a person supposed to hide? With no News channels allowed to be watched, no Twitter or Instagram or Facebook or any other social media

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platform allowed to be scrolled – I guess the only place to hide would be under a rock. In his article, he espouses how a 60/40 portfolio is what he uses. Now, I found this incredibly frustrating as well. I guess I am having a really hard time deploying 40% of a portfolio to fixed income when rates are in the 2-3% range, the Fed is beginning its interest rate hiking cycle, and inflation is running rampant which could be even more destructive to the market value of bonds. This brings me to one of the points I wanted to cover today and that is our US Monetary Policy.

At the most recent Federal Open Market Committee meeting minutes, the FOMC stated that they intend to do all in their power to rein in inflation but due to the current international situation and its effect on our domestic economy they don't intend to implement a “series of rate hikes” but instead make decisions on a meeting-by-meeting basis. It has been agreed that since we are coming off of a zero-interest-rate policy currently a "faster pace" of rate increases could be necessary particularly when we are operating at full employment. The Federal Reserve has adopted the fight against inflation as a top priority given the fact that employment is fully engaged. The currently elevated level of inflation can be traced to three primary causes:

1. The extended zero-interest-rate policy (ZIRP) engineered by the Federal Reserve in an effort to stimulate the economy during the Pandemic.
2. Unprecedented fiscal policy largesse in 2020 and 2021, which poured trillions of dollars into Pandemic relief even long after the worst of its economic impact had passed, including federal unemployment benefits, helicopter money drops across the nation and a series of loans to businesses that were "forgivable" in many cases.
3. An overwhelming level of consumer demand for goods at a time when global production capacity was severely constrained due to the Pandemic, thereby creating the worst supply-chain disruptions in modern history.

The FOMC is reconvening this week to review the latest economic data and determine what they feel is the best course of action. So, they will be measuring; employment data, inflation data, and the improvement in the supply chain to make this decision. I'm sure glad this is their job and not mine! What we do know is that ZIRP is over and higher interest rates are a when not if scenario. Throw on top of this additional supply-chain issues by China now shutting down due to a new Omicron breakout and Europe in a state of flux due to Russian conflict and it appears that our interest rate increase cycle could take longer than the FOMC initially planned.

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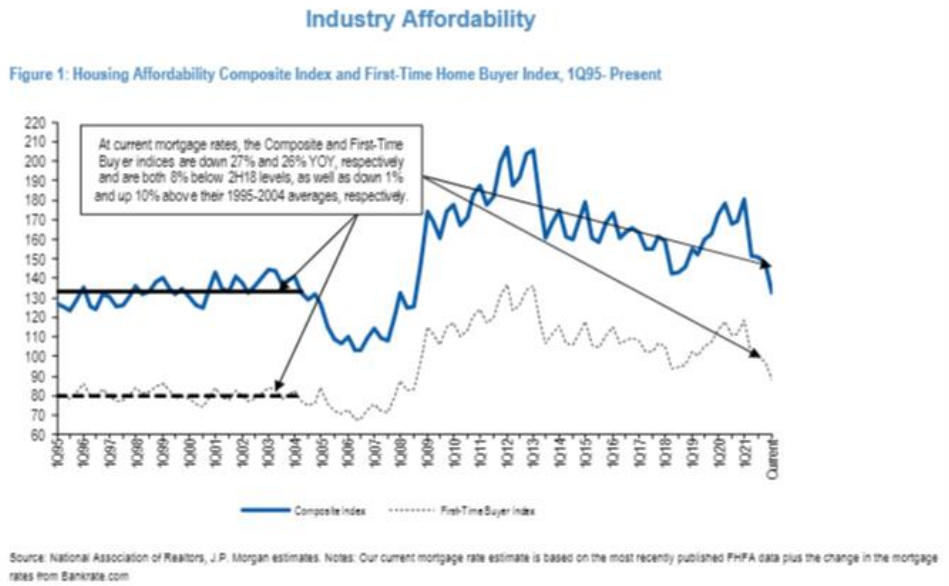
The next point that I want to bring up is the current "Affordability Index" of residential real estate prices. Residential real estate is truly in one of the strangest cycles I can ever remember. Interest rates are still very low, finding contractors to do work on a home or build a new one is practically impossible, most real estate agents that I run across have reached a virtual activity shut down due to a complete lack of homes to be sold, and when a home does come on the market I am hearing of prices being offered anywhere from 30% to 100% above the price the homes are being listed for. This is not just the case in California, where I am most familiar, but rather in Texas, Tennessee, and Florida as well, just to name a few.

If this isn't a clear indication of too many dollars chasing too few opportunities and subsequently leading to runaway inflation of price levels, nothing does! I am seeing much the same in the new and used car markets. I am including the chart of Industry Affordability going back to 1995 and Industry Supply for Single Family homes as well. I find this super interesting particularly when it is clear that there is a previous spike just post the housing crisis in 2008-2009.



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Industry Supply

Figure 2: Single-Family Existing for Sale (bar graph, left) and Months Supply (line graph, right), 1983-Present

Now that I have covered many aspects of inflation, I wanted to make one thing clear; it isn't fun to have things cost more, but at the same time, this doesn't happen if the economic situation isn't thriving! The biggest issue for our Fed is how to slow down the inflation situation yet not do so at an intensity level that takes our economy that is improving coming out the backside of a Pandemic and throws it into an immediate recession.

Again, I am glad I don't have their job! This brings me to my final point; where are we in this current equity market decline, and what is going to cause the bottom to form and a recovery to ensue. In looking at the stock market, one important aspect of a market move is breadth. The major US indexes traded at lows at the end of January, Mid-February, and we started this week going to new lower lows in the NASDAQ.

What is changing is that each time a low has been put in, the number of companies trading at new lows has been progressively smaller number. This has historically indicated a bottoming process as the velocity of decline seems to be diminishing. This brings me to my "factoid" of the moment. This year, 2022, is the 4th worst start (so far) to a calendar year since the S&P 500 has been recorded. It has declined almost 12% in the first 48 trading days. The table below shows the rest of the times that a year has started out poorly and look at the price returns from days 49 to year-end! This is what I'm talking about!!!

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Rank	Year	Price Return Through 48 Trading Days	Price Return: Day 49 to Year-End
1	2009	-16.9%	48.5%
2	2020	-15.1%	37.0%
3	1935	-14.1%	64.6%
4	2022	-11.8%	?
5	1933	-11.6%	62.9%
6	1982	-10.8%	28.3%
7	2001	-10.6%	-2.7%
8	1960	-10.1%	8.0%
9	2008	-10.1%	-32.6%
10	2003	-8.6%	38.3%
11	1948	-8.6%	8.6%
12	1942	-8.2%	22.4%
13	1968	-6.6%	15.2%
14	1978	-6.5%	8.1%
15	1984	-6.4%	7.7%

In closing, it is no shock to anyone that 2022 has not been a joyous beginning of the year for really anything but Energy and overall commodity indexes. It is also a different situation given that it has been since late 2011 that commodities outperformed US Equities in general from a relative strength perspective. This is why we have been concentrating on opportunities in this space. Does it feel normal? Well, I guess a better question today is what is the "new normal?" What I do know is that it will be a welcome change when the US Equity markets put in a low and begin a recovery move higher. We have no idea how long Russia will continue its conflict with Ukraine. Nor do we know what the next international friction de jour will be, but we are here to steer the ship as best we can given turbulence all around us.

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The opinions voiced in this material are for general information only and are not intended to provide specific advice or recommendations for any individual. To determine which investment(s) may be appropriate for you, consult your financial professional prior to investing. All performance referenced is historical and is no guarantee of future results. All indices are unmanaged and cannot be invested into directly.

All information is believed to be from reliable sources; however LPL Financial makes no representation as to its completeness or accuracy.

Investing involves risks including possible loss of principal.

The Standard & Poor's 500 Index is a 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 is comprised of 30 stocks that are major factors in their industries and widely held by individuals and institutional investors.

The Nasdaq-100 is a large-cap growth index. It includes 100 of the largest domestic and international non-financial companies listed on the Nasdaq Stock Market based on market capitalization.

The Russell 2000 Index is an unmanaged index generally representative of the 2,000 smallest companies in the Russell 3000 index, which represents approximately 10% of the total market capitalization of the Russell 3000 Index.

This information is not intended to be a substitute for specific individualized tax advice. We suggest that you discuss your specific tax issues with a qualified tax advisor.

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