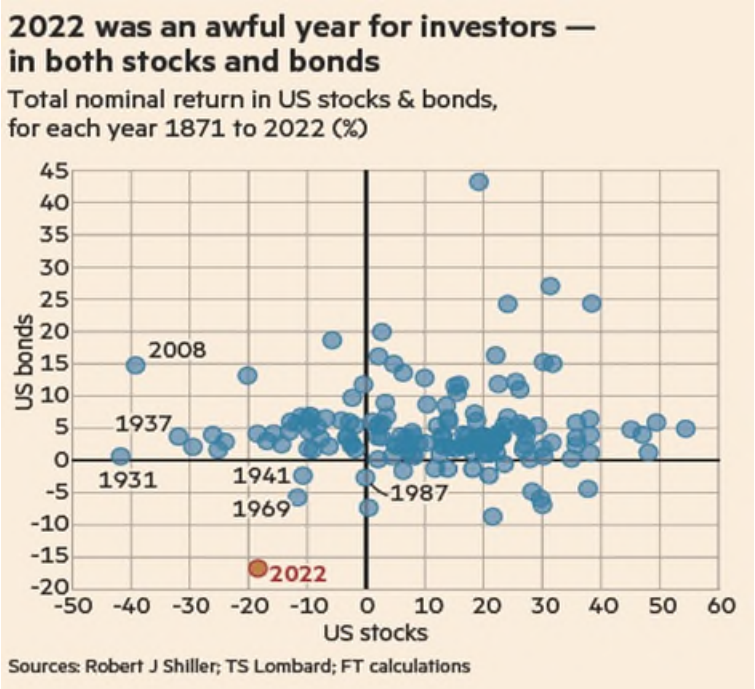
2022 has come to an end and for that we are thankful. Near zero interest rates enabled unsustainable zombie companies to survive, inflated the real estate market to bubble valuations and growth orientated stocks to trade at unjustifiably high valuations. This easy money policy (Modern Monetary Theory) had been in place for over a decade. It is finally over. We are now witnessing the repercussions. 400 years of financial data illustrated the foolishness of this practice. While painful, this reset is necessary to rationalize public policy. 2022 returns were, to put it succinctly, ugly. But this is the cost that allows equities to outperform in the long run.

S&P 500:	*-18.2%*
S&P 400:	*-13.3%*
Russell 2000:	*-20.5%*
NASDAQ:	*-32.6%*
MSCI World ex-US:	*-16.0%*
US Agg. Bond:	*-13.0%*

Value strategies outperformed Growth. Market capitalization was not a factor as LargeCap did not significantly outperform SmallCap. Gold finished the year down -1% and Bitcoin imploded (-65%). Essentially, there was nowhere to hide.

This chart from the Financial Times, illustrates how bad 2022 was from a historical perspective:



Diversified portfolio strategies had their worst year since the 1930's and long-term fixed income the worst possibly since data began in the 18th century. 2022 performance was an extreme outlier in this chart. Again,

unprecedented Government intervention creates unprecedented returns. The good news is interest rates have normalized, employment and innovation are strong.

Negative sentiment around inflation and interest rate policy pushed equity returns into Bear Market territory. The US yield curve inverted indicating stress in markets. The US Dollar is falling after reaching 20-year highs. This suggests investors are finally out of options for parking safe assets. Fortunately, extremes are short lived.

We have not yet seen full capitulation (and may not), but the lack of afternoon market rallies suggests the 'Buy the Dip' retail crowd has left the building. This is positive. Put/Call option ratios indicate sentiment. Currently, we are witnessing nearly 50% more put option interest than call. This is pessimistic. This has happened several times in the last five years. Each has proved a technical buying opportunity in the S&P 500 index. We may finally be finding a bottom…

The debate around a 2023 recession remains intact. Size and length are unknown. Declining inflation data hinders the possibility but rising interest rates and unemployment counter this. Many economists project modest GDP growth in 2023, mainly in the second half. There is good consensus 2022 lows are tested early in the year with a later rally in the second half of 2023. This seems plausible as it is a classic triple bottom testing. The first lows were set in May when we first began deploying cash.

Headlines will revolve around the energy crisis in Europe, war in Ukraine, and China Covid policies. These help sell newspapers and boost ad sales. What matters in equity markets is the pricing of risk. This cannot be sorted until inflation data subsides and interest rate policy has normalized. We are therefore preparing for another year of choppy equity returns.

Portfolio positioning matters more than any headlines. We did not like Tech when it traded at 40 times earnings; we liked energy when it traded at single digit multiples. Each was rationalized suggesting once again valuation is paramount. Current valuations are fair but, again, evaluating the P/E ratio is difficult when one cannot surmise the appropriate 'E.' Clarity will be determined by inflation and interest rate policy.

Heading into 2023, we look to utilize Treasuries for safe assets. 6-month T-bills now yield greater than 4%. This is a negative real yield (-4%), but far better than bank accounts which still earn zero. We still firmly remain in a position where one starves slowly to death in "safe" assets.

Positioning in equity allocations should remain neutral to our target amount of domestic stock. We will look to overweight our targets should we see an early year selloff. Non-US equities are historically inexpensive. We are therefore comfortable with an overweight to our target amount of exposure. Adjusting our allocations allows portfolios to capture more upside in an eventual recovery. Equities will prevail with patience. Wealth is created by innovation, patents, and technology. We are in a strong period for all of these. Markets price sentiment six to nine months forward. Remaining invested through down markets ensures no portion of the inevitable rally is missed. If one misses a rally, it takes 10 to 15 years to recover while it generally takes about 18 months to recover from a bear market. We are in the beginning of the end of this bear market and the risk is on the upside.

Happy New Year!