BLUE GRANITE CAPITAL, LLC

INVESTMENT COMMENTARY, JANUARY 2023

Happy New Year – We hope you had a great Christmas holiday and send our best wishes for the coming year.

In 2022, The Federal Reserve (Fed) did everything in their power to subdue economic growth and extinguish inflationary flames causing the equity and fixed income markets to drop considerably. After 3 years of superior stock market gains, the S&P 500 fell nearly 20% and the Bloomberg US Aggregate Bond Index dropped 13% to record its worst performance in 40 years, rattling even the most conservative investors. All told, it was simply an extremely poor outcome which has caused considerable angst for most investors and will weigh on sentiment in 2023.

All major stock indices fell into bear market territory in 2022 and posted their worst yearly performance since the 2008 financial crisis. The S&P 500 Index saw its 4th worst performance since its introduction in 1957 and the tech-heavy Nasdaq fell 33%, its third worst performance on record and the first time it has ever fallen all four quarters. Volatility was everywhere -- consider that the S&P 500 had 46 daily moves of 2% or more throughout the year.

The Fed-induced steep rise in bond yields resulted in substantial bond market losses in almost every fixed income category and, notably, in bonds maturing ten years or longer, which Blue Granite avoided in our clients' portfolios. With interest rates on the rise, bond yields have now become quite attractive for the first time in decades and offer a compelling investment opportunity. Bonds in our portfolio strategy have always been the rudder to reduce volatility and provide downside protection, but now they will deliver a respectable return.

The big question for 2023 is how the stock and bond markets will perform. Volatility is likely to remain a big component for the markets this year and a renewed interest in fixed income yields can have the effect of competing with and slowing money flows into equities. Economic uncertainty remains a dominant theme because the Fed's main priority of fighting inflation persists despite evidence of slowing demand for goods, services, and housing due to the series of rate increases. The bigger question and concern should be when the Fed and other major central banks will become more accommodative with their monetary policy and stop raising interest rates. As we have previously written, our view is the Fed's interest rate policy has become too onerous and, given more time, the higher rates already in place will in fact slow the economy and curb inflation. While the Fed may not be listening – we think they should.

Global investors are closely watching as the threat of recession casts a wide net affecting our spending, consumption, and likewise that of our largest world partners. In the face of such concerns and with notably few safe havens for investors, central banks around the world also raised interest rates to mitigate inflationary pressures. As a side show to more orderly markets,

cryptocurrency speculators felt even more pain as “bitcoin” declined more than 62% last year and failed convincingly in its promise to provide a hedge that could compete effectively with gold.

To be sure, no one is satisfied with the outcome of 2022, and despite the market’s poor performance, please be assured that your balanced portfolio strategy is a very sound and prudent investment approach, especially now. Stock valuations have fallen considerably as a result of near record inflation and recession fears. With interest rates now at 40-year highs, bonds once again have become an attractive asset class. Likewise, the stocks in your portfolio are large, financially strong companies that have compelling values, generate considerable cash flows, have sizable competitive advantages, while also paying dividends to shareholders. In aggregate these are the very companies that tend to experience less volatility and benefit advantageously in an economic recovery.

It is also worth noting, that when equities decline, the following year they have recovered to rally 14% on average, 80% of the time. In fact, the S&P 500 has only fallen two years in a row 4 times since 1928. While we do not forecast markets, higher rates are finally slowing the economy and tempering inflation which possibly improves the outlook for 2023. Though stock market prices do not necessarily move in lockstep with economic data and geopolitical matters (e.g. China, Ukraine, Covid risks, energy constraints), we are very confident your portfolio holdings will continue to do well over the long-term.

Thank you for your continued trust and please contact us if there is anything you wish to discuss.

Warmest regards,

Scott, John, Dave & John