BH | Beech Hill Advisors

December 31, 2022

Dear Clients,

Equity markets declined in December and provided mixed returns for the fourth quarter with the Dow Jones Industrial Average and S&P 500 Index gaining 15% and 7% respectively, while the NASDAQ lost 1%. Throughout the quarter investor preference remained consistent, favoring large capitalization, value-oriented securities at the expense of technology and emerging growth components. Despite the gains in the fourth quarter, equity markets declined for the year, with the Dow Jones Industrial Average, S&P 500 Index and the NASDAQ declining 8.8%, 19.4% and 33.1%, respectively, illustrating the bias for the larger capitalization, less volatile, and more defensive segments. Historically, all three indexes had their worst showing since 2008 and the most volatility since then as measured in daily moves of 2% or more in either direction. A hawkish Fed, rapidly rising interest rates, paired with significant inflationary pressures, served to curtail risk appetite, sow economic uncertainty, and hamper investor returns in both equity and fixed income markets. Add to those factors, residual supply chain constraints and the Russia-Ukraine war, both exacerbate inflationary pressures, dampening investor spirits. Our portfolios were not immune and finished as expected, in line with their comparable indexes, with returns led by our income equity strategy, followed by our balanced focus, and the laggard growth discipline. We are glad to close out 2022, a historically negative year, and we anticipate both the impact from the Fed rate hiking cycle and inflation will diminish by the second half of the year.

As discussed in earlier commentaries, the Federal Reserve continues to drive investor sentiment and market valuations. The Fed fund rate, which began the year at .25%, closed the year at 4.5%, rising at the fastest pace in 40 years with the promise of more hikes in the offing. As a proxy for the bond market, the 10-year US treasury began the year yielding 1.5%, peaking at 4.2% and ended the year at 3.8%, the largest annual rise since the 70's. As bond prices move inversely with yields, bond portfolios suffered their worst declines in a generation. The negative impact of higher yields also significantly increases the cost of borrowing, creating higher expenses for both consumers and corporations. On the corporate level, higher rates raise the required return necessary on any capital expenditure, expansion, or acquisition to achieve target profitability. And lastly, higher rates reduce the present value of emerging growth companies as their future earnings and cash flow are discounted by higher rates. These factors illustrate how the negative ripple effect of higher yields has impacted both equity and bond markets and investor conviction. The silver lining, higher yields have made bonds more attractive than we can remember and we

anticipate adding more to our allocation in balanced and income portfolios, and our money market fund now yields approximately 3.4%.

Parsing Fed commentaries has become the obsession of investors looking for that nuanced remark that will indicate the pivot has arrived. Powell has been steadfast in his message, and we continue to see the repetitive cycle of optimism rise into each commentary only to be rebuffed with his consistency. The minutes from the Fed's Dec. 13-14 policy meeting indicated that the central bank officials are open to slowing the pace of tightening to evaluate the impact their measures have had on US economic growth. However, it was coupled with the consistent warning, "Participants continued to anticipate that ongoing increases in the target range for the federal funds rate would be appropriate to achieve the Committee's objectives,", "No participants anticipated that it would be appropriate to begin reducing the federal funds rate target in 2023." which is at odds with estimated Fed Fund futures showing a decline in 2023. And as we interpret a jab at equity market exuberance, "Participants noted that, because monetary policy worked importantly through financial markets, an unwarranted easing in financial conditions, especially if driven by a misperception by the public of the Committee's reaction function, would complicate the Committee's effort to restore price stability." Once again something for bulls and bears alike, however, the tone has softened to be less hawkish on balance. We believe the Fed will capitulate if financial markets, and/or labor markets weaken substantially. Inflation data has begun to soften, in the commodity markets, in the ISM manufacturing index, and in the rate of wage growth, among others. We believe there is risk to the economy and investors if the Fed dogmatically adheres to their restrictive policy for too long and is unable to avert a significant recession, much in the way they labeled inflation as transitory and were late to respond before inflation accelerated dramatically. For now, the economy seems to be on firm footing, much will be determined in the next two quarters and will guide investment decisions.

Strategically, we believe 2022 began a new chapter in the investment framework as the era of easy money, deflationary pressures, industrial globalization, and conceptual growth investment themes has given way to more concrete financial tenets where cash flow and profits matter, interest rates create a real cost of capital, inflationary pressures erode margins, and geopolitical frictions advance economic nationalism. As such we have maintained higher cash levels, added to value oriented, large cap, dividend paying equities, and we anticipate continuing the same, picking up sold-off blue chip companies as opportunities arise. Earning season begins this Friday and we anticipate firms will temper expectations based on the aforementioned factors as well as the uncertainty regarding the Fed and the economy. We are optimistic the economy will muddle through the near-term weakness, and we believe the second half should provide investors relief with a muted Fed

and significantly reduced inflationary pressures. Timing the turn in investor sentiment is nearly impossible in the short term therefore we will consistently upgrade portfolios with ongoing data points confirming softening inflation and economic resilience.

We wish everyone a happy and prosperous new year!

Best regards,

Beech Hill Advisors