Market Summary

U.S. Equity Markets (%)	4Q'22	1 Year	3 Years	5 Years	10 Years
S&P 500	7.6	-18.1	7.7	9.4	12.6
Russell 1000 Growth	2.2	-29.1	7.8	11.0	14.1
Russell 1000 Value	12.4	-7.5	6.0	6.7	10.3
Russell 2000	6.2	-20.4	3.1	4.1	9.0
Russell 2000 Growth	4.1	-26.4	0.7	3.5	9.2
Russell 2000 Value	8.4	-14.5	4.7	4.1	8.5

Top/Bottom Sectors (%)	4Q'22	1 Year
Energy	22.8	65.9
Industrials	19.2	-5.9
Materials	14.9	-12.5
Cons. Discretionary	-10.2	-37.2
Comm. Services	-1.4	-39.4
Real Estate	3.7	-26.3

Price Comparison (in USD)	Dec. 31, 2022	Dec. 31, 2021
Oil (WTI spot)	$80.51	$75.21
Natural Gas	$4.08	$3.58
Gold	$1,830	$1,829
Fed Funds Rate (Upper Target)	4.50%	0.25%
10-Yr Treasury	3.84%	1.52%
VIX	21.67	17.22

Non-US Equity Markets (in USD) (%)	4Q'22	1 Year	3 Years	5 Years	10 Years
MSCI AC World Ex U.S.	14.3	-16.0	0.1	0.9	3.8
MSCI EAFE (Developed)	17.3	-14.5	0.9	1.5	4.7
MSCI Emerging Markets	9.7	-20.1	-2.7	-1.4	1.4

Non-US Regions (in USD) (%)	4Q'22	1 Year
Developed Americas	7.8	-11.6
Developed Asia	14.3	-12.5
Developed Europe	19.3	-14.6

Non-US Regions (in USD) (%)	4Q'22	1 Year
Emerging Americas	6.5	10.5
Emerging Asia	11.2	-20.3
Emerging EMEA	6.1	-27.5

Source: MSCI, S&P Global, FTSE Russell; Refinitiv, St. Louis Federal Reserve Bank; Periods greater than one-year have been annual

Market Review:

Global equity markets reversed the downtrend of the first nine-months of 2022 and finished solidly in the black for the fourth quarter. Non-U.S. markets generally bested U.S. markets (in U.S. dollar terms), aided by a steep sell-off in the greenback in the last two-months of the year. The volatility that has gripped markets all year continued and for the full-year the S&P 500 moved by 1.15% on average from open to close each trading day, almost 70% above the average of the prior ten-years. For the quarter, the S&P 500 returned 7.6%, and value stocks significantly outpaced growth stocks with the Russell 1000 Value returning 12.4% relative to 2.2% for the Russell 1000 Growth. Despite the markets strong advance, stocks that have historically had lower volatility profiles performed relatively well with the S&P 500 Low Volatility Index returning 11.3%. Small caps generally trailed large caps as the Russell 2000 returned 6.2%. Non-US equities topped U.S. equities as the MSCI All-Country World ex-US Index rose 14.3% for the quarter, almost doubling the return of the S&P 500 and outpacing the U.S. index for the full year. Crude prices finished the year almost exactly where they began, but that masks an almost 67% price climb in the first six-months followed by a steady march down in price in the back half of the year. Interestingly, energy stocks did not experience the same sell-off in the second half of the year as S&P 500 Energy holdings rose 25.8% in the back half of the year and 65.9% for the full year, to lead all other sectors in both periods.

Directionally Correct

While October and November may have brought a brief respite for investors, 2022 still goes down as a year most investors would like to forget. Almost every asset class took a beating thanks to coordinated central bank action to combat surging inflation around the globe. 2022 was one of only five years in the post WWII era where U.S. stocks and bonds were both down in a calendar year. Although the pain did not stop with just stocks and bonds as real estate, commodities and cryptocurrencies also sold off. In the U.S., 2022 saw the Federal Reserve begin an all out assault against the highest inflation experienced in the U.S. since the early 1980's. The Fed raised short-term interest rates from near zero to 4.5% and remains committed to further rate increases to squelch inflation down from its 9.0% peak last summer to the Fed's 2.0% target range. In order to achieve that goal the Fed will almost assuredly have to get real interest rates solidly above zero, which would imply at least another 0.75% to 1.00% in rate increases over the coming

Exhibit 1 *(Source: Bureau of Labor Statistics)*

Consumer Price Index for All Urban Consumers, Monthly, Seasonally Adjusted

Month	MoM Change	YoY Change
Jan-22	0.65%	7.53%
Feb-22	0.80%	7.91%
Mar-22	1.24%	8.56%
Apr-22	0.33%	8.22%
May-22	0.97%	8.52%
Jun-22	1.32%	9.00%
Jul-22	-0.02%	8.48%
Aug-22	0.12%	8.25%
Sep-22	0.39%	8.22%
Oct-22	0.44%	7.76%
Nov-22	0.10%	7.12%

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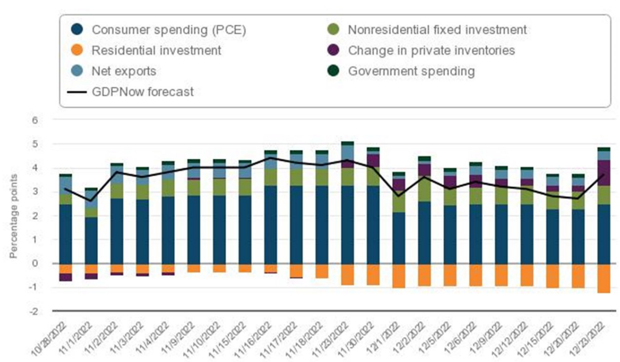
months. The Fed's actions represent the most dramatic tightening cycle since the 1980s and it appears to already be impacting the most interest rate sensitive sectors of the economy such as housing which is showing significant slowing. Exhibit 1 shows the path of the Consumer Price Index (CPI) in the U.S. over the past year. 2022 began with inflation already running a hot 7.5% year over year before peaking at 9.0%. Since the summer, inflation has ticked back down to just over 7% year over year and monthly gains have slowed to almost zero. Recent disinflationary readings are certainly welcome news, but due to base effects even if monthly changes remain flat it will be summer 2023 before the Fed starts to see inflation approaching their target range. The Fed has made it clear they will not risk a start and stop approach to fighting inflation, which means the Fed is fully prepared to tip the economy into recession, if that is required to quell wage and price increases.

Threading the Needle

Monetary policy can only impact the demand side of economic activity, unfortunately, the Fed is not able to do anything to impact supply chains and for prices to come down either supply must rise to meet demand or demand must fall to meet the currently constrained global supply chains. Unfortunately, monetary policy works with long and variable lags, making the job of "sticking the landing" a very difficult one indeed. Consumption drives two-thirds of economic activity in the U.S. and consumer spending remains resilient given strong wage gains and healthy consumer balance sheets. The Atlanta Fed's GDPNow Forecast (see Exhibit 2), a running estimate of real GDP growth based on available economic data for the current measured quarter, currently shows fourth-quarter GDP at 3.7% with consumer spending driving 2.5% of the gain.

Exhibit 2 *(Source: Federal Reserve Bank of Atlanta)*

Subcomponent contributions to GDPNow real GDP growth forecasts

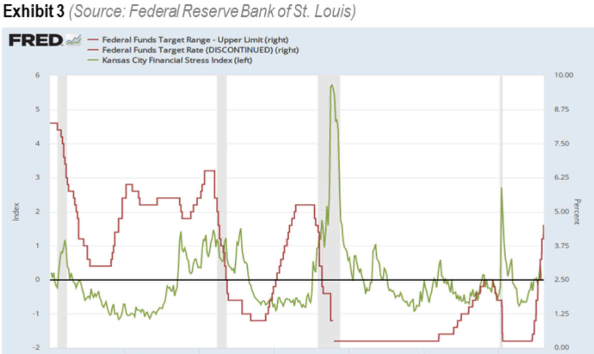


The most important input into consumer spending is whether or not one has a job. Job openings are still over three million above their pre-pandemic level (although down by 1.5 million from their peak), and the total number of persons employed is around one million greater than before the pandemic. In early 2022, much of the inflationary pressures were the result of goods prices such as autos and housing, both of which are now seeing deflationary pressures. Today, price pressures are more present in the services sector, where wages are the primary problem and a much larger component of prices. The positive of this outcome is that supply chain pressures are less of a concern, but the downside is that wages tend to be very sticky downward and it is difficult to reduce service sector costs without reducing payrolls. To date there is little sign of significant job reductions within the service sector. There have been recent announcements of job cuts at quite a few large technology companies, but in aggregate those firms account for a very small portion of the workforce. Companies with fewer than 250 employees are where the jobs reside in the U.S. and these small companies are the driving force of labor demand accounting for 80% of job openings and over 90% of the post-pandemic new jobs. Currently there is little sign of slowing demand for labor among small businesses. However, a clear recessionary path of the economy will quickly create slack as small businesses do not have the balance sheet strength to maintain headcount through a slowdown. The Fed's only real path to a "soft landing" is to reduce job openings without killing jobs. We believe room exists for this path but admittedly history is not on the Fed's side.

Challenges Still Ahead

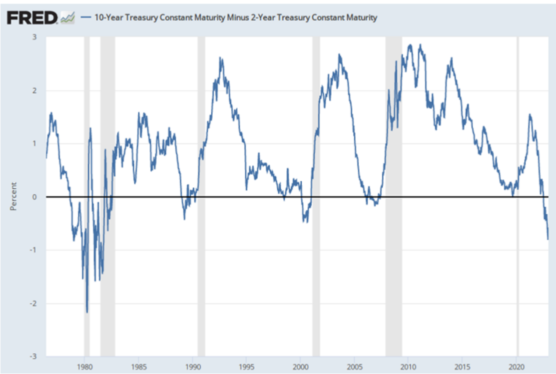
If the stock market is going to reverse the losses of 2022, a prompt end to the Fed's rate hiking campaign and improvement in financial conditions are likely key components. In addition to the rapid increases in interest rates the Fed is undertaking quantitative tightening via a reduction in the size of its nearly $9 trillion balance sheet. Despite the recent run-off, the Fed's balance sheet still stands at almost 40% of U.S. GDP, in comparison the balance sheet was just over 5% of GDP prior to the Global Financial Crisis. To keep inflation under wraps significant further balance sheet run-off appears necessary. Unfortunately, since 1980 the Fed has never managed to undertake a cycle of tightening financial conditions, be it interest rates increases, balance sheet reduction or both without ultimately precipitating a financial crisis in some form. From the Latin American Debt Crisis of the 1980s to the Russian Debt Crisis and Long-term Capital Management Collapse

Exhibit 3 *(Source: Federal Reserve Bank of St. Louis)*



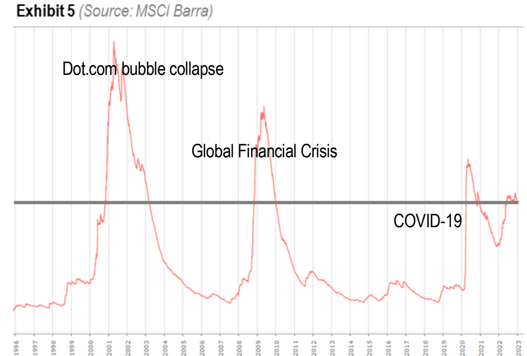
of 1997-1998 to the Global Financial Crisis of 2007-2009 (plus a few more along the way), tightening financial conditions has invariably led to financial market pain. Exhibit 3 shows the history of Fed Funds rate cycles and the impact on financial conditions, as gauged by the Kansas City Fed Financial Stress Index. While not yet of significant concern, the financial market climate is worsening and beginning to approach levels of early in the collapse of the dot-com bubble. Another indicator of challenges ahead is the yield curve. Since 1980, an inversion of the yield curve has preceded every recession, except for the short-lived, COVID-19 recession. The yield curve (Exhibit 4), as measured by the 10-Year Treasury Constant Maturity minus the 2-Year Treasury Constant Maturity, has not been this inverted since Paul Volcker was Fed chair and it is plainly forecasting a recession. Yet credit spreads, which have widened notably, are not yet near recessionary levels. Credit markets continue to function relatively well, which is crucial if a soft landing is to be achieved, and are not yet flashing the levels of stress that would indicate a recession is imminent. Indicators to watch are further widening in high yield spreads from the current 4.6% to closer to 10% and investment grade spreads from the current 1.3% to north of 3%.

Exhibit 4 *(Source: Federal Reserve Bank of St. Louis)*



Equity market risk metrics have also remained stubbornly high in the post-pandemic era. Exhibit 5 shows the risk of the beta factor within the Barra Long-term U.S. Equity Model (USE4). Beta risk, along with other measures of equity market risk such as momentum and residual volatility, have remained elevated and near "recessionary" risk levels ever since the beginning of the pandemic.

Exhibit 5 *(Source: MSCI Barra)*



Conclusions

Market themes for 2023 are likely to remain similar to 2022 as stubbornly high inflation and sharply higher interest rates continue to compress valuations, incite fears of recession and pressure corporate profits. As noted in our September 2022 letter, at Smith Group we are more concerned with the potential for a downside recessionary surprise than further upside inflation surprises. Given the resolute commitment of central banks to combat inflation we believe that inflation has peaked and will further recede in 2023. Whether the U.S. can avoid a recession remains a significant question. Europe is likely already in a recession and consensus seems to be that the U.S. will experience at least a mild recession during 2023 or 2024. The first half of 2023 is likely to be a challenging period for corporate profits. Every major inflationary peak since WWII has experienced a downturn in corporate profits over the 12-months following the peak. If history holds then 2023 earnings for the S&P 500 would be expected to be $200-$205 per share, considerably lower than the current $231 consensus. Whether this potential earnings downturn is already priced into market valuations, or whether the downturn even comes to pass, is still very much up in the air. Either way a recovery to significantly higher earnings in 2024 and beyond appears likely and that prospect should provide a strong base for global equity markets into late 2023 and beyond.