The Conservative Strategist

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2023: Look abroad, seek yield, continue to diversify

We like volatility. It opens opportunity. In 2022, we saw volatility in equities, in bonds, in currencies, and in commodities. Consequently, there is likely more to do in 2023 than there has been in a long time. Volatility tends to create imbalances, which reveal cheap and expensive assets.

Foreign stocks cheap to the US

For years, foreign stocks have been lagging their US counterparts. This year, continued stressors include a strong US Dollar, an impending tough winter in Europe, and China's zero-COVID policy rebounding across Asia.

But now foreign stocks are so cheap relative to the US that even a strong Dollar could not give US stocks the edge this year. An 8.3% rise in the Dollar this year did not produce eight points of outperformance in US stocks. In fact, developed foreign markets beat the S&P by a point and a half, and emerging markets finished in a dead heat with US stocks.

We appear to be at that point in many foreign markets where fundamental cheapness may be providing a floor under equity prices. That's a prime time to accumulate. We like British stocks in general, European small companies, and emerging markets value.

Yields now healthier

The record rise in interest rates in 2022 has surfaced some decent bargains in income-oriented investments. TIPs got quite cheap in early Q4, and non-agency mortgage-backed residential securities are yielding 7%+, as are medium-term investment grade bonds. High-yield bonds are close to 9%. Private credit funds are offering payouts in the 8% to 10% range. So there are plenty of candidates for adding yield to the portfolio. And while we pick and choose, we are hiding out in ultra-short bond funds that are paying close to 5%.

SuperCash remains a key diversifier

We harbor no illusions: 2023 will continue to be rocky. With a recession likely, the stock market does not appear to have reached a viable bottom. With inflation persistent, interest rates are not plunging back to pre-2022 levels anytime soon. But the recent rise in rates is raising the return potential of several of our alternative strategies. A substantial component of the return of merger and convertible arbitrage strategies, for instance, depends on the so-called risk-free rate, which recently has risen from a fraction of one percent to nearly five percent. So we continue to allocate, even over-allocate, to the basket of lower-risk strategies and approaches that comprise the SuperCash bucket. ■

Why Emerging Markets in 2023?

1. **Emerging markets (EM) have better growth, lower inflation, and less sovereign and private debt, yet EM equities and currencies trade at crisis-level valuations.**
2. **Despite the slowdown in China, we expect many other EM countries to see an acceleration in growth, which will drive earnings and market share.**
3. **The growth story is underpinned by the post pandemic recovery, a manufacturing renaissance, commodity tailwinds, digitization and a favorable political cycle.**
4. **We believe that most investors are under-allocated to EM, considering the potential returns from this asset class.**

We agree that after years of underperformance, EM is now dirt-cheap and under-owned worldwide, while fundamentals are now in place for outperformance. Similar conditions prevailed in 2002, and years of strong returns followed. Source: Eaton Vance's 2023 Investment Outlook: Emerging Markets (12/14/2022)

The Markets December 31, 2022	Price/Yield	Gain, Qtr	Gain, 2022
US Stocks (S&P 500/Vanguard Index)	3839.50	7.52%	-18.23%
International Stocks (Vanguard Index)	16.66	14.69%	-16.05%
Emerging Markets Stocks (Vanguard Index)	24.70	8.15%	-17.90%
Real Estate Stocks (Vanguard REIT Index)	27.41	4.31%	-26.30%
Bonds (30 year US Treasury/Vanguard Index)	3.96%	-1.24%	-29.58%
Dollar (US Dollar Index)	103.52	-7.67%	7.87%
Gold (London Afternoon Fix)	$1813.75	8.49%	0.44%
Money Market Funds (Vanguard Federal - VMRXX)	4.24%	1.46%	2.10%*

*change in yield

Portfolio Planning

For an unpredictable 2023, an alternative fund of alternatives

2022 has been a rocky year for mainstream assets, with both US stocks and core bonds down mid-to-high teens. *Seasonal Strategy*'s clients are mostly down low-to-mid-single-digits. What helped us this year is a healthy allocation to Real Assets (they outperformed substantially) and a large dose of SuperCash, or what most call *alternative* assets.

These can include private equity, private real estate, alternative credit, private infrastructure, and hedged or arbitrage strategies. They can be powerful return drivers, but perhaps their chief benefit is the substantial non-correlation to the rest of the portfolio. They help stabilize the overall portfolio.

2023: More volatility on the way

We don't have a crystal ball for 2023, but we think it's highly likely that we see continued volatility in the mainstream markets. So we are allocating more heavily than usual to SuperCash funds. One we like is the *First Trust Alternative Opportunities Fund* (VFLEX), which broadly allocates among alternative asset classes. The fund finished 2022 with a fractional gain, and at no time during the year was it down even one percent. Its performance since its 2017 inception is two percentage points better than our conservative benchmark, *Vanguard LifeStrategy Conservative Growth*, yet it has taken less risk.

A flexible approach to alternatives

While most of our SuperCash funds specialize in an individual strategy, VFLEX, true to its ticker, flexibly allocates among private equity, private real estate, alternative credit, hedged strategies and co-investments, depending on where the best risk-reward ratios exist. It an invest up to 30% of its portfolio in each of the five areas above. Most investments are made through diversified private funds, but the co-investment sleeve offers a unique benefit. Here, VFLEX invests directly alongside sponsors, bypassing the fund structure and its associated fees. Nearly 25% of the portfolio is co-invested in private credit deals currently, with net yields in the mid-teens.

A solid yield

The co-investment yields help give the fund a net yield in the seven to eight percent range currently. Since much of its yield investments are floating-rate, higher interest rates have caused it to recently up its annual payout from 5% to 7%, all of which is being earned from net investment income (no return of capital).

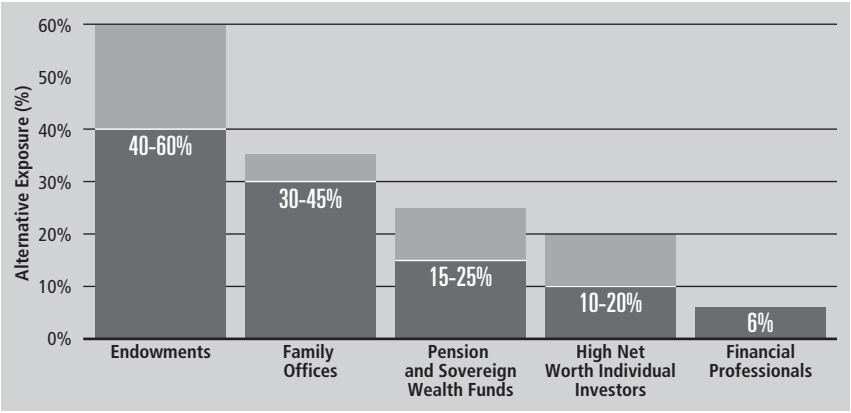
Interval fund structure helps

Like the *Variant* and *Cliffwater* funds we own for clients, VFLEX is an interval fund, which means it is offered like and operates like a conventional open-end mutual fund, with the exception that it allows redemptions of the fund only up to 5% of the fund's total value per quarter. This is to prevent a sudden flood of redemptions from forcing the fund to sell assets at what may be the wrong time. Since VFLEX's underlying assets are less liquid than the typical stock or bond, the interval structure is aligned with the longer-dated nature of the assets. It's a fund for patient capital, and that patience should be rewarded over time. The so-called illiquidity premium has been documented to be 2% to 3% per year, long-run.

(Also, note that VFLEX has never had quarterly redemption requests totaling 5% of fund assets in any one quarter, and so has always been able to redeem 100% of all fund requests). ■

Most financial professionals behind the curve on alternative assets

Percent of portfolio represented by institutional vs. alternative assets exposure



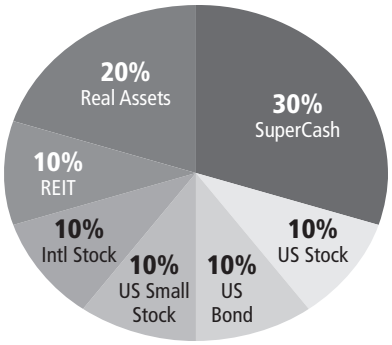
*While some of the nation's most sophisticated and successful institutions allocate substantially to alternative assets, financial professionals lag in their adoption. At **Seasonal Strategy,** we have always had a dedicated sleeve for alternatives (we call it SuperCash), with the default allocation at 20%. Lately we have been ramping up the allocation amidst tepid prospects for mainstream stocks and bonds.*

Sources: UBS Alternative Investments, UBS Global Family Office Report, Statista, FundFire

SuperDiversified Portfolios (SDPs)

60/40 portfolio debacle 4th worst in a century

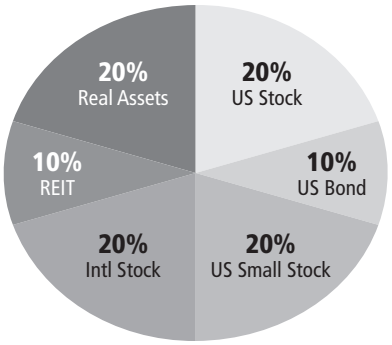
SDP1 *Conservative*



4th Quarter	*2022*
4.10%	***-10.71%***

The 60/40 portfolio (60% US stocks, 40% US high-quality bonds) has been the lodestar for many institutions for decades. But this year, it did not cover itself in glory. With both stocks and bonds down together for the first time since 1969, the 60/40 lost more than 16% in 2022.

SDP2 *Moderate*



4th Quarter	*2022*
3.66%	***-9.76%***

That miserable tally would rank it the 4th worst year for investors in the past one hundred. It doesn't get any better when factoring in inflation. The so-called real return of the 60/40 is -23% this year, which also comes in as the 4th worst, behind 1931 (-24%), 1937 (-24%) and 1974 (-25%).

The above model portfolios are not intended to indicate the performance of any real account, but reflect the composite performance, before fees, of the percentage allocations in the asset classes and funds listed in the table below. Seasonal Strategy's actual allocations vary from these models, and among portfolios.

How the Sectors Performed

2022 a mini-2008: Nearly every asset class sank

Asset Class	Mutual Fund	Performance 4th Quarter '22	Performance 2022	
SuperCash	PIMCO Instl Low Duration	0.29%	-5.53%	Best
	Merger	1.00%	0.71%	Worst
	Calamos Market Neutral	3.09%	-4.49%	
US Stock	Vanguard Index Trust 500	7.52%	-18.23%	
US Bond	Vanguard Long-Treasury	-1.24%	-29.58%	
US Small Stock	Vanguard Small-Cap Index	7.94%	-17.71%	
Intl Stock	Vanguard Intl Index	14.69%	-16.05%	
REIT	Vanguard REIT Index	4.31%	-26.30%	
Real Assets	PIMCO Commodity Real Return	3.39%	8.44%	

Of our seven active asset classes, fully six were down in 2022. And the single one that rose didn't exactly set the world on fire: Real Assets rose less than 9% this year.

The broad selloff looked like a milder version of 2008, and followed a similar script with the Q4 rebound. If the analog continues, we should see a quarter or two of further pain before a turn. Bear in mind, however: History seldom repeats but it does rhyme.

Cambria Emerging Shareholder Yield

As 2022 closes, emerging markets stocks are modestly undervalued. But a subset — emerging markets value stocks — are downright cheap. Global asset allocation firm GMO estimates they could return 9% per year above inflation over the next seven years. Globally, small and mid-cap companies are cheaper than larger companies. That leads us to the few emerging markets value funds that ply their trade among small- and mid-cap stocks.

A 4-star fund from Cambria

One we especially like is *Cambria Emerging Shareholder Yield* (EYLD), an ETF from the innovative Cambria family. Shareholder yield encompasses dividend yield, share buybacks and debt paydown. The theory is that companies that are maximizing these metrics have high free cash flow and tend to outperform over time.

EYLD has outperformed the MSCI Emerging Markets average by more than two percent per year since its 7/14/2016 inception, and has beaten all 20 of the 20 largest emerging markets funds over the same period.

January Effect

We think this fund is poised to outperform over the long run as well as seasonally. The so-called *January Effect* tends to favor smaller companies and high-dividend-yield companies. EYLD is chock full of both.

A focus on value stocks

Morningstar style box for EYLD's holdings, as of 10/31/2022.

Boxes show percent of portfolio in each style and market cap.

69% of EYLD's portfolio is in pure value stocks, and a third is in small-caps.

Another way of looking at it: Only 14% of the portfolio is not in either value or small-cap.

Source: Morningstar

	VALUE	BLEND	GROWTH
LARGE	26	3	0
MEDIUM	26	9	2
SMALL	17	10	6

SEASONAL STRATEGY

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Top financial regrets — and what we can learn from them

If we never made any mistakes and we took advantage of all available opportunities, it's likely we'd never have any regrets. So perhaps regrets are in part a measure of mistakes made and opportunities missed.

On that score, the record of American savers and investors is troubling. Many of us harbor regrets over one or more of five major lifetime financial mistakes, according to a recent study by Abigail Hurwitz of the Hebrew University of Jerusalem and Olivia S. Mitchell of University of Pennsylvania's Wharton School — "Financial Regret at Older Ages and Longevity Awareness."

The researchers found that many older folks experience high levels of financial regret. Here are regret statistics for five major life decisions (made or unmade):

Not having saved more	57%
Not buying long-term care insurance	40%
Not working longer	37%
Not purchasing lifetime income (annuity)	33%
Not delaying Social Security benefits	23%

The power of regret

The avoidance of regret later can be a strong motivator. Prior studies on regret have shown that regret is less likely when people are unable to compare the results of the choice they have made against other outcomes.

If an individual, for instance, does not think about anticipated longevity and lacks accurate information about it, that individual is less likely to experience regret in later life over financial decisions already made. It's a clear case of *what you don't know CAN hurt you.*

And let's face it, this happens quite often because dwelling on the subject of our own mortality is not something most people relish. The irony is that turning our attention to such matters long enough to obtain and understand the odds of our survival can help us make better choices that will enhance our older age and perhaps even extend our lives. Such is the power of regret.

The takeaways for our children — and grandchildren

Given that the main regret is a lifetime of under-saving, we should be doing what we can to teach our children and grandchildren about the importance of savings and investment.

Message 1 is *Start Saving Now.* Every dollar saved in one's teens or twenties is far more powerful than a dollar saved in one's forties or fifties thanks to the miracle of compounding. Pay yourself first and think of spending as secondary.

Message 2 is *Save a Lot.* Twenty percent of gross income is a stretch savings goal that will put a young person in the catbird seat.

Message 3 is *Educate Yourself About Investing.* There are great short books about investing written in simple understandable terms. One of my favorites is *The Elements of Investing* by Burton G. Malkiel and Charles D. Ellis. It will make an impression.

Message 4 is *Live Within Your Means.* Buy less, and buy stuff that lasts. This should be aligned with the vital environmental consciousness shared by most young people today.

And Message 5 is *Understand that Life is Long — and Getting Longer.* Confronting one's longevity early can lay a foundation for a high savings rate.

Clearly young people are getting some kind of motivational message, given the encouraging savings statistics in the graph shown here. ■

Youngsters saving less than older folks, right? Wrong.

Percentages of each age cohort saying they are ahead of schedule and behind schedule in saving for retirement

AGE COHORT	AHEAD OF SCHEDULE	BEHIND SCHEDULE
Baby Boomers (58-76)	7%	71%
Gen X (42-57)	9%	65%
Millennials (26-41)	19%	46%
Gen Z (18-25)	31%	30%

These numbers were confirmed by additional survey results that found younger workers are also increasing their contributions at a faster rate than older workers. Perhaps with record government debt, a fraying social safety net, climate change and geopolitical turmoil, younger generations are not taking anything for granted about their long-term prospects.

Source: Bankrate survey, September 2022 (2,312 American adults sampled)