Pinney&Scofield

Building long-term relationships with long-term investors

April 15, 2022

Dear Client,

So far 2022 has not been good for the markets and it feels like we have jumped from the frying pan into the fire: pandemic to war. What is happening in Ukraine is horrifying and unjustifiable.

The war, increase in interest rates and high inflation have caused a lot of uncertainty. As a result, all the major indices are negative for the first quarter of the year – both stocks and bonds which is rare for both to be simultaneously. Interestingly, within the equity indices, all those with a value tilt, including foreign equities, performed better than all the growth-oriented indices. In other words, of all the value indices we track, the worst was better than the best growth index across all asset classes.

With gas prices soaring and continued shortages in the supply chains, it is easy to think the down markets will continue to fall and we will end the year in the red. But history shows this is typically not the case. Look no further than March 2020 when COVID 19 first broke out, shutting down the world economy. At the bottom of that bear market, US stocks were down 35%. How did they end the year? Up 21%. If we look back to 2009, there was a similar outcome. In 2009 we were still in the Great Recession. The markets bottomed in March, down 27% from the start of the year. By year end they were up 28%. Of course, a reversal of return does not always occur. In 2008 US stocks were down as far as 49% and ended the year with a negative 37% return. We have attached a chart that shows the intra-year declines in US stocks over the last twenty years along with the calendar year return. Since 2002, there have only been three years that ended with a negative return. Think of all the dire news about the markets over the last twenty years and yet US stocks have ended the year with a positive return 85% of the time. As you know, past performance is not a guarantee of future results, but the message from the chart is clear – ignore the short-term noise.

We've touched on Bitcoin (and crypto in general) briefly before, most significantly in our July 2021 letter. At that time, we commented that Bitcoin was being touted as an inflationary hedge and "store of value." As we said then, up to that point Bitcoin had only been available in a non-inflationary environment so there wasn't much evidence to support that conclusion. Since then, however, inflation has reared its' ugly head in a significant way which begs the question what has happened to Bitcoin?

The short answer is not much except a lot of volatility. Analyzing the price of Bitcoin is a little tricky because it trades 24 hours a day so there's never a fixed closing price. For our analysis we've used the price history publicly available on the Yahoo!Finance website and according to those numbers, Bitcoin in the first quarter of 2022 was down slightly along with the other indices. Going back 6 months through the past two quarters as inflation really took off, Bitcoin had a huge runup in October and November only to come crashing down again resulting in a net return of 3.99% over the 6 months. Looking back a year,

22 Hilliard Street, Cambridge, MA 02138 • (617) 492-6223 • Fax (617) 492-8025 • www.pinneyandscofield.com

Bitcoin is down 22.71% from March 31, 2021 to March 31, 2022 versus the Russell 1000 Value being up 11.67% over the same time. Again, past performance is not a guarantee of future results, but with inflation flaring, Bitcoin has yet to live up to "inflation hedge." Indeed, after its' initial burst on the scene and becoming mainstream, Bitcoin is acting more like stocks. Data from March shows the 90-day correlation to the S&P 500 rising to 0.49, what some call "unprecedented in Bitcoin's history" (correlation is a measure of how similarly two things behave on a scale of -1 to +1 with -1 meaning exactly opposite and +1 meaning exactly together, the closer to +1, the more similarly they behave). The conclusion we draw is Bitcoin still has a way to go to demonstrate where and how it will fit into a diversified investment portfolio. Proponents say "$100k is around the corner!" while detractors say "it's all made up!" Both may be right. We are watching closely. As you know, we err on the side of prudence.

Which leads to the question, what changes are we making to your portfolio to navigate through this time of war, high inflation, and rising interest rates? With Bitcoin out of the way, are we going to increase your holdings in Treasury Inflation Protected bonds (TIPS) to help combat inflation or lower your exposure in long-term bonds which will get hurt when interest rates rise? This shifting of allocation is called tactical investing. With tactical investing you start out with a strategic allocation – a desired percentage in various assets classes. This is what we do with your portfolio but that is where the similarities end. A tactical investor will then change their long-term strategic allocation to try to capitalize on perceived short-term opportunities in the markets. They will overweight their portfolio with TIPS when inflation is on the rise and then eventually return to the long-term strategic allocation. Sounds like a good, sensible approach. Except it does not work. Tactical investing is a form of active management and with any form of active management, you need to be right not once but twice: when to buy and when to sell.

> "Timing markets is the dream of everybody. Suppose I could verify that I'm a .700 hitter in calling market turns. That's pretty good; you'd hire me right away. But to be a good market timer, you've got to do it twice. What if the chances of me getting it right were independent each time? They're not. But if they were, that's 0.7 times 0.7. That's less than 50-50. So, market timing is horribly difficult to do." -- Professor Robert Merton, a Nobel laureate

We believe in the long-term you are better off simply staying seated. Your portfolio is built to weather all storms – the icebreaker analogy we've used before. We do not think it should be adjusted outside of normal rebalancing during different market conditions. There will always be something to worry about, and the possibility of unwelcome or unexpected events should be addressed by the portfolio's initial design rather than responding to current headlines.

That being said, there has been a change in your portfolio recently beyond our control – your exposure in Russia. Yes, you did own Russian companies through the emerging markets funds we use, however both Dimensional Fund Advisors and Vanguard have removed Russia from their list of approved markets for investment. They made this decision based on the government's sanctions, restrictions on foreign investors in the markets and market liquidity. Money that was invested in Russia was redirected to other emerging market countries. Russia only makes up 3% of the world's GDP so you did not have a large exposure to the country to begin with.

Finally, we have two regulatory disclosures we are required by law to make this time of year. First, we are enclosing our Privacy Policy statement and second, we are informing you that our SEC disclosure document, form ADV, has been updated and is available upon request. Call if you would like us to send you a copy. The form is also available on our website for you to easily access.

John, Richard, Mary, and Ryan