2022 – Anything but Normal

We have been writing our annual letter since 2019 and so it was fitting to revisit our previous writings as we embarked on recapping 2022.

The pandemic changed life as we knew it for most of us. Reading back to our 2020 annual letter "The Year That Everything Changed", we sent our team members home on Friday March 13th as the World Health Organization declared COVID-19 a pandemic. Prognosticators and optimists had predicted that it would be a matter of weeks before we returned to our normal daily routines – largely underestimating the length and pace of the reopening. I really started thinking about this more deeply as I had a conversation with a gentleman that I met while flying over the holidays. He said to me "maybe at some point we will get back to the way things were". The expected bounce back to normal never quite came; instead, now we have a new reality. As of the writing of this letter, 1039 days have passed.

If we take a step back, the protracted timeline of a return to "normal" actually started to change our routines. Many of us now either work fully remotely or in hybrid capacity. The office culture has shifted for many firms and companies are still experimenting with the mix of in-office engagement. The impact of this change can be seen in the commercial office space market. Rising vacancies in the office space market have hit near record highs in many major gateway markets, according to a research report published by Commercial Edge. Our home market of Boston is a great microcosm of the gateway markets with the commercial office vacancy rate hitting over 12% in 2022, a near doubling of the 2017 vacancy rate. This data is clear in showing us that we haven't returned "normal", at least not in terms of office occupancy levels.

So, what gives? It has been almost three years since COVID-19 was declared a pandemic and while many of life's activities have come roaring back, the way we do things has changed; and we are still searching for a sense of normal in many aspects of our lives. Perhaps, the reality of what is normal has changed while we hang on to an outdated sense of what we consider normal. Human beings are very good at anchoring in past experience, it gives us a base upon which to assess events and circumstances in our lives. It more importantly gives us a relative perspective: good vs. bad; happy vs. sad; pain vs. pleasure – our lens for viewing the world around us.

This leads me to the setup of what happened in our economy and capital markets in 2022. After a record market recovery coming out of March of 2020, the equity markets marched steadily higher until they peaked in early 2022. The rapid market recovery was driven by unprecedented levels of monetary and fiscal stimulus which worked its way into the financial system from 2020 to 2021 while the Federal Reserve kept its benchmark rate near zero (0-.25%). The amount of liquidity that went into the system made the stimulus and relief programs of the Great Recession of 2008-2009 pale in comparison. Approximately $5 Trillion was injected into the economy between the 2020 Coronavirus Aid, Relief, and Economic Security Act and the American Rescue – mostly in the form of stimulus

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money for individuals and the Paycheck Protection Program business loans which were forgiven. Essentially, free money was pumped into the economic machine as the US Treasury and Fed collaborated in attempt to mitigate the potential damage of shutting down the US Economy.

The effects of this rush of liquidity combined with easy access to capital and historically low rates created an asset boom. Nearly every asset class, readily investable or not, had a market and appreciated significantly from the bottom of the pandemic induced 2020 recession to the very beginning of 2022. Some of the assets that experienced strong returns included:

- Stocks
- Bonds
- Real Estate
- Private Equity and Venture Investments
- Commodities
- Cryptocurrency
- SPACs
- Used Cars
- Watches and Jewelry

To some extent the US Treasury and Fed's strategy worked as the pandemic recession was the shortest on record – it lasted only 3 months.

This explosive growth in asset values translated to enormous gains in what is called the Wealth Effect. Aggregate wealth increased globally at the fastest annual rate ever recorded in 2021, according to Credit Suisse's Global Wealth Report. Aggregate global wealth, adjusted for exchange rates fluctuations, increased by about 13% and household wealth in the United States increased by 23%. Most of these gains in wealth were fueled by rapid appreciation of the assets identified on the list above and the generally, the riskier the asset the greater the level of appreciation. We were in an environment where lots of new wealth (money) was chasing an increasingly short supply of goods and services due to supply chain logjams left over from the pandemic. Massive premiums, over sticker price, waitlist, extended lead times – these were all terms that we got used to hearing. This same logic was applied to company valuations, both private and public. It became "normal" to see initial public offerings (IPOs) in 2020 and 2021 hit the public markets at 20 to 30x trailing 12-month sales valuation – many of these companies were not profitable. The excess liquidity combined with historically low rates created an environment of chasing returns, goods and services. This appetite for risk assets most certainly wasn't normal behavior, the returns across risk assets in 2021 wasn't normal, but people got used to easy money. Meanwhile, this chain of events was progressively laying the foundation for future inflation and investors that were overly concentrated in riskier parts of the market would be setting up to get hurt in 2022.

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The stock market peaked on January 3rd, 2022, as inflationary pressures became more persistent than the Federal Reserve (the organization responsible for setting interest rate guidance) anticipated. What was originally deemed to be transitory, supply chain related inflation became stubborn and very real. The Fed pivoted its dual mandate focus of maximum employment and price stability to hone in on trying to tame the record levels of inflation. The Fed's massive underestimation of the rate and persistence of inflation in the economy led to drastic measures in attempt to restore price stability – in a consumption driven economy like the United States, no one wants to see the price of eggs and milk nearly double every few years. The current tightening cycle is the fastest on record, going back to 1958. While we are in uncharted waters when it comes to the potential market impact, we have already witnessed the impact of rapidly rising rates on the equity and fixed income markets. The S&P500 closed out the year still in Bear Market territory while bond investors experienced double digit losses in many highly rated issues. The pendulum swung the other way more quickly again than both the Fed and market prognosticators predicted. Almost nothing worked from an investment standpoint except for commodities (namely oil) as demand outpaced supply, driven by an increase in energy demand and high demand for many production inputs like lithium which is use in electric vehicle battery production. The only other major asset class that provided a positive return for the year was cash, even though the returns were paltry as the banks were slow to increase customer deposit rates on the back of the Fed's hikes (cash provided a negative return on an inflation adjusted basis). High Yield Bonds, European Equities, Investment Grade Bonds, Japanese Equities, Emerging Market Debt, Developed Market Sovereign Debt, US Equities, Emerging Market Equities, Chinese Equities, and REITS were all negative for the year by double digits. This again, was most certainly not a normal year.

The Feds actions from 2020-2021 created a time of easy money, low rates, peak wealth. In 2022 the Fed's actions (rapid rate increases combined with their Balance Sheet reduction program eviscerated liquidity, causing a progressive decline in the value of assets – everything from stocks to high-end wrist watches to used cars). The Federal Reserve and its actions have largely influenced the direction of the markets.

2023 and beyond – getting back to economic fundamentals that are aligned with reality will be very important. Some companies that came to be through the pandemic period may not survive, the investable universe will most likely continue to change, the way the market ascribes value will likely also change. And that it ok, it is part of the natural cycle of markets. This is why we believe a TOTAL NET WORTH approach to managing wealth is so important. While diversification does not protect against market risk, we create globally diversified portfolios for our clients that seek to help navigate difficult environments and do not carry any significantly concentrated risk of capital impairment. Our overarching mission with the TOTAL NET WORTH approach is leverage a process that we can control to create the financial confidence for our clients to move closer to their goals.

If the next few years prove to be a period of historical "renormalization" (3-5% interest rates) we will potentially have the opportunity to take less risk in client portfolios while pursuing reasonable

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returns. *At the time of this writing a 6-month Treasury Bill is yielding about 4.7% on an annualized basis.* In the zero-bound rate environment of the pandemic time period investors had to push way out on the risk spectrum to seek returns. We would be perfectly happy if the environment affords us the opportunity generate more return with less risk. The key is for inflation to come down and for the Fed to start backing off its rate increases; and nobody has a compass for that exactly how that will go.

So, what is normal? Perhaps, normal is what we get used to and what feels good from a relative standpoint. The reality is that the world around us is dynamic, always changing; so perhaps, we are always entering a new normal.

While we cannot predict the future, we remain intently focused on what we can CONTROL while using what MATTERS to our clients as our roadmap. We continue to make dedicated, strategic investments that establish continuity and continually enhance the experience we deliver to our clients. We continue to bolster our team by adding talented individuals across portfolio management, operations and client service. There are firms out there that are unprepared for a transition of control and would not be able to continue to serve their clients in the same capacity should something happen to their founder/owner. Today's events have made this proposition even more real; yet, it continues to be ignored by many operators. Every dollar that we invest back into our firm is intended to better serve our clients and their future generations. We don't believe that there is any other way. Our "against-the grain" approach of investing heavily in building our team, our infrastructure and evolving our suite of services is working. We proudly capped off the year by being recognized by **Forbes** as one of the **Top 100 Registered Investment Advisors** in the country.

We are very grateful for the trust that our clients place in us, and we look forward to facing the future together.

Sincerely,
Max G Winthrop
Chief Executive Officer

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