The Client Letter

It Could Have Been Much Worse

As of June 29, 2022

Andrew Hill Investment Advisors, Inc.
ResponsibleAdvisors.com

Andrew D.W. Hill
President & Co-Founder, CFA

Andy Hill has more than 30 years of portfolio management experience. Andy holds an MBA from Syracuse University and a Bachelor of Science degree from Canisius College. Andy often contributes to Investor's Business Daily, Naples Daily News, and Fort Myers News Press. He has also appeared on CNBC and FOX.

Jennifer R. Figurelli
Managing Director & Co-Founder, CTFA

Jennifer Figurelli has over 20 years of experience in the trust administration field. Jennifer has a Bachelor of Arts degree in Business Administratiofrom Florida Southern College and a Legal Assistant's Certificate from Florida Atlantic University. She also is a graduate of the Florida Bankers Association Graduate Trust School and holds a Series 65 license and Life, Health and Variable Annuity designations.

2nd Quarter Review-A Rough One

The second quarter of 2022 is going to be remembered as one of the worst ever periods for financial performance as both stocks and bonds were in decline. For the quarter through June 24, 2022, the SP500 declined 13.3% and the Bloomberg Aggregate Bond Index declined 5.3%. Generally, most client portfolios held up a bit better than the market averages.

The decline in the bond market is largely due to rising interest rates resulting from accelerating inflation and the Federal Reserve's "The Fed" actions to tame inflation.

The decline in the stock market is more complex and could be grouped into three phases. The first phase from late 2021 through early March 2022 could be termed the "profit taking phase." After a nice rally, the second phase of the decline began in late March 2022 and lasted until mid-May 2022. It can be described as the "price-to earnings contradiction" phase. As the Federal Reserve implemented its strategy of increasing interest rates, investors used a higher discount rate of future earnings that lowered the value of stocks. Also, investors who used borrowed funds on "margin," began to liquidate their holdings to pay down debt. The current phase, "mass liquidation," is often the final phase of a decline. With profit expectations declining and investors panicking, investors often sell in fear. It's too early to conclude that a bottom has occurred, however, there are a few indicators suggesting we are in the vicinity. Corporate executives are buying their own stock aggressively and the put/call ratio, which measures optimism of options traders, is showing extreme pessimism, often a useful contrarian indicator.   *Written by Andrew Hill*

HIGHLIGHTS

Economic Review-"It's Still Sunny Now, What is Coming Next?"

Normally, the trends of the financial markets precede the "Main Street" economy by six to 12 months. Gross Domestic Product (GDP) is expected to grow 2.6% in the second quarter with moderating growth in the second half of the year, according to Bloomberg data of consensus economist estimates. Also, the probability of recession in the next 12 months is 33%, up from 15% last year. Given the hot inflation, inflation fighting policies of the Fed, and declining consumer spending, these estimates could be very optimistic.

Inflation has taken over as the primary economic issue on the minds of investors and the public. The May Consumer Price Index (CPI) report showed an 8.6% annual increase. Inflation is running well above normal levels and significantly above the Fed's 2% target rate. The underlying factors causing hot inflation are largely the lack of supplies of labor, industrial commodities, fuel, food, and housing. Covid-19 supply chain disruptions and the Russian invasion of Ukraine are responsible for a large part of the recent supply challenges. On the demand side, consumers with wage gains and stimulus funds had been willing to pay increased prices but appear to be gaining caution lately. Unfortunately, inflation longer term could remain high. For the past three decades, sourcing products from cheaper foreign providers has become unreliable. China's zero Covid policy and political issues are showing signs of a pending divorce from commerce with the United States. *Written by Andrew Hill*

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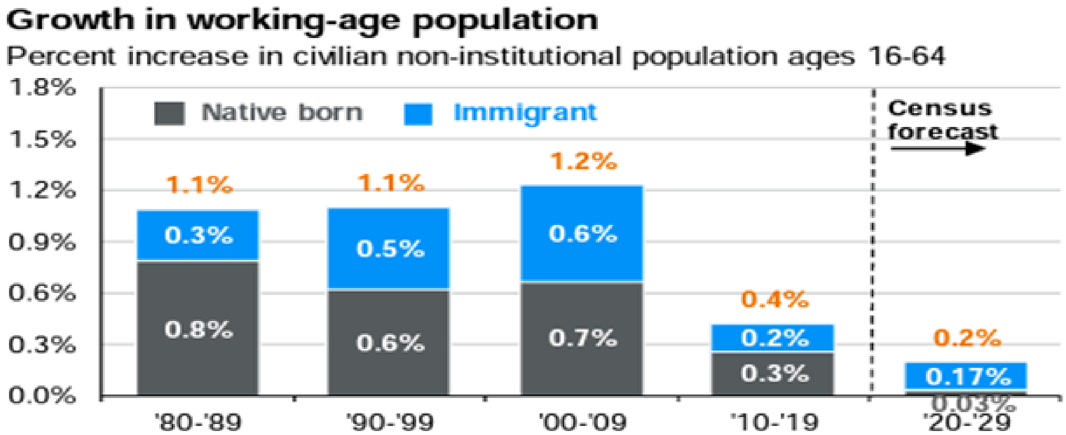
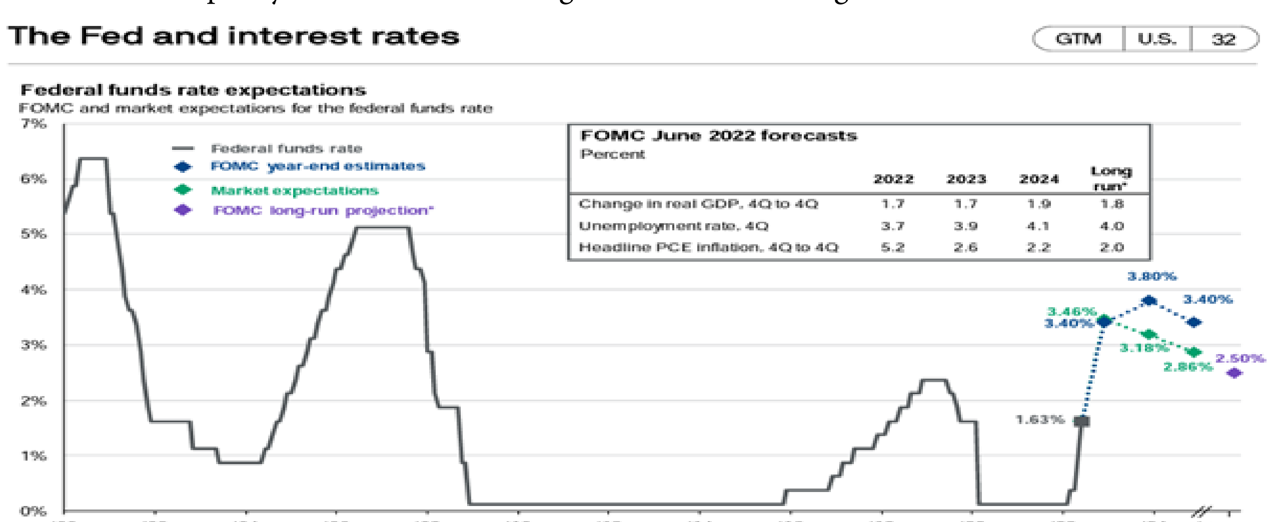
The demographics of the United States is a long-term issue causing the labor shortage. With the total population barely growing, fewer working age persons, and the immigration door largely closed, there is a severe labor shortage. To add further to the problem, millions of workers left the workforce during the pandemic. With fewer workers, wage gains are the best in decades for those who are employed. While this is good for the average hard-working person who has seen nominal wage gains in decades, it presents an inflation challenge for the Fed. The Fed is particularly concerned that wage increases could become perennial thus creating an inflation spiral similar to that experienced in the 1970's.



In addition to losing cheap internationally sourced products and labor shortage, the lack of capital investment is becoming obvious across many sectors. From baby food to energy, the story is similar. The lack of productive capacity becomes a crisis when the remaining producers have an issue. Gasoline refining capacity has been in decline for decades due to poor investment returns and no community wants a refinery in its backyard. I remember the smelly Ashland Oil refinery in Buffalo, New York that is long gone. A fire at one of 11 refineries in the U.S. last year set the current crisis in gas prices. The national baby formula shortage is a similar saga, except that **Abbott Labs** had a contamination problem. Investment is needed across many industries employing the latest technology to bolster increased productivity.
Improved tax incentives for investment of domestic manufacturing in essential industries would be helpful. China has done a much better job than the United States in infrastructure investment of critically important industries including semiconductor, lithium battery, steel, solar panels, and artificial intelligence to site just a few.

Fed Reserve Policy-Catching up with Inflation

The Federal Reserve recently made a bold move increasing the Fed Funds rate, (its primary tool to set short-term interest rates) by 0.75%, the largest increase in a single meeting since 1994. With the recent increase and expected additional increases at the July meeting, Fed Funds will soon be near the neutral rate of 2.5%. Chair Powell has stated that Fed Funds may need to be restrictive, and above the neutral rate to reduce inflationary pressures. Now, both the bond market, using the two-year Treasury bond as a proxy for the Fed's future policy moves and the Fed's guidance, are both aligned at about 3.1%.



FOMC June 2022 forecasts
Percent

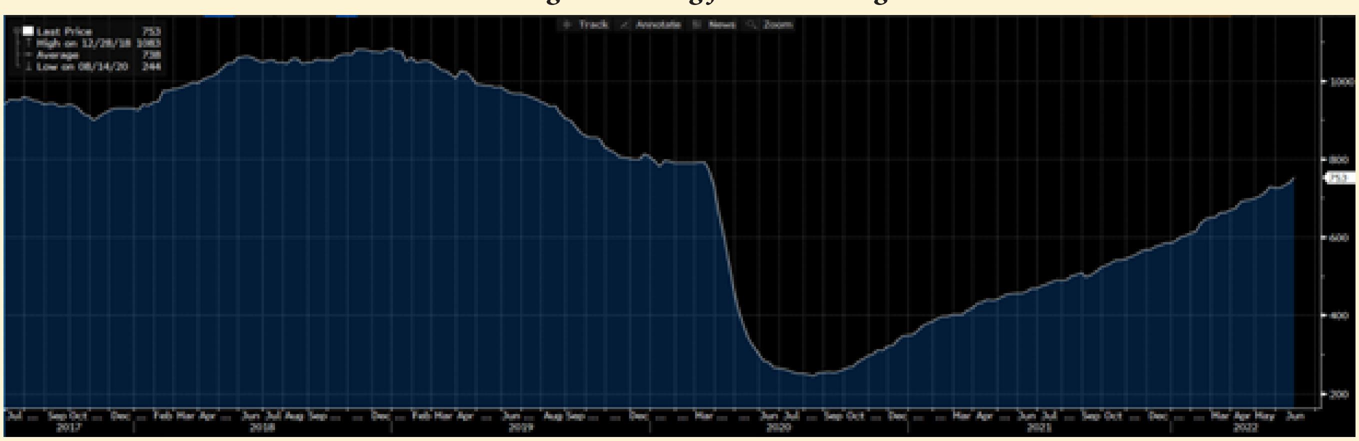
	2022	2023	2024	Long run*
Change in real GDP, 4Q to 4Q	1.7	1.7	1.9	1.8
Unemployment rate, 4Q	3.7	3.9	4.1	4.0
Headline PCE inflation, 4Q to 4Q	5.2	2.6	2.2	2.0

The Fed has two challenges. First, how does it combat inflation when a significant portion of inflation is the result of a lack of supply of products and services? Will leaders start vaccinating people in China with Moderna's messenger RNA technology to prevent supply chain problems? Will able body people get off their parent's couch and off to work? Even more challenging is the oil market. Russia's barbaric invasion of Ukraine is reducing the supply of many commodities from the world's markets. Oil, natural gas, and wheat have been the most noticed. Raising interest rates to combat rising oil prices due to a reduction of supply of extraordinary circumstances may be counterproductive. The solution for high energy prices is investment in new technology. Electric vehicles and plug-in hybrids all significantly reduce fueling and maintenance costs but as interest rates rise, with 90% of vehicles financed, cost of acquisition of a fuel-efficient vehicle moves further away for many consumers afford ability. As I stated in a recent Naples Daily News opinion article, the transition to EV's begins with the wealthy who own multiple cars. While my recommendations are long-term solutions, every vehicle contributes to reducing oil demand. The second challenge for the Fed is their definition of the "unemployment rate". Presently, the unemployment rate is calculated by estimating the number of persons who are looking for work as a percentage of the total number of persons working. Due to many factors, there are actually fewer workers working than prior to the pandemic. Using a broader definition of full employment, such as the percentage of persons working of the total population, may provide a more realistic interpretation of the economy.

While the Fed is raising interest rates to slow the economy, commodity markets are beginning to self-correct. As prices rise, new sources of supply often appear and demand falls. In the oil market, the total number of oil rigs working in the United States has increased by 54% from a year ago and new production will soon be reaching the market. Over the last week, oil prices dropped by 14%, evidence that demand destruction is occurring. For example, my top-secret sources tell me the volume of boat trips in the Everglades National Park is down significantly. In real estate activities, the price of lumber is falling like Bitcoin. Mortgage rates have doubled from a year ago and are currently approaching 6%.

Below is a chart of the number of active oil and natural gas drilling rigs in the U.S. Chart courtesy of the Bloomberg Terminal.

U.S. Oil Rigs Increasing from a Year ago 54%



Looking forward, with signs of economic slowdown expanding, supply chains improving and domestic oil production increasing, red hot inflation could be peaking soon. However, the process of returning inflation to the 2% target of the Fed is hard to see a clear path. Major challenges of labor shortages, unreliable foreign markets, and geopolitical issues disrupting commodity markets are factors that may prevent the Fed from achieving their 2% inflation objective anytime soon. On a positive note, investments in technology offer the best strategy to reduce inflation overtime. Core holdings in **Trex**, **NextEra Energy**, **Tesla**, and **Intuitive Surgical** provide excellent examples of how leading-edge technologies can reduce the cost of services to the consumer.

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Investment Strategy for a Bear Market

As the third quarter begins, it will be one of the more challenging periods for investment manage Given the recent market chaos, a brief review of our portfolio management strategy is warranted. Generally, client funds projected to be withdrawn from a client's portfolio within the next five years, are invested in high-quality bonds. This strategy provides a sound financial base. With the financial needs covered, the residual of the portfolio assets can be invested for long-term capital appreciation. Lately, there is a small allocation to commodities to hedge against food and fuel inflation. Basically, a client has two portfolios: a conservative bond portfolio for intermediate term, and a long-term growth portfolio.

Presently, in most portfolio's, cash balances are high. Fixed income portfolios are concentrated in shorter-term issues and equities are under weighted relative to client investment long-term targets. The big investment question is when do we leave the safety of cash and the Fidelity Conservative Income Bond Fund for the potential of higher long-term returns? From an asset allocation process, fixed income markets may be a better buy before equities. As the federal government increases short-term interest rates, the long-term risks of inflation declines, thus making bond yields more appealing. Stocks may have more time before a sustained bottom has been confirmed. While sharp stock market rallies are common in bear markets, historically, it takes a while for markets to turn higher for good. Recently, with the bond market showing signs of peaking yields, we have begun to "nibble" on stocks and bonds. The addition of **Alphabet** has been the largest.

10-Year Treasury Yield at Highest Since 2011

Currently, client bond portfolios are being analyzed for gaps in bond ladders (years in which there is not a bond maturity). The municipal bond market is starting to look enticing. High quality tax-exempt bonds are offering yields of 3.75% to 4%. The JP Morgan preferred stock yielding close to 6% is also interesting, although with a bit more risk. With the Fed's action, bond yields of maturities of two years or more are well over 3%. For the first time in years, investors can make a reasonable return on their high quality bond portfolio. Written by Andrew Hill

With Stocks in a Bear Market, What is the Strategy Now?

With the SP500 index on pace for the worst start to a year since 1970, and in a bear market decline of 20% or more, where do we go from here? With most client portfolios holding the lowest percentage of equities in the history of AHIA, our bias is shifting from defensive. The sharp decline in stocks is largely explained by the increase in interest rates. Stocks tend to correlate inversely with the yield on two-year Treasures. After the recent federal government action to raise the Federal Funds rate by 0.75%, investors are gaining confidence that inflation is peaking. After recent spikes, many commodities including oil, copper and lumber have declined sharply. The energy sector is often the last segment of the equity market to fall as it was in 2008. The decline in commodities has been noticed by bond investors. Stability in bond yields is the first factor for a bottom in the stock market.

And the high frequency data, like the boat ramp on Chokoloskee Island, are showing signs of a sharp economic slowdown. Although corporate earnings have held up through the first quarter, it is likely that the expectations for the rest of the year will be too high. Industries leveraged to borrowing such as real estate are already hurting as reported by home builder lender which saw a sharp reduction in home buyers beginning in June. Less cyclical industries such as technology, healthcare, and utilities may be safer sectors as the economy slows.

With equity markets already down over 20% from the highs on January 4th, many investors have already sold out. Could the SP500 fall further? Yes, logical levels based on technical analysis are 3500 and 3100. A significant negative event, such as a new geopolitical event or a deeper and more protracted economic decline could result in sharp declines although that's not the most likely scenario.

The SP500 Index looks better from a long-term perspective as the chart from StocksCharts.com shows. Stocks overtime produce returns over 10% but it's not a straight line up.

SP500 Index Long-Term Trend Remains Positive

Equity holdings are focused on several secular long-term trends. The most important trends include technology, healthcare, energy transition, banking, and climate change. Technology holdings are focused on leveraging the cloud, including **Microsoft**, **Nvidia**, **Apple**, and **Alphabet.** Energy transition to low carbon has gotten a boost from Europe that is quickly building its renewable energy base. **NextEra Energy** continues to be the leading utility in renewable energy production. It's growing customer base of new Florida residents is under appreciated by investors lately. A position in **Enphase**, a leading renewable electronics firm, was established with funds after reducing the position in **Tesla** due to the Twitter saga which posed a distraction to the opportunities in EV's and battery storage.

Healthcare and banking have been surprisingly weak sectors. Both sectors are positioned for revenue growth. In the case of banking, revenues will be increasing thanks to the federal government.

Rising temperatures globally are presenting long-term demand for companies like **Carrier** and **Deere**. **Carrier** is benefiting from the demand of air conditioning. **Deere's** high technology solutions are helping farmers increase productivity as weather challenges are hurting crops and livestock yields.

Portfolios have exposure to a mix of growth companies and dividend yielding stocks. **Oneok**, the natural gas pipeline, has a 6% yield. **AbbVie** 3.5% yield; and the three bank holdings yield over 3%. Although we have been making small purchases lately, most portfolios are materially under weighted in stocks relative to their investment objectives. We are looking for attractive opportunities overtime. At some point, a new bull market for stocks will begin. The leadership will include new companies that we are currently researching. Written by Andrew Hill

Cryptocurrencies Starting to Look Like Tulips

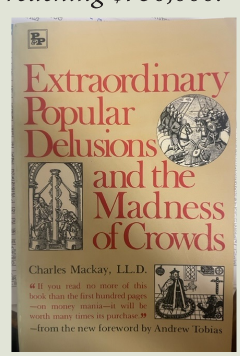
History is full of speculative investment strategies that have gone bad. The tulip bulb mania in the 1600's was one of the first documented and had the basic elements of a novel concept that revolutionized the initial price surge of tulip bulbs, which created massive wealth for the early adapters. Manias tend to end when an exodus shock uncovering the fundamental weakness that evolves into the ensures the beginning of a quick financial collapse.
Below is the chart of Terra Classic, a Crypto stable coin that fell to basically nothing when underlying assumptions failed. Chart courtesy from the Bloomberg Terminal.

Terra Classic, a "Stable" Cryptocurrency Collapsed.

The crypto mania is just beginning its decline with Bitcoin down only two-thirds from its highs. Tighter monetary conditions have bruised the crypto bubble with limited tangible value. As a superior way to conduct international money transfers, the crypto industry fought any form of regulation. Unfortunately, now many non-investors are experiencing financial losses, motivated by celebrity endorsements.

What was the Dutch Tulip Bulb Bubble Markets?

- *Tulips first appeared in Europe in the 1500's.*
- *Exotic flowers at the time, and unique from all flowers currently in Europe*
- *A luxury item, and affluent individuals purchased them for their gardens, thus tulips became a status symbol.*
- *Middle class wanted to appear wealthier than they actually were, demand for tulips increased.*
- *Over time, even the lowest classes became market participants.*
- *Tulip bulbs reached market values that were equivalent to $50,000 - $150,000 today, with the best reaching $750,000.*
- *Stock exchanges began creating markets for tulips to increase liquidity in 1636.*
- *Futures markets created speculation from those who never actually owned tulips.*
- *Companies were formed whose sole purpose was to trade tulips.*
- *Market participants began purchasing with leverage with the hopes of repaying loans as the prices continued to increase.*
- *By 1637, the bubble popped, people who owned tulip bulbs could no longer find buyers, and prices normal levels.*
- *Fortunes were made and lost overnight.*



Written by Aiden O'Lay

Time for A Mid-Year Financial Checkup

1. Review your income tax situation. Changes in income, realized capital gains and losses, and adjustments to retirement savings can impact your tax liability. The same applies to major life events, such as a marriage, divorce, and/or having a child.

2. Review your year-to-date IRA or 401(k) Contributions. Look at your year-to-date numbers to make sure you are on track to maximize your contributions. If you have earned income, you can contribute up to $6,000 in an IRA, and an additional $1,000 if you are age 50 or older. If you are participating in an employer-sponsored retirement plan, such as a 401(k), you can contribute up to $20,500, and if you are age 50 or older, an additional $6,500. Maxing out may also lower your taxable income.

3. Charitable Giving. If you are someone who makes gifts by writing a check or transferring stock, consider Fidelity's Charitable Gift Fund. This unique account allows you to continue to support the same charities you do now, and take advantage of the tax deductions, but in a more efficient manner that is simple and streamlines your tax recordkeeping in one account. Please call Jennifer at 239-777-3129 if you would like more information about the Fidelity Charitable Gift Fund.

4. 2022 Gifts to Individuals. If you are considering gifting appreciated stock or cash to a family member, you can gift up to $16,000 per person per year for 2022 without having to file a gift tax return. In addition, the IRS allows unlimited amounts for someone's tuition without paying tax. To qualify, the payment must be made directly to the student's school, which must be a qualifying educational institution.

5. Do you qualify for a Health Savings Account? If you are covered under a high deductible health care plan, you may be eligible to open a health savings account which provides tax-free contributions, earnings, and withdrawals. Individuals and families can contribute up to $3,650 and $7,300, respectively. Fidelity Investments offers Health Savings Plans and our firm can access these plans along with a client's other investment accounts. *Written by Jennifer Figurelli*

Troubleshooting Tips: Black Diamond Client Portal

Black Diamond, our firm's portfolio management software provider, offers all clients with the ability to keep track of their portfolio's asset allocation, transactions, performance, and projected income. In addition, Black Diamond allows clients to view, share and store documents in your personalized vault.

We have received inquiries from some clients who have encountered challenges accessing their account via Black Diamond. Therefore, we hope this communication will address these issues to allow our clients to take advantage of Black Diamond as it is a great tool to stay connected to your financial picture.

The most common challenge that clients encounter is when they are asked to change their password. User passwords are valid for 90 days. After this time, a user will be locked out of Black Diamond until they create a new one. When creating a new password, please keep in mind it must have 3 qualifications. 1. The password must be at least 12 characters long; 2. The password must include at least one capital letter, one number and one special character; and 3. The password can't be one that was previously used in the past.

Clients who use the Black Diamond app on their mobile phone should follow the same guidelines for password management. The passwords for a personal computer and a mobile phone must be identical. If they do not, the system will not recognize the password and a user will not be able to log in.

Client users who make more than 3 attempts to log into Black Diamond will be locked out of their account. If this occurs, please feel free to contact Elicha @ elicha@responsibleadvisors.com who will unlock the account. In some instances, it may be necessary for a client user to reset their credentials. This option fixes all user and password errors. Again, please contact Elicha if you need to have your log on credentials reset.

Whenever new documents, reports, or communications are available to a client, they will receive an email from Black Diamond sent on behalf of our firm. The email includes a link to access the portal. We recommend that clients open a new browser (preferably Google Chrome) and type in ix.bdreporting.com instead of using the link provided in the email. We recommend our clients save or bookmark the above website. By doing so, it will provide easy access to the website.

Celebrating Juneteenth

In June of 2021, for the first time in American History, the federal government, and the stock market declared Juneteenth as a national holiday. Juneteenth's commemoration is on the anniversary date of the June 19, 1985, announcement by Union Army General Gordon Granger who proclaimed freedom for the enslaved people in Texas. The significance of that date is the final notice to the enslaved in this country; two years after Abraham Lincoln signed the Emancipation Proclamation issued on January 1, 1863. Juneteenth marks our country's second Independence Day. Since 1865, Juneteenth National Independence Day has been celebrated annually in various parts of the United States. It is the longest-running African American holiday in history. In 1979, Texas became the first state to make Juneteenth an official holiday. Other southern states soon followed. The historical legacy of Juneteenth shows the value of never giving up hope during uncertain times.

- Aiden O'Lay has joined AHIA as Associate Financial Analyst.
- Andy Hill was appointed to the Greater Naples Chamber Board of Directors