Q1 22 WEALTH MANAGEMENT QUARTERLY INVESTMENT LETTER

Opus CAPITAL MANAGEMENT

The Fed's Challenge

Quick Look

- Despite highly accommodative policies, inflation remained mysteriously and stubbornly below the Fed's 2% target throughout the 2010s.
- The lesson learned from the 2008 Financial Crisis was the bigger the better regarding policy responses to crisis.
- The monetary and fiscal response to the 2020 pandemic was both swift and enormous, fostering a remarkably quick recovery.
- Policy since the initial vaccine rollout is more open to question, and has almost certainly contributed to the largest spike in inflation in 40 years.
- As a result of constantly rising inflation figures, Fed policy has pivoted. In the past six months, the Fed has gone from one expected rate hike by the end of year 2022 to nine rate hikes.
- The combination of inflation, rate hikes, yield curve inversions, and commodity price shocks make the Fed's mission to curb inflation especially challenging.
- This was an atypical quarter in which both stocks and bonds were negative. In fact, it is just the 2nd time in the past 53 quarters this has occurred.
- Bonds had a miserable quarter by their standards, with the broad index falling 6%. Despite the grim outlook for bonds moving forward, we can make a case that their prospects are improving.

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About Opus Capital Management

Opus Capital is an evidenced-based investment advisory firm driven by our overriding mission to help people. We believe the marriage of comprehensive financial planning + statistically proven investment principles creates the clearest roadmap to long-term success.

We are independent and transparent in all aspects of investment management decision making and financial planning. We selectively partner with like-minded individuals and families, endowments, foundations, and 401(k) plans in over 30 states.

Quarterly Investment Letter, Q1 2022

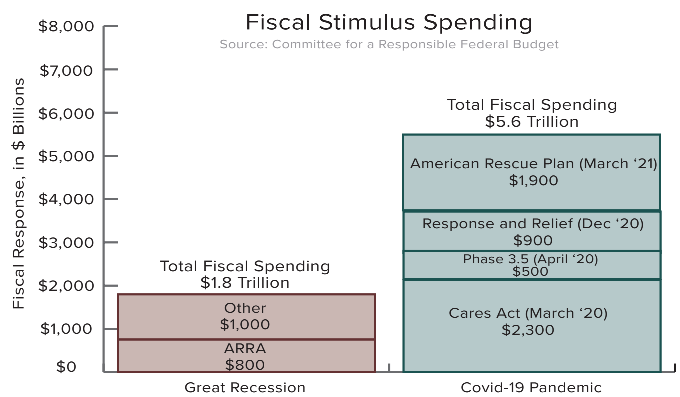
"As I've written in the past, economics is the science of choice. Few options in these fields offer only positives and no negatives. Most entail tradeoffs. However, the negatives often become apparent "only when the tide goes out". – Howard Marks

Prior to the pandemic, business cycles had settled into a reliable timeframe, with each lasting between 7-10 years. Cycles are like seasons; they are born with early-stage recovery amid deep pessimism, settle into a multi-year mid-cycle expansion as confidence improves, before eventually aging into a slowdown and ultimately fading into contraction to wash away the excesses. Spring, summer, fall, winter. The current cycle, originating during the COVID shutdown, has felt like watching a movie in fast forward. The timing has been jarring and well off the standard two-hour fair. The plot has, at times, been elusive.

In the fall of 2008, history has written that the bold actions by Ben Bernanke and Hank Paulson (Fed Chair and Treasury Secretary at that time) saved the U.S. from financial depression. While a deep recession was unavoidable, programs such as TARP (the fund that bought toxic assets from banks) were designed at the height of the crisis and rescued the system from the brink of disaster. Due to the damage absorbed by our financial system and necessary deleveraging, the process of moving from contraction to recovery and into expansion was slow moving. Early-stage economic growth was fairly muted, and employment took a long time to gain momentum. Eventually though, expansion took hold, and the 2010s became the first decade ever without a recession. From trough to peak, the S&P 500 gained 400% over the associated market cycle.

The biggest critics at that time were inflation hawks (best remembered by the rise of The Tea Party), but despite historically accommodative polices, inflation never arrived. In fact, despite 0% Fed rates for six years, inflation remained mysteriously and stubbornly below the Fed's 2% target throughout the 2010s. By decade-end, universal basic income and Modern Monetary Theory, the premise that governments can create more money without consequence provided prices remain stable, were non-mainstream ideas that were gaining in popularity. The lesson learned from the 2008 Financial Crisis was the bigger the better regarding policy responses to crisis.

In early 2020, the pandemic provided an atypical shock to the system, and the policy response was both swift and enormous. Congress passed the CARES Act, which along with the December 2020 Appropriations Act, provided more than $3 trillion in stimulus checks, unemployment benefits, and forgivable loans to small businesses. The end result was fiscal stimulus twice the size of 2008 fiscal aid. Not to be outdone, the Fed slashed rates to 0% and promised asset purchases for as long as necessary. The COVID recession was the largest contraction since the Great Depression, but the recovery was remarkably quick. U.S. stocks fully recovered their losses within five months. Once again, an aggressive policy response had proven capable of circumventing certain disaster and was widely praised given the dire outlook in March 2020. Presently, it still looks like the right call given the alternative, even if the details could be quibbled.



Policy since the initial vaccine rollout is more open to question. In March 2021, with both the health crisis rapidly improving and the economic recovery well underway, Congress passed another $2 trillion in stimulus; most of which was sent directly to consumers. As luck would have it, two weeks later the Ever Given container ship would get stuck in the Suez Canal, blocking global cargo for six days. Inflation, dormant for a generation, was suddenly awakened. The bear had been poked.

U.S. EQUITY RETURNS (%)

As of 03/31/2022	Q1 2022	1-Year	3-Year	5-Year	10-Year
S&P 500	-4.6	15.7	18.9	16.0	14.6
Russell 1000 (Large Cap) Growth	-9.0	15.0	23.6	20.9	17.0
Russell 1000 (Large Cap) Value	-0.7	11.7	13.0	10.3	11.7
Russell 2000	-7.5	-5.8	11.7	9.7	11.0
Russell 2000 (Small Cap) Growth	-12.6	-14.3	9.9	10.3	11.2
Russell 2000 (Small Cap) Value	-2.4	3.3	12.7	8.6	10.5

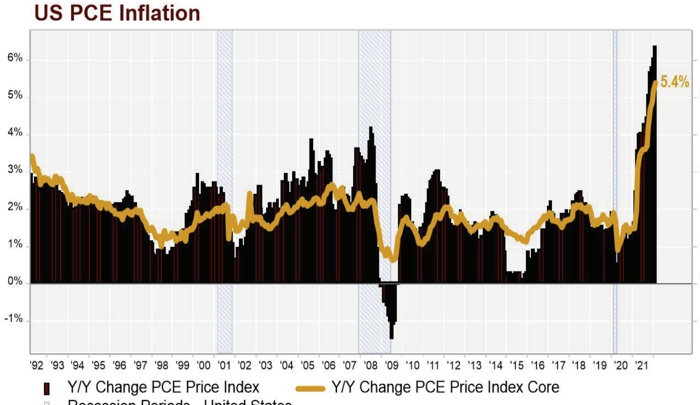
Source: Morningstar

Continued from page 2 . . .

The Fed believed the initial burst of inflation to be transitory and expected the peak to occur last summer. For most of last year, the Fed continued to reiterate that they would not consider raising rates until it saw "actual inflation" and that the continued pandemic-relief aid was still necessary. A well-documented change in policy during COVID was the Fed's intention to let inflation run a little hot to ensure a 2% average core inflation rate, which consistently came up short in the prior decade.

These policy miscalculations played a large role in fostering our current state of affairs, which is the largest spike in inflation in 40 years. Core Personal Consumer Expenditures (PCE), which is the Fed's preferred measure of inflation, has risen every single month since March 2021, marking now a full year over their 2% target. Inflation has momentum from a number of different forces all trending higher – strong demand, tight labor markets, disrupted supply chains, and what was initially a price surge on goods has now spilled into services as well.

US PCE Inflation



Source: FactSet

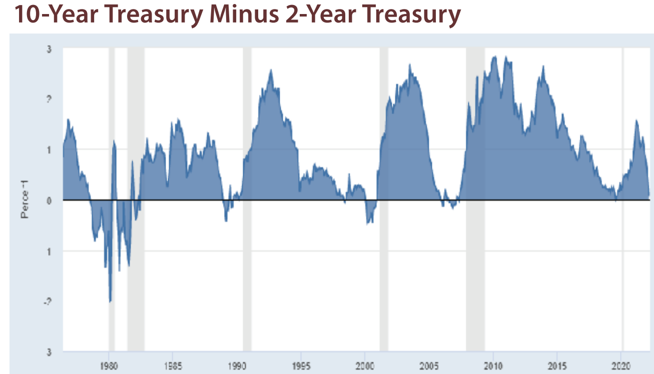
The good news is that consensus expectations predict that inflation will begin to roll over in the next two months. The caveat is that we have been seemingly two months away for the past nine months. The emergence of the Delta and Omicron variants throughout the world have been a continued hindrance to global supply chains, and Russia's invasion of Ukraine has significantly exacerbated supply constraints while negatively impacting global growth. The optimism from last year's economic reflation has morphed into concerns about possible stagflation.

These developments have caused a major pivot in Fed policy. In the past six months, the Fed has gone from one expected rate hike by the end of year 2022 to nine rate hikes. For that math to work, this would entail a rate hike at each of the remaining six Fed meetings this year, with three of those rate hikes being half-point moves. It is the most ambitious rate hiking agenda since Alan Greenspan's 300 basis point increase to the Fed Funds rate in 1994. This is lauded as one of the great achievements in Fed policy, as Greenspan was able to get ahead of what the Fed saw as rising price pressures and slow the economy without contracting it (the elusive "soft landing").

The Fed's mission may be more challenging this time. Inflationary pressures in 1994 were still nascent when Greenspan initiated his policy, whereas real policy rates currently trail core PCE by 5% and have never been so negative. Besides being late to the game, the Fed is attempting to thwart inflation that has been ignited, at least partially, by supply constraints. Raising rates should help reduce demand-side inflation pressures, but it won't produce more wheat or drill more oil. The Fed's chances of success would be greatly improved if some of the supply-side pressures (supply chains, geopolitical) began to alleviate.

Compared to 1994, Powell's Fed will attempt to thread the needle through a smaller eyelet. Greenspan's rate hike flattened the yield curve, but did not invert it. At quarter-end, the 2s10s spread has already inverted on Powell, an unsettling development given the yield inversion track record as a leading indicator of recessions. The U.S. economy currently boasts a strong jobs market (maybe too strong) and well-fortified consumer balance sheets, but the combination of rate hikes, curve inversions, and commodity price shocks could make for a bumpy landing.

10-Year Treasury Minus 2-Year Treasury



Source: Federal Reserve Bank of St. Louis

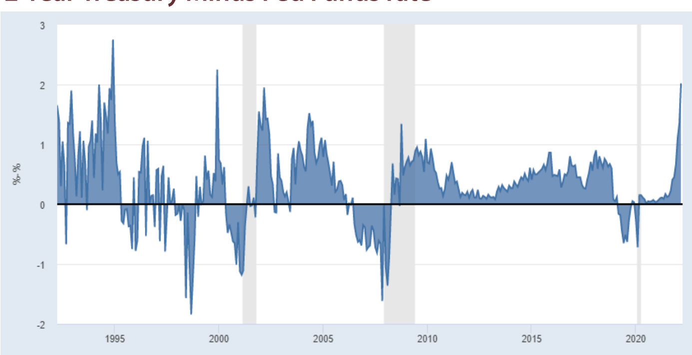
Portfolio Performance

This was an atypical quarter in which both stocks and bonds produced negative returns. In fact, it is only the 2nd time in the past 53 quarters this has occurred. In short, both asset classes were impacted by the hawkish change in Fed policy. Bond prices fell on the rise of interest rates, while stocks fell on the speculative consequences of higher interest rates.

U.S. stocks performed admirably well given the headwinds presented this quarter, declining 4.6%, if judged by the S&P 500 Index. Perhaps surprising to some, the S&P 500's lowest point this quarter was the market's open on the morning Russia invaded Ukraine. Stocks rallied more than 10% after the invasion. Our modest tilt towards high-quality value within our portfolios continues to reward, as that investment style has outperformed low-quality growth in 13 of the past 14 months. Stocks possess a track record of providing long-term positive real returns superior to other major asset classes for investors who can handle their short-run volatility.

Bonds had a miserable quarter by their standards, with the broad index falling 6%. To put that in perspective, the largest calendar year decline on record for the Bloomberg Barclays Index dating back to its 1977 inception was the 2.9% decline in 1994 during Greenspan's before-mentioned rate hike campaign. Our shorter duration within bonds helped mitigate some of the decline, but losses were broad based across all fixed income sectors.

2-Year Treasury Minus Fed Funds rate

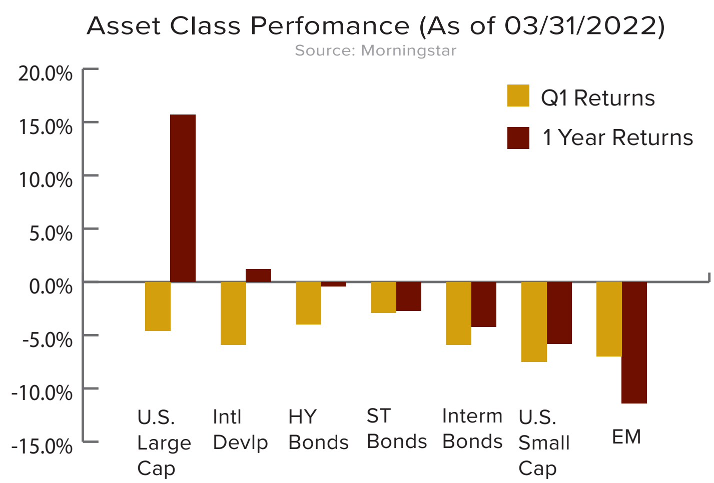


Source: Federal Reserve Bank of St. Louis

The outlook for bond returns remains limited, but we can offer a case that their prospects are improving. First, as can be seen in the chart above, the spread between 2-Year Treasuries and the Fed Funds rate is now 2%; indicating that bond yields have already priced in eight Fed hikes. Using history as a guide, this spread is near its highs of the last 30 years, meaning most of the price damage from Fed rate hikes has likely already been felt. Second, after years of income parity, bond yields are now roughly a full percent higher than S&P 500 dividend yields. Finally, with recession risks rising, bonds remain the best ballast to an equity market drawdown. While the continuation of rising rates seems likely, it is far from a certainty, and bonds once again experienced a flight to safety during the brief period this quarter in which stocks reached a 10% drawdown.

Amid the uncertainties and changing economic environment, we added real assets exposure this quarter to discretionary portfolios. While this addition was more of an embrace of diversification as a risk-management tool than a market call, it does recognize the potential for an elevated level of sustained inflation above the Fed's 2% target. The Fund we are utilizing has four distinct exposures to real assets: private infrastructure, private farmland, private timberland and public real assets. We believe this gives us a broad allocation to income-producing physical assets with built-in inflation protection and resilience to economic cycles.

On a final note, this quarter gave us the first meaningful opportunity in two years to accelerate dollar-cost averaging schedules and harvest tax losses in taxable accounts. Our experience has proven that making rules-based and disciplined decisions is extremely important to achieving long-term goals. We thank you for your partnership; please contact our team with any questions or needs.



INTERNATIONAL RETURNS (%)

As of 03/31/2022	Q1 2022	1-Year	3-Year	5-Year	10-Year
Int'l Developed ex US	-5.9	1.2	7.8	6.7	6.3
Emerging Markets	-7.0	-11.4	4.9	6.0	3.4

Source: Morningstar

FIXED INCOME RETURNS (%)

As of 03/31/2022	Q1 2022	1-Year	3-Year	5-Year	10-Year
Aggregate Bond	-5.9	-4.2	1.7	2.1	2.2
Muni	-5.7	-4.0	1.4	2.1	2.3
Int'l Bonds	-5.2	-6.1	0.4	1.2	0.6
High-Yield	-4.0	-0.4	3.9	3.9	4.8
Short-Term	-2.9	-2.7	1.4	1.6	1.5
90-Day T-Bill	0.1	0.1	0.7	1.1	0.6

Source: Morningstar

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