



Investment Insights Monthly

From The Desk of Bill Hornbarger, Chief Investment Officer

February 2023



Would You Rather Be Generally Correct or Precisely Wrong?

Q: *How do you know when you are diversified?*

A: *When you are always unhappy with the performance of a portion of your portfolio.*

The period spanning late 2008 until early 2022 was such a unique time for investors. It started in the Global Financial Crisis, with 0% interest rate policy, and remained that way until 2015, with the target Fed Funds Rate again falling to 0% in March 2020 and staying there until last year. Aided by the strong tailwinds of global quantitative easing and ZIRP (zero percent interest rate policy), equities staged a powerful and sustained rally with intermittent periods of weakness including an “almost” bear market in late 2018 and the Covid-19 bear market in early 2020.

From the bottom in March of 2009, the S&P 500 rallied more than 4,120 points to its peak in early 2022. One of the most definitive characteristics of that rally was the pronounced outperformance of U.S. large cap stocks (particularly growth), led by the mega cap tech names. Per Bloomberg, from the March 2009 lows to the January 2022 highs, the S&P 500 (U.S. large cap), the MSCI EAFE (international developed), and the Russell 2000 (U.S. small cap) returned 816%, 292%, and 685% respectively, while the tech-heavy NASDAQ had a total return of 1,345%.



With that persistent outperformance, many U.S. investors have reduced their exposure to – and in some cases, shunned completely – investments outside of U.S large cap growth. That was a winning strategy while interest rates and bond yields were declining, leading to expansion in price earnings multiples and a willingness to pay high multiples of earnings for innovation. However, as the interest rate and investing environment has changed, market leadership has also changed.

The chart below (often called a quilt chart) shows various asset class returns year-by-year in descending order for the past decade (see below chart for representative index descriptions). Domestic large cap growth was ranked first

three separate years, it was the leader for the 10-year period, and it was in the top three spots 70% of the time. Real estate securities (REITs) were next, with three top-spot finishes, and cash, managed futures, and emerging equities each finished on top once. However, last year, as the Federal Reserve embarked on a path of raising interest rates, large cap growth suffered a last place finish.

Over the timeframe captured in the quilt chart, there was a single year in which every referenced asset class “worked” showing very strong performance (2016) while 2022 was a year in which very few asset classes/strategies generated positive returns.

The Importance of Diversification

Annual returns of various asset classes

2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	10 Yr Avg
Real Estate Securities 20.1%	Small-Cap Stocks 41.3%	Real Estate Securities 27.2%	Large-Cap Growth 5.7%	Small-Cap Stocks 26.6%	Emerging Markets 37.3%	Cash 1.9%	Large-Cap Growth 36.4%	Large-Cap Growth 38.5%	Real Estate Securities 39.9%	Managed Futures 22.1%	Large-Cap Growth 16.1%
Emerging Markets 18.2%	Large-Cap Growth 33.5%	Managed Futures 15.8%	Managed Futures 3.6%	Mid-Cap Stocks 20.7%	Large-Cap Growth 30.2%	Govt./Corp. Bonds -0.4%	S&P 500 Index 31.5%	S&P 500 Index 18.4%	S&P 500 Index 28.7%	Cash 1.5%	S&P 500 Index 13.9%
Mid-Cap Stocks 17.9%	Mid-Cap Stocks 33.5%	S&P 500 Index 13.7%	Real Estate Securities 2.3%	Large-Cap Value 17.3%	International Stocks 25.0%	Large-Cap Growth -1.5%	Real Estate Securities 28.1%	Emerging Markets 18.3%	Large-Cap Growth 27.6%	Large-Cap Value -7.5%	Small-Cap Stocks 12.5%
Large-Cap Value 17.5%	Large-Cap Value 32.2%	Large-Cap Value 13.2%	S&P 500 Index 1.4%	S&P 500 Index 12.0%	S&P 500 Index 2.8%	Real Estate Securities -4.1%	Large-Cap Value 26.5%	Mid-Cap Stocks 13.7%	Small-Cap Stocks 26.8%	Equal Weight Blend -12.1%	Mid-Cap Stocks 12.4%
International Stocks 17.3%	S&P 500 Index 32.4%	Large-Cap Growth 13.1%	Govt./Corp. Bonds 0.2%	Emerging Markets 11.2%	Mid-Cap Stocks 16.2%	Managed Futures -4.4%	Mid-Cap Stocks 26.2%	Small-Cap Stocks 11.3%	Large-Cap Value 25.2%	Mid-Cap Stocks -13.1%	Large-Cap Value 11.7.2%
Small-Cap Stocks 16.3%	International Stocks 22.8%	Mid-Cap Stocks 9.8%	Cash 0.1%	Equal Weight Blend 10.3%	Equal Weight Blend 15.4%	S&P 500 Index -4.4%	Small-Cap Stocks 22.8%	Equal Weight Blend 10.6%	Mid-Cap Stocks 24.8%	Govt./Corp. Bonds -13.6%	Real Estate Securities 9.5%
S&P 500 Index 16.0%	Equal Weight Blend 18.3%	Equal Weight Blend 8.9%	International Stocks -0.8%	Real Estate Securities 9.3%	Large-Cap Value 13.7%	Equal Weight Blend -6.7%	International Stocks 22.0%	Govt./Corp. Bonds 8.9%	Equal Weight Blend 17.0%	International Stocks -14.5%	Equal Weight Blend 8.5%
Large-Cap Growth 15.3%	Managed Futures 7.5%	Govt./Corp. Bonds 6.0%	Equal Weight Blend -1.0%	Large-Cap Growth 7.1%	Small-Cap Stocks 13.2%	Large-Cap Value -8.3%	Equal Weight Blend 19.9%	International Stocks 7.8%	International Stocks 11.3%	Small-Cap Stocks -16.1%	International Stocks 6.5%
Equal Weight Blend 12.3%	Real Estate Securities 3.2%	Small-Cap Stocks 5.8%	Small-Cap Stocks -2.0%	Managed Futures 4.2%	Real Estate Securities 9.3%	Small-Cap Stocks -8.5%	Emerging Markets 18.4%	Large-Cap Value 2.8%	Managed Futures 7.5%	S&P 500 Index -18.1%	Emerging Markets 4.0%
Govt./Corp. Bonds 4.8%	Cash 0.1%	Cash 0.0%	Mid-Cap Stocks -2.2%	Govt./Corp. Bonds 3.1%	Govt./Corp. Bonds 4.0%	Mid-Cap Stocks -11.1%	Govt./Corp. Bonds 9.7%	Managed Futures 1.8%	Cash 0.1%	Emerging Markets -20.1%	Managed Futures 3.9%
Cash 0.1%	Govt./Corp. Bonds -2.4%	Emerging Markets -2.2%	Large-Cap Value -3.8%	International Stocks 1.0%	Cash 0.9%	International Stocks -16.1%	Cash 2.3%	Cash 0.7%	Govt./Corp. Bonds -1.8%	Real Estate Securities -25.1%	Govt./Corp. Bonds 1.7%
Managed Futures -8.0%	Emerging Markets -2.6%	International Stocks -4.9%	Emerging Markets -14.9%	Cash 0.3%	Managed Futures -2.3%	Emerging Markets -16.6%	Managed Futures -4.6%	Real Estate Securities -5.6%	Emerging Markets -2.5%	Large-Cap Growth -29.1%	Cash 0.7%

Source: Benjamin F. Edwards

- ICE BofA U.S. Three-Month U.S. Treasury Bill Index
- Credit Suisse Managed Futures Liquid Index
- Barclays Capital U.S. Govt./Credit Bond Index
- Russell 1000 Growth Index
- Russell 1000 Value Index
- S&P SmallCap 600
- S&P MidCap 400
- S&P 500
- NAREIT Index
- MSCI EAFE
- MSCI Emerging Markets Index
- Asset Class Blend



We recently completed our annual update to our Capital Market Assumptions (CMAs) which is a long-term estimate (7 to 10 years) of forward returns. Our work suggests that we have entered a different inflation and interest rate regime. The last 10 plus years have featured generally declining inflation and interest rates. While we don't look for a return to the days of double-digit bond yields and inflation, we do think the next 10 years will feature higher inflation and bond yields than what many investors have become accustomed to.

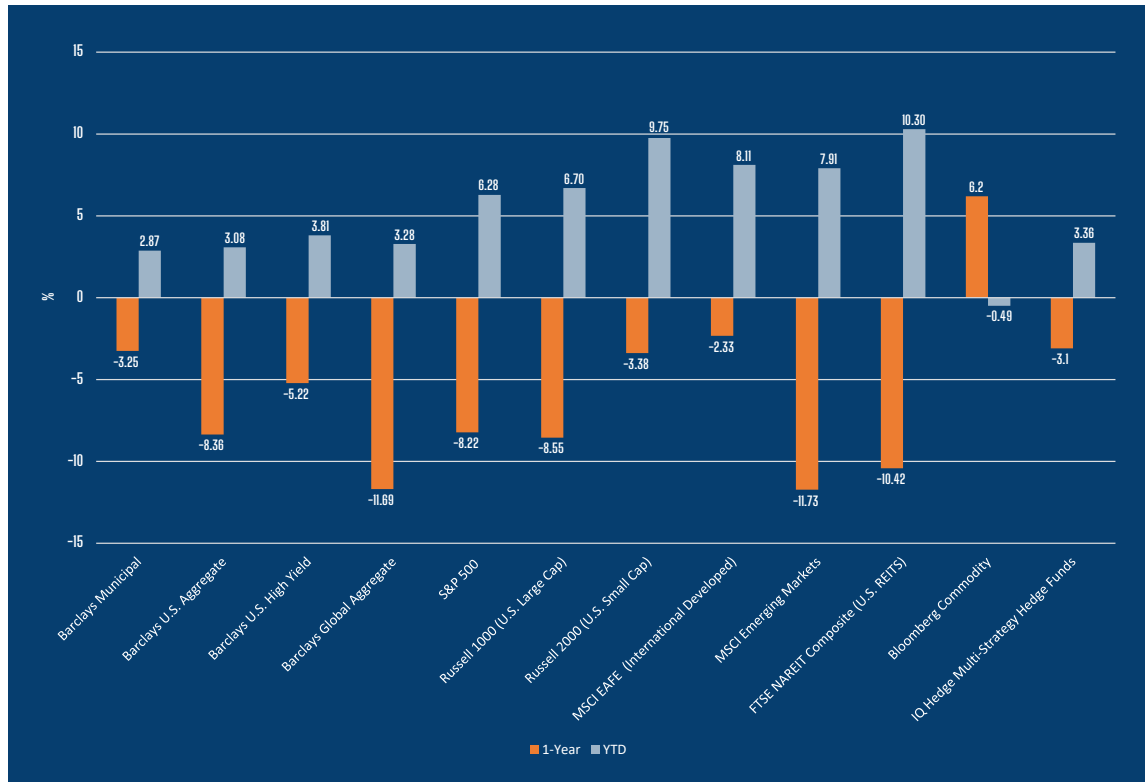
That environment, coupled with differences in valuations, leaves us to believe that market leadership could also change. Growth stocks and momentum have been in style for much of the last decade, as exhibited by their returns relative to other asset classes and strategies. Going forward, we would advocate for a more diversified portfolio, with exposure to a mix of value and growth across the capitalization spectrum. We also believe that international equities (developed

and emerging markets) warrant serious consideration. International lagged over the trailing decade, with the strong U.S. currency providing a significant headwind.

After the last decade, our experience is that many investors are overweight domestic large cap growth and have become conditioned to believe it is the "best" investment. The quality of the balance sheets of those companies is desirable, but with the changes in the investing environment, we believe there are going to be opportunities in other sectors of the markets. For domestic investors, U.S. large cap is likely going to be the largest equity weighting (our asset allocation models reflect that), but we don't want to own it (and specifically high growth tech names) exclusively. Diversification is a risk management tool and, more importantly, we think other areas of the markets are poised to provide better relative returns (to U.S. large cap growth) than they have over the past decade.



Asset Class Returns as of January 31, 2023
Comparing Recent 1-Year and Year-to-Date Total Returns



Source: Morningstar

Fixed Income

- Yields fell sharply across the globe, providing a nice backdrop for fixed income.
- Core fixed income and municipals gained ground while spreads tightened in riskier credit.
- U.S. dollar weakness provided another significant boost for non-U.S. assets.
- After a terrible, outlier year for bonds in 2022, 2023 is off to a much better start.

Equities

- Equities and other risk assets were off to the races as the calendar flipped to January.
- U.S. equities rose across all areas, led by tech/growth stocks and small caps.
- Growth beat value, and small caps generally outperformed large caps.
- Non-U.S. equities gained 7-8% in January with solid performance from all regions.
- Europe drove gains in the EAFE Index, and China powered the Emerging Market Index higher.
- Small caps lagged large caps outside the U.S.
- U.S. dollar weakness added 180 basis points to EAFE returns and 136 bps for emerging market returns.



January 31, 2023	MTD	QTD	YTD	1-Year	3-Year	5-Year	10-Year
Fixed Income Indices							
Barclays U.S. Treasury Bill 1-3 Month	0.34%	0.34%	0.34%	1.86%	0.77%	1.27%	0.76%
Barclays Municipal	2.87%	2.87%	2.87%	-3.25%	-0.42%	2.07%	2.38%
BBgBarc U.S. Govt/Credit Intermediate	0.80%	0.80%	0.80%	-2.21%	-0.23%	1.14%	0.96%
Barclays U.S. Aggregate	3.08%	3.08%	3.08%	-8.36%	-2.35%	0.86%	1.43%
Barclays U.S. High Yield	3.81%	3.81%	3.81%	-5.22%	1.29%	2.96%	4.28%
S&P/LSTA Leveraged Loan	2.73%	2.73%	2.73%	1.75%	3.28%	3.67%	3.84%
Barclays Global Aggregate	3.28%	3.28%	3.28%	-11.69%	-3.85%	-1.25%	-0.03%
JPM GBI EM Global Diversified	4.29%	4.29%	4.29%	-7.89%	-4.38%	-2.54%	-1.69%
U.S. Equity Indices							
DJ Industrial Average	2.93%	2.93%	2.93%	-0.92%	8.68%	7.77%	11.98%
S&P 500	6.28%	6.28%	6.28%	-8.22%	9.88%	9.54%	12.68%
NASDAQ Composite (Price)	10.68%	10.68%	10.68%	-18.65%	8.18%	9.34%	13.94%
Russell 1000	6.70%	6.70%	6.70%	-8.55%	9.66%	9.38%	12.51%
Russell 1000 Growth	8.33%	8.33%	8.33%	-16.02%	9.89%	11.22%	14.53%
Russell 1000 Value	5.18%	5.18%	5.18%	-0.43%	8.54%	6.94%	10.15%
Russell Mid Cap	8.30%	8.30%	8.30%	-3.33%	9.02%	8.02%	11.11%
Russell 2500	10.00%	10.00%	10.00%	-2.05%	9.13%	7.28%	10.35%
Russell 2000	9.75%	9.75%	9.75%	-3.38%	7.51%	5.54%	9.36%
Russell 2000 Growth	9.95%	9.95%	9.95%	-6.50%	4.26%	4.68%	9.54%
Russell 2000 Value	9.54%	9.54%	9.54%	-0.52%	9.94%	5.78%	8.84%
Non-U.S. Equity Indices							
MSCI World	7.10%	7.10%	7.10%	-6.99%	8.10%	7.05%	9.64%
MSCI ACWI	7.19%	7.19%	7.19%	-7.54%	7.33%	6.06%	8.80%
MSCI ACWI Ex-U.S.	8.13%	8.13%	8.13%	-5.22%	4.12%	1.85%	4.68%
MSCI EAFE	8.11%	8.11%	8.11%	-2.33%	4.74%	2.63%	5.44%
MSCI EAFE Growth	8.50%	8.50%	8.50%	-6.28%	3.76%	3.60%	6.35%
MSCI EAFE Value	7.74%	7.74%	7.74%	1.34%	5.09%	1.23%	4.28%
MSCI Europe	8.69%	8.69%	8.69%	-2.65%	5.69%	3.11%	5.47%
MSCI Japan	6.22%	6.22%	6.22%	-6.35%	1.85%	0.91%	6.15%
MSCI AC Asia	7.50%	7.50%	7.50%	-8.67%	2.49%	0.24%	5.27%
MSCI EAFE Small Cap	7.47%	7.47%	7.47%	-8.42%	2.88%	0.79%	6.82%
MSCI ACWI Ex-U.S. Small Cap	7.21%	7.21%	7.21%	-8.03%	4.98%	1.52%	5.93%
MSCI Emerging Markets	7.91%	7.91%	7.91%	-11.73%	1.77%	-1.11%	2.45%
MSCI EM Asia	8.64%	8.64%	8.64%	-10.81%	3.38%	-0.17%	4.66%
MSCI China	11.78%	11.78%	11.78%	-9.93%	-2.28%	-4.52%	3.35%
MSCI EM Eastern Europe	8.18%	8.18%	8.18%	-79.22%	-40.31%	-24.78%	-12.67%
MSCI EM Latin America	9.90%	9.90%	9.90%	12.08%	0.57%	-1.27%	-1.24%
MSCI EM Small Cap	5.94%	5.94%	5.94%	-8.61%	9.12%	1.52%	3.91%
MSCI Frontier Markets	4.50%	4.50%	4.50%	-19.90%	-1.91%	-2.42%	3.29%
Hedge Fund Indices							
IQ Hedge Long/Short	3.39%	3.39%	3.39%	-6.32%	2.54%	2.41%	--
IQ Hedge Multi-Strategy	3.36%	3.36%	3.36%	-3.10%	0.60%	1.04%	2.50%
Real Assets Indices							
FTSE NAREIT Composite	10.30%	10.30%	10.30%	-10.42%	2.40%	6.73%	7.40%
Alerian MLP	6.61%	6.61%	6.61%	25.66%	13.91%	4.24%	1.43%
Bloomberg Commodity	-0.49%	-0.49%	-0.49%	6.20%	15.37%	5.92%	-1.57%
S&P Global Infrastructure	5.04%	5.04%	5.04%	5.91%	2.84%	4.66%	6.71%
Other							
Oil Price Brent Crude	-1.18%	-1.18%	-1.18%	-5.70%	13.35%	4.23%	-2.96%
CBOE Market Volatility (VIX)	-10.48%	-10.48%	-10.48%	-21.87%	0.98%	7.46%	3.11%

Source: Morningstar



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