

BCM 4Q22 Market & Strategy Commentary: Decathlon Aspect

Entering the Year Cautiously Contrarian: Considerations of Key Market Levers and Emerging Opportunities

By the BCM Investment Team

What a difference a year makes. In hindsight, the markets entered 2022 on an unstable precipice. Conversely, 2023 is beginning to look like a valley, with much of the prior excesses already stamped out in a painful 2022 for investors.

Stock Market	2021	2022	Change	Economy	2021	2022	Change
S&P 500 P/E Trailing	22.7	17.5	-22.9%	Fed Funds Rate	0.08%	4.33%	4.25%
S&P 500 Trailing 1 Year Performance	28.7%	-18.5%	-47.2%	10 Year Treasury	1.51%	3.87%	2.36%
3 Year	26.0%	7.5%	-18.5%	30 Year Mortgage 2021 Low vs. 2022 High	2.83%	7.32%	4.49%
5 Year	18.4%	9.4%	-9.0%	Nominal GDP Growth Q3 2022	10.2%	9.2%	-1.0%
ACWI P/E Trailing	21.6	15.6	-27.8%	Real GDP Growth Q3 2022	5.0%	1.9%	-3.1%
ACWI Trailing 1 Year Performance	19.1%	-18.0%	-37.0%	Inflation High	7.0%	9.1%	2.1%
3 Year	21.0%	4.4%	-16.6%	Inflation Low	1.4%	7.1%	5.7%
5 Year	15.0%	5.8%	-9.2%	Crude Oil Current	\$77	\$79	2.1%
S&P 500 Profit Margin	13.1%	11.1%	-2.1%	Crude Oil High	\$85	\$124	46.1%
VIX (average)	19.63	25.55	5.9%				
AGG Return	-1.77%	-13.02%	-11.3%	Other	2021	2022	Change
# of IPOs	2436	1333	-45.3%	Daily Global Covid Cases at Year End	2,040,940	317,959	-84%
IPO Proceeds (\$B)	\$459.9	\$179.5	-61.0%	Bitcoin Price 2021 High to 2022 Current	\$67,734	\$16,579	-76%
# of Trillion Dollar Companies	7	4	-3	Sam Bankman Fried Net Worth	\$15 to \$20B	\$0	-100%

2022 was an incredibly challenging investment environment. Although prospective investment returns look positive, the investment environment remains fraught. Global economic conditions are weakening, Central Bankers remain inflation obsessed, a war rages on in Ukraine and the world's second largest economy re-opened in earnest despite medical missteps. If we are indeed headed for a recession, it may be the most anticipated in history.

Market participants seem steeled for worse to come. We believe the investment environment is significantly risk-averse, returns are battered across virtually every asset class, investor sentiment is depressed, and hedging is widespread. On the corporate front, CEOs are taking decisive preventative measures in anticipation of falling demand. This caution is a positive for both the economy and investors as it reduces the likelihood of businesses blindly misallocating resources and building overcapacity, resulting in a deeper and longer economic contraction.

Entering the year (again) as contrarians. While our quantitative systems entered 2022 signaling caution, in this "prepared" and risk-averse environment, our systems are relatively contrarian once again, this time seeing favorable shorter-term risk-reward across a broad range of sectors. As a result, we begin 2023 with our Decathlon strategies near the high end of their equity exposure range at each risk level (Conservative, Moderate, Growth). Our bottom-up fundamental view is also constructive. Favorite contrarian sectors include Semiconductors and Homebuilding, but our systems see opportunity across a relatively diverse set of sectors.

However, continuing uncertainties temper our short-term outlook with some caution. None of this is to say we enter 2023 absent risk—it is still unclear whether the Fed's aggressive interest rate hikes may have some unforeseen consequences or if they are actually as adamant about increasing unemployment as they imply. If some asset class or business was to "break" from the fallout, we would expect further market turmoil and would try to respond quickly.

Over the long term, we remain optimistic that technological innovation will continue to drive growth.

While the focus is currently on the short-term economic outlook, in the long run economic prosperity is driven by innovation, not simply the tempering of economic cycles. We’ve enjoyed several decades of low inflation and rising quality of life from serial innovations in technology. First the personal computer empowered us, then the internet connected us to the world’s information, and most recently the mobile smartphone enabled us to access all this knowledge and transact at any place and time. Perhaps a new form-factor on the path towards further connectivity and integration with computers will emerge. The internet of things (smart appliances of all kinds), wearable healthcare, biological “programming” or the integration of useful artificial intelligence might be the next steps in this evolution.

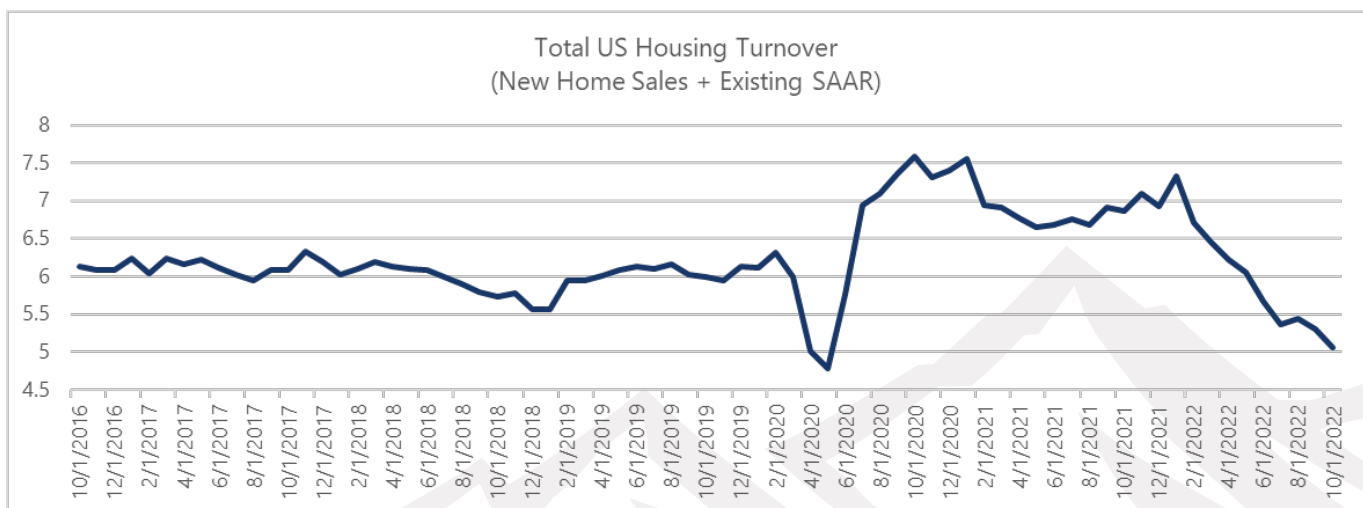
On the Fed, Inflation and Interest Rates:

The modern world economy is an incredibly quick problem solver, likely far more adaptive than that of the 1970s.

- An increasingly digitized and interconnected economy can adapt quickly.
- Despite anti-globalist and onshoring rhetoric, we’ve seen some impressive Global coordination:
 - Within 9 months of being declared a pandemic, the world sequenced Covid-19 and developed tremendously effective mRNA vaccines.
 - After Russia’s invasion of Ukraine, the European economies innovatively sourced enough natural gas to completely fill storage for Winter 2022-23 and replace Russian sources. In this same vein, consider the coordinated response to the Russian invasion and Ukraine’s clever and efficient use of weapons to withstand and push back the Russian invaders.
- We expect the modern economy to continue to solve the recent inflation problem without potentially harmful Central Bank intervention.

Most inflation, aside from wages, appears to be transitory.

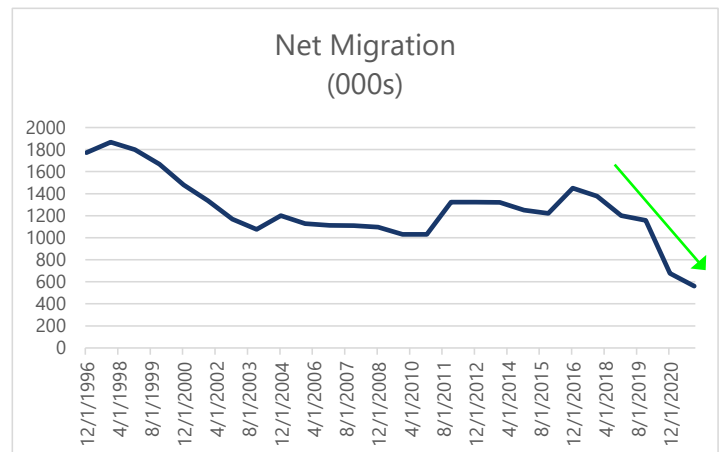
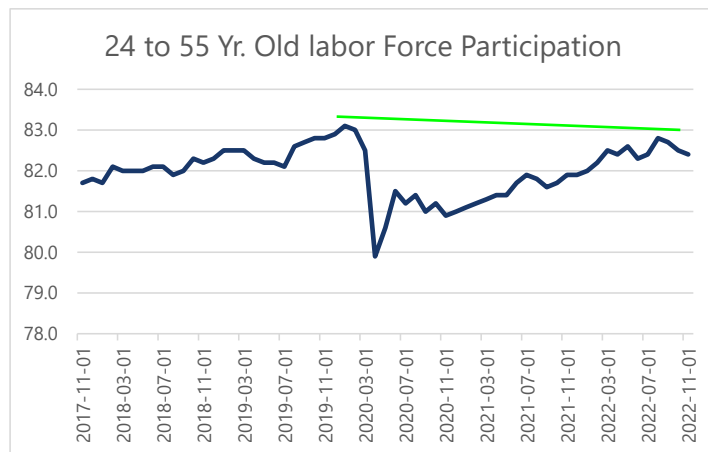
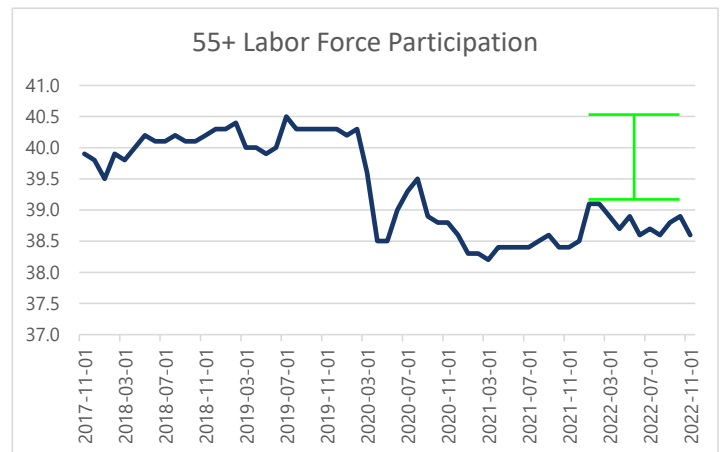
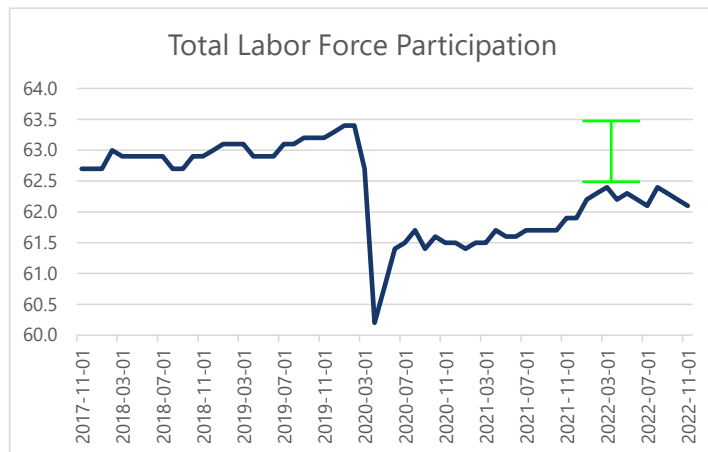
- Energy prices have dropped dramatically.¹
- Shipping rates and Covid-related supply-chain bottlenecks have been solved.²
- Food prices are temporarily disrupted by weather and Ukraine.
- Thanks to the Central Banks’ rate hikes, any sectors that require credit financing such as housing and automobiles³ have seen sharp declines in demand.



Source: Bloomberg, Data from 10/31/16 to 10/31/22

The labor market has structurally changed and the solution isn't higher interest rates.

- The Covid-19 lockdowns and the work-from-home technological revolution revealed the tradeoffs of office work and the new life-enhancing possibilities of more flexible work-from-home arrangements.
- Financially secure Baby-Boomers have chosen to age out of the workforce while net immigration into the U.S. continues at depressed levels—due to Covid-19 restrictions—limiting the supply of workers in many service industries.
- The result is a large shortfall in the overall supply of labor, not excessive demand for labor which interest rates might curb.⁴



Source:For Labor Force Participation, FRED data from 11/1/2017 to 11/1/2022 by quarter. For Net Migration, Bloomberg with annual numbers from 1996 to 2021.

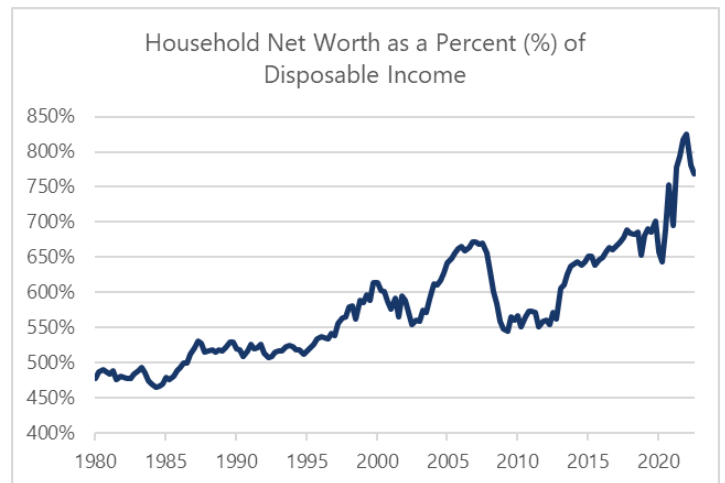
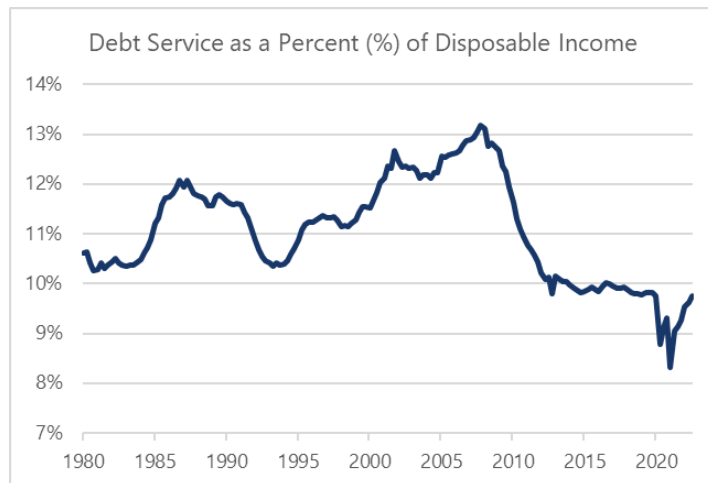
We expect Central Bankers will soon recognize they have played the part of an impatient doctor – continuing to over-dose their seemingly unresponsive “patient” with interest rate hikes.

- The FED's successive interest rate hikes haven't had the intended effect of slowing wage inflation.
- They have caused immediate and worrisome adverse effects on other important sectors, particularly housing-related and real estate.
 - Housing turnover has skidded to a near halt, causing a dramatic recession in real estate, mortgage origination, home furnishings and construction trades. Heretofore, this same Federal Reserve would be racing to rescue the crucial sector.
 - In another strange twist, existing homeowners have been spared from the pain of higher interest rates, as just about everyone refinanced their mortgage far below prevailing rates.

On the Economy:

We believe the prospective recession of 2023 may look very different than those of the past.

- It would likely be self-inflicted, rather than forced through a major misallocation of resources and accumulation of bad debt.
- Neither Consumers nor Businesses are encumbered with debt. Only the Federal government has accumulated large amounts of debt from the Covid response.⁵ Setting aside the potential future tax obligation, interest expense is historically low as a percentage of disposable income, and household wealth remains high which should add resilience.



Source: FRED database 1/1/1980 through 7/1/2022 by quarter.

Nearly every industry that experienced a surge in growth during Covid-19 has reverted towards trend. Most have already taken steps to correct these errors.

- Many businesses falsely read the changes in demand as permanent and, subsequently, over-invested in human resources and inventory. It wasn't just startups like Peloton, DoorDash and Shopify, but some of the best growth companies in the world including Amazon, Google, and Target.
- We expect many of these companies to resume their successful growth after they digest the excesses and recalibrate their trajectory. Amazon, Apple, Google, Meta and Microsoft all are meaningfully reducing staff or limiting growth to selective areas, as are young gig-economy companies, like Lyft, DoorDash and Shopify.
- In some cases, these mis-calibrations are likely to present healthy businesses with attractive M&A opportunities as otherwise valuable businesses struggle to find capital to internally fund their operations.

On Innovation:

The recent Electric Vehicle bubble is reminiscent of the dot.com bubble.

- The recent fall from grace of Tesla's high-flying stock price⁶ and the whole electric vehicle sector is reminiscent of the ending of the dot.com stock bubble.
- In hindsight, after the dot.com share prices collapsed, there was somewhat of a "golden age" for the leading internet companies with truly revolutionary products, like Amazon.com, E-Bay, and Google.
- By analogy, with all sorts of innovative electrical vehicles on the horizon from both start-up and incumbent auto manufacturers, we might be beginning a great period for "electrification" investments, and perhaps electric vehicles will evolve into "smart cars" with unanticipated capabilities in the same way the cellphone became the smartphone.

In healthcare, the “War on Covid-19” catalyzed many innovations.

- Certainly, mRNA technology has many exciting applications.
- Also on the healthcare front, breakthrough medicines from Novo Nordisk and Eli Lilly originally developed to treat diabetes appear to have extraordinary potential as weight-loss medications. Obesity is a common underlying factor of many life-shortening healthcare problems and affects quality of life. The new medicines might quickly become the biggest sellers and most impactful of all-time.

AI and Deep Learning technologies are reaching a consumer-facing stage.

- Microsoft recently announced a \$10B investment into Open AI after their Chatbot ChatGPT reached over one million users in online beta testing.⁷
- It is likely AI will augment humans and potentially increase productivity in unforeseeable ways in the near future.

Looking Ahead:

Asset markets are forward-looking discount mechanisms. In a potential reverse of 2022—when the economy held up while asset prices fell in anticipation of weaker economic conditions—economic conditions are likely to further deteriorate into 2023, and yet attractive investment opportunities may emerge.

While both our fundamental view and quantitative models are currently constructive on risk, we acknowledge that it may be seductive to chase risk after a poor year for all assets while the environment remains very uncertain. Lower risk assets like fixed income may also be attractive given their higher yields. Acting nimbly is likely to be more beneficial than simply increasing risk.

As always, we thank you for your business and trust, and we look forward to navigating these ever-shifting market environments.

Beaumont Capital Management (BCM) Strategy Commentary

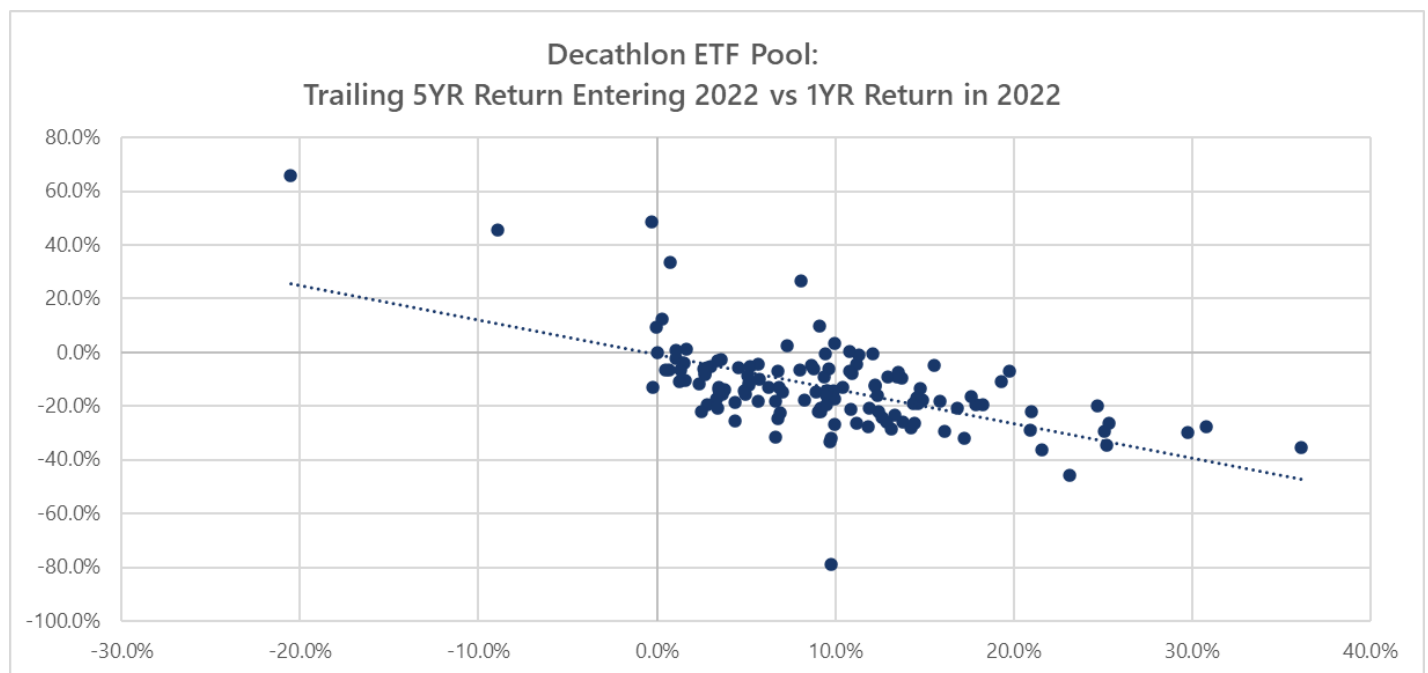
BCM Decathlon Aspect Strategies

Asset markets continued to rebound in the fourth quarter with both stocks and bonds ultimately rising despite a poor end to the year. All three risk profiles (Conservative-Profile 1, Moderate-Profile 3, Growth-Profile 5) entered the quarter roughly in-line with their neutral risk level and added additional equity positions near the end of the year. While adding additional equity exposure as markets declined was uncomfortable, it has been a good decision so far as equities have rallied in the new year. We believe the portfolios contain unique collection of diversified equities giving us multiple ways to “win”. As last year progressed, the Decathlon system continued to digest the new information patterns of this unique environment and as a result, security selection within equities improved. Positions that we added to the portfolios later in the year, such as home construction and S&P dividend, have continued to realize strong performance relative to the broad equity markets.

The Decathlon quantitative system takes a psychological, risk-adjusted, probabilistic approach to asset allocation. It’s greatest contribution to performance may come when it is correctly contrarian--identifying favorable entry points in market declines or taking profits when markets are too enthusiastic for their own good. In the first case, which represents the current environment, the risks are highly publicized and well-reflected in asset prices, making for an attractive risk-reward ratio.

The major headwinds to performance during the quarter were interest rates and the U.S. Dollar, which both fell, reversing their price action from the previous quarter. Fixed income allocations in Profiles 1 and 3 generally have a lower duration and higher credit exposure than broad U.S. fixed income. The additional credit exposure was a positive contributor to performance, but it was not enough to offset the impact of lower portfolio duration. For most of the year the U.S. Dollar served as a “goldilocks” asset, rising steadily with low volatility, but this trend reversed in the fourth quarter. The falling U.S. Dollar provided a lift to all international assets making them relatively more attractive than U.S. assets which made up the majority of the portfolios.

While only time will tell if it is permanent, 2022 may have represented a “sea change” within the equity markets. Not only did the market leaders falter, but across our entire investment universe there was a strong inverse relationship between trailing 5-year returns of a security entering 2022 and that security’s performance in 2022. Our system capitalized on the strong performance of these market leaders in the past, but due to the long-term nature of these patterns, it can take time for the system to recognize long-term changes in leadership. Many of the most recent positions in our quantitative systems represent sectors we haven’t seen highly ranked often in the past, such as industrials and financials. If we are indeed in the midst of a sea change in leadership, our systems may also have learned to embrace the new environment.



For illustration purposes only.
Source: ETF data is from the 129 ETFs in the Decathlon pool from 12/31/16 through 12/31/2021 and 12/31/2021 through 12/31/2022.

BCM Decathlon Growth Aspect (Profile 5) – Prior Quarter Attribution

We expect the portfolio’s average asset allocation over time will be roughly 70% global equities and 30% fixed income, with significant variation over shorter periods due to the strategy’s opportunistic nature. At the end of the quarter the portfolio was allocated to 60% U.S. equity, 30% global equity, and 10% fixed income. The portfolio underperformed a 70% MSCI ACWI / 30% US Broad Market Index benchmark during the quarter.

What Helped:

- Maintaining a higher average allocation to equities, as equities outperformed fixed income
- The equities that we added near the end of the year performed relatively better than global equity markets

through the end of the year

- More value-oriented sectors that we added in the second half of the year, such as dividend stocks and home construction, continued to perform well during the quarter

What Hurt:

- Adding equities near the end of the quarter as equities performed poorly to end the year
- Limited exposure to international equities, which received a performance boost from the falling U.S. Dollar
- Continued exposure to growth equities, specifically the technology sector

Quarterly Attribution:

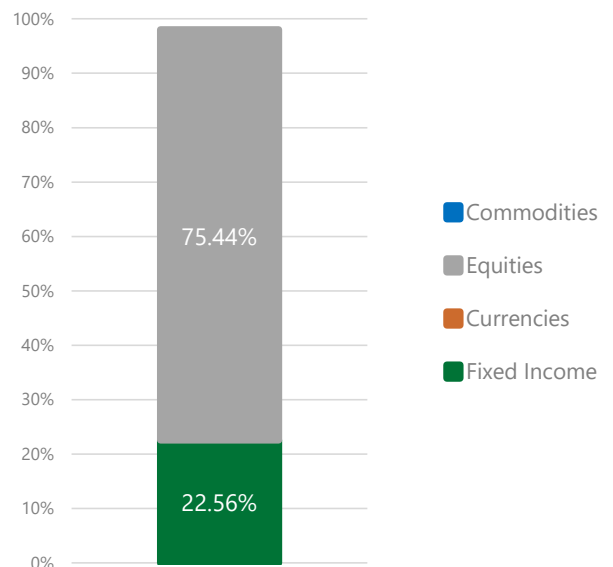
Top Performers

	Asset Class	% of Time Held
Home Construction	Equity	100%
Global Healthcare	Equity	50%
S&P Dividend	Equity	100%
North American Natural Resources	Equity	16%
U.S. Medical Devices	Equity	100%

Bottom Performers

	Asset Class	% of Time Held
Short-Term Treasuries	Fixed Income	50%
Convertible Bonds	Fixed Income	93%
U.S. Broker Dealers	Equity	50%
U.S. Technology	Equity	100%
U.S. Consumer Discretionary	Equity	50%

Average Asset Allocation



For the period 10/1/2022 through 12/31/2022. Please refer to the disclosure section for additional information. The top and bottom performers identified do not represent all of the securities purchased, sold, or recommended. The top and bottom performers were determined using model performance, including fund expenses and the reinvestment of dividends, of ETFs actually held in the portfolio but do not reflect actual trade timing or execution experienced by an investor.

For up-to-date strategy performance please visit [eWealthManager > Investments > Strategies > Beaumont Decathlon Aspect > click on the "Performance" tab right below the commentary tab on eWealthManager.](#)

BCM Decathlon Moderate Aspect (Profile 3) – Prior Quarter Attribution

We expect the portfolio's average asset allocation over time will be roughly 50% global equities and 50% fixed income, with significant variation over shorter periods due to the strategy's opportunistic nature. At the end of the quarter the portfolio was allocated to 50% U.S. equity, 30% fixed income, and 20% global equity. The portfolio underperformed a 50% MSCI ACWI / 50% US Broad Market Index benchmark during the quarter.

What Helped:

- Exposure to convertible bonds, which resulted in a higher equity market sensitivity than the portfolio's asset

allocation would suggest

- The equities that we added near the end of the year performed relatively better than global equity markets through the end of the year
- More value-oriented sectors that we added in the second half of the year, specifically dividend stocks, continued to perform well during the quarter

What Hurt:

- Adding equities near the end of the quarter as equities performed poorly to end the year
- Limited exposure to international equities, which received a performance boost from the falling U.S. Dollar
- Continued exposure to growth equities, specifically the technology sector

Quarterly Attribution:

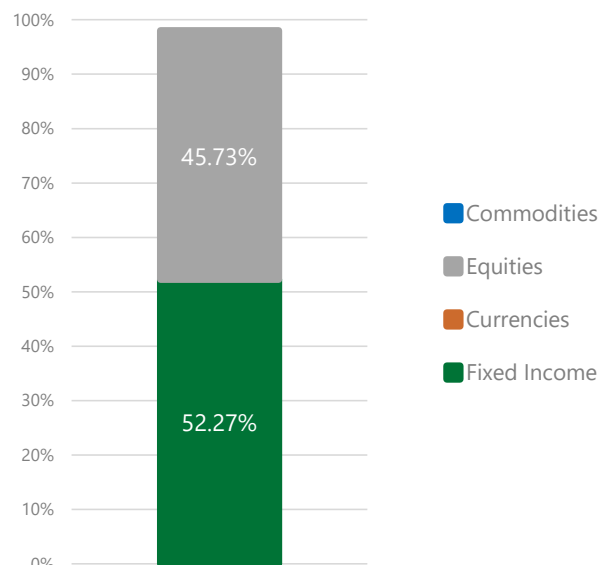
Top Performers

	Asset Class	% of Time Held
S&P Dividend	Equity	100%
Convertible Bonds	Fixed Income	84%
Semiconductors	Equity	100%
Home Construction	Equity	16%
Global Healthcare	Equity	16%

Bottom Performers

	Asset Class	% of Time Held
Limited Term Bond	Fixed Income	50%
Short-Term Treasuries	Fixed Income	70%
U.S. Broker Dealers	Equity	50%
U.S. Technology	Equity	100%
1 – 3 Year Treasuries	Fixed Income	84%

Average Asset Allocation



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BCM Decathlon Conservative Aspect (Profile 1) – Prior Quarter Attribution

We expect the portfolio’s average asset allocation over time will be roughly 20% global equities and 80% fixed income, with variation over shorter periods due to the strategy’s opportunistic nature. At the end of the quarter the portfolio was allocated to 70% fixed income, 10% U.S. equity, 10% global equity, and 10% currency. The portfolio underperformed a 20% MSCI ACWI / 80% US Broad Market Index benchmark during the quarter.

What Helped:

- Selling the technology sector in November, after a strong start to the quarter
- The equity position that we added near the end of the year performed relatively better than global equity markets through the end of the year
- Exposure to high yield bonds as credit spreads tightened during the quarter

What Hurt:

- Adding equities near the end of the quarter as equities performed poorly to end the year
- The U.S. Dollar fell during the quarter, reversing its strong performance from the third quarter
- Holding more short-term bonds as interest rates generally fell during the quarter

Quarterly Attribution:

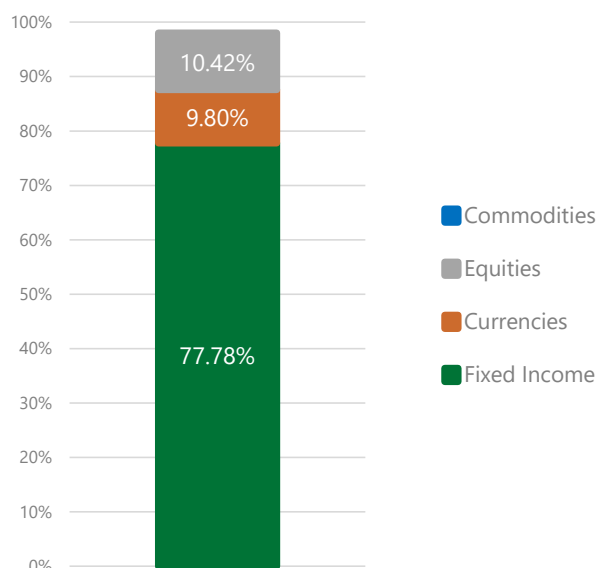
Top Performers

	Asset Class	% of Time Held
Short-Term High Yield	Fixed Income	100%
Global Healthcare	Equity	16%
U.S. Technology	Equity	50%
MBS	Fixed Income	60%
Enhanced Yield Agg.	Fixed Income	6%

Bottom Performers

	Asset Class	% of Time Held
Agency Bond	Fixed Income	100%
Short-Term Treasuries	Fixed Income	100%
1 -3 Year Treasuries	Fixed Income	100%
U.S. Broker Dealers	Equity	39%
Convertible Bonds	Fixed Income	93%

Average Asset Allocation



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Sources and Disclosures

¹Crude oil fell from a high of \$123 in March to a price of \$77 on 12/31/2022. Source: Bloomberg

²The Baltic dry index, a measure of the cost of ocean freight has declined 55% from its highs in May. Source: Bloomberg³Federal Reserve Bank of St. Louis, Federal Funds Rate from 1/1/2022 through 9/30/2022

³The Manheim US Used Vehicle Value Index has fallen 14.9% year-over-year through December 2022. Source: Bloomberg

⁴The Federal Reserve has hiked rates at the most aggressive pace in history starting in April, yet the U.S. economy didn't have as many people employed as Pre-Covid until August.

⁵Government debt increased \$5 Trillion or roughly \$16,000 per capita

⁶Tesla's stock price reached a high of \$409.97 on 11/4/21 and closed 2022 at \$123.18 a decline of 70%. Source: Bloomberg

⁷Microsoft in talks to invest \$10 bln in ChatGPT-owner OpenAI, Semafor reports | Reuters

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