Clothier Springs
Capital Management

Premium Points

Timeless Truths | New Perspectives | Endless Evolution

In this issue:

From the CIO's Desk

I read a lot: investment research, economic forecasts, product fact sheets, historical perspectives, investment summaries… you get the picture. The aim is to stay abreast of ever evolving market and economic conditions and remain current with industry best thinking and practices.

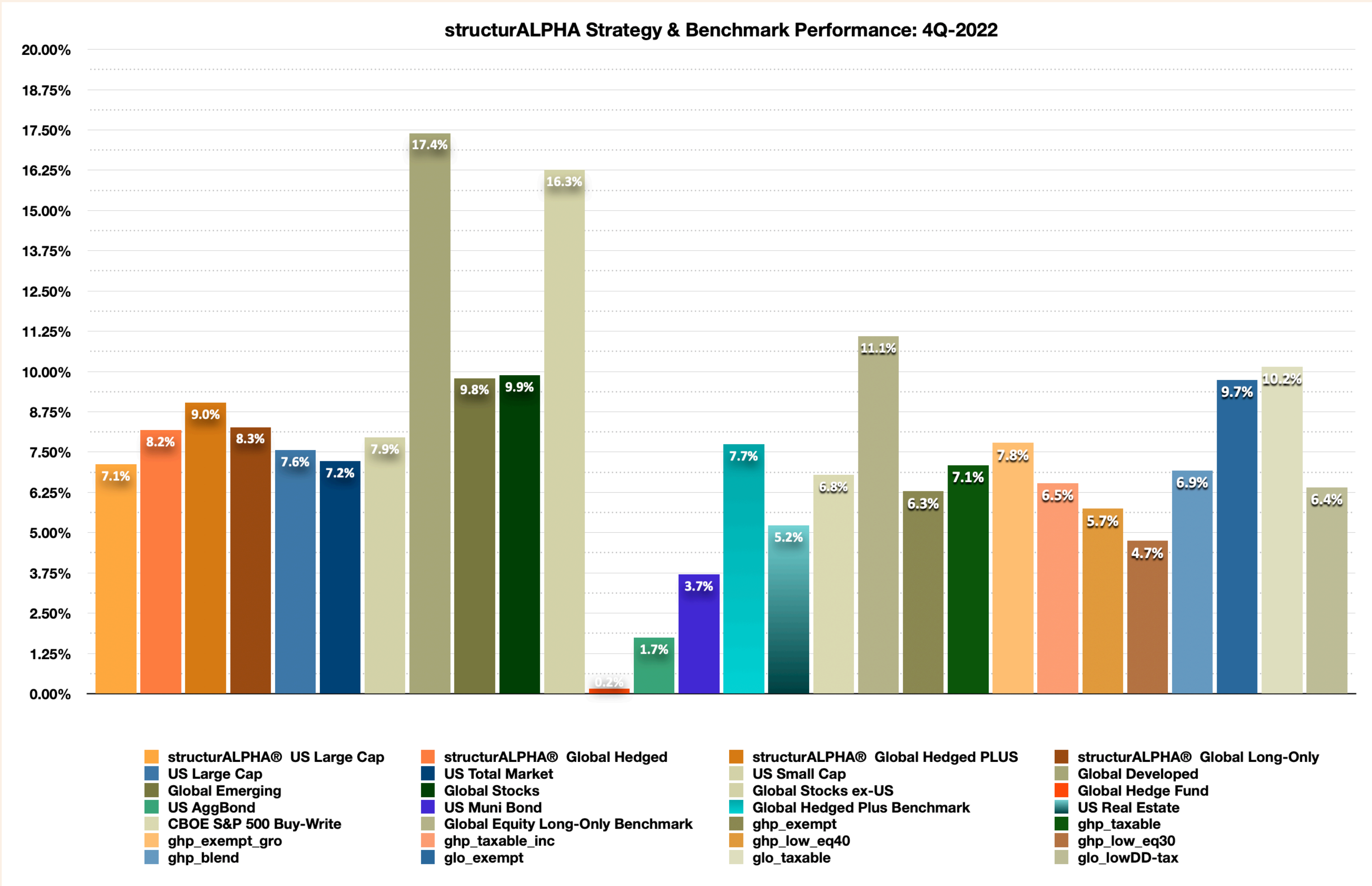
I recently read a book titled *"The Psychology of Money"* by Morgan Housel. Published in 2020 it is an eminently readable collection of short chapters exploring how large a role human psychology and emotion plays in investing.

In his own words:

> ***"…financial success is not a hard science. It's a soft skill where how you behave is more important than what you know."***

As an investment professional, knowledge is paramount. And the longer I am in this business the more obvious it is to me that helping clients manage their behaviors is every bit as important as knowing how to invest and operate in the capital markets to advise, build and manage portfolios and deliver their desired results. I am still learning.

Thomas F. McKeon, CFA
January 30, 2023



Review & Outlook 4Q-2022

Although December was a dud, the markets staged a healthy rally in 4Q-2022 to take the edge off an unpleasant year. Late in the year evidence was gathering that stubbornly high inflation was easing. More data points in early January 2023 confirm that reality.

As such, the markets collectively seem to expect that the Federal Reserve can slow, stop or even reverse the rate hikes they used to stem inflation. Rising interest rates were the primary cause for falling asset prices in 2022. If the Fed sees fit to take its foot off the brakes, asset prices should (will) stabilize and recover.

Some 2022 Market Metrics

Here are a few of the relevant metrics from the capital markets in 2022.

S&P 500 | The broad market returned -19.4% for the year, troughing at -24.9% in October. Over the past 40+ years, only 2002 and 2008 were worse than 2022.

Fed Funds: Fed Funds rose from 0.1% to 4.4%, the largest annual move since 1973. (This explains much of the market decline.)

10 Year: Treasury yields rose from 1.5% to 3.9%, the primary catalyst for falling multiples. (see Fed Funds)

Inflation: CPI rose from 7.0% in Jan. to 9.1% in June, and is forecasted at 6.7% in Dec.

Housing: Median home prices rose from $359k to a peak of $414k and are at $371k.

The Return of Yield

With the rising interest rates, yields are up across the board. Short-term treasury yields moved from less than 1.0% at the beginning of 2022 to 4.5% near the end. While investors endured real pain this year as all assets were repriced lower, it is now possible to collect 4.5% on relatively safe U.S. Government issued Treasuries. Bonds across the board are now more attractive than they have been in years.

With the down-market and the attractive yield to be earned across the range of fixed income investment, now is a good time to review your asset allocation.

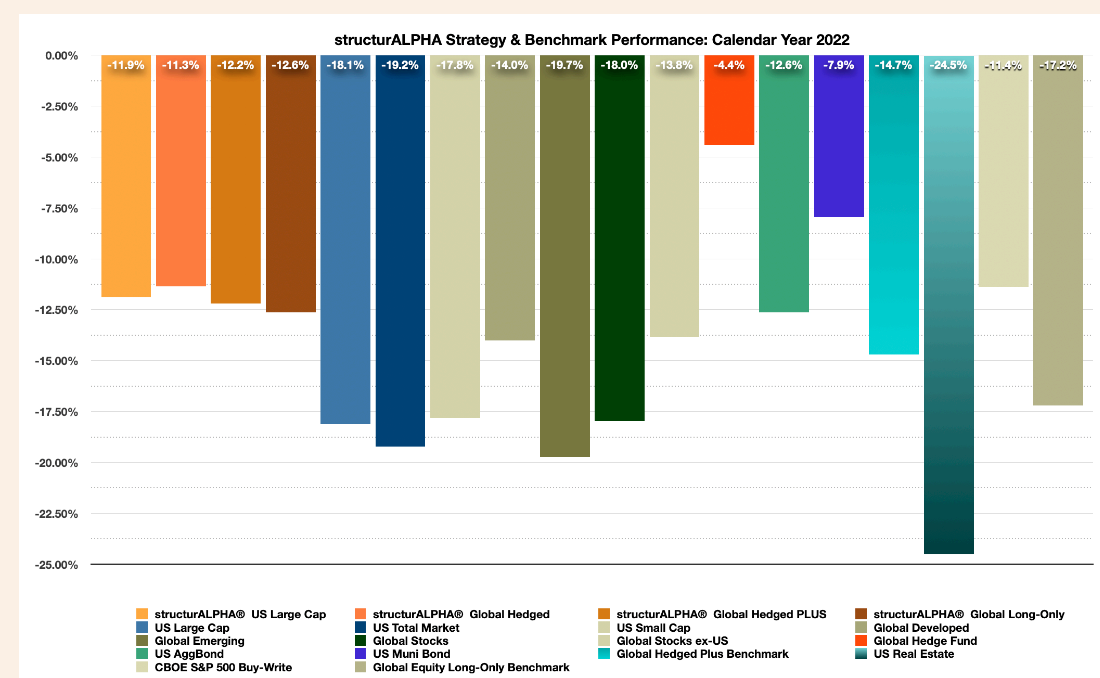
The Return of Bargains

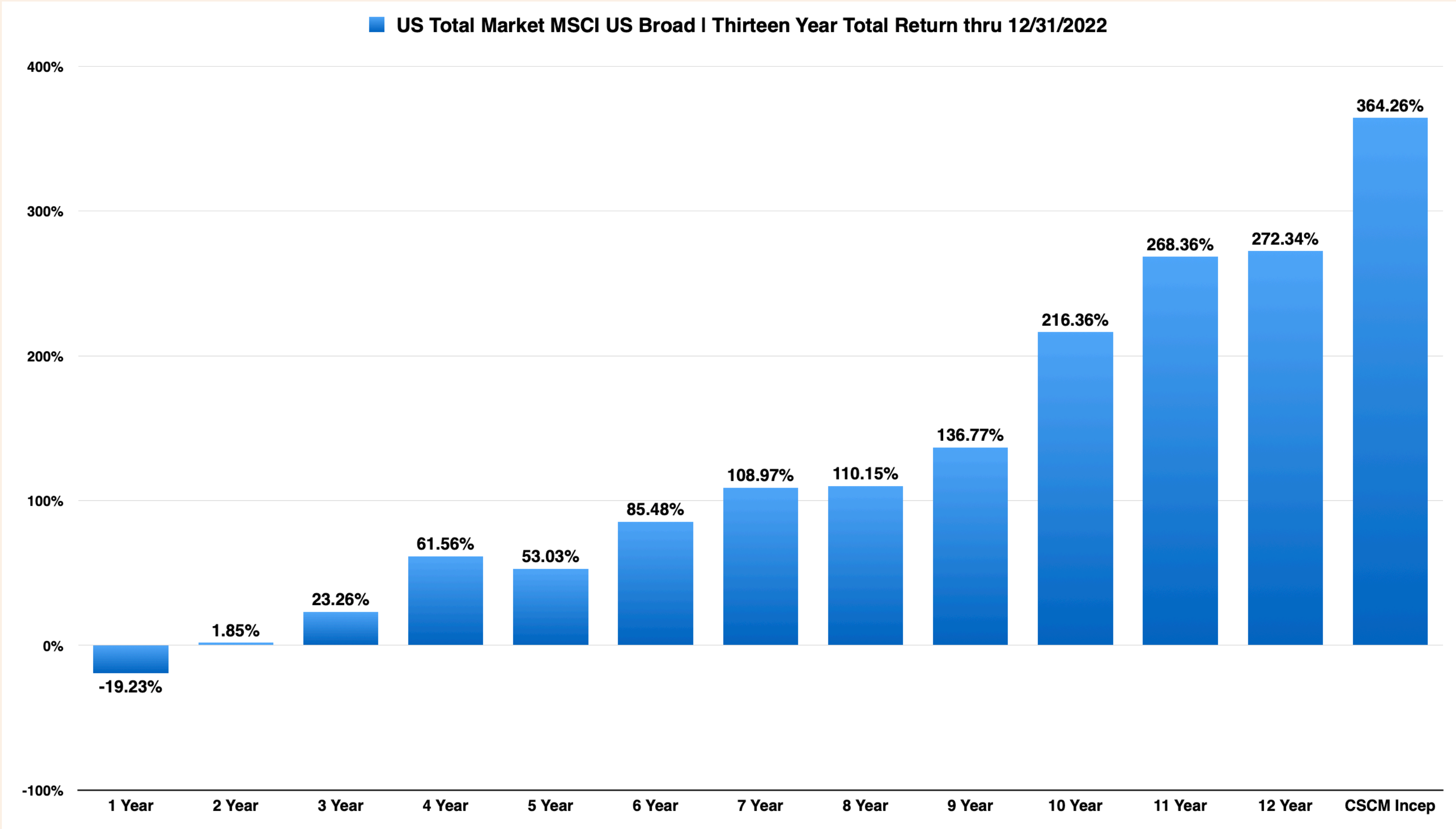
Rising interest rates in 2022 made the present value of all assets decline. Hence, the third-worst year for stocks since 1980. Bonds, preferreds and real estate all took a drubbing as well. (See Chart Below).

The upshot is that all assets are on sale. Investing at sale prices tends strongly to provide superior returns. And now that there is some healthy income to be earned, you can get paid to wait for the inevitable rebound across all markets.

What Game Are You Playing?

There are many different types of participants in the capital markets: long-term investors, day-traders, hedge funds, prop trading desks, and more. They all have different agenda's, time horizons, capital, etc. Let's make sure you know the rules of the game for the investing we advise.





Time and Inactivity Are Your Friends

The chart above is the (almost) thirteen-year cumulative total return of the MSCI US Broad Equity Market Index. That time period coincides with the total lifespan (so far) of Clothier Springs Capital Management.

Most recently, 2022 delivered a decline of 19.23%. Not so much fun. The cumulative two-year return barely above zero at 1.85%. 2022 almost erased a very strong return in 2021.

This chart covers exactly 50 quarters of performance history. The image to the right is a screenshot of the spread sheet we use to monitor market return data. The ratio of up quarters to down quarters for the period is exactly 40 to 10, a 4 to 1 ratio. That ratio might be slightly better than the historic ratio of 3 to 1. Still, we seek to take what the market gives us and an investor who held their position in the market exposure would have earned a total return of 364.26% over this 50 quarter time period, even after this year.

The average quarterly return over that period is just a bit over 3.0%. Only two quarters of that period had a return of 3.xx%: 2Q-2018 at 3.94% and 2Q-2017 at 3.01%. The best quarter was 22.27% in 2Q-2020 coming right after the scary -21.06% in 1Q-2020 when the pandemic broke and lockdowns were enacted. We all know that returns vary around the average, sometimes significantly. But we hope that this can help you see the benefits of time and inactivity and staying invested to earn the "average" over time.

	MSCI US Broad
4Q-2022	7.21%
3Q-2022	-4.46%
2Q-2022	-16.78%
1Q-2022	-5.26%
4Q-2021	9.29%
3Q-2021	0.02%
2Q-2021	8.42%
1Q-2021	6.41%
4Q-2020	14.79%
3Q-2020	9.23%
2Q-2020	22.27%
1Q-2020	-21.06%
4Q-2019	9.07%
3Q-2019	1.21%
2Q-2019	4.03%
1Q-2019	14.13%
4Q-2018	-14.36%
3Q-2018	7.07%
2Q-2018	3.94%
1Q-2018	-0.61%
4Q-2017	6.35%
3Q-2017	4.53%
2Q-2017	3.01%
1Q-2017	5.84%
4Q-2016	4.12%
3Q-2016	4.48%
2Q-2016	2.64%
1Q-2016	0.91%
4Q-2015	6.30%
3Q-2015	-7.21%
2Q-2015	0.12%
1Q-2015	1.84%
4Q-2014	5.27%
3Q-2014	-0.01%
2Q-2014	4.93%
1Q-2014	2.01%
4Q-2013	10.15%
3Q-2013	6.33%
2Q-2013	2.76%
1Q-2013	11.03%
4Q-2012	0.20%
3Q-2012	6.24%
2Q-2012	-3.15%
1Q-2012	12.95%
4Q-2011	12.12%
3Q-2011	-15.24%
2Q-2011	0.01%
1Q-2011	6.35%
4Q-2010	11.70%
3Q-2010	11.62%

Happy 30th Birthday to the ETF

The SPDR S&P 500 Trust ETF was born with $6.5 million of seed money on 1/22/1993 and started trading a week later on 1/29/1993.

Initially received as a bit of an odd duck, the ETF complex now holds more than $10 trillion of investor/client assets.

In short, ETFs were founded to wrap ultra-low-cost, passively managed benchmarks like the S&P 500 into a fund wrapper that could be bought and sold like a stock during market hours.

With ETFs, investors large and small (and their advisors) can access broadly diversified, ultra-low-cost market exposures around the globe and build optimally efficient, institutional quality portfolios.

The enormous success of passively managed ETFs has of course attracted all manner of investment product manufacturers who want to wrap their strategy in an ETF, believing that the ETF is the magic.

For us, the return and risk profile and cost of the strategy is the sole determinant of merit. A market exposure has to make sense within an allocation and it has to be ultra low cost. And for us, the ETF wrapper is ideal because we can execute trades, invest, re-balance all in real time during market hours.

Here's to the next 30 years.

A Word About Performance

It is of course a given that investors invest to earn a return. Goals, objectives and constraints across the spectrum of investor types may vary widely, but ultimately all investors want to end up with more money than they started with. How investors arrive there can also vary widely.

Access to the public capital markets has never been greater or less expensive. With the right capital and account permissions on a brokerage account, investors can use: stocks, bonds, real estate, preferred stocks, commodities, foreign currencies, options, futures and cash. All of these instruments can be traded individually and most if not all can be accessed through pre-packaged vehicles: mutual funds, Exchange Traded Funds, ETFs, common and collective trusts, annuities, life insurance, private funds and the whole array of hedge funds. Investors can take long positions (betting on up markets), short positions (betting on down markets) and use margin to leverage the account. The potential actions and positions are almost unlimited.

You Will Have a Result

Any time an investor commits capital to the market there will be an outcome—profit or loss. The lifespan of the position can vary from seconds or minutes to years and decades. Regardless, the position will either gain or lose over the period the position was open. Will it be the result you require?

Optimized, fiduciary investing reduces to this simple proposition: ***what market exposures in what proportions (asset allocation) over what time horizon and in what vehicles gives me the greatest opportunity to meet my objectives at a risk level I can tolerate and at a fair total cost?***

Much of the Wall Street complex is now squarely focused on their own profitability. The hedge fund and private equity universe charge fees that we consider shamefully exorbitant. Whether they collectively deliver returns to justify those fees is not really in doubt--they don't. Aside from these bandits, the Street has gotten very good at manipulating investor behavior: stampeding the markets up or down based on their own proprietary positions and profits.

What's An Investor To Do?

Don't play the Wall Street game. Invest in market exposures with positive expected returns over your time horizon and well-documented historic returns. Limit your activity. Effectively hitch your account cart to the market horse and let time pass. Re-balance infrequently. Manage your behavior. Ignore the touts and endless financial chatter and click-bait. Keep your costs as low as possible, because investors earn returns net of all costs. If that sounds like how we advise clients here at CSCM, thank you... you've been paying attention.

Structure IS the Strategy!

Clothier Springs Capital Partners Update

The partnership ended a relatively uneventful year with our weakest quarter to date...a scant return of 0.4% for the quarter. The full year total return came in at 6.45%. Compared to the listed markets--where the S&P 500 fell almost 20%, our return was welcome diversification. But we are aiming for better returns.

We had one capital event in the second half of 2022. Penn Capital-University Drive was an early, smallish investment and the total return of 94.0% was great, but the impact was limited.

At year-end 2022, we are fully invested and our asset mix is: 71.4% equity, 26.0% debt and 2.6% cash.

We collected more than $75,000 in income for 2022, from interest and preferred dividends, and our current portfolio is projected to collect more than $100,000 for 2023. We have one significant capital event pending for late January 2023 which the deal sponsors inform us will provide a 2.0 multiple of our invested capital of $150,000. This alone should drive a quarterly return for the partnership better than 4.0%.

Our average equity investment is now just over $160,000 so capital events will be more beneficial (assuming projected or better returns).

The disruptions from Covid and lockdowns are receding into the past and the housing shortage remains. We are invested with a number of solid sponsors in geographies and projects with superior potential. We believe we are well positioned for better future returns.

The objective of the partnership is to earn the superior returns that result from non-traditional construction lending and the value-added activities of developers, syndicators and re-habbers combined with their typical capital stack and standard leverage, and capturing the premium for accepting illiquidity risk of private investments and markets.

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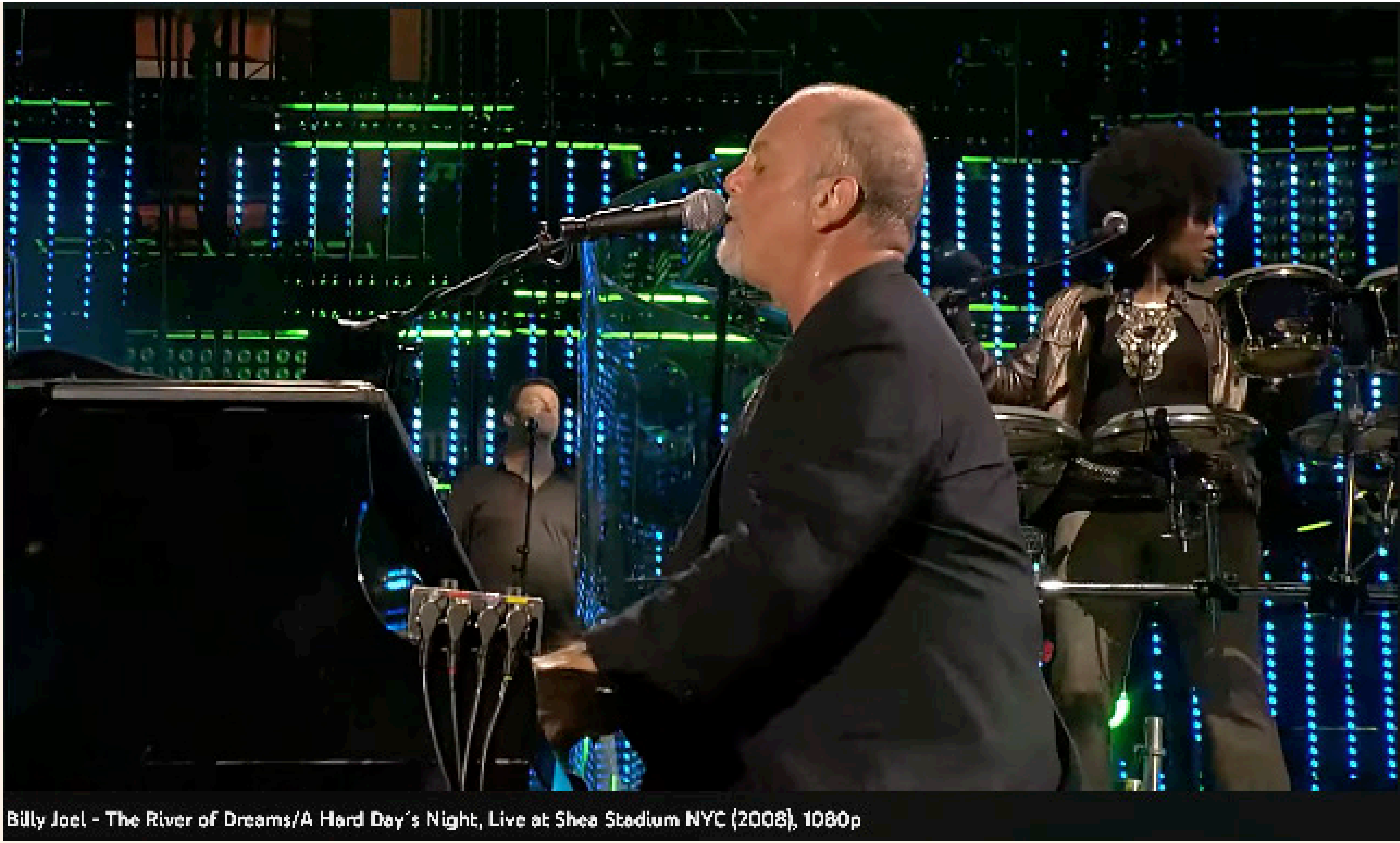

Billy Joel and his band performing the "[River of Dreams / Hard Day's Night](#)" medley at the Last Play at Shea Stadium concert in 2008. Hard to tell who is having more fun…the band or the audience.

Closing Thoughts

So far in 2023 (thru 1/27) the markets are off to a good start and for the Philadelphia Eagles faithful all is right with the world as the Eagles are headed back to the Super Bowl after handling the San Francisco '49ers in the NFC championship.

With inflation appearing to abate, the Federal Reserve will have less and less cause to raise rates. Those rate hikes were the direct cause of lower asset prices across the board.

Having endured that pain, investors can now enjoy some healthy yields and income from their bond and cash investments. Historically, this is a more normal state of affairs, where there is a meaningful cost of capital and return to investors for providing it.

When I entered the business in 1980, investors could collect a more than 20% (annual) Yield to Maturity on 30-Year Zero Coupon bonds, a result of Fed Chairman Paul Volcker's rate hikes then to stem runaway inflation. For perspective, 20% is and was more than double the long-term total return on U.S. stocks.

FT reports that ETFs attracted net inflows of $867bn globally during the year, the second-highest on record after 2021's $1.29tn peak, according to data from BlackRock, despite the market crash. In response to the increased yields, Government bond ETFs saw net inflows of $181bn, more than in the three previous years combined, BlackRock said, with records broken across the curve, in short, intermediate, long and blended maturity funds.

Remember, Structure IS the Strategy and Inactivity is Your Friend.

Thomas F. McKeon, CFA | January 31, 2023