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Quarterly Review and Outlook

The past three months provided little respite from the myriad economic and geopolitical concerns which have plagued global investment markets since the beginning of this year. The volatility in market prices for energy-related products, the continuing upward price pressure on necessary consumer items, and little relief from higher input costs for critical raw materials needed in a wide variety of industrial activities have bedeviled suppliers of finished goods and created or exacerbated rifts between trading partners and among political constituencies, both domestic and multinational.

Our domestic investment markets have been volatile and trending lower as investors intensified their focus on the apparent weakening of economic underpinnings, the upcoming midterm elections, the worrisome global concerns related to the Russia and Ukraine conflict, the growing instability in the Middle East, and China's efforts to widen its role and influence as a major military and economic force internationally.

Transitioning into the third quarter, we have seen the focus of investors turn to our Federal Reserve's commitment to temper and reverse the pernicious effects of systemic inflation. Our Fed is on a stated course of periodic increases in market interest rates and steps to drain excess monetary liquidity from capital markets, much of which was injected during the Covid 19 uncertainties. The Fed chairman has stated his belief and that of most other Fed governors that our economy is financially strong enough to adjust to these moves, even if a mild recession ensues.

Our financial history is replete with such counter-trend policy moves; and the varied effects on the entire economic fabric have led to other mid-course changes in policies as public and political moods and support ebbed and flowed. In this instance, it seems evident that our Fed needed to alter its policies and directives because unchecked and unchallenged inflation was already impacting broad areas of economic activity. It is very early days of these remade policy actions, but there are signs that certain areas of strain and excesses may be moderating. As these occur, we, and many other investors, will be intense in our scrutiny of the effects of these and other policy actions that follow.

It is always risky to extrapolate singular events into broader trends, particularly when there are complex and counter forces involved and volatile items, such as sentiment and political choices come into play and revisions may be frequent. However, that does not mean that any of the multitude of economic, financial, or sentiment measures are deserving of short shrift. Rather, these reports highlight the complex nature of any dynamic infrastructure, and we should expect volatility in these measures going forward.

We are on the threshold of corporate reporting of results in the quarter ended in June, and we will be intently interested in whether the recessionary forces are still strong and whether further reductions in economic activity on a sector basis is appropriate and cuts in corporate earnings prospects are likely. We would hope to see cooling in commodity prices, which could portend a near term peaking in key broader measures, as well as supporting price stability in equity and bond markets.

Ordinarily, given the conflicting forces and concerns outlined above, it would be appropriate to take a highly defensive strategy for our portfolios. However, investment returns have already reacted, and equities and fixed income results during the past six months have recorded meaningful declines. History shows that such duality of performance is highly unusual and offers few hints as to direction and magnitude of future returns. Our investment construct is always directed by an unwavering commitment to identifying sectors and specific companies which have demonstrated financial strength, consistent management direction, and a record of growth in free cash flow and earnings per share. It is also our experience that patience is well rewarded over the longer term by regular review of existing holdings and their adherence to their corporate missions during periods of challenge. We strive to be intelligent and careful stewards of our clients' assets and to add value through concentrated analysis and a proper mixture of skepticism and opportunism when values are distinct.

We believe that more selling pressure on equities is probable because we doubt that our Federal Reserve is likely to stop their contractionary monetary actions in the near term. Also, the Fed's stated objective of achieving higher market interest rates will affect the broad spectrum of fixed income securities for several months. While this certainly is not an across-the-board all clear signal for bullish sentiment and behavior, it is necessary to restore a calmer and more rational backdrop for longer term securities analyses. The current fear that a deep and prolonged economic recession is looming is not a given in our judgment. The reasons for this outlook rest importantly on our reading of relatively high levels of liquidity in the banking, corporate, and household sectors, as well as the current availability of jobs in a wide spectrum of industries. An additional area of importance is the lessening impact of commodity prices, as there are signs of reversals occurring in both industrial and consumer sectors. Supply chain clogs are starting to ease even though China's policy of forcing covid shutdowns is uncertain and volatile. Good news never seems to come in a straight line. European nations are weakening further, and the resulting economic disruptions of the Ukrainian conflict are increasing and adding to international trade and financial tensions. These issues deserve constant attention, as they could deliver a variety of outcomes.

As a consequence of the foregoing crosscurrents and the reality of the Fed's likelihood of maintaining tighter monetary policies and actions, we are noting the increased reductions of forward earnings estimates and "buy" recommendations for broader groups of equities, as well as fixed income issues of mid or long maturities. As we have repeated frequently, we have maintained an equity structure for our client portfolios of both strongly positioned cyclical companies and an equally proven and diversified selection of high-growth companies. To the extent to which we see that market prices are out of line with our judgments of value and potential price targets, we will adjust our weightings. Currently we are witnessing market prices which are nearing our preferred levels of increased exposure in equities. Any programs to boost equity weightings will be gradual and reviewed frequently since the news backdrop will likely continue to be mixed and markets will remain volatile. We will continue a policy of regularly reviewing and challenging our assumptions vis-a-vis the varied economic, financial, and political trends, as they evolve.

As always, we urge our clients to interact with our portfolio management team professionals with questions and/or preferences as to current portfolio structures and concerns specific to your individual needs and objectives. We value the personal trust and insights that help constitute a strong, rewarding, and lasting relationship!