

NEWSLETTER AND CAPITAL MARKETS REVIEW

JANUARY - FEBRUARY 2022

January is in the books, and it was a rough ride. The month-end numbers belie just how rough. There was nowhere to hide for investors as everything – equities, bonds, even digital assets – were being indiscriminately dumped. But, that is also only the picture looking at a single month in isolation. Take a step back and look again, and January does not feel quite so bad, charting a 5 – 7% retreat after a booming 2021 and an even more astonishing near-doubling from where the market troughed in the depths of the pandemic panic in March of 2020. Inflation has certainly been driving the headlines, but what explains what just happened, and what is likely yet to come?

The market, in our view, is trying to come to grips with a less accommodative yet still supportive monetary and fiscal policy environment. Federal Reserve policy is dominant at this moment, since it appears fiscal policy progress has paused until the mid-term elections and perhaps beyond. The Fed is unlikely to turn away from its recent pivot towards being less “dovish”, which in light of recent inflationary trends is still a far cry from an aggressively “hawkish” stance.

It seems probable the market will re-test the lows of January 24th over the coming days or weeks, and from there we will ultimately see from which way the equity market breaks. The recent intra-day volatility was reminiscent of some of the price action during the financial crisis, particularly around the 2008 election. When it appeared that President Obama

would easily win, the S&P 500 rallied over 18% from October 27th to election day November 4th. With deep uncertainty about who would fill the new President’s cabinet and what steps they would take to address the worsening crisis, the S&P 500 subsequently fell nearly 33%. The market ultimately bottomed when Timothy Geithner,

Obama’s most important new cabinet appointee at that moment (Sec. Treas.), announced the deployment of the TARP funds. There are certainly differences between 2008-2009 and now, most notably the health of the financial sector. However, the market fears uncertainty and that is a common thread between now and then. Another more tenuous thread, but one worth watching, is the speculative bubble in digital assets that has already partially ruptured, and the run-up in residential real estate in part fueled by loose lending practices. Today’s uncertainty is primarily around what the future holds in a less accommodative monetary and fiscal environment. Economic activity, while still growing, appears to be slowing and high inflation persists, prompting concerns about the potential for stagflation. [chart Wilde Capital Management © 2022, data from Standard & Poor’s 500 Index]



Review and Outlook cont'd

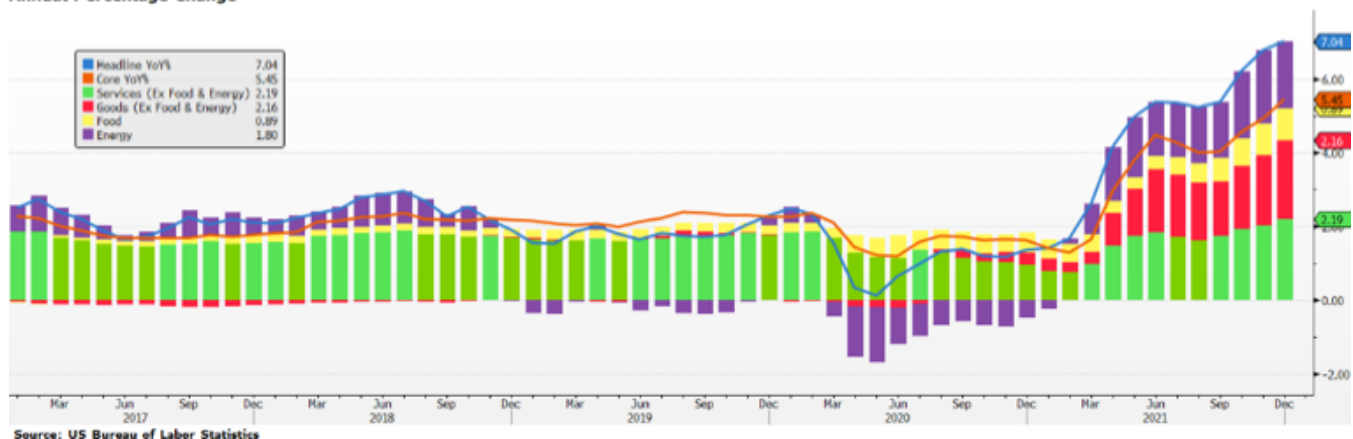
Policy status quo has kept us at portfolio status quo. Central bank policy and the surges of inflation are dragging on but not causing a crisis for fixed income. As rhetoric from the Fed is shifting to less accommodative we are on watch for language changes that warrant an asset allocation response. We continue to hold an overweight allocation to equities overall as well as a modest underweight in fixed income, also leaving cash meaningfully underweight. Within global equities, we are overweight with respect to the US, underweight in Emerging Markets, neutral with respect to Eurozone stocks and underweight Japan. Within fixed income, we are overweight in the US with a preference for mortgages and investment grade corporate credit. We have little to no exposure to non-US fixed income except through Green Bonds in our ESG series portfolios. All portfolios holding fixed income maintain lower duration than the benchmark.

The rate of change of consumer prices across all key segments began to increase sharply in March 2021 as depicted in the next chart of the Consumer Price Index from the US Bureau of Labor Statistics. CPI briefly leveled off through the Summer of 2021 only to jump again through the Fall. We are expecting over the next few months that inflation will remain elevated. Bloomberg's survey of economists forecast for February's release of headline inflation will be 7.3%, an

increase from 7.0% in January. Once this regime of elevated prices has worked into the year-over-year growth measures, the headline inflation number may fall back to more palatable levels. But, declining inflation does not equate to declining prices. The increased cost of goods, services, food and energy most likely will remain embedded in the economy until the next recession, which functions like a tax on the broad consumer population.

Even though the market decline that marked January seems to have at least taken a pause, there are several reasons that equity and risk asset prices could head lower. The era of cheap money from coordinated (and un-coordinated) global stimulus is coming to an end, and the cost of debt servicing for corporations, government and individuals will rise. Indications are that a CMBS default wave fueled by the pandemic rent moratoria and reinforced by looser underwriting on issuance is looming. 70% of S&P companies have exceeded earnings expectations, but the market is still fully valued and higher interest rates may lead to further discounting. And lastly, on the geopolitical stage, Russia moving against Ukraine (seemingly imminent) could upset energy markets, and China moving against Taiwan (less likely but in some ways more concerning) could destabilize Asia Pacific markets.

US Consumer Price Index
Annual Percentage Change



Portfolio Positioning

We have taken the step of reducing stock market risk across our portfolios as January has settled into a series of drawdowns exhibiting disquieting patterns. Maybe most notable is that even a positive move early in a trading session dissipated and was overrun by sellers that have caused a pattern of disappointing closes to start the year. Technology in particular has been hit hard, breaking through prior support in July and October and looking to test the March and May lows. We shifted to an underweight allocation to equities overall as well as keeping a modest underweight in fixed income, with cash now meaningfully overweight. Within global equities, we significantly reduced an overweight with respect to the US, kept an underweight in Emerging Markets, and remained neutral with respect to Eurozone stocks and underweight Japan. Within fixed income, we are overweight in the US with a preference for mortgages and investment grade corporate credit. We have little to no exposure to non-US fixed income except through Green Bonds in our ESG series portfolios. All portfolios holding fixed income maintain lower duration than the benchmark.

Risk Outlook

- **Inflation** – The headlines are increasingly troubling, but inflation does not seem to be systemic -- yet. In many regards it is surprising, maybe even astonishing, that inflation has not been more of a concern for years now. We are more than a decade in to post-Crisis easy monetary policy and a booming stock market only briefly interrupted by the pandemic. The market may be the answer, though. The coordinated government response to the economic damage of the pandemic has been massive. Had all of that stimulus settled into the “real” economy, inflation would be on a tear. We believe that the capital markets have been serving as a pressure relief valve, with stimulus settling out of the real economy and in to the capital markets inflating asset prices. Correlation does not equal causation, but there seems to be a relationship of some sort between the magnitude of the stimulus and the increase in aggregate value in just the public markets. We have seen spikes in prices of building materials and scarcity of new cars for purchase as examples. But, while we cannot discount those observations entirely, we principally see them as graphic examples of how interdependent world economies and supply chains
- are and how fragile they were with just-in-time inventory management. While investors have extolled just-in-time since Toyota popularized it, it introduced an inelasticity into global supply chains that was not capable of absorbing the blow of COVID. We liken this to everyone on the highway cruising at 70 Mph riding bumper-to-bumper and doorhandle-to-doorhandle. It works fine until somebody swerves or stamps on their brakes. This was further exacerbated by climate-related issues with beetle infestation and fire affecting Western timber stocks and storms knocking petro-chemical production capacity off line among several other challenges. The results were issues such as a microchip shortage affecting the ability of factories to finish automobiles for delivery. We believe as major parts of the global economy get back on pace that the current situations will self-correct, but as investors and market watchers we are looking longer term at the confluence of business practices that are not sustainable, resilient or adaptive and externalities like global health and climate change which can and will disrupt businesses and markets again.
- **Rates** – Benign conditions do not always result in benign outcomes. As discussed elsewhere, even a slight normalization of the rate environment, which would reflect stabilizing economic conditions, could have profound effects in fixed income markets, severely dragging down assets like 30-year Treasury Bonds which are normally seen as safe harbors from risk. Wall Street has been cautioning about the risk of rising rates since the end of the Financial Crisis in 2009, but we have yet to actually have to live with those risks because a slow grind recovery followed by a series of crises including COVID have conspired to hold central bank policy where it has been – accommodative. A mild turn of phrase by the Fed Chair has resulted in temporary shocks in the bond and even equity markets, so we can anticipate that rising rates are not welcome in markets that have enjoyed easy money for more than a decade now. This compels us to think about risk in globally diversified portfolios differently, where the traditionally more conservative parts of asset allocations may actually represent more material risk in the nearer term.



Risk Outlook [cont'd]

- **The National Balance Sheet** – Continuing on the related themes of inflation and rates, the Federal Reserve has begun to signal their intent to start winding down the extraordinary measures they have been taking through asset purchases. That has a couple implications – one is telling the markets that the training wheels can come off. The Fed feels like their additional help is no longer as needed. That is positive in tone which should be good for market sentiment, but offset by the disappointment of losing a major bond investor. This does mean a more orderly bond market where institutional investors are not competing with the government for bond inventory. Again, this is good, but it also means less liquidity. This is a slow turn of the battleship of state. They are not really shrinking the balance sheet. Just growing it less fast, so most of the market reaction will be sentiment-driven rather than based on real stresses from lower liquidity.
- **Spending** – We cannot get away from the not-so-invisible hand of government in how markets are functioning. It may not be a risk per se, but we are mindful of the legislative efforts around major spending initiatives coming out of Washington DC. Discussions around infrastructure have been bipartisan and bicameral, and the President signed the legislation in to law on November 15th. The \$1 trillion will be more fundamental to the economy because it is being spent on “stuff”, and that spending will take time to deploy (5 years) and for the bridges, roads, broadband, etc. to be built or restored. That spending becoming a sure thing does get discounted into the market so it has an immediate effect on asset prices, but in a more durable way than the sugar buzz of pure cash stimulus we have been getting. Next up is Build Back Better, which may or may not happen since it does not enjoy the bipartisan support of infrastructure. As we have been saying since the election, an evenly split government means a lot of triangulation and not a lot of surprises, so we do not think the market will either jump or drop materially on the outcome.
- **COVID-19** – We are now looking at the global transition of SARS CoV-2 and COVID-19 from pandemic to endemic, and what that means for progress and prosperity in developed and developing economies. Vaccine deployment continues and close on its heels the promise of new therapies in pill form that may make addressing severe illness as simple for COVID as Tamiflu does for influenza. New strains of the virus may contest the efficacy of those vaccines, but after two years the world has become more adaptive to the challenge and the need to hit the “off switch” on the world economy is far less than the early stages when the virus represented all danger with no defense. As we have previously expressed, the global community remains vulnerable to a have/have-not dichotomy based on access to virus-fighting resources. Indications are that pricing will be calibrated according to economic capacity, which is a promising development that may help to reduce the gap between developed and developing nations in the same way COVAX is working to do so through access to vaccinations. With these developments we may be less than a year away from COVID no longer being a meaningful factor in global economies.
- **China and Russia** – One of our long-term risk themes continues to be our focus on Chinese Communist Party actions which have not materially shifted for the better in the COVID era. From aggression in the Asia-Pacific region to military tension along the border with India to suppression of Hong Kong citizens’ rights and the interests of the Uighur population and the lack of contrition for their early role in failing to stop COVID-19 in its tracks, all may contribute to China-directed backlash or retaliation. There does seem to be regional coherency in the response as nearly all Pacific nations have aligned with the US against Chinese aggression. From lack of respect for intellectual property rights to involvement in global criminal drug trafficking to financial crimes and human rights abuses bordering on genocide, the country is finding it harder to get the global community to look the other way. We view this as a risk to investment in China and investment in companies reliant on a Chinese supply chain, but likely bullish for other parts of the Asia Pacific interested in usurping China’s role as the manufacturing floor for the world. Meanwhile Russia continues to operate from other pages in the same playbook, manipulating natural gas markets in Europe and massing troops on the Ukraine border.



ESG Considerations

ESG, Inflation, and the Nature of Work

What are the ESG implications of and for inflation as we move from COVID pandemic to endemic and how does that relate to the broad economy and the capital markets? In this and the next two issues, we will explore that in three primary areas – work, housing, and what we will describe generally as “stuff”.

The nature of work changed through the pandemic, and in all likelihood will not change back. This has played out in what workers will do, where they are willing to do it, and what they are willing to accept as compensation for doing it. Focus on workers is a significant portion of the ESG review of a company. Are workers fairly and equitably compensated for their work? Is the workplace safe? Are there basic benefits? Opportunities for development and advancement? A lot of these questions are anchored in the fact that workers in lower economic tiers have historically had very little leverage since it has been a buyer's market for labor. Combined with a minimum wage that has not moved since the last crisis

(\$7.25/hr. as of July 2009), and a tipped wage for service works than in some cases begins at barely more than \$2/hr., and a massive tilt even in skilled jobs in the technology sector toward independent contractor (1099) status, enfranchising the labor force is a key ESG consideration.

Then comes the pandemic. At first it was a complete disaster for lower income workers. One of the most abrupt and largest drawdowns of labor in history happened when the world slammed on the economic brakes and everyone but essential workers went into hiding. Information economy workers mostly kept their

jobs, and the “WFH” (work from home) acronym and Zoom became ubiquitous.

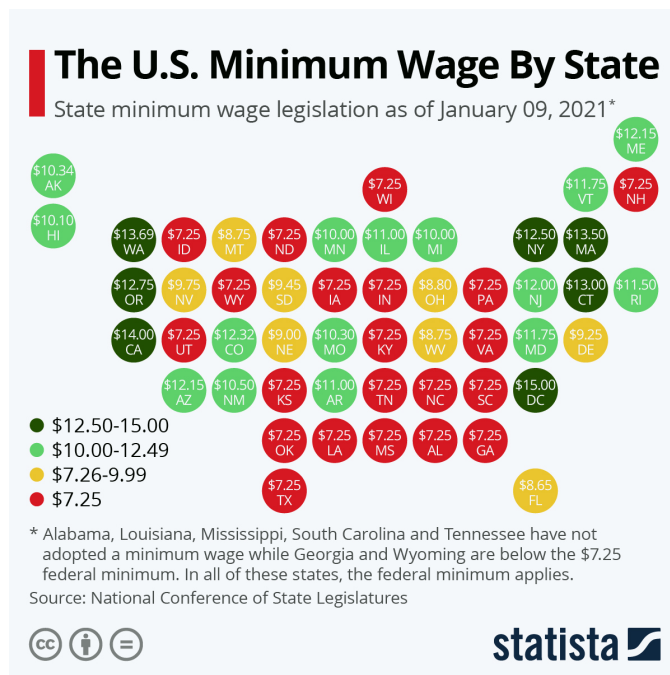
But then, a couple things happened that completely changed the calculus. Massive coordinated stimulus was dumped into the economy when consumption had not really declined all that much in relative terms. People were not going in to restaurants and movie theatres and shopping malls, but they were ordering takeout and delivery, streaming video, and shopping in their pajamas. So, there was a massive recall for workers, less in store front retail but more in logistics, kitchens, etc. The employment relief funds in the CARES Act and subsequent legislation unlocked an interesting

phenomenon. By giving workers the economic buffer while they could not work, they could be closer to solvent when it was time to go back, which meant not that they would not go back to work, but they could be more thoughtful about the work to which they returned.

Because we are near or at full employment with strong demand for labor, the free market is now working to the benefit of low-wage workers. Workers presently have the market power to reach for the better paying role with more security, less risk, and greater overall job satisfaction.

The statutory minimum wage did not get moved, but the minimum that workers are willing to accept when there is more demand than supply has risen. Labor is an essential input, and companies are aggressively competing in the free market for that labor. This is the proverbial case of America's labor force making hay while the sun shines. That is the good news.

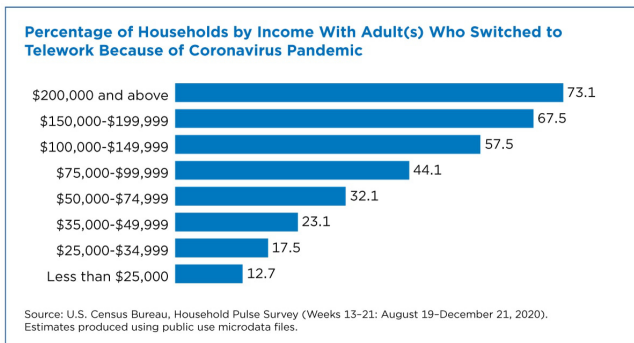
[Mid-pandemic snapshot of the minimum wage - <https://www.statista.com/chart/17169/state-minimum-wages-united-states/>]



ESG Considerations [cont'd]

It is also the bad news. Labor being an essential input means that labor is also a key component of cost, and so rising wages translate to higher prices – inflation. There is an offset, although not necessarily 1:1, between the new money coming in at the beginning of the month and the higher bills being paid at the end of the month. Workers have made gains, but it comes at a cost. The question is, at the overall systems level, is this good and sustainable?

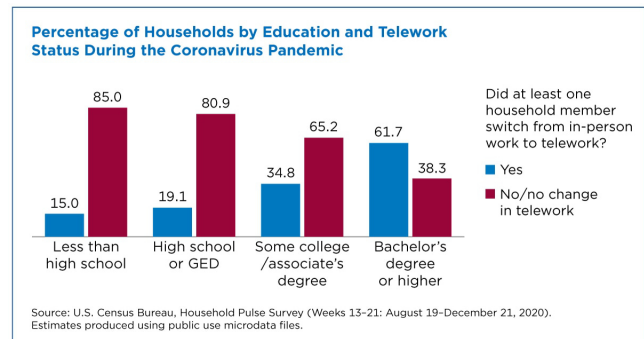
We have been running below trend for years now on inflation. This has been good for asset prices and kept prices of most consumer goods largely in check, but wages have remained stagnant even while prices climb a little, so purchasing power has still been falling for lower income workers. Assuming the current high rate of inflation as measured by the CPI (~7%/annualized) does not persist, a steep but brief bout of inflation moves us closer to trend, but wages and benefits have also had a rare chance to catch up some.



Meanwhile, in the more tech-enabled parts of the working economy, we probably experienced a decade, maybe even a generation of evolution in six months. The idea of place for work has changed, the meaning and necessity of physicality has been re-evaluated. There is generational tension as Boomers and GenX grew up in a business world where presence and productivity are measured by line-of-sight, while Millennials and Zoomers are digital natives, all manner of interactions naturally occur in a virtual space, and productivity is measured by output. Two years into the pandemic, co-working spaces now seem like a quaint idea to slowly ease us out of the permanent office environment, and we just leapfrogged to a world where the workplace is wherever your laptop and cellphone are sitting. And,

while older generations are talking about the barriers to knowledge and culture transfer without “the office”, the younger generations have spent two years standing up and monetizing ventures entirely in the ether. Strip away the goofy sci-fi and video game trappings of a virtual or “meta” universe, and we can start to appreciate the fundamental reordering of business, with the radical centralization of some business activities and the radical decentralization and distribution of others.

In the ESG space this means companies can and are rethinking everything from the human resources manual to how to site corporate facilities which will change resource consumption patterns, shorten, thin out or entirely eliminate commutes, reduce corporate travel, and even allow companies to move closer to their customers whether in real or virtual space. This could result in a profound reduction in the environmental footprint for a worker who codes, answers a service line, teaches, or trades a portfolio. This could also be a countervailing force to inflationary pressures since companies will be able to reduce cost allocations per unit of headcount, workers will be less consumptive in terms of everything from apparel to cars and fuel, and there could even be mutually agreed reductions in compensation as workers can locate to more affordable and satisfying locales and lifestyles and companies can adjust compensation to be appropriate to those arrangements.



In next month's issue we will explore ESG and housing as it relates to inflation, understanding how it is playing out for the housing-insecure as well as those at the median and upper ends of a real estate market that was disrupted in the same way as, and even by, the labor market and the pandemic.



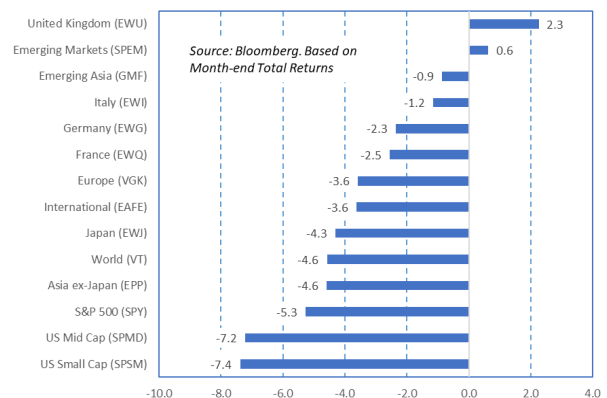
January 2022 Capital Market Review

Nowhere to hide. That is the best way to describe how January was in listed markets as well as in alternative and new asset types like digital assets. The old rules still apply – under stress all correlations in financial markets move to 1.0. Technology led the way down. After testing support twice in early and late December after touching all-time highs in mid-November, the NASDAQ Composite, which is heavily tech-laden, broke loose and wiped out a year's worth of price returns by January 27th. Individual companies that had been pandemic darlings were hit particularly hard as other old rules came back into force, like earnings matter. Inflationary concerns and a Fed starting to tap the brakes further aggravated the break lower, in many areas taking fixed income down as much as equities. But, for as bad a month as it was, January was not that bad. The decline was less than half of what was booked for the calendar month of March 2020 as the COVID shutdown went into full force, and comes at the end of a huge year for equities in 2021, and an even more massive climb if we look back to April of 2020. The question on our minds is whether this is a market catching its breath and shifting into more of a slow or no-growth mode, or if there is more pain in our collective future as the realities of the end of stimulus, the rise of inflation, and the echoes of COVID converge to make asset risk unappealing.

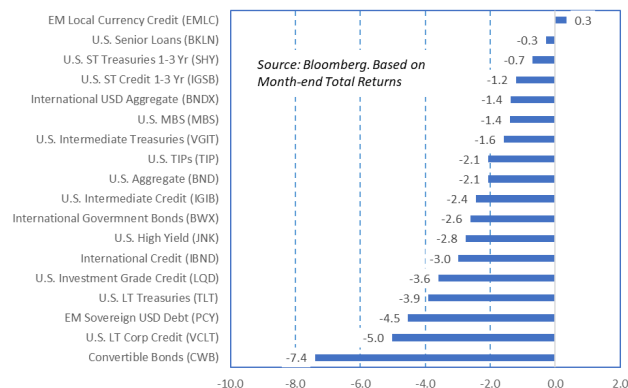
Equity Markets

January 2022 saw a complete reversal from the kind of market performance that marked the end of last year, taking back December's strong finish for most markets. The only thing that remained measurably consistent was the dispersion of results, again showing a spread of 200 to 700 basis points and almost a thousand between US Small Cap (SPEM) coming in at -7.4% and the UK (EWU) leading the pack again this month at a positive 2.3%. Month-to-month the differences are stark as well with indexes like the S&P500 (SPY) finishing -5.3% after being up 4.6% in December. Emerging Markets (GMF, SPEM) have ironically continued to be the slow and steady contributors while more developed markets rock.

Global Equity ETF Performance
January 2022



Global Bond ETF Performance
January 2022



Bond Markets

January reinforced that fixed income is not meeting (misplaced) expectations of providing a safe harbor. Even excluding highly equity-sensitive asset types like Convertibles (CWB) and High Yield (JNK) January was uniformly bad as bond markets process the end of stimulus and the beginning of tightening in the face of rising inflation. Corporates were hurt (IGIB, VCLT), but Treasuries (VGIT, TLT), the ultimate safe harbor, were also hurt to a similar degree. Bonds are a work in progress as we work through this regime change more than 40 years after the Volcker Fed broke the back of inflation/stagflation to end the 1970's.

The returns cited reflect total return performance of exchange traded funds listed in the corresponding bar charts



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