TOTAL WEALTH PLANNING

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Economic & Investment Outlook 2023

The year 2022 was unusual for the markets in many respects. Most notable was the performance of the bond market, which historically has tended to rise during periods of stock market declines, but in 2022 provided little protection. For the year the S&P 500 Index, which represents large US stocks, dropped -18%. At the same time, the bond market dropped -13%, representing the worst performance in fifty years. The broad market indices below provide a summary of investment performance:

Index	4th Qtr.	2022	3 year*	5 year*	10 year*	Description
S&P 500 Index	7.56%	-18.11%	7.66%	9.42%	12.56%	Large-Cap Stocks
Russell 1000 Growth	2.20%	-29.14%	7.79%	10.96%	14.10%	Large-Cap Growth Stocks
Russell 1000 Value	12.42%	-7.54%	5.96%	6.67%	10.29%	Large-Cap Value Stocks
Russell 2000 Growth	4.13%	-26.36%	0.65%	3.51%	9.20%	Small-Cap Growth Stocks
Russell 2000 Value	8.42%	-14.48%	4.70%	4.13%	8.48%	Small-Cap Value Stocks
MSCI – EAFE	17.40%	-14.01%	1.34%	2.03%	5.16%	International Stocks
MSCI – Emerging Market	9.79%	-19.74%	-2.34%	-1.03%	1.81%	Emerging Market Stocks
Barclay's Agg. Bond Index	1.87%	-13.01%	-2.71%	0.02%	1.06%	Domestic Bonds
Consumer Price Index	0.30%	7.11%	5.00%	3.83%	2.60%	Inflation

**Returns are annualized; ** CPI returns are as of November 30th, 2022*

The Year in Review

At the beginning of 2022, the Federal Reserve was anticipating making small, incremental increases to interest rates. The Federal Funds rate stood at 0.13% and the Fed only expected to raise it to 0.90% by the end of the year. Expectations changed quickly as inflation concerns began to rise and were exasperated by the rising energy costs as a result of the Russia-Ukraine conflict. The Federal Funds rate skyrocketed to 4.38% at year-end, resulting in large increases in borrowing costs for mortgages, car loans and business loans.

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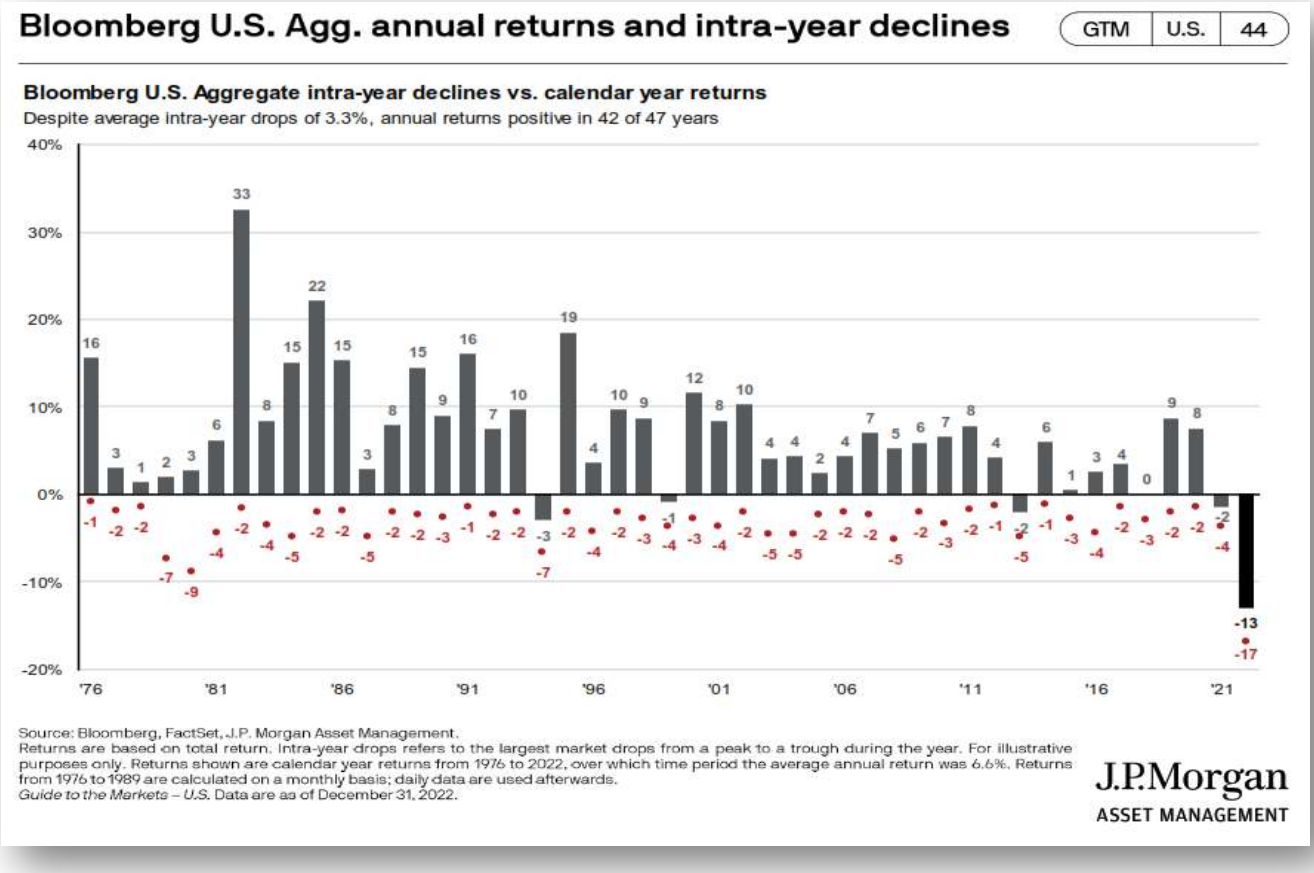
The impact on the bond market is that as interest rates rise, bond prices fall, and in 2022 resulted in declines that have not been experienced in over fifty years as illustrated in the chart below:



The gray bars in the chart indicate the annual returns since 1976 for the Bloomberg U.S. Aggregate Index, a broad measure of the US bond market. The worst performance prior to last year was -3% and it had only declined four times. In 2022, the index declined -13% and was down "intra-year" as much as -17% as indicated by the corresponding red dot. Note that our investment approach is to minimize risk in the bond portion of the portfolio by overweighting less volatile short-term, high-quality bonds while minimizing exposure to more volatile long-term bonds. This provided relative outperformance in the fixed income portion of the portfolios in 2022.

Another unique event over the last year occurred within the U.S. stock market. We observed the strong performance of "value" stocks, which include energy and financial companies. These outpaced the returns of "growth" stocks, which are comprised mostly of technology and health care companies. For the year, large U.S. growth stocks declined -29.1% versus only -7.5% for their value counterpart. Client portfolios are strategically overweighted to value stocks since we know from Nobel-Prize winning research that they will provide excess returns over growth stocks over time. (For more information about Dimensional Fund Advisors and their research on the "value premium", feel free to visit our website at www.twpteam.com/blogs where you will find a number of blogs dedicated to this topic.) In 2022, this overweight to value stocks provided ample opportunities for the equity portion of client portfolios to

outperform as the value premium persisted in large, medium and small-cap investments, both internationally and domestically.

Expectations for the coming year

Inflation has begun to trend downward and was last year's concern. The threat of recession will be the concern for the coming year. Although a recession is not inevitable for 2023, it is considered an unavoidable part of the business cycle and occurs when a nation's economy experiences negative gross domestic product (GDP), rising levels of unemployment, and falling retail sales.

As we described in last year's *Economic and Investment Outlook*, the stock market is considered a forward economic indicator, having a remarkably strong record of moving downwards in anticipation of economic slowdowns and upwards before an economic recovery actually begins. The exact timing and magnitude are unpredictable which prevent investors from being able to successfully time the markets.

The ideal scenario would be that the economy avoids a recession. Our belief, however, is that a recession is likely. Importantly, for a number of reasons, we do not foresee the recession to be severe but instead mild and brief. In this event, with the U.S. stock market having dropped -18% last year, it may currently be "oversold", having experienced more of a decline than investors would expect for this economic scenario. A recovery could be on the way in a very short period. In fact, it may have already begun as reflected in the strong fourth quarter results illustrated in the first chart.

If instead a more severe recession occurs, then the stock market could experience additional volatility and may temporarily give back some of the returns that were generated during the fourth quarter. It could take several weeks, or possibly months for the recovery to take hold but it is reasonable to expect the stock market to provide positive returns for the year even in this scenario. The U.S. stock market has only experienced back-to-back declines two times since World War II and we do not believe the fundamentals are currently in place for that to happen this year.

International markets withstood the declines better than U.S. stocks in 2022, helped by the +17.40% rise in the fourth quarter. For most of the year, the value of the U.S. dollar was rising due to the elevated inflation risks and increased energy costs. This results in a drag on international investment returns when profits that are made overseas are brought back to the United States. We do not expect the dollar to continue to rise, and may possibly decline, since inflation appears to be moderating and the cost of oil has dropped from $120 to $80 a barrel. Valuations are more attractive and dividends are higher for international equities than they have been in decades. All of these factors will likely lead to tailwinds for international markets in 2023.

For bond investors, the silver lining to interest rates rising in 2022 is that dividend yields on high quality bonds are now between 4-6%. Money market rates are also close to 4%. Not since prior to the 2008 financial crisis have rates been this high on fixed income investments. If rates decline, which is a good possibility for the economic climate we have described, then the total returns for bonds, which includes price appreciation plus dividend yield, could possibly reach double digits.

Prudent Portfolio Management Integrated with Comprehensive Financial Planning Provides the Best Long-Term Results

Many people become fearful during ominous economic and investment times, which often cause them to behave inappropriately as investors. Fear drives investors to run away when they likely should be moving forward, and immobilized when they should be taking informed positive actions. When consumer sentiment is low and news relative to world events is unsettling, equity markets most often bounce back.

Rather than being reactionary to daily news commentaries, we steadfastly remain emotionally detached from the day-to-day, and instead make proactive ongoing investment management decisions based upon our own internally formulated economic forecasts. By maintaining a consistent exposure to a diversified array of assets, and making tactical shifts over and above periodic rebalancing and profit taking opportunities, we seek to add value to our client portfolios, especially during periods of elevated volatility. Also, by continuously monitoring for tax loss harvesting opportunities in taxable portfolios, our clients benefit from a lesser tax burden and thereby increased investment returns.

At Total Wealth Planning, our team of financial planning and investment management professionals work closely together to ensure that opportunities for adding value to your financial situation are not overlooked. In our opinion, wealth-building and preservation must include not only investment management, but also financial planning activities. These include cash management, debt management, tax planning, risk management, college funding, retirement planning, and estate preservation.

We appreciate the trust and confidence clients have placed in us for the past 30+ years, and we look forward to seeing you in 2023!

Total Wealth Planning Investment Policy Committee:

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