OVERVIEW

First Quarter 2023

CAPITAL ADVISORS

Key Points

- While testifying before congress on March 7, 2023, Jerome Powell, Chairman of our nation's central bank opined, "Nothing about the data suggests to me that we've tightened too much."
- Two days later a classic run-on-the-bank by the customers of *Silicon Valley Bank* (SVB) sparked a financial contagion that triggered the second and third largest bank failures in U.S. history and a shotgun marriage to rescue the second largest investment bank in Switzerland.
- These events are a direct consequence of 13 years' worth of "emergency" monetary policy after the Global Financial Crisis, followed by a sharp reversal in 2022 into one of the most aggressive tightening campaigns in history (although management at the failed institutions shares a lot of responsibility due to inexcusable risk management).
- We believe recent events have likely re-written the script for the economy and the financial markets for remainder of the year.
- Our most confident forecast is a further tightening of lending standards throughout the banking sector in response to heightened deposit insecurity and stricter underwriting standards for loans.
- We suspect this market-based tightening of credit conditions can supersede monetary policy in the fight to tame inflation, enabling a pause in the Fed's rate-hiking cycle for the foreseeable future, and a possible reduction in short-term rates before year-end.
- Tighter credit conditions would be an incremental negative for the economy and the outlook for corporate profits, while the likelihood of recession has risen according to most economists (and we agree).
- However, if tighter credit conditions can contribute to lower inflation and interest rates, we believe financial markets can find their footing without a major drawdown, even if volatility remains elevated in the near-term, as seems likely.

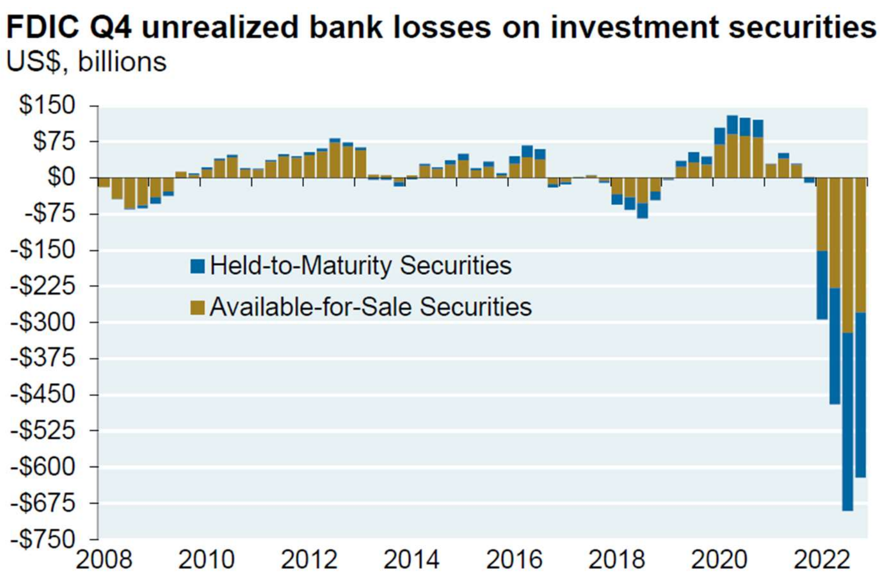
The Fed is in a Pickle

A strong argument can be made that the PhDs who populate the Federal Reserve (Fed) have no one to blame but themselves for the predicament they find themselves in. Setting aside the sticky question of blame for the sake of brevity, suffice it to say the Fed is in a pickle.

The Central Bank of the United States is bestowed with enormous responsibility. Not only is it charged with implementing the nation's monetary policy toward the dual mandate of stable prices and full employment, the Fed must also regulate the banking system. The current crop of Fed Governors finds itself in the unenviable position of executing an aggressive monetary policy – by necessity – that the banking system is poorly equipped to handle. This unfortunate condition contributed to the recent flare-up in bank failures, and we expect it to shape the financial market climate for the foreseeable future.

The Cause of Bank Fragility

All banks are under some degree of stress today because neither side of their balance sheet is positioned for the interest rate environment they currently find themselves in. During 13 years of miniscule interest rates following the Global Financial Crisis, including two years of zero-percent rates *and* massive money printing during the pandemic, banks accumulated an entire balance sheet of loans and securities at the rock-bottom interest rates that prevailed at the time. This is a problem now that interest rates have exploded higher because the value of *existing* loans and securities goes down when interest rates go up. The scale of this problem is reflected in the chart blow, which shows an unrealized loss of more than $600 billion on the securities holdings of domestic banks (mark-to-market losses on loans would be incremental to this figure).



Source: FDIC. Q4 2022.
For the Period 01-01-2008 to 12-31-2022

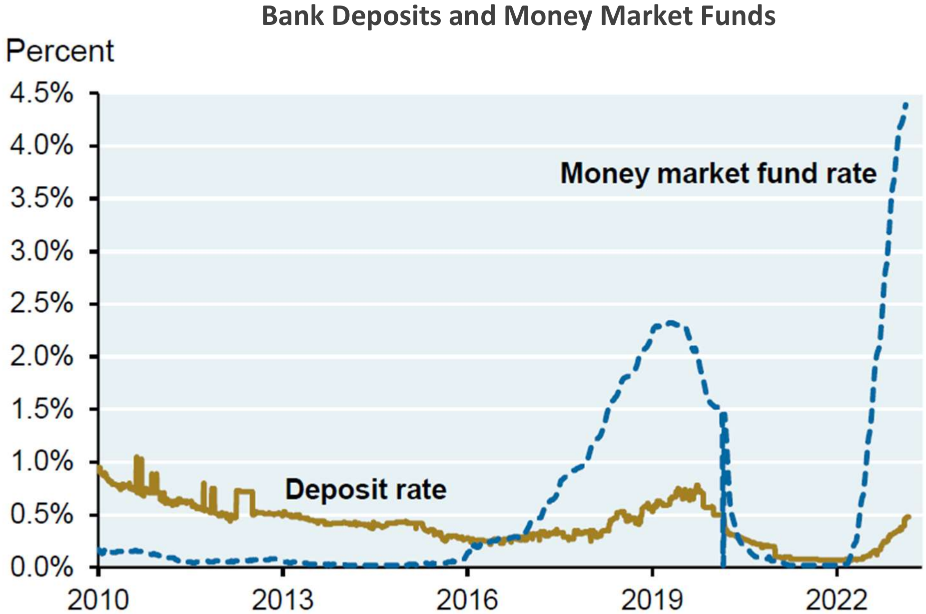
Given time, banks can adjust to higher interest rates because loans reprice as they are renewed, and low-coupon securities can be reinvested into higher yielding bonds as they mature. Unfortunately, raging inflation took the option of a gradual approach to monetary tightening off the table for the Fed. So instead of normalizing interest rates at a pace the banking system could handle, the Fed hiked rates by 5.0 percentage points in 12-months, a pace and magnitude that no degree of risk management can fully offset.

The Deposit Side of the Balance Sheet Matters Too

As alarming as a $600 billion+ hole in the asset side of the banking system might sound, it is not a problem *unless* a wave of deposit withdrawals forces banks to liquidate their underwater securities at a loss. This is due to an unusual accounting quirk in the banking sector. Bonds that are expected to be held to maturity can be carried on a bank's balance sheet at cost, even if the current price is substantially below cost. However, when a bank is forced to sell its underwater securities to address an outflow of deposits, the loss must be recognized as a permanent reduction in regulatory capital. This is what happened to *Silicon Valley Bank*.

Here again, the unprecedented speed with which the Fed took rates from zero to 5% has contributed to the vulnerability of bank deposits by making them uncompetitive with savings rates available from money market funds and Treasury Bills. The chart below reflects the interest rate differential between bank deposits and money market funds in recent years.

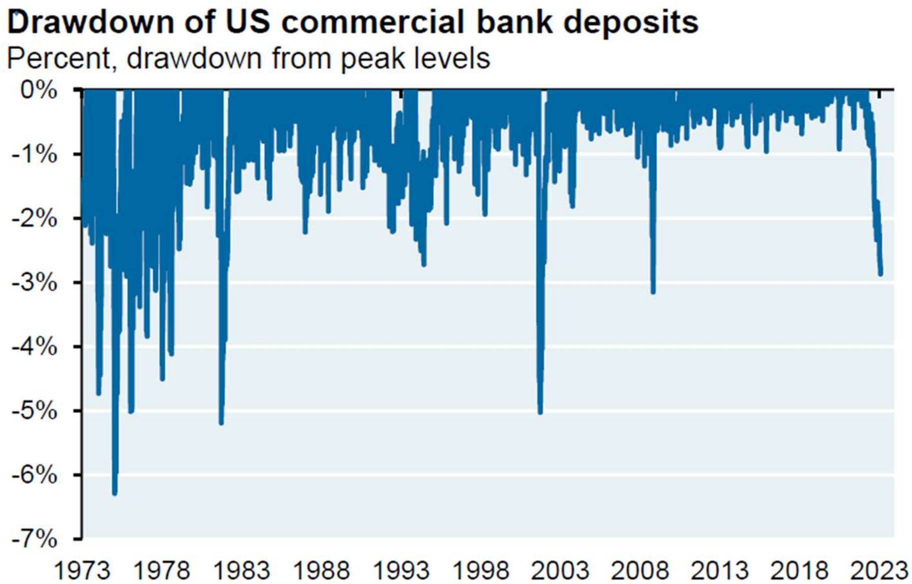
Interest Rate Difference Between
Bank Deposits and Money Market Funds



Source: Bloomberg, JPMAM. March 13, 2023.

For the Period 01-01-2010 to 03-13-2023

The yawning gap that emerged between the yield available on bank deposits relative to money market funds and Treasury Bills created a huge incentive for the owners of these deposits to move them. As the chart below reflects, this is exactly what has been happening, starting well before the collapse of *Silicon Valley Bank*.



Source: Bloomberg, JPMAM. March 1, 2023.
For the Period 01-01-1973 to 03-01-2023

The Case for Guarded Optimism

We believe financial markets can find their footing without a second coming of the Great Financial Crisis because today's challenge is an interest rate problem, rather than a credit problem. Back in 2008, each new policy tool that was concocted for the crisis ultimately fell short because hundreds of billions worth of leveraged mortgage derivative garbage went to zero when speculators in the housing market stopped paying their mortgage. No amount of policy magic can turn a worthless security into something useful.

Today, the primary assets behind the stress in the system are U.S. Treasury and agency securities with *zero* credit risk.[1] These securities are underwater due to the surge in interest rates over the past year, but they will mature at par given time. Importantly, the policy tools that have been implemented by the Fed and the Treasury thus far are intended to provide *time* for banks to accommodate an orderly reorienting of their balance sheets without triggering a wave of bank failures.

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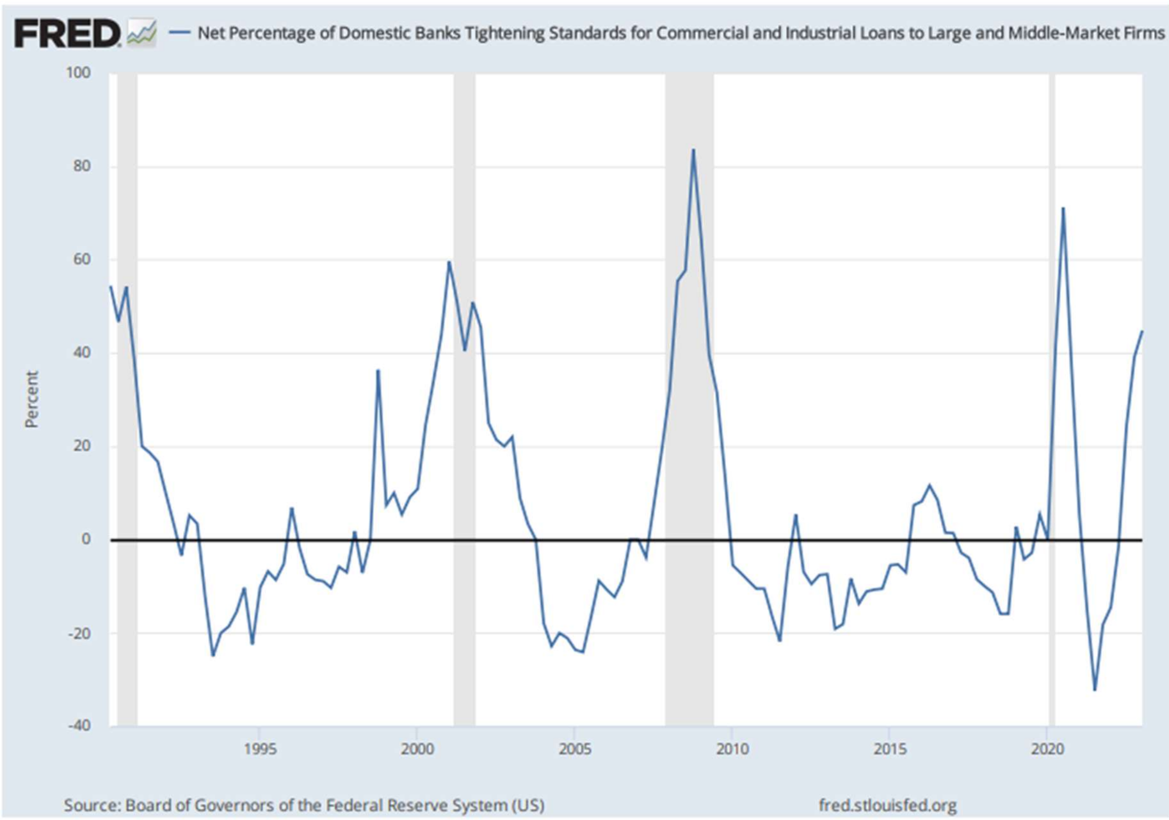
[1] U.S. Treasury and agency securities are perceived to have zero credit risk because the U.S. government can create the currency with which to repay the bonds. This statement presumes Congress will avoid voluntarily defaulting on U.S. Treasuries as a consequence of the debt ceiling extension process.

Investment Implications

Although we are optimistic that a disorderly banking crisis can be avoided, we recognize that the path to a new equilibrium for the banking system will almost assuredly result in a material tightening of credit conditions throughout the economy. Banks will need to pay more to retain deposits, limiting their profitability, and they will likely seek a higher margin of safety for their net capital position, limiting their appetite to extend new loans.

Bank Lending Standards Started to Tighten *Before* the Recent Bank Failures
04-01-1990 to 01-01-2023



This needn't be disastrous for financial markets if tighter credit conditions can supersede aggressive monetary policy in the fight against inflation. On balance, we believe a market-driven improvement in the path of inflation, accompanied by a pause in the Fed's rate hiking campaign, can be a net neutral for the financial markets, even though it implies a downgrade to the outlook for the economy and corporate profits.

Current Design of Our Investment Strategies[2]

The remainder of this report addresses the current positioning of each of our investment strategies under current macro conditions. The specific design of *your* portfolio is customized to match your return objectives and risk tolerance. **For a refresher on how your portfolio is designed, and why, please reach out to your Wealth Advisor any time.**

ASSET LEVEL	Based on your investment objectives and risk tolerance, we set parameters for an optimal stock/bond mix. Instead of keeping your portfolio at a stagnant allocation, we have the ability to change the stock-to-bond-to-cash ratios as market conditions change.
PORTFOLIO LEVEL	By understanding the types of portfolios/accounts we're managing, we structure each portfolio to fit its stage in the investment life cycle (accumulation vs. distribution). We also take into account legacy positions and/or outside assets.
STRATEGY LEVEL	By understanding your optimal asset allocation range and the types of portfolios being managed, we determine how our specific strategies should be combined. We utilize both fundamental and tactical strategies to help take diversification one step further.
SECURITY LEVEL	Our team of CFA charter holders performs deep research behind each security selected and provides rationale for trades. We strive to position your portfolio for prevailing market conditions to participate in long-term trends.

Managed Equity Strategies

Liquidity-driven asset inflation essentially pulled investment returns forward during the Covid response period of 2020-21, in our view. Liquidity began to pull back or normalize in 2022, underpinning asset price deflation. While stock and bond indices declined, there was a significant underlying rotation. For instance, the *Managed Equity Dividend* strategy eked out a gain for the year. We expect rotations to remain the highlight in 2023, though not all in the same direction.

Longer-term equity returns have been rather consistent since the Korean War in the 8%-11% range. For perspective, had the equity market returned (the more conservative version of) its "more typical" annual growth rates since 2018, the *S&P 500* would be just below where it is now.[3] Point-to-point, from 2018 through March 22, 2023, stocks are still up at a 10% annual rate, despite the recent round trip of excess returns in 2020-21 and bear market in 2022.[4] Note how, on the stem of the "T" table below, returns over various longer-term holding periods are somewhat tightly bound around the 9%-10% area.

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[2] The portfolio strategy discussions in this section are supplemental to a compliant presentation. A complete list of Capital Advisors' portfolio models and compliant presentations are available by contacting Capital Advisors.

[3] The "normal" line increases the year-end 2018 S&P 500 Index level by 9% per year, which is the average annual S&P 500 Index increase since 1950. The median increase (since 1950) is 11% by annual calendar year and 10% by weekly calendar year. As of December 27, 2022

[4] Source: Bloomberg, Orion. From December 31, 2018 – December 30, 2022. "The market" is represented by the S&P 500 Index. For consistency, the calculations and chart exclude dividends.

S&P 500 Index Since 1950		
% up days with a rolling 3-year holding period	% up days with a rolling 5-year holding period	% up days with a rolling 10-year holding period
90%	93%	97%

Annualized Returns As of Oct. 4, 2022
Since 3 years ago
10.5%
since 5 years ago
10.3%
since 10 years ago
12.1%
since 20 years ago
10.2%
since 30 years ago
9.8%
since 1950
11.2%

Source: Bloomberg; 1-1-1950 to 12-31-2022

Multiple key management teams have announced operational restructurings designed to defend near-term profitability in a more challenging macro – or at least the cessation of headcount expansion. Companies have had to make substantial supply chain and logistics investments since COVID. With the easing of supply chain bottlenecks (in some areas, quite significantly), those investments could now help defend margins and therefore the bottom line. On an aggregate basis, margins and balance sheets remain solid, giving good management teams flexibility to deal with shallow economic slowdowns, in our view. We believe rotations within the stock market will remain substantial and continue to believe the rotation will be in favor of well-capitalized secular growth leaders at reasonable prices.

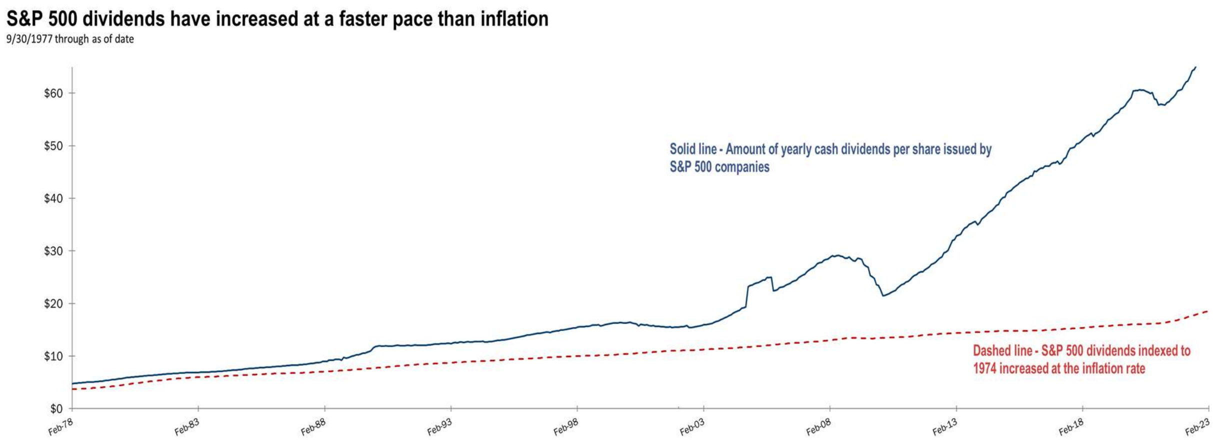
Managed Equity Dividend

The goals of the *Managed Equity Dividend* strategy are to provide clients with steady, healthy cash flow, cash flow growth over time, and exposure to the equity market for longer-term capital appreciation.

With potential for economic volatility, and with last year's Value-over-Growth rotation in jeopardy, we are maintaining a focus on stronger balance sheets, though we seek to maintain the portfolio yield. We effectively reduced portfolio turnover in 2022. We expect 2023 to be more challenging vs. the equity market, so expect an uptick in turnover.

We believe the *Managed Equity Dividend* strategy has several attractive attributes for the current market climate:

- The amount of cash the Strategy has returned to shareholders has grown nicely over time. For instance, assuming no withdrawals, the strategy has expanded its dividend cash flows at more than 7% annually since inception. The increase in cash income from the strategy was another 23% last year after logging a +9% 2021.[5]
    - The following chart shows dividend growth for the overall equity market, represented by the S&P 500, versus inflation:



- The *Strategy* returns are linked to the stock market, which over the long term, is generally regarded to be a solid inflation hedge. We expect inflation to decline in 2023 but remain above the pre-Covid levels.
- The *Strategy's* beta vs. the *S&P 500* is approximately 0.7, suggesting it has been meaningfully less volatile than the broader market.[6] In 2022, that lower volatility held true while the strategy significantly outperformed "the market."[7]

We purposefully manage the Strategy to mitigate risk within the confines of focused exposure to higher dividend paying stocks. While that focused exposure has multiple benefits, there are times when market conditions do not favor that factor. Our risk management process seeks to mitigate this risk, but cannot fully avoid it. In 2022, for instance, the Strategy posted a gain despite the broader equity market being down materially.[8]

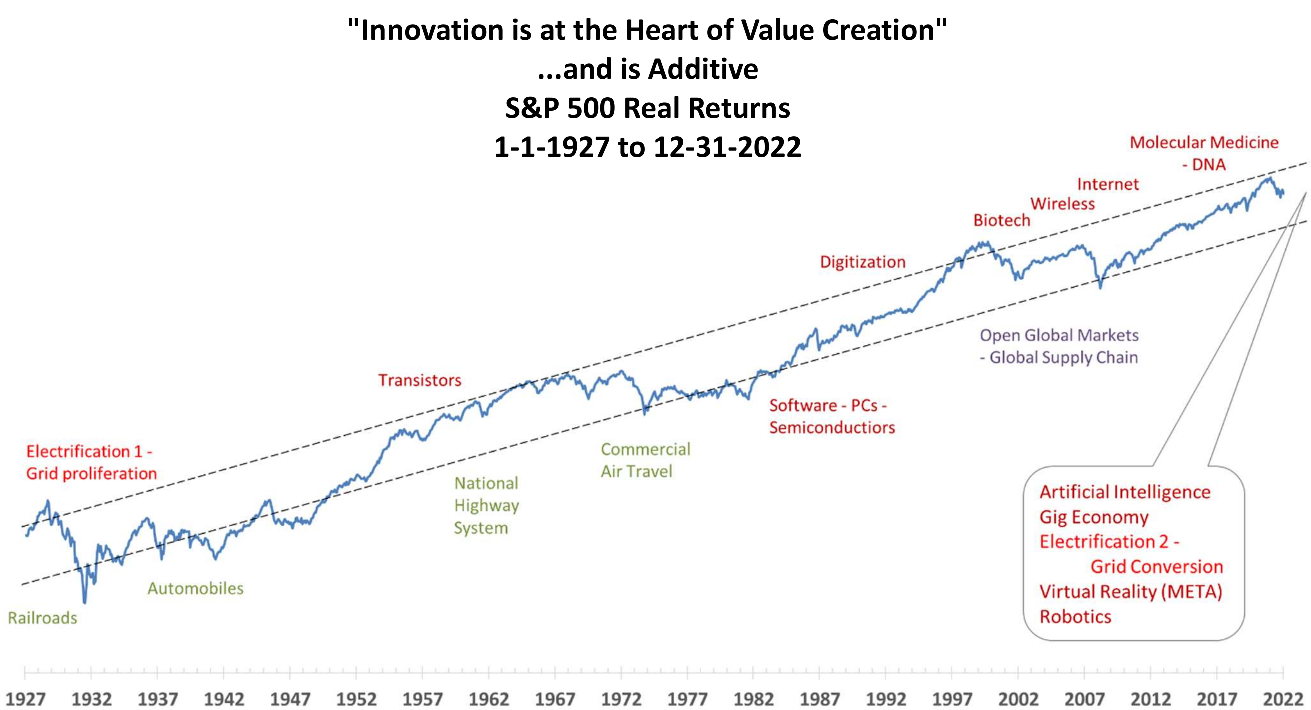
We continue to look for "bathwater" stocks – those whose prices have declined substantially because of consensus fears but that still have superb assets, including excellent management teams, leadership of attractive markets, and strong balance sheets.

[5] Source: ORION
[6] The market as reflected by the S&P 500 index's total return
[7] Source: Bloomberg as of December 27, 2022. The market is represented by the S&P 500 Index.
[8] Source: ORION; Bloomberg

Managed Equity Growth

The *Managed Equity Growth Strategy* slightly outperformed the *S&P 500 Index* in 2022, while retaining its growth style and a 0.9 beta (signifying lower volatility risk than the index). The benchmark *Russell 1000 Growth Index* underperformed the *S&P 500* by roughly 11.0 percent last year (1,100 basis points), while the *Morningstar* mutual fund category for Large-Cap Growth (our *Morningstar* peer group) underperformed the *S&P 500* by approximately 11.9 percent (1,190 basis points).[9]

Just because 2022 was a down year for asset prices, especially growth-style equities, does not mean global economic innovation has stopped - far from it. Innovation typically thrives in times of stress and necessity, often clearly visible in hindsight. Those times also help to separate weak companies from the great ones that can emerge stronger than before. In the current financial climate, we are looking for great companies whose stocks have been "thrown out with the bathwater," and well-managed leaders of trends that could grow strongly as the global economy evolves. The following chart is intended to put the equity market in perspective by showing how innovation drives sustainable value creation, and those innovations typically build upon each other.



Source: Capital Advisors, Inc.

[9] Source: ORION; Bloomberg; Morningstar

We believe there are opportunities to pick up excellent companies at attractive prices when viewed over the long term. Since the Strategy is already constructed around this philosophy, we also intend to use some cash to strengthen selected positions. We retained a moderate cash reserve over 2022, so we do not have to sell good stocks to take advantage of these opportunities. Just a brief reminder: Cash serves a dual role in the *Managed Equity Growth Strategy*. One is to balance risk taken elsewhere in the portfolio. A second is to take advantage of excellent opportunities during volatile periods without having to sell the stocks of great companies at depressed prices.

Managed Credit Strategies

Within our *Managed Credit Strategies*, we have continued to tilt the portfolios toward better credits, with roughly 70% of our clients' exposure in companies currently rated A- or better, on average.[10] We believe our BBB exposure has better balance sheets than the broad market, but we are willing and able to further reduce this exposure should we see specific situations worsen. We have also increased our allocation to U.S. Treasuries, as applicable, to provide further credit diversification from a potential slowdown in the economy. Our overweight to investment grade corporate credit generally underperformed Treasuries this quarter, and our defensive duration posturing somewhat detracted from relative performance to our clients' benchmark proxies. With interest rates still elevated versus the past many years, we will look to add to the longer end of the maturity spectrum to lock in higher yields for longer. On a go forward basis, portfolios are now yielding between 4.4% and 4.7%[11] depending on one's yield curve positioning.

Municipal Bonds

Our *Municipal Bond* portfolios are still focused on "A" and above credits with strong debt coverage and liquidity profiles. We have also intentionally over-weighted essential service revenue bonds (water & sewer, utilities, etc.), and general obligation bonds with an average portfolio credit quality of "AA." Citing stretched valuations up to this point, portfolios have been generally positioned with less interest rate sensitively to rising rates relative to the benchmark, somewhat underperforming benchmark proxies in Q1. As maturities come due, however, we will look to take advantage of the rising likelihood of increasing tax rates across America to lock in tax-free yields for longer. Looking forward, portfolios are now yielding between 2.5% to 2.9% tax free *(between 4.0% and 4.6% at the 37% highest marginal tax rate)*[12] depending on one's yield curve positioning, providing solid levels for tax-sensitive bond investors.

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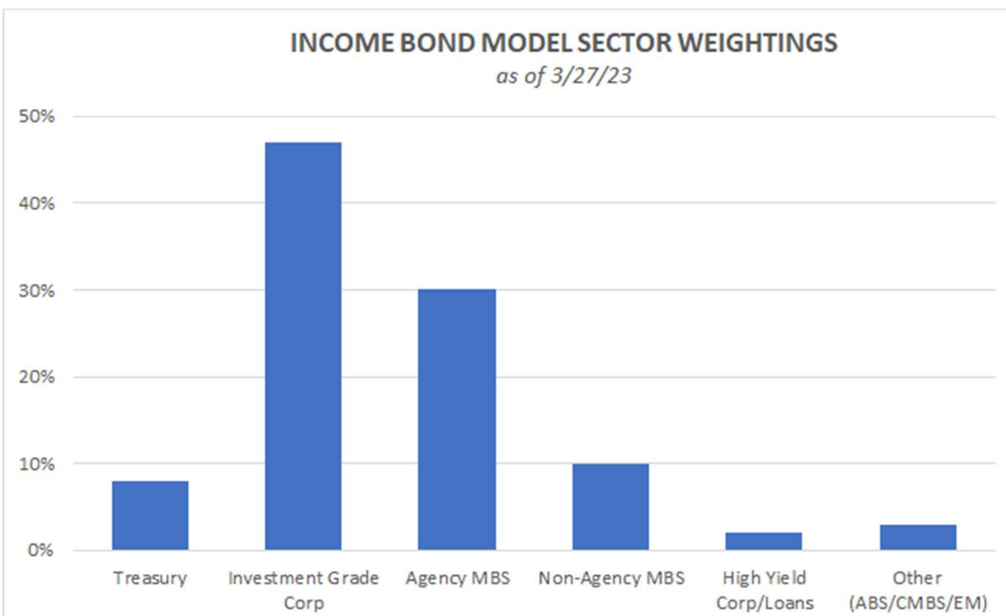
[10] Source: ORION
[11] Source: ORION; Bloomberg
[12] Source: ORION, Bloomberg

ETF Bond Models

Our *Aggregate Bond* ETF strategy continues to be 100% invested in "defined maturity," investment-grade corporate bond ETFs. Today, there is a relatively even laddered maturity structure of ETFs ranging between 2025-2029, thus remaining relatively conservative from an interest rate sensitivity perspective. We took advantage of higher rates this quarter by selling our exposure to the **iShares iBonds Dec. 2024 Corporate ETF (IBDP: ~$24)** and added to the **iShares iBonds Dec. 2029 Corporate ETF (IBDU: ~$23).** This proved to be timely as we were able to lock in elevated yields for longer just ahead of the looming banking crisis and a precipitous drop in market interest rates. With the increases in overall market yields over the past year, the model now carries an average net acquisition yield close to 5.0%[13].

The *Income Bond* ETF strategy has focused on maximizing cash flows within the construct of balancing risks. For many quarters now, the model has been defensively postured relative to the benchmark from both an interest rate and credit risk perspective. However, we began to take advantage of higher rates this quarter by selling some of our exposure to the **iShares iBonds Dec. 2026 Corporate ETF (IBDR: ~$23)** in the model, while adding the **iShares Broad US Investment Grade Corporate Bond ETF (USIG: ~$50**), a portfolio whose securities have an average maturity of ~10 years[14]. As highlighted in the *Aggregate Bond* discussion, we were able to lock in yields for longer just ahead of a drop in market interest rates.



Source: ORION, iShares, State Street

[13] Source: Bloomberg, iShares, State Street

[14] Source: iShares.com

We continue to hold over 50% of the model's exposure invested in active managers (**SPDR Doubleline Total Return ETF (TOTL: ~$41) and Janus Henderson Mortgage-Backed Securities ETF (JMBS: ~$46),** both of whom attempt to avoid many pitfalls in times of market stress along with taking advantage of pricing inefficiencies when prudent. For example, as interest rates remained elevated in the Treasury market heading into Q1, **TOTL** carried the largest Treasury exposure and longest interest rate duration positioning for at least the past eight years.[15] Meanwhile, **JMBS** took advantage of a massive move higher in mortgage borrowing rates late last year to optimize its portfolio positioning within the "AAA-rated" agency mortgage-backed securities (MBS) market. Both managers outperformed their benchmark proxy this quarter. With the increases in overall market yields over the past year, the model now has an average net acquisition yield north of 5.1%[16] with an overweight to high quality corporates and Agency MBS.

Tactical Global Growth Strategy

The most noteworthy change in the asset allocation for the upcoming quarterly period is an increase in domestic small-cap stocks to overweight, and a reduction in high-yield credit from overweight to neutral.

Tactical Global Growth Strategy
Asset Allocation for the Upcoming Quarter

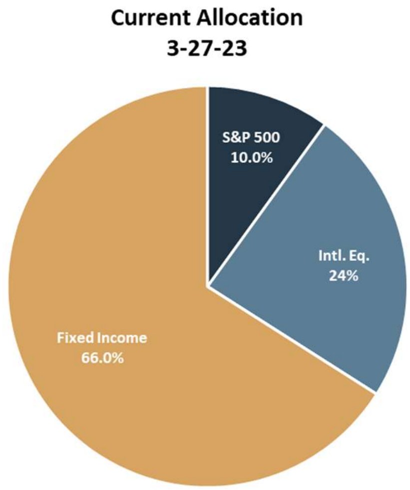
Asset Class	Target Weighting (2Q 2023)
U.S. Large-Cap Value	Overweight (17%)
U.S. Mid-Cap	Overweight (17%)
U.S. Small-Cap	Overweight (17%)
High-Yield Credit	Neutral Weight (11%)
International Developed Markets	Neutral Weight (11%)
International Small-Cap	Neutral Weight (11%)
Emerging Markets	Underweight (5%)
Real Estate	Underweight (5%)
U.S. Large-Cap Growth	Underweight (5%)

The *Tactical Global Growth* strategy provides a strategic allocation to nine major risk markets globally. Broad diversification across multiple geographies, factors, asset classes and market caps support the risk-adjusted return profile of the strategy. We strive to further enhance long-term returns by systematically adjusting the weightings among the nine sectors to overweight markets that demonstrate relative strength, while reducing the allocation to markets that exhibit relative weakness.

[15] Source: State Street, Doubleline
[16] Source: Bloomberg, iShares, State Street

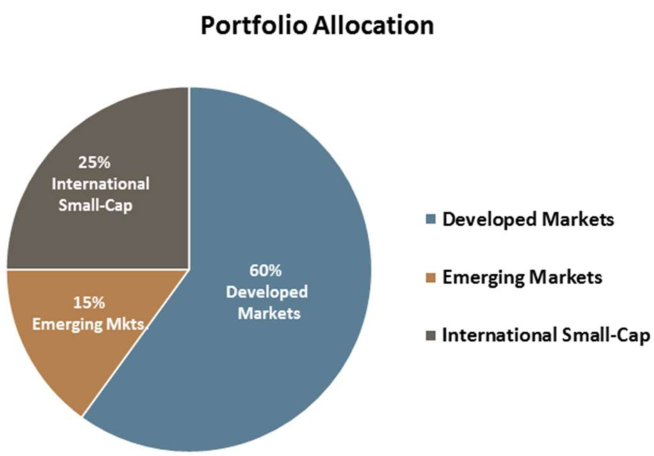
Dynamic Allocation Strategy

This strategy responded to the flare-up in market volatility in February and March by shifting toward a more conservative asset allocation. As of late-March the portfolio had roughly 66% of its assets in short-term U.S. Treasury reserves, with the remainder in large-cap equities within the *S&P 500 Index* and *MSCI EAFE Index* (international markets).



International Focus Strategy

International equities had a strong start to the New Year in January before pulling back in February and March. This strategy had a modest gain year-to-date as of the final week of March.



The *International Focus* strategy provides a strategic commitment to international equities to expand the universe of companies for investment beyond the U.S. market within a diversified portfolio. To enhance the potential diversification benefits of this expansion, the strategy seeks to capture a return premium relative to common international equity benchmarks through disciplined emphasis on three market factors that have demonstrated a long-term history of attractive risk-reward characteristics: Value, Momentum and Low Market Capitalization, or “small cap."

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This presentation is not an offer or a solicitation to buy or sell securities. The information contained in this presentation has been compiled from third party sources and is believed to be reliable; however, its accuracy is not guaranteed and should not be relied upon in any way, whatsoever. This presentation may not be construed as investment advice and does not give investment recommendations. Any opinion included in this report constitutes the judgment of Capital Advisors, Inc. as of the date of this report, and are subject to change without notice.

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The **S&P 500 Index** is a stock market index based on the market capitalizations of 500 leading companies publicly traded in the U.S. stock market, as determined by Standard & Poor's. The index is calculated on a total return basis with dividends reinvested and is not assessed a management fee.
The **Russell 1000 Growth Index** seeks to track the investment results of an index composed of large- and mid-capitalization U.S. equities that exhibit growth characteristics.
The **Russell 1000 Value Index** seeks to track the investment results of an index composed of large- and mid-capitalization U.S. equities that exhibit value characteristics.
MSCI EAFE Index is a free float-adjusted market capitalization index that is designed to measure the equity market performance of developed markets, excluding the U.S.
MSCI Emerging Markets Index is a free float-adjusted market capitalization index that is designed to measure equity market performance in the global emerging markets.
MSCI EAFE Small-Cap Index is a free float-adjusted market capitalization index that is designed to measure the equity market performance of small- and mid-cap stocks in the developed markets, excluding the U.S.

Estimated portfolio yield represents the 12-month run-rate of interest and/or dividend payments in a strategy divided by the market value of the securities and cash reserves invested in the strategy. Estimated interest/dividend payments and market values are calculated by a portfolio accounting system from *Orion* using a single client portfolio that Capital Advisors believes to be representative of clients' portfolios invested in the same strategy. The actual portfolio yield for any single client portfolio may be lower or higher than the yield quoted. The underlying holdings of any presented portfolio are not federally or FDIC-insured and are not deposits or obligations of, or guaranteed by, any financial institution.

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Items of Note Regarding Exchange Traded Funds: An Exchange Traded Fund (ETF) is an investment company that typically has an investment objective of striving to achieve a similar return as a particular market index. The ETF will invest in either all, or a representative sample of the securities included in the index it is seeking to imitate. Like closed-end funds, ETFs can be traded on a secondary market and thus have a market price that may be higher or lower that its net asset value (NAV). If these shares trade at a price above their NAV they are said to be trading at a premium. Conversely, if they are trading at a price below their NAV, they are said to be trading at a discount.

The information provided is supplemental to a fully compliant presentation. A complete list of Capital Advisor's portfolio models and compliant presentations are available by contacting Capital Advisors at the number listed below. The actual return and value of an account fluctuate, and at any time the account may be worth more or less than the amount invested.

Additional information, including management fees and expenses, is provided on Capital Advisors' Form ADV Part 2, available upon request or at the SEC's Investment Adviser Public Disclosure site, https://adviserinfo.sec.gov/firm/summary/104643

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