QUARTERLY COMMENTARY
Notes from the NewSquare Community

NEWSQUARE CAPITAL

2nd Quarter • 2022

Managing risk is key, through these challenging times and the full market cycle.

"The essence of investment management is the management of risks, not the management of returns."

Benjamin Graham, the man recognized as the father of value investing, wrote those words just a few years after he had lost a lot of money in the stock market crash of 1929 and its aftermath. Graham outperformed that market, both on the way up and the way down, through what we all recognize today as a true foundational block of investing success: risk management. His lessons are worth revisiting today, as spiking inflation, rising interest rates, recession worries, and the war in Ukraine weighed on both equities and bonds in the first half of 2022. Are we seeing the end to a long run of historically great returns since 2009?

In times like these (and during the roaring bull markets we've seen recently, when most everything seemed to work), it's important to set your expectations and measure your results over a full market cycle. Full market cycles, generally defined as the period from one stock market peak to another, which include a price decline of at least 20% and a rebound that establishes a new, higher peak, typically last from five to 20 years. This most recent six-month period hurts. At times like this, it's critical to manage your emotions, no matter what's happening in the markets, and ensure you don't make decisions that can drive poor long-term outcomes. The key to managing emotions, we'd argue, is managing risk.

Getting through the tough innings

We like to think about it in baseball terms: Losing an inning (or two, or three) doesn't matter, as long as you win the game. No matter how good a baseball team may be, they'll struggle through difficult frames and even losing streaks. But, there are more innings to play before the end of the game, and many more games in the season.

Likewise, even the best investment processes will disappoint at times. Value investor Joel Greenblatt, a Columbia University professor and co-founder of Gotham Asset Management, often points to a study that examined the **top-performing** investment managers over a 10-year period. Of those who ranked in the top 25% of returns for the whole decade…

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—Benjamin Graham, *Security Analysis*, 1934

- Nearly all (96%) spent **at least one 3-year period** in the bottom half of the performance rankings.[1]
- More than three quarters (79%) had **at least one 3-year period** in the bottom quartile.[1]
- Nearly half (47%) spent **at least three of the 10 years in the bottom 10%.**[1]

These are absolutely **stunning** numbers!

Those managers dealt with some very tough innings, but they all "won the game" in the end. The lesson for investors? We know that investing will include bull markets, corrections, and even lengthy, painful market drawdowns. Through it all, the keys to long-term success in investing remain simple (if not always easy) and timeless:

- Set your expectations for the long term; historically investing over full market cycles works.
- Understand your risk tolerance and build your allocations and portfolio to match.
- Mitigate risk.

Those principles work. There will also be short-term periods when they don't seem to work. Sometimes, those trailing periods come when markets rally, and those who manage risk for the long haul may find their portfolios aren't keeping pace. Those innings can be tough, because you can feel like you're missing out. In reality, history says that over the full game, the long haul, you may not be.

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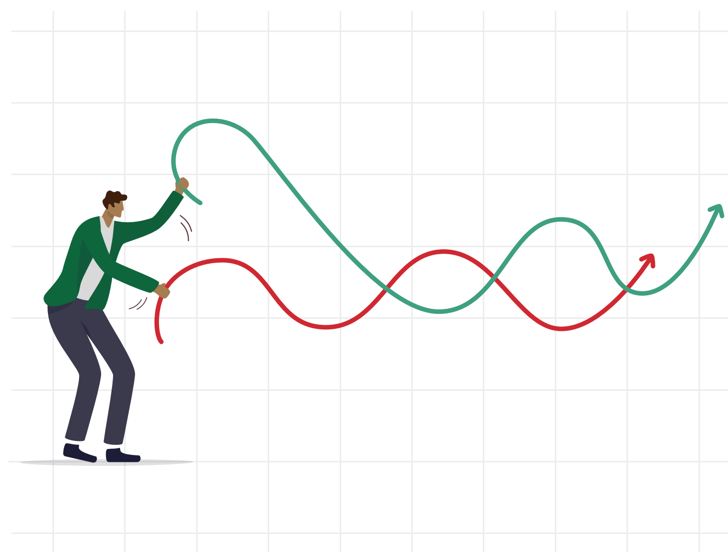
Times like these lead to opportunities

At NewSquare Capital, we're investors. We know this market doesn't feel good right now. We also know that over a full market cycle, what feels significant now is most likely a minor stumbling block on the path to success. It is just a part of the process. We strive to stay steadfast through each phase of the cycle, and we encourage you to do the same. One of the things we tell every investor and advisor we work with is really simple, but a lot of investment professionals don't say it enough: There will be periods of underperformance.

For many investors, the first half of 2022 was one of those periods. Still, it's not unique at all, even over the last long bullish cycle. In the Great Recession, the S&P 500 Index hit bottom in March of 2009. From then until January 3, 2022, the index advanced more than 800%, averaging nearly 19% per year. Stunning numbers, indeed. However—and this can be easy to forget—it wasn't always easy.



Since 2009, it feels like equities have been on a steady rise. That's not the case. The S&P 500's bear market of 2022 was preceded by numerous pullbacks and drawdowns …

S&P 500® Drawdowns Since the 2008 Crash[3]

Peak	Trough	Drawdown
4/23/2010	7/2/2010	-16.0%
4/29/2011	10/3/2011	-19.4%
11/3/2015	2/11/2016	-13.3%
1/26/2018	2/8/2018	-10.2%
9/20/2018	12/24/2018	-19.8%
2/19/2020	3/23/2020	-33.9%

It was even worse for the Russell 2000 Index, which measures the smallest 2000 stocks in the Russell 3000 …

Russell 2000 Drawdowns Since the 2008 Crash

Peak	Trough	Drawdown
4/23/2010	7/6/2010	-20.5%
4/29/2011	10/3/2011	-29.5%
6/23/2015	2/11/2016	-26.4%
8/31/2018	12/24/2018	-27.2%
2/19/2020	3/23/2020	-41.6%

Source: https://awealthofcommonsense.com/2021/12/this-bull-market-hasnt-always-been-easy/

Even this series of bull markets, interrupted by the pandemic in 2020, featured periods when risk management was, very obviously, critical. It's those periods—when the easy call might have been to pull out and run for safety—that define the truly successful long-term investor. We've seen people get out of the market before, and it's really hard to time the market. If an investor does pull out, it's just as hard to get back in at the right time. Not many do.

Bottom line, it's tempting to be an aggressive investor when the market is going up, then become more conservative during a downturn. History tells us that when investors do that without a plan, the switch is usually flipped after most of the downside has materialized. Investors who chase performance generally underperform, dreadfully.

We've seen that in the current pullback. The stocks that led the market up, not just recently but over the last 15 years or so, are growthy, technology-related names in the information technology, consumer discretionary, and communication services sectors. Performance-chasing investors piled into them, and when the market turned, those same stocks led the charge downward. Below, you can see the percentage of S&P 500 stocks in each sector (as well the index itself and the NASDAQ 100), that were above their 200-day moving average, a common way to identify stocks on an uptrend, in late June 2022.

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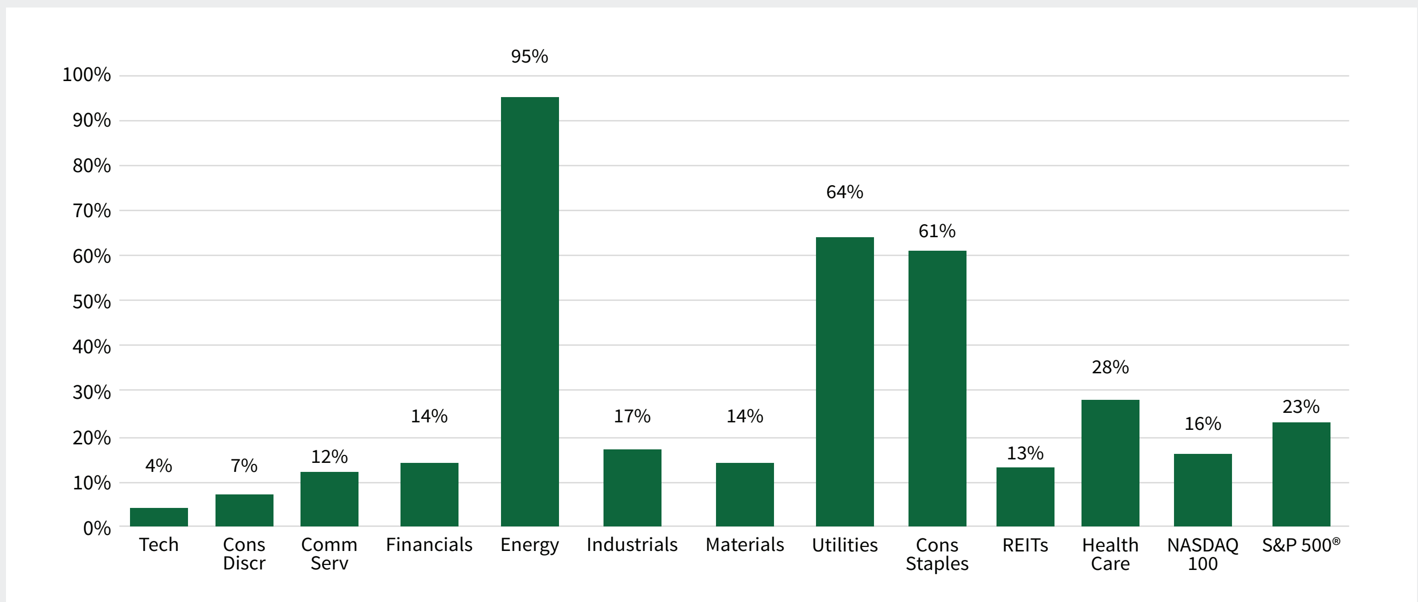
% of sectors and indices above 200-day moving average, as of 6/28/2022



Source: Charles Schwab, Bloomberg, as of 6/28/2022. S&P 500® sectors shown.

Fact is, emotions and behavioral factors, such as recency bias, overconfidence bias, and disposition bias, can lead investors to make poor decisions, move away from their long-term plan, and lose money over a full market cycle or a lifetime. (Check out our piece on all this at newsquarecapital.com. We keep it right at the top of our Insights page because it bears repeating.)

The lesson? Markets drop, sometimes in ways that feel precipitous and scary. Bear markets are an unavoidable part of investing. But there is a way to respond. Again, if your portfolio matches your time horizon and risk tolerance, periods of volatility shouldn't shake your resolve, so long as you mitigate risk.

There's a massive difference, by the way, between chasing performance or switching away from your long-term plan and managing risk or making tactical adjustments within your portfolio. Those kinds of moves may have paid off for some, even in this challenging stretch.

Remember, every downturn can at some point lead to opportunities, which will let investors take advantage of the full market cycle. When those opportunities will come, we'll be ready.

Market Review

Inflation, exacerbated by the war in Ukraine and supply-chain disruptions, rising interest rates driven by the Fed's moves to reign in surging prices, and fears of a recession dominated the markets in the second quarter and the first half of 2022. There was, in effect, "no place to hide." Year-to-date, the S&P 500 was down -19.97%, the NASDAQ 100 returned -29.22%, and the Bloomberg U.S. Aggregate Index declined -10.35%.[2]

For equities, only the energy sector advanced, backed by high oil prices. What's more, looking under the index's hood showed an even uglier picture. The average stock in each actually performed much worse than the indexes themselves. Even commodities joined the downturn toward the end of the quarter, as few areas of the financial markets would escape the liquidity drain of rapidly tightening Fed policy, inflation, and associated worries about the impact on economic growth.

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Not Pretty

A deeper dive shows that many stocks performed much worse than broad indexes in 2022 and over the last year, as the energy sector and a limited number of outperformers lifted index returns. It's yet another example of the value of risk management.

Major indexes and maximum drawdowns

	Year-to-date			Past 52 weeks			
Index	YTD return	Index maximum drawdown from YTD high	Average member maximum drawdown from YTD high	Index return from YTD low	Index maximum drawdown from 52w high	Average member maximum drawdown from 52w high	Index return from 52w low
S&P 500®	-21%	-24%	-29%	3%	-24%	-31%	3%
NASDAQ	-29%	-33%	-42%	4%	-34%	-51%	4%
Russell 2000	-25%	-27%	-42%	3%	-32%	-51%	3%

Source: Charles Schwab, Bloomberg, as of 6/21/2022. Indexes are unmanaged, do not incur management fees, costs, and expenses, and cannot be invested in directly. Past performance is no guarantee of future results. Some members excluded from year-to-date return columns given additions to indices were after January 2022.

Turning to Fixed Income, the first half was one of the most difficult six-month periods in decades. As inflation continued to ratchet up, the Fed and other key central banks hiked interest rates, tightened policy, and threatened more hawkish moves ahead. Expectations changed quickly, with the federal funds rate forecast to hit 3.75% or more by mid-2023, nearly double the projections from just a few months prior. It all added up to tremendous pressure on bond markets. The good news? Yields are more attractive than they've been in years. The sell-off has been orderly and valuation-driven, tied directly to rising interest rates as opposed to panic selling. Most importantly, remember: typically if you hold bonds to maturity, you'll still get your principal back. That's a big reason, one of many, that bonds can help preserve capital, generate income, and provide diversification, thus reducing a portfolio's volatility and smoothing out risk-adjusted returns over time.

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[1] Source: Davis Advisors. 176 managers from eVestment Alliance's large cap universe whose 10-year average annualized performance ranked in the top quartile from January 1, 2000 – December 31, 2009.

[2] Source: Bloomberg.

Statistical data sourced from: Bloomberg Finance, LPL Research., Morningstar, and NewSquare Capital, LLC

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The S&P 500® is widely regarded as the best single gauge of large-cap U.S. equities. The index includes 500 leading companies and covers approximately 80% of available market capitalization.

The Nasdaq-100® is a stock market index made up of 102 equity securities issued by 101 of the largest non-financial companies listed on the Nasdaq stock exchange.

The Bloomberg Barclays US Aggregate Bond Index is a broad-based flagship benchmark that measures the investment-grade, US dollar-denominated, fixed-rate taxable bond market. The index includes Treasuries, government-related corporate securities, MBS (agency fixed-rate pass-throughs), ABS, and CMBS (agency and non-agency).

The Russell 2000® Index measures the performance of the small-cap segment of the US equity universe. The Russell 2000 Index is a subset of the Russell 3000® Index representing approximately 10% of the total market capitalization of that index.

[3] Peak is the Market High, Trough is the Market Low and the Drawdown is the percentage drop from Peak to the Trough.

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