FAHNESTOCK ASSET MANAGEMENT

of Oppenheimer & Co. Inc.

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Dear Client,

Global financial markets struggled in the first half of the year. The S&P 500 had the worst first half since 1970 and the NASDAQ had the worst first half EVER. To follow is some context on why the market sold off, how we are reacting to the volatility, and why we continue to be optimistic about the future of the economy and your portfolio.

In the wake of Covid shutdowns, governments and central banks implemented aggressive fiscal and monetary stimulus. In recent testimony, the chairman of the Federal Reserve commented that the magnitude of the stimulus unleashed was proportional to the time it would take to develop a vaccine. **They assumed it would take two to three years; it took only six months**.

This miscalculation overstimulated the economy pushing stocks, bonds, and real estate materially higher. The ability to borrow at very low rates and direct payments to businesses and families resulted in over investment and speculation. This excess stimulus is also responsible, along with factors discussed in previous letters, for pushing inflation to levels not seen since the early 80s.

To combat inflation and cool an overheated economy, central banks are now tightening financial conditions and raising interest rates. Markets reversed course too with the NASDAQ, S&P 500 and Dow Jones Industrial Average down 29%, 20%, and 16% through the first half of the year. The sectors that experienced rampant speculation on the way up – high growth profitless tech companies, cryptocurrencies, SPACs, and "meme" stocks – have also been those hardest hit on the way down, with some down 80-90%. Your accounts have held up well but they have not been immune to the volatility.

As long term investors, we cut through the short-term noise and concentrate on where we think investments will be in 2-5-10 years. **Financial markets have weathered major disruptive events in the past and living through periodic bouts of volatility is the price of entry for superior long term returns. Selloffs are common. From 1990 to 2021 the S&P 500 experienced an average 13.88% drop from peak to trough each year.** However, in that same time, the S&P 500 averaged annual returns of 9.89%. Time in the market is much more important than timing the market.

If the first rule of volatility is to not panic, **the second rule of volatility is to embrace it. Periods of market stress give patient investors the ability to buy investments at a discount and we have been doing just that**. The biggest opportunity has been in fixed income where materially higher interest rates triggered a selloff in longer term bonds. The US Aggregate Bond Index was down 10% in the first half of the year, a big loss for what is meant to be a low risk investment and one that we largely avoided by keeping maturities very short term. For the last decade this asset class yielded only 1-4% per year depending on maturity and credit quality. Over the last four months we have been purchasing bonds of low risk issuers, locking in 4-7% yields, and extending maturities out to 4-8 years.

We have also been sifting through the rubble of high growth, no profit technology companies that have been left for dead. We are buying companies with strong earnings growth, strong balance sheets, and a defined path to profitability for 20 cents on the dollar compared to just 6 months ago. **We humbly recognize that we will never buy at the bottom and that a new investment might go down before it goes up. But we do not care where**

prices will be in 2-3 months, only where they will be in 2-5-10 years. Time and patience are our biggest assets. When things feel the most daunting, and the emotional pendulum has hit an extreme, that is the time to buy. We do not know if the bottom is in but it does feel like most of the damage has been done.

It remains to be seen if central bank tightening will cause a recession and frankly, we do not spend a lot of time thinking about it as the current environment is not the backdrop of a financial crisis. Household and corporate finances are strong and industrial output continues to grow. There is a record job market, banks are healthy, and economic fundamentals are generally on solid footing. This is not a typical economic cycle, rather it is one reacting to the ebbs and flows of stimulus and is part of the journey to a post-Covid normalization.

If you have any questions at all about your portfolio or your finances, do not hesitate to reach out. Enjoy the rest of your summer and stay cool!

Sincerely,

Craig W. Hutchison
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