January 2023

Dear friends and colleagues,

Happy New Year! We hope your year is off to a great start after a somewhat challenging 2022. Thankfully, the COVID global pandemic began shifting toward endemic status as new variant severity declined and we adapted our lifestyles to accommodate this unwelcome intruder. The world offered a new series of challenges, however, including a major land war in Europe, energy challenges and physical attacks on major pipelines, heightened geopolitical tensions across the world and clouds of a global recession beginning to form as central banks across the world began tightening monetary policy by raising interest rates in one of the most aggressive adjustments in history.

Not surprisingly, equity markets reacted by shedding roughly one-fifth of their value. While each of the above individual events was impossible to predict and timing markets is equally fruitless, some of the investment industry's conventional wisdom broke down to the unfortunate surprise of many investors. Just because one can't predict events doesn't mean you can't take prudent action to protect clients. Most private banks and wealth management firms continue to maintain their cookie cutter asset allocation models where clients are put into model portfolios such as 60% stocks and 40% bonds or some variation of those ratios depending on whether they checked the conservative, moderate or aggressive box on a questionnaire. And why not? The strategy worked fine for 30 years, so the industry lemmings had no reason to change course and marched right off the cliff.

In 2022, 60%/40% portfolios had one of their worst years in history, certainly the worst since the 1930s, primarily because bonds had their worst year ever. The allocation to bonds was supposed to provide ballast and protection in a down market. Unfortunately, in a year when equities experienced steep losses, bonds compounded the problem as intermediate Treasuries lost 13% while long-term Treasuries fell more than 29% - far worse than the 18% decline in the S&P 500. In some cases, these so-called "balanced" portfolios surprisingly declined more than equity markets.

While no one can time markets, a more thoughtful approach to portfolio construction would have dampened losses. There is no magic in a 60%/40% or other model portfolio variants. The theory was that the addition of bonds to a portfolio, a lower volatility asset which are negatively correlated with equity markets in a "normal" market, would provide some protection for investors. When bond markets were pushed into a bubble territory as a result of lower and lower interest rates, however, it should have raised caution flags. At a minimum, advisors should have been warning clients about the increasing risk in these safe haven assets. Unlike Gresham, most wealth management firms don't have the ability and/or the willingness to offer alternative approaches for risk reducing assets. Even cash would have been a better place to hide, but whether it's simple-minded momentum or conflicted advisors having no incentive to allocate to these less sexy alternatives, the damage to portfolios was significant.

The willingness to think unconventionally about portfolio construction – and other elements of investing – rarely manifests its value and is underappreciated until we reach a year like 2022. Over Gresham's 25-year history, which has included many difficult market years, the benefits to our clients of this approach have been significant, softening declines during the worst market environments. Prudent portfolio construction doesn't need to protect "on average," as most industry statistical models imply, but rather it needs to protect during the worst periods so that investors can remain invested through these rough patches.

We will certainly take some credit for being willing to think about investing differently and challenge conventional wisdom, but more credit should go to our clients and the nature of how we have built our business that affords us the opportunity to think unconventionally. Our independence in both ownership and mindset liberates us from the need for conformity. It's one thing to talk about these differences, but I get the most enjoyment out of watching younger members of our investment team gain exposure to other investors who are required to make decisions that are based on non-investment considerations. 2022 reminded us of how grateful we should be for the investment flexibility afforded to us by our clients, as it is during difficult market environments where the seeds of differentiated results are sown, even if it's something as subtle and infrequently visible as a different approach to portfolio construction.

Since we are on the subject of thanking our clients, Gresham successfully celebrated its 25th anniversary this past year. We ended the year with our largest and strongest team, including several new promotions. It is the future leaders of our firm to whom we entrust guarding our founding principles and our sustained independence, as we ourselves were once tasked to do. Many of our clients are themselves business owners and leaders and understand the gratification of overcoming hurdles and watching your baby grow up. We are truly proud of what we are building, and we couldn't have done this without you.

Thank you for your continued partnership and support.

Ted

Edward F. Neild IV
Chief Executive and Chief Investment Officer