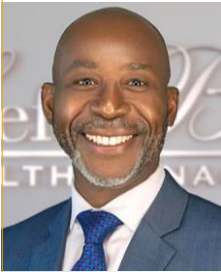


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NOLAND'S Notes

Creating, Building, and Preserving Wealth

What did 2022 tell us about investment opportunities? How does 2022 inform Left Brain's investment strategies for 2023? CEO Noland Langford analyzes the investment landscape of the past year, evaluating the events and dynamics of 2022 within the unique perspective of our Left Brain Lens. Then, looking forward, he offers expert insights on the economic factors that will shape investment opportunities in the year to come.

NOLAND'S NOTES 2022 RECAP/2023 OUTLOOK

*For those of you who are new clients or those who are reading this note for the first time, let me explain Noland's Notes: each year I sit and write you a note. In the note, I analyze the prior year in my own words, so you have a better understanding of the investment environment in which we are managing your accounts. I also offer my views of the landscape, as we enter the new year. Our brief discussions we have throughout the year do not permit me time to explain to you my full market analysis. My hope is that in the 20 minutes (or so) that it takes you to read my note, you will gain a better feel for how we view the present investment climate, as well as our general thought process of how we discover winners in the ever-changing investment markets. **Welcome aboard (or welcome back) and I appreciate your feedback!!!!***

Though this note was written with you, the client, in mind. Please send it to your inner circle of family, relatives, or friends, should you think it appropriate. This letter offers an introduction to the philosophy of our work, should you wish to introduce Left Brain to colleagues.

Let's Get Started!

Here are the official returns from 2022:

INDEX	CLOSE PRICE	RETURN (%)
DOW JONES IND. AVERAGE (LARGEST U.S. STOCKS)	33147.25	-8.92
S&P 500® (U.S. STOCKS)	3839.50	-19.44
RUSSELL 2000 (SMALL CAP COMPANIES)	1761.25	-21.56
NASDAQ (TECH AND GROWTH FOCUS)	10466.48	-33.10
MSCI EAFE® (INTL STOCKS)	1949.40	-16.04
MSCI EMERGING MARKETS (TICKER EEM)	37.90	-22.42
MSCI US REIT (REAL ESTATE)	1146.11	-27.33
AGGREGATE U.S. BOND INDEX	96.99	-14.98
GOLD (PER OUNCE)	1819.70	-0.43
OIL (PER BARREL)	80.26	+6.71
BITCOIN	16547.50	-64.27

(Source: S&P Dow Jones Indices, FTSE Russell, Nasdaq, MSCI, S&P U.S. Aggregate Bond Index, FactSet)

(For those of you wishing for the abridged version of this note, navigate straight to the summary which starts on page 9. For everyone else, we have lots to discuss since it has been a whole year. And, what a year it has been. So, let's jump right in!)

 **WHAT HAPPENED IN 2022?**

Plenty! But not much that we would consider good! 2022 was historic in many ways that investors won't want to repeat.

One of the major reasons I drafted Noland's Notes a couple of weeks later than normal is I thought the letter would be more relevant if written after we listened to 4th quarter earnings releases. We place a lot of value on hearing from corporate CEOs and their views of the direction of economic conditions.

The year started off on the wrong foot, as January started on a sour note -- the rest of the year took its cues from there. We watched in horror at the Russian invasion of Ukraine. We observed soaring inflation, increasing interest rates, still-broken supply chains and worst of all, dramatically falling company earnings predictions. As a result, markets had a lot of volatility. 2022 was a record setting year. It was only the [5th time in the last 100 hundred years](#) when both bonds and stocks fell.

Interest rates were certainly on the rise. The Federal Reserve has been raising interest rates on Wall Street and these rising rates have definitely had an impact on Main Street. Mortgage rates went from [3.11% to start the year](#) to 6.42% to end 2022. Rising interest rates have certainly cooled the housing sector and with rates this high, it is hard to imagine any homeowner doing a mortgage refinance in this decade. Given these conditions, homeowners are unlikely to move homes, swapping a 3% mortgage for a new 7% mortgage, in the process. We think this could lead to booming business in the home improvement sector, as owners beautify their current home and pass on trading up.

But there is also a positive side to higher interest rates. The rise in rates means that income seekers can now earn yields of 6-9% on high quality bonds. Speaking of bonds: 2022 marked the [second consecutive year](#) of negative US Treasury bond returns. We find it hard to imagine 2023 marking the 3rd straight year of negative bond returns, as that has never happened in recorded market history dating all the way back to 1928!

Inflation was a major theme of 2022 and has yet to subside to customary levels. Most investors lack much experience with prolonged high inflation – it has been since the early 1980s since the economy has been confronted with persistent rising prices. I know consumers can attest to how unpleasant runaway prices can be. For 2 years now, it seems that everywhere we go, prices have been elevated, including everything from gasoline, rents, groceries, utilities, and fees for services of all kinds.

We expect interest rates to settle down soon and many investors project interest rate cuts in the following 12 months after they stop rising. We will watch closely to see if prices for goods and services follow suit.

 **WHAT LOOKS INTERESTING?**

We have spent more than enough time discussing 2022 market action. As investors may know, the more severe the downturn, the more likely it is that attractive buying opportunities will materialize! At Left Brain, we are rolling up our sleeves, finding attractive opportunities in both stocks and bonds. Markets are forward looking, so we are looking to a time beyond the current inflationary

environment to work on finding securities we think have the chance to perform in the next 3-5 years, rather than the next 3-5 months.

In analyzing the longest stretch of significant inflation in modern U.S history, we reference the Volcker years of the 1970s and early 1980s. Inflation [spiked from 3.27% in 1972](#) to 13.55% in 1980! It was at this time that then Federal Reserve Board Chairman, Paul Volcker, seared his name in the history books by raising rates 9 times between August 1979 and February 1980, including a one-time increase of 5.25% to 20%(!), in the process getting inflation to fall dramatically. Our view is that this current bout of inflation is nowhere near as troublesome as it was in those years, but there is much that we can learn by studying the history of interest rates.

There is one main takeaway to glean from current business conditions. Companies seem determined to “do more with less.” That is, they want to grow sales, while, at the same time, trimming costs. Corporate America’s new focus is squarely on profitability. This “doing more with less” focuses not only on reducing headcount, but also being more efficient with the tools at companies’ disposal. Technology is a tool that makes companies more efficient, leading to increased productivity and lower costs.

So, it makes sense that technology is a force for good and historically has served as an antidote to inflation. However, many companies struggle with the sheer number of tools that litter their tech stacks. As we have studied the earnings calls of technology companies over the past year, we have heard, time and again, that the focus now is shifting to find comprehensive solutions to problems. Companies want to move beyond using multiple one-solution tools, to platforms that can solve many of their problems. In our view, this means that the ultimate winners in enterprise technology will be those companies that can incorporate a suite of solutions into one elegant interface.

Speaking of technology -- the bad guys never sleep. The most valuable currency in today’s world is data and more of that data is moving to the cloud. This valuable data must be protected at all costs -- cybersecurity is thus not a luxury; rather, it is a necessity. Therefore, we expect cybersecurity spending at corporations to remain durable. This is an investment theme we are likely to pursue for some time.

On the other hand, what is our view of the consumer? Consumer spending makes up [70% of U.S GDP](#). If the job market softens and workers household costs increase, what does that portend regarding consumer spending? With changing attitudes about consumable products, we are pessimistic about consumer goods. We expect that apparel, home goods, and other consumer markets (outside of beauty) will be challenged. On the other hand, we are optimistic about travel-related companies, which we cover more below.

SIZING UP THE INVESTMENT CLIMATE

I am often asked for my thoughts on the current investment climate. At Left Brain, we want you to understand our current views of the investing landscape, at any given time. This is the lens through which we view the investment climate -- The Left Brain Lens. The lens (our decision-making

process) never changes, but quite often, the landscape we see through that lens does change. Here is what we see through the Left Brain Lens for 2023:

Interest Rates

Everyone everywhere seems to understand that interest rates are up. The Federal Reserve has raised interest rates 8 times over the last 2 years and the Federal Funds rate now stands at 4.75%. What all investors are trying to decipher is when rates will stop rising and where they will find a high-water mark. At present, we have no definitive answers.

The Federal Reserve keeps hinting that inflation readings are still too high. They are in a standoff with bond investors, who seem to be betting that the Fed will stop hiking rates soon and that rate cuts are around the corner. The current narrative is that rate increases will send the weakening economy into recession. The subsequent recession will likely then force the Federal Reserve Board to start cutting short-term interest rates, in an attempt to revive the economy.

Here at Left Brain we have never hung our hat on macroeconomic forecasting. Macroeconomics is concerned with predicting the direction of inflation, interest rates, and currency exchange rates. We know that selecting the right companies in which to invest is hard enough. Trying to figure out the macroeconomic forecast consistently is sort of like predicting Chicago's weather -- you might be right on occasion, but inevitably you will be wrong often enough to result in a poor prediction record.

The data suggests that prices have increased enough to force consumers and businesses to adjust their behavior and these adjustments are already happening in real time. We think it is simply a matter of time before lower housing prices, lower gas prices, and slower spending show up in the data that the Fed watches so intently. Thus, we are calling the current Interest Rate outlook: **Neutral**

Inflation

Inflation can be defined as the price increase of goods and services. The average inflation rate between World War II and 2018 in [the US is 3.74%](#), though that can be skewed by some very high rates in the 1940s and 1970s. Inflation generally runs between 1 and 3% in normal times. However in 2022, inflation US inflation [averaged an eye-popping 8%](#)!

If inflation tops out and begins to moderate, we think that is an outcome that investors can tolerate. However, if high costs persist, we fear a number of negative consequences could result. Food companies have experienced a large increase in their input costs (sugar, fruit, grains, transport costs, packaging costs, plastics, etc.) and they have raised their prices as a result, which has a direct impact on sales volumes. This is just one example of how inflation wreaks havoc on an economy.

No healthy economy can withstand ongoing annual price increases of 7%+. The Fed is right in responding to bring down inflation. While goods inflation is beginning to show signs of at least slowing, one area that concerns us is the labor market. Even though companies have started laying off workers, the labor market remains tight (for now), with wages not yet dropping.

We offer a theory that the tight labor market has more to do with the health of the U.S. Economy than anything else. During the Trump Presidency, immigration rules had a clear impact on the supply of workers. However, sustained strength in the U.S. economy means that the demand for workers has continued unabated. We think something will eventually give to forestall the current wage inflation.

Our view is that Inflation will crest this year. Once it does, this will be a positive backdrop for securities prices. Decreasing inflation will be a big boost, both to bonds and stocks. At this time, we're calling the current Inflation outlook: **Neutral**

Earnings

2022 was not a good year for corporate earnings, by any measure. S&P Earnings [fell by 11% in 2022](#) (we are finishing up the 4th quarter earnings releases as we go to print). Companies are releasing their earnings expectations for 2023 and the numbers are not pretty. Higher costs (labor and cost of goods), coupled with lower revenues, have caused earnings to slump.

The good news is that analysts are already expecting below average sales or profit growth this year. In many, cases investors are writing off 2023 and are looking for profit growth starting in 2024. Through our research and listening to management statements, we have noticed that many companies are cutting costs across the board, in an effort to preserve profit margins. The upshot is that when sales volumes rebound, we think profitability could reach record levels, with companies of all shapes and sizes sporting a newfound emphasis on controlling costs. Should this thesis play out, we expect a boon for stock prices. Markets seem to have already absorbed a lot of bad news. Any results that exceed investors' fears of the worst should eventually lead to better price action. We are calling the current Earnings outlook: **Neutral**

Valuations

Valuation is a term that describes what price investors are willing to pay for each dollar of sales, earnings, or free cash flow. In a low interest rate environment, [like the one we've experienced from 2009-2021](#), investors are willing to pay higher prices for businesses. However, in a high interest rate environment, stocks compete with low-risk instruments like money markets for investment. In such an environment, investors require a higher return to make them interested in leaving the safety of Treasury bonds, CDs, and money markets. That was the story of 2022 -- *valuation compression*.

We expect that with interest rates topping out this year, that the "boot" of higher rates that holds down valuations will come off the "throat" of securities prices. It seems each time the market has received improved inflation data over the past year, investors rush to the buy button. Unfortunately, most of these bounces have been temporary and markets have swooned a number of times, usually when we have seen yet another hot inflation report.

Despite all the talk of inflation, we continue to find many opportunities in both stocks and bonds that we find very attractive. In recent years, when we have identified superior companies, those

opportunities were often overpriced. Not today -- we find today's securities prices more attractive than those we have seen in at least a decade.

We have always subscribed to the theory that you either get good cheap prices or good news, rarely both. Thus, we are calling valuations: Attractive

FREDDY'S SECTION – SECURE ACT 2.0

This year's financial planning section is focused on a current topic many haven't heard of, and even fewer can explain. In December 2022, Congress passed another year-end bill, called SECURE Act 2.0, with significant financial planning implications. This followed on the heels of the original SECURE Act, which passed just 3 years prior. We wanted to review for you some of the implications of the newest version of this Act.

The SECURE Act, which stands for "Setting Every Community Up for Retirement Enhancement" was originally passed in 2019 with the stated intention of making retirement savings easier and more accessible. The SECURE Act 2.0 was signed into law via the \$1.7 trillion-dollar Omnibus bill, signed into law on December 29, 2022. The goal of the act is to improve an individual's ability to save for retirement, expand access to retirement plans, and ease plan administration for employers.

There are quite a few provisions in SECURE Act 2.0 that impact investors:

- Required Minimum Distributions (RMDs) changes.
- Pre-Death RMD Removal
- 529 Rollover to Roth Account
- Catch-Up Contribution increases
- Potential Roth accounts for Simple and SEP IRAs
- Employer Matching contributions into Roth accounts
- Part-time Employee Participation into Employer Sponsored Plans
- Reduced penalty for missed RMDs

In today's letter, we will expand upon a few of the provisions that we think have the most dramatic impact on Left Brain clients. If you need additional information on any of these, or on the provisions we did not cover here, please contact your advisor for more details.

Required Minimum Distributions (RMDs)

As part of the original SECURE Act, the age at which RMDs must commence was changed from age 70½ to 72, for anyone reaching that age after 2020. With SECURE Act 2.0, RMDs are further delayed to age 73, for those reaching this age starting in 2023. In 2033, the beginning RMD age will move

again to age 75. To clear up any confusion, if you turned 72 in 2022, you were still required to take an RMD for 2022.

However, if you don't turn 72 until January 1st, 2023 (or later), you will no longer be required to take a required minimum distribution until the year in which you turn 73. With that said, it may make sense to consider strategic Roth IRA conversions prior to your RMD date to minimize overall taxes.

We also want to direct your attention to reduced penalties for missing your RMDs. Under section 302, the penalty for a failure to take an RMD has been reduced from 50% to 25% of the missed RMD amount. If a failure to receive an RMD from an IRA is corrected in a reasonable time (defined in the law), the excise tax is further reduced from 25% to 10%.

529 Rollover to Roth Account

Before The SECURE Act 2.0, funds from 529 accounts that were used for non-educational purposes were subject to taxes and penalties. Effective in 2024, a beneficiary's unused 529 funds may be transferred to a Roth IRA in the name of the beneficiary, subject to several rules:

- The lifetime amount that can be transferred is \$35,000 and is subject to the annual contribution limits (a Roth contribution for the year will reduce the amount that can be transferred from the 529 for that year).
- The 529 plan must be established for at least 15 years and no funds (or associated earnings) that were contributed to the previous five years prior to the transfer may be used.
- There are no income limits or phase-out restrictions when making a 529 to Roth transfer.

Catch-Up Contributions

Currently, if you are age 50 or older you can make an annual catch-up contribution of \$1,000 to an IRA, resulting in an aggregate contribution limit of \$7,500. Section 106 in the Act will now allow this limit to rise over time, considering indexing factors such as inflation. Moreover, section 107 includes a specific catch-up limit for investors age 62-64. Starting in 2023, if you fall into this age range, you can make an additional retirement contribution of \$3,500 annually, for a total contribution limit of \$10,000.

These contributions do carry stipulations. Historically, catch-up contributions could be placed in either Traditional IRA or Roth IRA accounts. SECURE Act 2.0 abolishes this flexibility, making all catch-up contributions subject to Roth (after-tax) rules. However, if the account owner has an income less than \$145,000 during the previous year, Traditional (pre-tax) IRA catch-up contributions will still be allowed. The pressures of this rule will be felt the most by high earners -- they will be required to pay taxes on catchup contributions during high earning years at high marginal tax rates, instead of deferring taxes into the future, presumably when they pay a lower tax rate.

The SECURE Act 2.0 may have implications for your retirement account strategy, depending on your age, income, tax bracket, and employment situation. If you would like to better understand the

implications of this law for your financial plan or if you have questions about the Secure Act 2.0, then please contact us. We would be happy to examine your retirement planning process and complete a comprehensive portfolio review to make sure you are taking full advantage of the provisions in the new law.

 **SUMMARY -- OUR 2023 PLAYBOOK**

There are many moving parts to today's economy. As investors we have experienced a great deal of turmoil over the last 18 months. With the combination of inflation, rapidly increasing interest rates, softening economic conditions, war in Europe, and economic uncertainty. The volatility has been enough to give us whiplash. And yet, here we are, with markets again starting to find their footing. As companies report 4th quarter earnings and give their forecasts for 2023, it seems that the bar for profit expectations is lower. Valuations have certainly dropped, almost across the board. The question is whether valuations are low enough to make today's stock and bond purchases profitable in the future.

It is impossible to know how long economic uncertainty will be with us. What we can confidently say is that there is a world of securities whose prices will be much higher a couple of years from now. Those opportunities are what we strive to unearth in 2023, as we plant the seeds for growth in your accounts.

The question then becomes: where are these golden opportunities? One area of the market where we have a high degree of confidence is oil/gas pipelines. These are unglamorous businesses that are involved in our country's energy infrastructure. We think they will be beneficiaries from the \$1.2 trillion dollar infrastructure bill [passed in 2021](#). We think pipeline operators will benefit from America's clear move to develop energy independence. We also think these securities will benefit investors because many pay dividend yields over 7%, most of which grow annually. What's more, investors get all of this for a cheaper price than infrastructure-related stocks have historically demanded.

["Revenge travel"](#) is definitely in vogue. Hotels, rental car companies, and airlines have all reported very strong business trends. After the Covid years it seems that travelers are back in force and aren't particularly cost conscious -- *yet!* We expect this development to continue. We find travel an attractive sector in which to invest and our favorite stock in the industry is **Airbnb (ABNB)**, which we think could be a long-term winner.

Broadly speaking, we think that the stock prices for the most superior businesses look attractive, after the stock market reset in 2021-22. After two difficult years for growth shares, we think this looks like a nice time for a share price bounce back in this corner of the market. Our view is companies in technology, biotech, and other fast-growing industries could see a resurgence in share prices, as their sales and earnings growth reaccelerate through 2023 and into 2024.

Speaking of technology: this sector has really been experienced a volatile last few years. Post-Covid, technology stocks went through a resetting of expectations. We are again attracted to several

companies in tech, whose management teams have successfully adapted their business models to suit this new economic environment.

We are particularly attracted to small and mid-cap businesses with strong competitive positioning and durable business models, who are steadily growing their revenues, while generating positive cash flows. We find that the stocks of small companies (the type tracked in the Russell 2000 index) are relatively cheap and attractive selling for 23 times forward earnings, which is below the historical average, as you can see on [page 16 of this Yardeni Research piece](#). We think small-cap stocks are poised for strong returns in 2023 and beyond.

Not only do we like stocks in a number of areas, but also we are very excited about the opportunities we are seeing in income securities this year. With the Federal Reserve raising interest rates aggressively, there are *finally* a number of ways for investors to lock in a generous annual return through fixed income vehicles: money markets have started paying over 3%, bank CDs are paying over 4%, and tax-free municipal bonds can be purchased at yields approaching 4%.

The major unknown is when will rates top out and how long they will remain high. Many investors seem to expect a recession is on the horizon, which would ultimately lead to the Federal Reserve Board cutting interest rates to pump up the economy. We think the time is now for investors to lock in predictable fixed streams of income while rates are high, to prepare for the eventual lowering of interest rates. The question then becomes how long investors should lock in passive income streams at today's elevated rates.

We find corporate bonds with yields of 7% or more and maturity dates of 7 years the most attractive. Securities selected through this 7/7 strategy could return a predictable ~50% total return to investors over the next seven years. We find High Yield bonds attractive, especially those we identify through our rigorous investment selection process. We specifically like [bonds rated BB](#), specifically those bonds that we think are on pace to receive a credit upgrade from High Yield to Investment Grade, due to improving financial conditions. Buying these potential "Rising Stars" can be a profitable strategy.

If we do, in fact, have a recession, the bond prices could drop. But what we like about bonds is the predictability of their cash flows to investors -- as long as the companies who issued the bonds remain in business, the interest income should remain fixed. Interestingly since 2000, High Yield bonds have [outperformed a 60/40 portfolio](#) of stocks and Investment Grade bonds (7.9% vs 7.6%), so we know there is history that suggests bonds in this category that can generate strong returns.

At some point the rise in interest rates and inflation will be in our rear-view mirror. With that thought in mind, we think it is time that we shift our focus away from uncertainty and toward opportunity. When the end of inflation looks near, we think that will signal the start of the next bull market. This could happen soon with the next piece of benign inflation data.

In our view, we think inflation will begin to taper in the second half of 2023. Of course, this outlook could change on a dime at any point. What will not change is our desire to own the best stocks and bonds, those with the chance to bring investors handsome profits.

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We wish to remind you that investing in US publicly traded stocks is still the best way to gain wealth passively and to outpace inflation. When uncertainty is high, prices are lower, therefore probabilities for investment profits are also higher.

No matter what happens, the Left Brain Team will be here looking for profitable opportunities to help you Create, Build, and Preserve your net worth.

Sincerely,

Noland Langford, MBA, CFP®
CEO and Chief Investment Officer

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