QUARTERLY REVIEW AND OUTLOOK

October 2022

- The global equity index (MSCI World Index) finished the quarter down -6.1% - the 3rd straight quarter closing at a loss and remains in bear market territory for the year down over -25%.

- US and developed international equity markets declined -4.9% and -9.4%, respectively, while emerging markets fell further closing the quarter down -11.6%.

- The bond markets continued to fall as interest rates continued to move higher. The Bloomberg Aggregate Bond index finished the quarter down -4.8% and is down –14.6% year to date.

- Diversifying investment strategies again proved to be helpful. The HFRX Macro/CTA index was up +2.7% during Q3 and is up +6.1% year to date. Broader hedge fund exposure (HFRX Global Hedge Fund index) was up +0.5% on the quarter and is down -4.6% year to date.

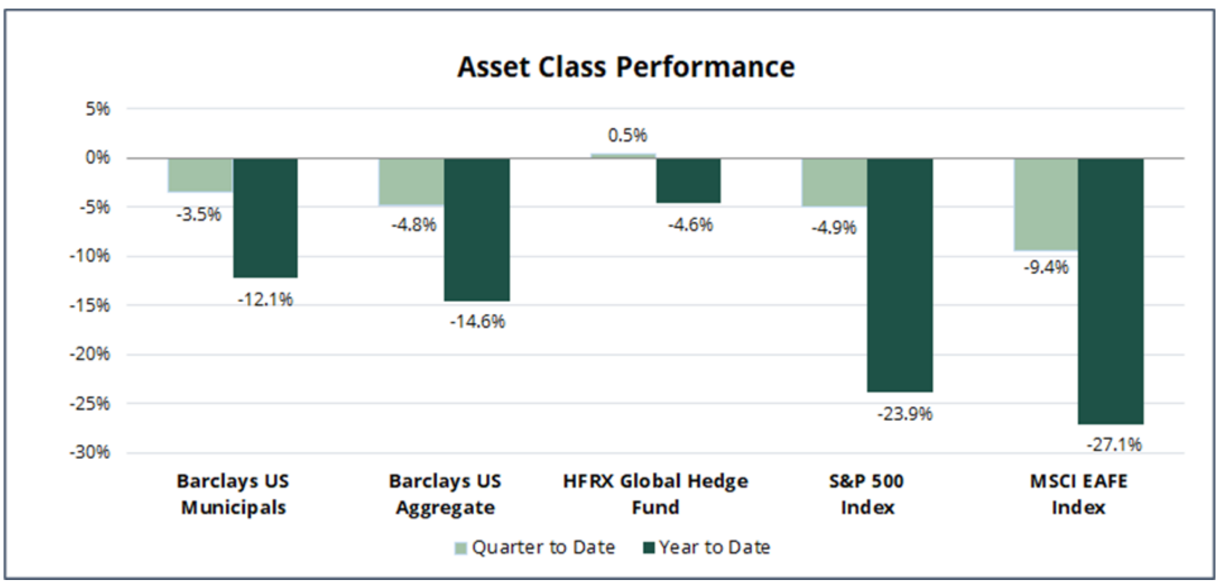
- Global financial conditions continued to deteriorate as monetary policy continued to tighten as the Federal Reserve focused on containing and ultimately reducing inflation globally. These efforts will have economic consequences likely leading to a global recession.

MARKET COMMENTARY

Investors continued to focus on the Fed's aggressive monetary policy activities raising the Federal Funds rate target from 0.25% to 3.25% over the last year to combat persistently high inflation and an overheated labor market. This tightening policy has increased recession fears as GDP numbers in Q1 and Q2 contracted while inflation continues to run hot. As a result, equity and bond markets both continued to decline through quarter-end.

In international markets, aside from the ongoing effects of the grinding war in Ukraine, currency moves are starting to dominate the news. In general, the US dollar has become much stronger over the course of the year. This will likely have a significant impact on US trading partners and the US domestically. While it is good news for US consumers that imported goods become cheaper, and potentially energy, US exports will be challenged. Additionally, it will have the effect of exporting US inflation around the world, upping the ante for a number of central banks. Given this backdrop, investors continued to sell non-US equity and fixed income resulting in a decline during the quarter of -9.4% for the MSCI EAFE Index and -4.8% for the Bloomberg Global Aggregate Bond Index, respectively.

An important portfolio component that held up well, and in many cases contributed to positive performance during the quarter, was in our diversified strategies asset class, particularly Global Trading and in many cases CTA and multi-strategy managers.



Performance as of September 30, 2022

It has not been an easy year for investors. Traditional asset allocation implementations continue to show their shortcomings. However, difficult periods like this can also demonstrate the virtues and importance of other approaches; for us, we have been very encouraged to see the steady, counter-cyclical contributions of strategies like Global Trading and certain other alternative strategies.

Portfolios did not escape the difficult market conditions as exposures to public equity and fixed income contributed to the decline during the quarter. However, portfolios that hold diversifying and Global Trading positions helped offset the decline in equity and fixed income returns.

WHAT WORKED AND WHAT DIDN'T

Economic Backdrop

Inflation is digging in, now reflected in shelter (housing costs and rent) and various services. Wage increases too, especially in the US, have started to be seen, with effects broadening from the low-wage, low-skill hourly workers in service areas, to a wider range of industries, occupations, and skills, including salaried workers. Further, inflation is oftentimes a self-fulfilling prophecy—i.e., if you think prices are going to be higher in the future you may be motivated to buy things sooner, pushing prices up immediately. Long-term inflation expectations (the University of Michigan 5-10 Year Index) are crossing over 3%, although these expectations in the US have eased off somewhat recently and remain less than seen in our neighbors in Canada, the UK, and in some other major markets.

Whether rising unemployment becomes prevalent or equity markets continue to decline, the Federal Reserve has indicated they will continue with aggressive monetary tightening to control inflation. Of course, the likely consequence to controlling inflation is a recession where corporate earnings and consumer spending falls, and unemployment picks up as the higher cost of capital impacts credit conditions. However, US companies across most industries appear in good financial condition and banks are in a strong position to manage through a tighter economic environment.

United Kingdom

The quarter ended with a surprising UK budget gambit rattled world markets further. The new administration, led by chancellor Kwasi Kwarteng, announced a variety of unanticipated, growth-oriented fiscal moves, cutting taxes for individuals and companies as well as capping energy bills. The tax reductions were the largest in 50 years. Markets were caught by surprise, with an immediate 50 bps spread widening in UK gilt bonds and a rapid multi-point decline in the GBP. Markets struggled to understand how these moves squared with the inflation fighting needs of the UK (and other major economies around the world). Moreover, the UK has been running budget deficits for years; this seemed like a step too far.

As a result, the Bank of England (BOE) had to step in and assure investors they would buy sufficient quantities of bonds to keep markets stabilized. This despite the fact that UK government reserves (at around $108 billion) are very modest compared to the size of its economy. For instance, Japan's currency reserves are 10X that size. In any case, while the Pound did recover, and some agree that these moves may be required to help sustain UK businesses in the short term while keeping default rates low, the shocking nature of these moves already called the staying power of the administration of new Prime Minister Truss into question.

Japan

Speaking of Japan—it has also seen a dramatic move against the USD. The Yen/USD cross rate was about 115 Yen per dollar at the start of the year. It is now a fraction below 145 Yen to dollar—a huge move in percentage terms and the weakest level since the early 1990s. While several factors are at play, the moves are principally driven by the growing differences in monetary policy (rates) between the two countries. Statistically, the difference between 10-year government bond yields across the two countries explains most of the movement. All of a sudden Japanese authorities have a situation on their hands; the Ministry of Finance undertook their first intervention since 1998 to the tune of around $20 billion USD, but it quickly fizzled out and the Yen deteriorated further. At some point, we have to wonder if the Yen is oversold.

While unemployment is still rather low in the US, that's not the case in many other developed and emerging markets. Many countries are still struggling to right themselves after the upheaval of COVID. Therefore, while it may not be fully appreciated in the US, economic "misery" (a measure popularized by American Economist Art Okun that combines unemployment and inflation) is at its worse level since the 1980s. All things equal, this points to a big demand headwind for much of the world.

Equity Strategies

The S&P 500 Index closed the quarter 20% below its 200-day moving average. While some look to this and think the market downturn may have further to go, historically, drawdowns of this sort have often, and on average, marked interesting times to buy. For example, according to Bloomberg data, once the index breaches the 20% level, returns are strongly positive—6.4%, 4.3%, and 7.6%, on average—over the next one, two and three months, respectively.

Also, as we have written before, broad market sentiment, which is counterintuitively a contrarian indicator in that extremely bearish sentiment can indicate a reversal, is as negative as it's been in years. The magnitude of the market decline and severe bearish sentiment point to a market that may be closer to a bottom and encourages us to focus on where the opportunities were and may be to prudently add equity risk in portfolios.

There remains dispersion among active equity managers, sectors, and factor exposures. On the year, more traditional value companies have held up better compared to growth or quality segments of the market, but the third quarter marked a reversal where value underperformed.

Fixed Income Strategies

Rates have further to go. The Fed has hiked the Fed Funds target rate five times already in this cycle, starting in March of 2022, to a current upper target bound of 3.25%. That's a +3% increase in half a year. Many analysts think that it will get to 4.5% or even 5% before they pause.

And unlike the post-COVID efforts, in the US at least, investors probably can't hold out for meaningful fiscal stimulus. It's possible with either a potential change of control of Congress in the Fall or general spending fatigue, it's less likely that some sort of spending package will be found to drive growth back to trend once rates do stabilize; investors will likely need to see them fall again, while other conditions remain stable, to see substantial performance from bonds (or risk assets).

It behooves us to stay away from spread products and securities that are very sensitive to the economic cycle, such as emerging market bonds, lower-rated bank loans, and segments of the private credit market where weaker-quality borrowers will likely face the direct impact of higher central bank policy rates via higher debt service costs which will likely be accompanied by deteriorating earnings power.

The market spotlight some of these deteriorating conditions. Levered loan funds have seen steady outflows since mid-year. For banks to bring loans to market, they are demanding new issues concessions of near 1%, which is what was seen in April of 2020. At quarter end, investment banks brought $8.6 billion of Citrix debt to market, which loans pricing at 91 cents on the dollars and bonds at 83 cents on the dollar. Shockingly low prices and results, which caused the underwriters to take a bath to the tune of $500 million to $700 million from their Q1 commitment levels.

But, unlike a year ago, there are pockets of value. Higher coupon agency MBS may be of interest because of valuations and the fact there is conversely still a large stock of low-coupon MBS on the Fed's balance sheet. Agency MBS are AAA-rated assets that offer relatively attractive spread, high levels of resiliency, and good liquidity.

Non-traditional Assets

Marketable Alternatives: Hedge Funds and Global Trading

Marketable alternatives are the best performing broad asset class on the year, albeit still negative, down -4.6% (HFRX Global Hedge Fund Index). Macro/CTA strategies are leading the returns within this space (up +6.1% year to date) as there are many directional trends across multi-assets in which these strategies are benefitting. Strong drivers to returns have been investing long in the US Dollar, being long energy, while shorting fixed income. Interestingly, these strategies' exposures to global equities (invested long) have detracted on the year. Most managers are now positioned to be short equities and should further benefit if the equity weakness continues.

More dynamic managers who have been able to shift their gross and net exposures held up well in Q3, being able to profit with equity indexes being down. In addition, sector specfic exposure (such as Healthcare and Biotechnology) profited on the quarter as the dispersion between winners and losers within this space remained wide.

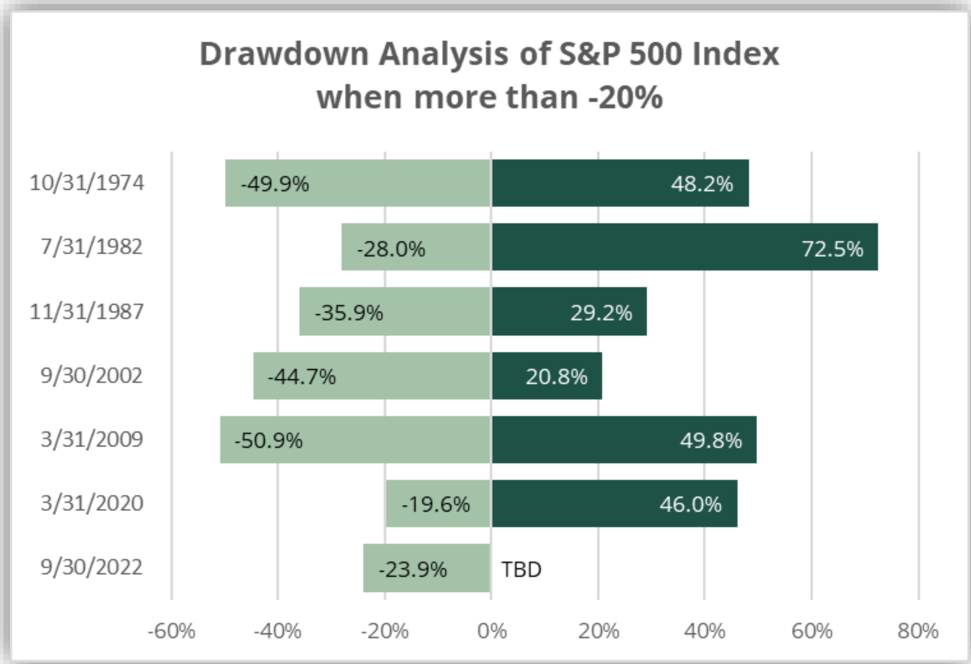
Real Assets

Energy and other commodities have been some of the few asset classes to be in positive territory for 2022. But while commodities have been a big beneficiary of the inflationary backdrop, they also are prone to sharp reversals. Additionally, futures oriented long-only commodity indices currently offer a positive carry in excess of 10% as of September 2022 (meaning forward curves are already discounting a considerable decline in commodity prices over the cyclical horizon). And, over time, most long-term holders of commodities do much worse than owners of productive assets, including ones which help to produce or mine those commodities.

For these reasons, we continue to favor commodity-related strategies that are agnostic about the long-run direction of commodities, but instead can exploit strong trends up or down. We have seen particularly good results from these strategies expressing a long inflation view (short bonds and long commodities) this year but have also seen good results from these strategies in a more sustained *deflationary* period. Admittedly, that is not the base case now, but we also think there are better ways to participate in the commodity markets. Further, while real estate faces headwinds from higher rates, smart real estate investments at fair cap rates and reasonable leverage still exist. While we will not be overweight real estate in the short term, we feel that quality, cash-flowing real estate, such as self-storage and industrial, is another great tool in an inflation-protecting arsenal over a multi-year horizon.

WHAT SHOULD YOU EXPECT GOING FORWARD?

We have learned over the last 30 years that every bear market and/or crisis creates opportunities. While we are feeling the pain of a global economic slowdown, we know from experience there will be countries, sectors, and companies that will be beneficiaries or hold up better than others. From a sector or company perspective we believe companies in the digital economy and biotechnology/health care sectors should be in a good position once the global economic picture stabilizes. We also favor US large cap equity and dividend growth. While the equity market could see further downside, we are confident that investments made today have the ability to generate exceptionally good returns over time at these levels. Historically investments made at this point in bear markets have excellent asymmetrical return characteristics. We have seen this in prior market bear markets shown below.



Average Return: 44.4% / Median Return: 47.1%
Historical Annualized Return (Feb 1988-Sept 2022): 10.3%

Given this view, we will be tactical and identify times when we want to be lighter or heavier with risk assets. But never all or nothing. Instead, by sizing strategies like Global Trading effectively (which means as much as 25% of an equity allocation), we want to build true diversifiers into portfolios, allowing equities to continue working while minimizing the overall volatility of the portfolio in aggregate.

Similarly, while we have been avoiding fixed income for some time, we recognize that we are getting closer to where traditional fixed income duration and maybe credit, to a lesser extent, should come back into portfolios. Rather than try to time that perfectly and necessitate more portfolio frictions when these trades may not be easy to achieve, we have worked to build-out Strategic Credit positions in portfolios in advance. We know that when conditions do become more favorable, this allocation will be ready to go. In other words, we are trying to layer in these important dynamic building blocks of portfolios that can behave in a predictable manner—this year was a perfect testament to that. As we move into 2023, we will look for other opportunities of this nature, including perhaps a unique and new opportunity in private credit and yield alternatives.

While it is frustrating to go through this together, we do believe this will lead to extremely attractive investment opportunities and we encourage patience. We have been through this before and came out in fine shape and we have no reason to believe this time is different.

Equities

We are not market timers and believe that equities, public and private, are an integral part of growth portfolios over time. We have seen time and again the folly of trying to get in and out of equities to adjust exposure up and down, even if an investor's thesis is sound. Inevitably, they get back in the market too late, and consequently have much worse compounded outcomes, to say nothing of the adverse tax effects. Our experience has been its much more effective to stay invested, even when it feels uncomfortable.

The US and Europe both have risks of recession over the next year, particularly if the monetary tightening globally continues and inflation does not show meaningful declines over that period. With that said, it does feel as though if recession is official, it is likely to be more mild than past periods as employment is strong and consumer, corporate, and bank balance sheets are in a good position. We will look to deemphasize developed international equity and emerging markets in portfolios as we prefer opportunities in US equities.

Fixed Income

With the aggressive moves by the Federal Reserve, bond yields are getting more attractive; however, investors remain cautious as the risk of a continued economic contraction could accelerate credit spread widening and price declines in anything with questionable credit quality. It is important to be patient to see how rate policy impacts overall economic conditions and inflationary conditions. If we see brighter skies ahead for credit, we will be prepared to move our stance from underweight to more neutral going forward. In the interim, we have been pro-active in allocating to short duration Treasury Bills (3 months to 1 year) as a way to pick up excess yield over money markets and while remaining nimble as the interest rate cycle continues to play out.

Alternative Assets

Alternative assets remain an integral part of portfolio construction as they tend to be more dynamic and able to profit in times of market stress. Separately, we are beginning see anecdotally stress in the private markets and will remain opportunistic within both these segments of alternative assets.

Asset Allocation Review and Guidance

Asset Class	Underweight	Neutral	Overweight
Cash			X
Taxable Fixed Income	X		
Non-Taxable Fixed Income	X		
US Equity		X	
International Equity	X		
Emerging Market Equity		X	
Marketable Alternatives		X	

Summary

We have been pleased to make a number of key strategic hires across all of our offices, strengthening our operations, client service, and investment teams. Most of these hires are quite seasoned and we are confident they will be able to further improve our responsiveness and skill in managing portfolios and delivering solutions for our families. During this past quarter we brought on Jacob Metro (Portfolio Adviser), Michael Rhea (Senior Investment Analyst), Payton Lill (Junior Analyst) further adding to the depth and capabilities of our investment team. Christopher Carroll (Managing Director, Marketing) also joined the team, allowing for additional focus on the firm's strategic marketing and business development initiatives.

We look forward to continuing to deliver these solutions to you, our family partners, as we go forward into 2023. Times like these present great opportunities, and while volatility will likely remain elevated, we are eager to work with you to be in the best position to participate fully in the rebound of individual assets and broader markets. We hope you and your family had a wonderful summer! As always, we are grateful for our partnership with our family office clients.

Respectfully,

The FFT Team

Appendix:

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