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Dear Clients & Friends,

Financial markets have been exceptionally volatile in recent days, causing market declines we have not seen since the pandemic in early 2020. In the last week, the NASDAQ has shed 12% and the S&P 500 declined 8%. For the year, those indices are down 27% and 17%, respectively.

Unfortunately, bonds markets have offered little relief. Through yesterday, the broadest measure of the US fixed income market - the Bloomberg US Aggregate Bond index - was down 10%. This is the worst performance by traditional bond investments in more than 40 years. (We note that NEXT client bond portfolios are structured very differently, so declines have been significantly more muted in this portion of the portfolio).

The war in Ukraine and China's renewed Covid lockdowns have affected risk appetites and growth expectations for the global economy. However, the primary culprit for this year's volatility is a shift in policy by the Federal Reserve. After years of ultra low interest rates and extraordinary measures designed to inject liquidity into financial markets (collectively, something we call "easy money policy"), the Federal Reserve has signaled a new approach. To combat persistent and rampant inflation across our economy, the Fed will aggressively hike short term interest rates and discontinue other programs designed to inject liquidity into the financial system.

The result of this shift is very much the opposite of what we have enjoyed in recent years. Higher interest rates will restrain growth in the economy, potentially dent corporate profits, and undermine inflated asset prices. Certain speculative bubbles have already burst in areas like SPACs, profitless growth companies, and crypto currencies as some of the most egregious risk taking has unwound.

It is impossible to know exactly when market volatility will cease. Markets can and often do overshoot to both the upside and downside. We observe, however, that at this point many high quality companies are trading at or below levels seen pre-pandemic, despite significant revenue and earnings growth over the last few years. The economy is also broadly healthy - particularly among consumers, the single biggest driver of growth in this country - amid a strong labor market. Meanwhile, broad stock market valuations have reset to more "average" levels.

Similarly, while higher interest rates translate to negative performance for bond portfolios, at some point those absolute yield levels begin to look attractive to investors. It was not long ago that tax free municipal bonds yielded around 1%; at 3-4%, those yields begin to look much more interesting. Yields on high yield bonds were just 4% in September; today those stand north of 7%.

Put another way, we believe that we are getting closer to the point where we can start capitalizing on this volatility. While markets have not yet become broadly cheap, we are starting to observe

some one-off opportunities. The persistence of this market decline has begun to spread and is causing irrational market pricing in specific assets.

It is important to understand, however, that the market environment going forward will likely be fundamentally different than the one we've enjoyed for the last decade. Many of us have become accustomed to sharp and rapid rallies following market declines (the so-called "buy the dip" phenomenon). The backstop and liquidity of the Federal Reserve helped fuel that behavior in recent years. With that source of stimulus now receding, and economic growth returning to a more modest outlook, we may very well face a more choppy, muted stock market in the future.

We believe your portfolios are largely prepared for this eventuality, with our focus on non-traditional assets that are less correlated to the equity markets. However, we understand that the intense market volatility of the past week is unsettling. We encourage you to maintain a long term perspective during these times and to understand that the most fruitful investment opportunities often emerge from market volatility.

We are here to speak with you about these issues and your portfolio. Please contact us at your convenience.

Sincerely,

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