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TAGStone CAPITAL INC

First Quarter 2023

FIRST QUARTER MARKET OVERVIEW

The First Quarter of 2023 saw most major stock indices end positively, except for a few exceptions, however, the journey was volatile.

The S&P 500 index in the US had a healthy gain of 7.50%, whereas small-cap stocks were more affected by volatility, with the Russell 2000 index gaining 2.74%. Foreign stocks outperformed their US counterparts, with the MSCI EAFE index of large stocks in Europe, Australasia, and the Far East gaining 8.47%.

Alternative asset classes had mixed results in the First Quarter. The MSCI Emerging Markets index gained 3.96%, while the Dow Jones US REIT index gained 2.77%. Bonds had relatively solid gains as interest-rate fears eased, with the Bloomberg Aggregate Bond index gaining 2.96%.

The steady stock market recovery from the Great Recession in 2008 to 2019 is not the norm, and investors should expect volatility to return at some point. In the past three years, the stock market has experienced extended periods of volatility, which can lead to "volatility fatigue" when investors move into cash until the market calms down.

It is difficult to predict how long the current volatility will last, but history has shown that investors who stay in the market during turbulent times are the ones who benefit most when the next bull market eventually arrives.

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When Headlines Worry You, Bank on Investment Principles

On Friday, March 10, and Sunday, March 12, regulators took control of Silicon Valley Bank and Signature Bank, respectively, as runs on both banks unfolded. Less than two months later, on May 1, regulators seized a third lender, First Republic Bank. With increasing anxiety, many investors are eyeing their portfolios for exposure to these and other regional banks.

While the urge is strong to rummage through your portfolio, looking for investments to sell when headlines make you anxious, a better first move should be to review your investment plan. Hopefully, your investment plan is designed with your long-term goals in mind and based on principles you can stick with, given your personal risk tolerances. While every investor's plan differs, ignoring headlines and focusing on the following time-tested principles may help you avoid making shortsighted missteps.

Six Time-Tested Investment Principles to Follow:

1. **Uncertainty Is Unavoidable:** Remember that uncertainty is nothing new and investing comes with risks. Consider the events of the last three years alone: a global pandemic, the Russian invasion of Ukraine, spiking inflation, and ongoing recession fears. In other words, it may have seemed as if there were plenty of reasons to panic. Despite these concerns, from March 1, 2020 through February 28, 2023, the Russell 3000 Index (a broad market- capitalization-weighted index of public US companies)

SELECTED 2023 EQUITY INDICES

	Mar. '23	1st Qtr.	YTD
S&P 500 Total Return (Large-Cap Stocks)	3.67%	7.50%	7.50%
Russell 2000 Total Return (Small-Cap Stocks)	-4.78%	2.74%	2.74%
MSCI EAFE (Developed International Stocks)	2.48%	8.47%	8.47%
MSCI Emerging Markets (International Emerging Stocks)	3.03%	3.96%	3.96%

SELECTED 2023 FIXED INCOME INDICES

	Mar. '23	1st Qtr.	YTD
Barclays U.S. Aggregate (Broad Domestic Bonds)	2.54%	2.96%	2.96%
Barclays 1-5 Yr. Credit (Short-Term Domestic Bonds)	1.44%	1.74%	1.74%
Barclays 5-10 Yr. Credit (Intermediate-Term Domestic Bonds)	2.99%	3.61%	3.61%
Barclays U.S. TIPS (Treasury Inflation Protected Securities)	2.89%	3.34%	3.34%
FTSE World Gov't 1-5 Yr. Hedg'd (Short-Term Global Bonds)	1.65%	1.81%	1.81%

returned an annualized 11.79%, slightly outpacing its average annualized returns of 11.65% since inception in January 1979.[1] The past three years certainly make a case for weathering short-term ups and downs and sticking with your plan.

2. **Financial Markets are Resilient:** Over the past 50 years, there have been three instances where the S&P 500 experienced a 50% decrease in value—January 1973-October 1974, March 2000-October 2002, and October 2007-March 2009. Despite these significant market downturns, American companies have managed to thrive and grow. In the past 50 years, the S&P 500 has increased 35 times and its cash dividend has risen 21 times, surpassing inflation which has only increased seven times. Furthermore, the average annual compound rate of total return (including reinvested dividends) for the S&P 500 was 10.3%, comparable to the hundred-year average, despite having experienced three halvings.

3. **Emotions are Volatile:** Our emotions can be one of the most volatile elements in investing, partly due to how our brains are wired. First, investors view stock market declines as "losses" instead of temporary setbacks in the long-term upward trend of shareholder capitalism. Second, these "losses" cause them totally self-generated "pain" that feels twice as bad as advances feel good. Finally—and most weirdly—they think the more the market declines, the greater the risk becomes of an even worse decline.

4. **Market Timing Is Futile:** Inevitably, when events turn bleak and headlines warn of worse to come, some investors' thoughts turn to market timing. The idea of using short-term strategies to avoid near-term pain without missing out on long-term gains is seductive, but research repeatedly demonstrates that timing strategies are ineffective. The impact of miscalculating your timing strategy can far outweigh the perceived benefits.

5. **Stay the Course:** The stock market consistently and wildly overdiscounts both positive and negative economic cycles and the fortunes of companies. As we have seen, great companies have a solidly positive long-term upward trend in earnings, dividends, and values. Furthermore, population growth, economic growth, innovation/productivity, and the law of creative destruction positively influence intrinsic values. Therefore, riding out the cycles and letting market prices migrate back toward fundamental values is best.

6. **“Diversification Is Your Buddy:”** Nobel laureate Merton Miller famously said, “Diversification is your buddy.” Thanks to financial innovations over the last century in the form of mutual funds and later ETFs, most investors can access broadly diversified investment strategies at very low costs. While not all risks—including a systemic risk such as an economic recession—can be diversified away (see Principle 1 above), diversification is still an incredibly effective tool for reducing many risks investors face.

   In particular, diversification can reduce the potential pain caused by the poor performance of a single company, industry, or country.[2] As of February 28, Silicon Valley Bank (SIVB) represented just 0.04% of the Russell 3000, while regional banks represented approximately 1.70%.[3] For investors with globally diversified portfolios, exposure to SIVB and other US-based regional banks likely was significantly smaller. If buddying up with diversification is part of your investment plan, headline moments can help drive home the long-term benefits of your approach.

When the unexpected happens, many investors feel like they should be doing something with their portfolios. Often, headlines and pundits stoke these sentiments with predictions of more doom and gloom. For the long-term investor, however, planning for what can happen is far more powerful than trying to predict what will happen.

Past performance does not guarantee future results. All investments include risk and have the potential for loss as well as gain.

Data sources for returns and standard statistical data are provided by the sources referenced and are based on data obtained from recognized statistical services or other sources we believe to be reliable. However, some or all information has not been verified prior to the analysis, and we do not make any representations as to its accuracy or completeness. Any analysis nonfactual in nature constitutes only current opinions, which are subject to change. Benchmarks or indices are included for information purposes only to reflect the current market environment; no index is a directly tradable investment. There may be instances when consultant opinions regarding any fundamental or quantitative analysis do not agree.

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[1] Dimensional Fund Advisors, “When Headlines Worry You, Bank on Investment Principles,” First Quarter 2023 Quarterly Market Review

[2] Consider that a study of single stock performance in the US from 1927 to 2020 illustrated that the survival of any given stock is far from guaranteed. The study found that on average for 20-year rolling periods, about 18% of US stocks went through a “bad” delisting. The authors note that delisting events can be “good” or “bad” depending on the experience for investors. For example, a stock delisting due to a merger would be a good delist, as the shareholders of that stock would be compensated during the acquisition. On the other hand, a firm that delists due to its deteriorating financial condition would be a bad delist since it is an adverse outcome for investors. Given these results, there is a good case to avoid concentrated exposure to a single company. Source: “Singled Out: Historical Performance of Individual Stocks” (Dimensional Fund Advisors, 2022).

[3] Regional banks weight reflects the weight of the “Regional Banks” GICS Sub-Industry. GICS was developed by and is the exclusive property of MSCI and S&P Dow Jones Indices LLC, a division of S&P Global.