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TAGStone CAPITAL INC

Fourth Quarter 2022

Steady As She Goes: Charting a Path Through Uncertainty in the Investment World

The year 2022 was tumultuous for the investment world, filled with uncertainty that tested investors' mettle. Despite these challenges, the central theme of 2022 was the ultimate heroic act of standing fast in the face of economic and inflationary uncertainty. We will highlight this in this quarter's newsletter.

The newsletter is divided into three sections. First, we will delve into the core principles that underpin our investment approach and how they were reinforced by the events of 2022. Next, we will share our current insights and outlook on the market. Finally, we will explore the challenges of predicting the future and the importance of having a disciplined long-term investment plan.

Fundamental Principles for Securing Long-Term Investment Success

As long-term equity investors, we believe lifetime investment success comes from ***sticking to a well-conceived plan,*** while investment failure generally comes from ***reacting to current events.***

The benefits of sticking to a well-conceived plan became even more apparent in the last three years since the pandemic started, which has exemplified the inherent unpredictability of the economy and the market.

SELECTED 2022 EQUITY INDICES

	Dec. '22	4th Qtr.	YTD
S&P 500 Total Return (Large-Cap Stocks)	-5.76%	7.56%	-18.11%
Russell 2000 Total Return (Small-Cap Stocks)	-6.49%	6.23%	-20.44%
MSCI EAFE (Developed International Stocks)	0.08%	17.34%	-14.45%
MSCI Emerging Markets (International Emerging Stocks)	-1.41%	9.70%	-20.09%

SELECTED 2022 FIXED INCOME INDICES

	Dec. '22	4th Qtr.	YTD
Barclays U.S. Aggregate (Broad Domestic Bonds)	-0.45%	1.87%	-13.01%
Barclays 1-5 Yr. Credit (Short-Term Domestic Bonds)	0.11%	1.78%	-5.56%
Barclays 5-10 Yr. Credit (Intermediate-Term Domestic Bonds)	-0.37%	3.63%	-13.74%
Barclays U.S. TIPS (Treasury Inflation Protected Securities)	-1.02%	2.04%	-11.85%
FTSE World Gov't 1-5 Yr. Hedg'd (Short-Term Global Bonds)	-0.31%	0.57%	-4.49%

FOURTH QUARTER MARKET OVERVIEW

The global capital markets experienced continued volatility in the Fourth Quarter of 2022, but stocks managed to rebound during this time. Despite this quarter's gains, stocks in various asset classes saw negative returns for the year.

In the US, the S&P 500 index had a positive quarter, with a 7.56% increase, though it ended the year down 18.11%. Similarly, the Russell 2000 index had a 6.23% increase in the quarter but decreased 20.44% for the year.

Fixed income securities had modest gains in the Fourth Quarter, but the rising interest rate environment still impacted the bond market. The Bloomberg US Credit Intermediate-term bond index had a 3.63% increase in the quarter but declined 13.74% for the year.

Despite the decline in stocks in December, the market saw a rapid rebound from mid-October to the end of November. During this period, the S&P 500 index gained 13.77%, and the Russell 2000 index gained 12.51%. This highlights the potential for quick market turnarounds, even in challenging conditions.

It's uncertain when the equity markets will fully recover from the current bear market. Still, one thing is certain: those who remain invested will be well-positioned for the eventual rebound. On the other hand, those who exit the market will likely miss the opportunity.

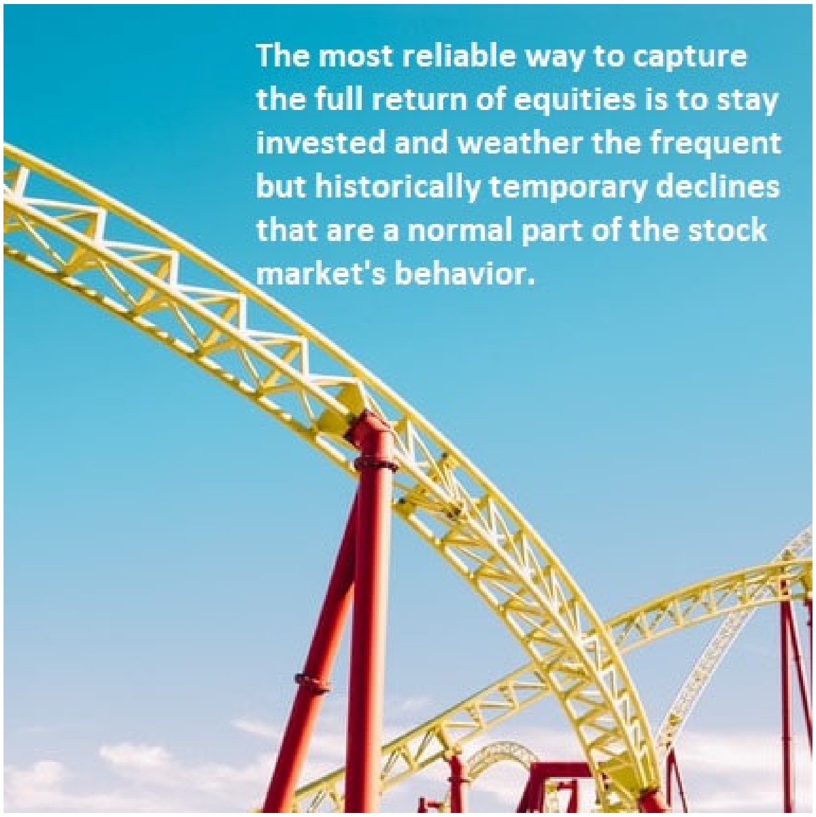
The unprecedented worldwide economic and political turmoil has shown us that ***the economy cannot be consistently forecast, nor the stock market consistently timed.***

As a result, we believe that the most reliable way to capture the full return of equities is to stay invested and weather the frequent, but historically temporary, declines that are a normal part of the market's behavior.

These principles continue to form the foundation of our investment policy as we work together towards achieving your long-term financial goals.

Braving the Storm: Standing Fast in the Face of Economic and Inflationary Uncertainty

Economic and inflationary uncertainty continued in 2022. The central drama of the year—and, it seems likely, for the coming year—was the Federal Reserve's belated, but very aggressive, efforts to bring inflation under control.



The U.S. equity market rose seven times in the nearly 13 years between the trough of the Global Financial Crisis (March 9, 2009) and January 3, 2022. In 2022, the U.S. equity market sold off sharply, and at its most recent trough in October, the S&P 500 was down 27%. Bond prices also declined in response to the sharp increase in interest rates.

It's somewhat ironic that despite the many challenges faced by the mainstream equity market since the onset of the pandemic early in 2020, the S&P 500 managed to close out 2022 somewhat higher than it was at the end of 2019 (3,839 versus 3,231, a gain of nearly 19%). While not outstanding, this performance is comforting given ***the past three years' economic, financial, political, and geopolitical turmoil***.

Our core investment strategy over the past three years of standing fast, ignoring the market noise, and sticking to our long-term plan has been validated by these results, and we believe it remains the best approach for investors.

Clouds on the Horizon: Is a Recession in the Cards for 2023?

The question of the hour is whether and to what extent the Fed's inflation-fighting efforts may cause a recession if it hasn't already. Over the coming year, the outcome will likely determine the short-term trend of equity prices. Our position remains that this outcome is uncertain and that a rational investment policy should not be based on an unknowable outcome.

However, we believe that the benefits of bringing inflation under control, which affects everyone in society, will far outweigh any temporary economic pain.

It's important to remember that ***we are not investing in the macroeconomy.*** Instead, we are investing in the ownership of enduringly successful ***companies*** poised to meet the needs of a growing (eight-billion-person) global population. We have confidence in the companies that make up our portfolios.

Unpredictable Future: The Power of Objectivity

Accurately predicting the future is a nearly impossible feat in the ever-changing world of finance. With hindsight, it's easy to fall into the trap of thinking we could have made better investment decisions if only we had acted on our instincts. For most investors, including you and me, such thinking is nothing more than wishful dreaming.

It is human nature to remember events through a distorted lens. We may truly believe we would have made better investment decisions if we had acted on our instincts. However, an experiment by Jason Zweig of The Wall Street Journal showed that respondents to his 2022 prediction survey “remembered being much less bullish than they had been in real-time." This illustrates that basing bold investment decisions on emotions or current market conditions is not a reliable approach to maximizing future investment returns.

In their best-selling book, "Thinking Fast and Slow," Daniel Kahneman and Amos Tversky highlight how peoples' instinctual ability to interpret statistical data and forecast trends tends to be influenced by inherent biases and overconfidence. This can lead to a false sense of having insider knowledge and the ability to predict trends accurately. In their book, the authors propose a decision-making process called reference class forecasting that uses probabilities of past similar events and assumes the future will likely follow historical averages. By adopting a similar approach, we seek to develop a sound investment strategy for each client that considers historical probabilities of markets and invests based on long-term averages instead of biased interpretations of current market conditions.

Steady Progress in Uncertain Times: A Commitment to Long-Term Investment Success

In summary, the past year was undoubtedly a challenging one for investors. But as we have always believed, the best way to achieve long-term investment success is to stick to a well-conceived plan and bet on the reversion of investment returns to their long-term averages. Our commitment to a disciplined, goal-focused investment approach has served our clients well. We remain committed to our belief that broad diversification, asset allocation, and periodic rebalancing are crucial to minimizing risk and maximizing returns.

As we look ahead to the coming year, continued market uncertainty and volatility will undoubtedly exist. But we are still confident that our investment philosophy should allow us to navigate these challenges and help you achieve your financial goals. As always, it is essential to personally review your asset allocation and see if your current stock-bond ratio is appropriate for your current risk level and financial goals, and now is an especially good time to do so.

We are grateful for your trust in us and honored to be your trusted investment advisor. Let us move forward with confidence and focus on executing your financial plan.

The commentary contained herein has been compiled by W. Reid Culp, III from sources provided by TAGStone Capital, as well as commentary provided by Mr. Culp, personally, and information independently obtained by Mr. Culp. The pronoun "we," as used herein, references collectively the sources noted above.

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