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Dear Atherean Wealth Management client:

Enclosed is your portfolio summary report for the quarter ending March 31, 2023, a summary of your investment objectives and target asset allocation as per our records, and an investment advisory fee statement for the second quarter of 2023. It is important that you review your investment objectives and target asset allocation and let us know if any of it is incorrect or if there are any changes to your financial profile or liquidity needs. For a full report of the holdings in your accounts we encourage you to refer to your statements generated by the custodian.

Market and economic environment

In the first quarter of 2023 we witnessed the first major bank failures in the U.S. since the global financial crisis, another casualty of rapidly-rising interest rates throughout the world. And in September of 2022 we witnessed another financial calamity related to the current interest rate environment: the U.K. pension liquidity crisis. Both Silicon Valley Bank and the U.K. pensions involved long-duration, unhedged, held-to-maturity, fixed-income assets which had to be marked to market in a rapidly-rising interest rate environment. In the case of the U.K pensions the assets (long-duration gilts) were matched with the liabilities (long-duration obligations to pensioners), however mark-to-market losses on these long-duration assets triggered margin calls. In the case of SVB many of the assets were long-term and accounted for at cost (no-mark-to-market losses, so long as they were not sold[1]) and the majority of the liabilities (customer deposits) were short-term and hence mismatched to the duration of the assets. As tends to be the case with banking crises, which throughout history have been periodic and frequent, the failure was related to asset-liability management at a high level. Many market participants have strong muscle memory of the persistently-low interest rates of the previous decade, and, accordingly, believed that rates would revert to their 2010s mean. The SVB treasury and loan portfolio represented a directional unhedged bet on lower interest rates which turned out to be disastrously wrong, and the situation was subsequently exacerbated by a deposit run. In general we believe that being equity holders in banks is a precarious investment as the shareholders' equity sits under assets leveraged ten times, and thus it does not take much change in asset values to wipe out the equity, not even considering the tenuous and fickle nature of their deposit-dependent funding.

[1] In a held-to-maturity portfolio, accounting rules allow the banking institution to carry these instruments "at cost" so long as they hold each and every one of these securities to maturity. If the banking entity were to sell just one of their held-to-maturity securities, the entire held-to-maturity portfolio would have to be reclassified as "available for sale", and marked to market

There has been much talk about the U.S. Fed printing money over the past few years, however there has been an increasing global demand for treasuries resulting from the dollar's reserve currency status and the growth of the world economy over the past few decades. Thus to some extent the Treasury (assisted by the Fed) has increased the supply of treasuries in response to an increase in global demand. That being said, the fiscal debt crisis is very real with U.S. debt currently comprising a level equal to 120% of GDP[2], the highest level since World War II. Since 1960 the only two time periods during which the U.S. federal government has run a budget surplus were between the years 1998 and 2001 and in 1969. And since then there have been only two periods in which the debt-to-GDP ratio has decreased: between 1970 and 1980, when the ratio declined from about 35% of GDP to about 31% of GDP during which time, despite running a budget deficit, the U.S. government was able to inflate its way out of a portion of its debt in real value terms. The other period was between 1995 and 2001, when the debt-to-GDP ratio declined from about 65% to about 55%, partially as a result of robust real economic growth and partially as a result of the U.S. government running a budget surplus[3]. In order to solve the current debt crisis the budget need not be balanced - a deficit less than or equal to the nominal rate of economic growth would be sufficient. It would be in the federal government's best interest to have high inflation over the next decade as this would result in an increased rate of nominal economic growth and thereby assist in bringing the debt-to-GDP ratio down to a manageable level. Throughout history this has been the easy and unwholesome way for governments to resolve their fiscal problems. If the bond market were to believe that this were the Fed's intention, the bond market would riot resulting in higher borrowing costs for the federal government. The long end of the treasury curve is hence a measure both the federal government's fiscal responsibility as well as of the central bank's willingness and ability to bring inflation under control. Simply put, a responsible, inflation-fighting government will have lower borrowing costs than an irresponsible, money-printing, highly-leveraged government.

Equity and Fixed Income Markets – Recent Performance and Valuation

In the first quarter of 2023 global equity markets rebounded following their worst year since 2008 with the U.S. large-cap (S&P 500) index up 8%, the U.S. mid-cap (S&P 400) index up 4%, the U.S. small-cap (S&P 600) index up 3%, and the Europe, Australasia, and Far East (EAFE) index up 9% on a total-return basis. Bond markets have similar rebounded from their worst-preforming year since 1803[4] with the Barclays Aggregate Bond index up 3% on a total-return basis as of the end of the first quarter. The S&P 500 is currently trading at a forward price-to-earnings multiple of just under 18[5] and the Shiller CAPE ratio is at a level of just under 29[6] as of the writing of this letter.

Portfolio Management and Investment Philosophy

We were not active in the first quarter[7]. We typically hold in our equity composite between a dozen and a half to two dozen individual equity positions at a time[8]. While we do not have a target turnover ratio, we do seek

[2] This is the total public debt, which includes debt held by the public as well as debt held by the Federal Reserve banks as of Q4 of 2022. The total public debt held by the public stood at 94% of GDP as of Q4 of 2022. Source: FRED, St Louis Fed

[3] Source: FRED, St Louis Fed

[4] 2022 was arguably the worst year on record for the U.S. bond market. British bonds, needless to say, have a longer history, with their worst year prior to 2022 being a decline of 23.2% during the first year of the Napoleonic wars (1803). Source: Grants Interest Rate Observer, "The Stocks Look Pale", October 14, 2022.

[5] Source: Yardeni Research, Inc, "Stock Market Briefing: Selected P/E Ratios", April 25, 2023

[6] For April 2023. Source: Robert Shiller via YCharts

[7] While we were not active in our equity composite, we may have rebalanced and/or updated the asset allocation for our wealth management clients and/or made modifications to your portfolio involving securities which are not a part of the equity composite. Please refer to your account statements from the custodian and/or your quarterly Investment Objectives and Target Asset Allocation for more information

[8] Wealth management clients typically have a portion of their portfolio allocated to passively-managed equity exchange-traded funds, fixed-income assets, and in some cases other securities in addition to (and in some cases in lieu of) securities which form our equity composite. We do this to accommodate

to invest, for the most part, in companies for a multi-year and in some cases multi-decade time horizon. So, you should not be surprised if significant amounts of time go by with no new equity positions. The year 2022 was an exceptional one in that many dislocations were created in global markets, as would be expected when the global macroeconomic environment changes rapidly as it did when policy rates throughout the world rose at their fastest rate since the early 1980s. Consequently, many high-quality companies became the cheapest they had been in many years, and in accordance with our investment philosophy of patience, discipline, focusing on the long term, and purchasing securities at a significant discount to their intrinsic value[9], we were very active in 2022 with eight new positions in our 22-position equity composite portfolio. During periods of market apathy (the vast majority of time over long time frames), such as the current year-to-date, we have a tendency toward inactivity. Warren Buffett refers to this as “lethargy bordering on sloth”[10], and many value investors refer to this as “time arbitrage” against the short-term mindset of Wall Street. Our investment philosophy seeks to exploit the fact that Wall Street, Main Street, and human nature in general run on short-term thinking. As recently as two years ago SPAC underwriting was rampant and meme stocks and Robin Hood trading were popular. Since then the retail herd has rotated from meme stocks to I-bonds to savings accounts in rapid succession[11], and the banking industry has rotated from SPAC underwriting to buying long-duration held-to-maturity “safe” treasuries to writing off their consumer banking businesses. Typically when we take a new position it is vetted against the current portfolio, and, if it is determined that what we already own is more attractive, then the new idea does not make it into the portfolio. We do this vetting regularly and continuously throughout the year. While we do not have hard position limits, we stay concentrated (as mentioned previously at a dozen-and-a-half to two-dozen positions in our equity composite) so as to maintain a balance between focus and diversification. Too many positions would result in lack of focus while too few would result in lack of diversification. In industry parlance our composite equity portfolios have high “active-share”, which in mathematical terms means a high deviation in position weights from those of the benchmark. Keep in mind that for wealth management clients this equity composite is one slice, or allocation within the overall asset allocation, as we build portfolios to accommodate your individual time horizon, risk tolerance and liquidity needs[12]. We plan to launch a standalone equity product within the next year or so for qualified retail and institutional clients.

As always, we are available to discuss your investment portfolio, discuss your financial plan, or address any other questions or concerns which you may have. Please feel free to reach out via phone or email if you would like to speak with us.

Sincerely,

Atherean Wealth Management, LLC

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your risk tolerance, time horizon and liquidity needs. Please refer to your account statements from the custodian and/or your quarterly Investment Objectives and Target Asset Allocation for more information

[9] Latin roots: intrinsecus - "inwardly, on the inside"; valere - "be strong, be well; be of value, be worth"

[10] From the 1990 Berkshire Hathaway shareholder letter: “Lethargy bordering on sloth remains the cornerstone of our investment style: This year we neither bought nor sold a share of five of our six major holdings”

[11] A recent wealth management survey from Ernst and Young found that about half of respondents aged 21 to 41 switched to cash in 2022 amidst the equity and bond market volatility. Source: 2023 EY Global Wealth Management Research Report

[12] Wealth management clients typically have a portion of their portfolio allocated to passively-managed equity index funds, fixed income assets and in some cases other securities in addition to (and in some cases in lieu of) securities which form our equity composite. We do this to accommodate your risk tolerance, time horizon and liquidity needs. Please refer to your account statements from the custodian and/or your quarterly Investment Objectives and Target Asset Allocation for more information.