Hi Mount Research

SECULAR HEADWINDS

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IN THIS REPORT:

- Secular Environment Has Shifted: From Strength To Headwind
- Despite Pessimism, Equity Exposure Still Historically High
- Low Liquidity Weighs On Forward Stock Market Returns
- Higher Yields Make Bonds A Compelling Alternative To Stocks
- Dynamic Allocation Helps Portfolios Adapt To Changing Trends

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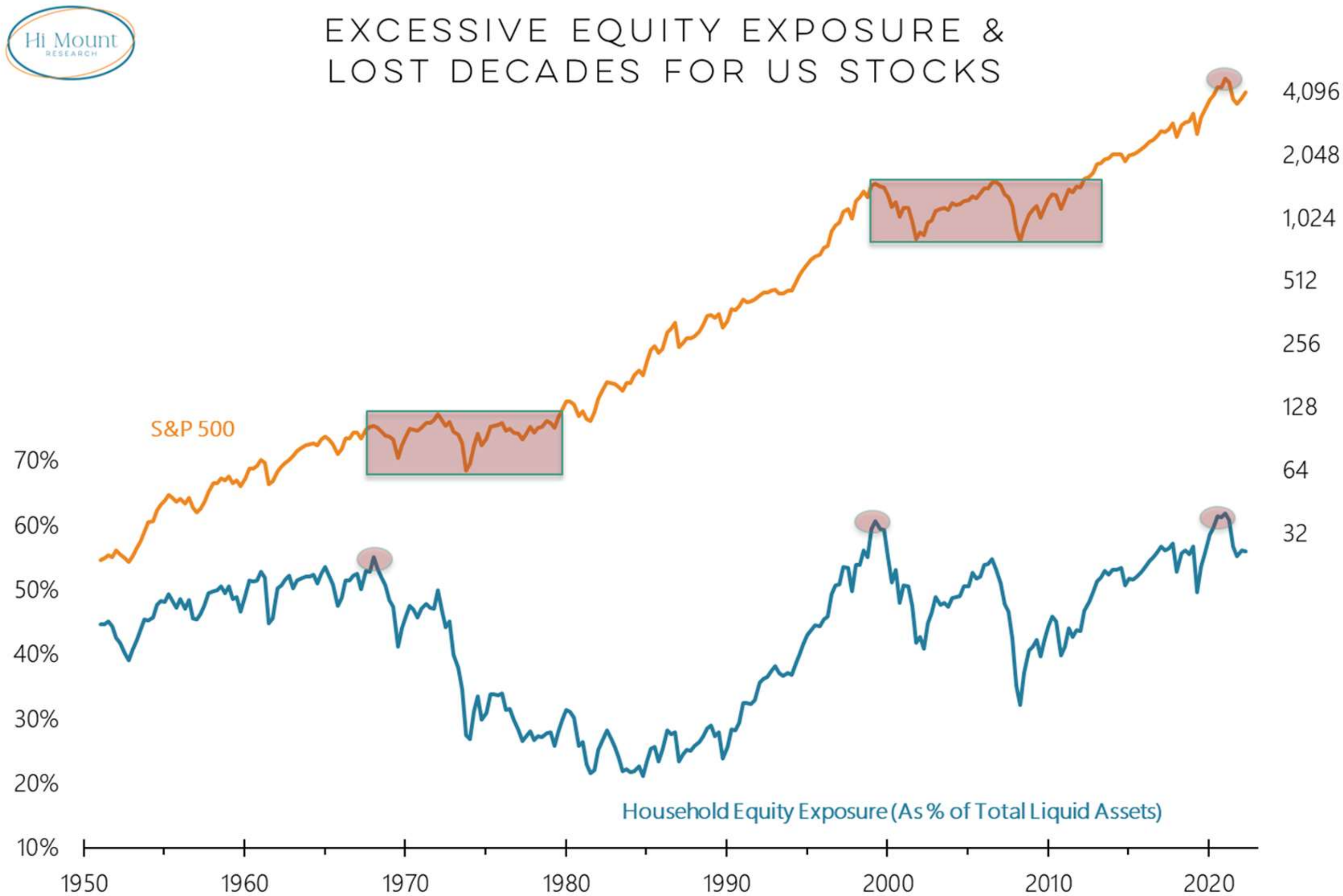
SECULAR HEADWINDS, 6/28/23

EXCESSIVE EQUITY EXPOSURE & LOST DECADES FOR US STOCKS



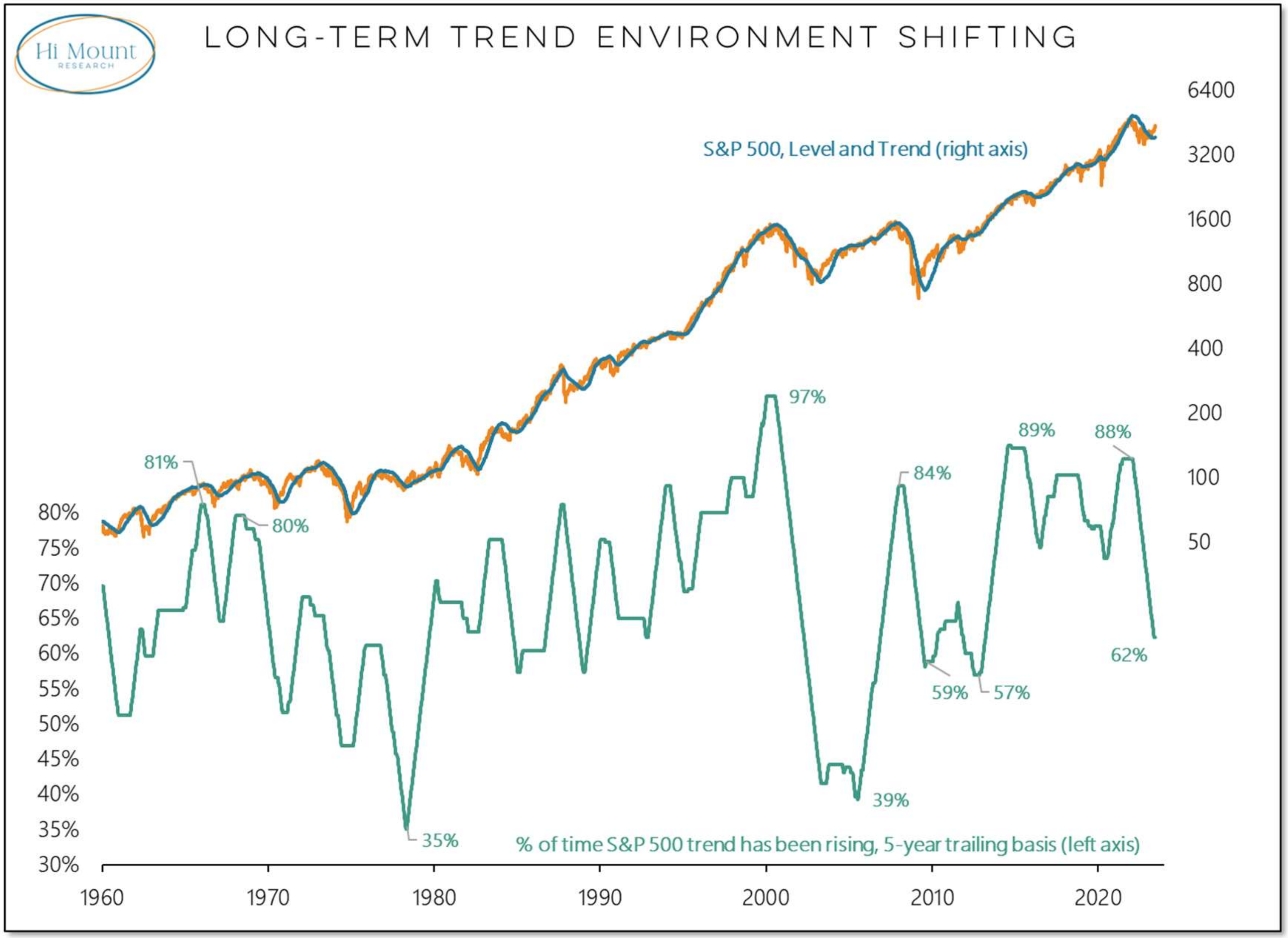
Household Liquid Assets include Checkable Deposits & Currency, Time & Savings Deposits, Money Market Fund Shares, Treasury Securities, Agency Securities, Municipal Securities, Corporate & Foreign Bonds, Mortgages, Corporate Equities & Mutual Funds. Data from Federal Reserve Z.1 report.

Household equity exposure peaked (at a new all-time high) in Q4 2021 and has since pulled back.

Similar peaks in the late 60's and late 90's were followed by lost decades for stocks.

The S&P 500 moved sideways in a broad range from Q4 1968 through Q1 1980 and Q1 2000 through Q4 2012.

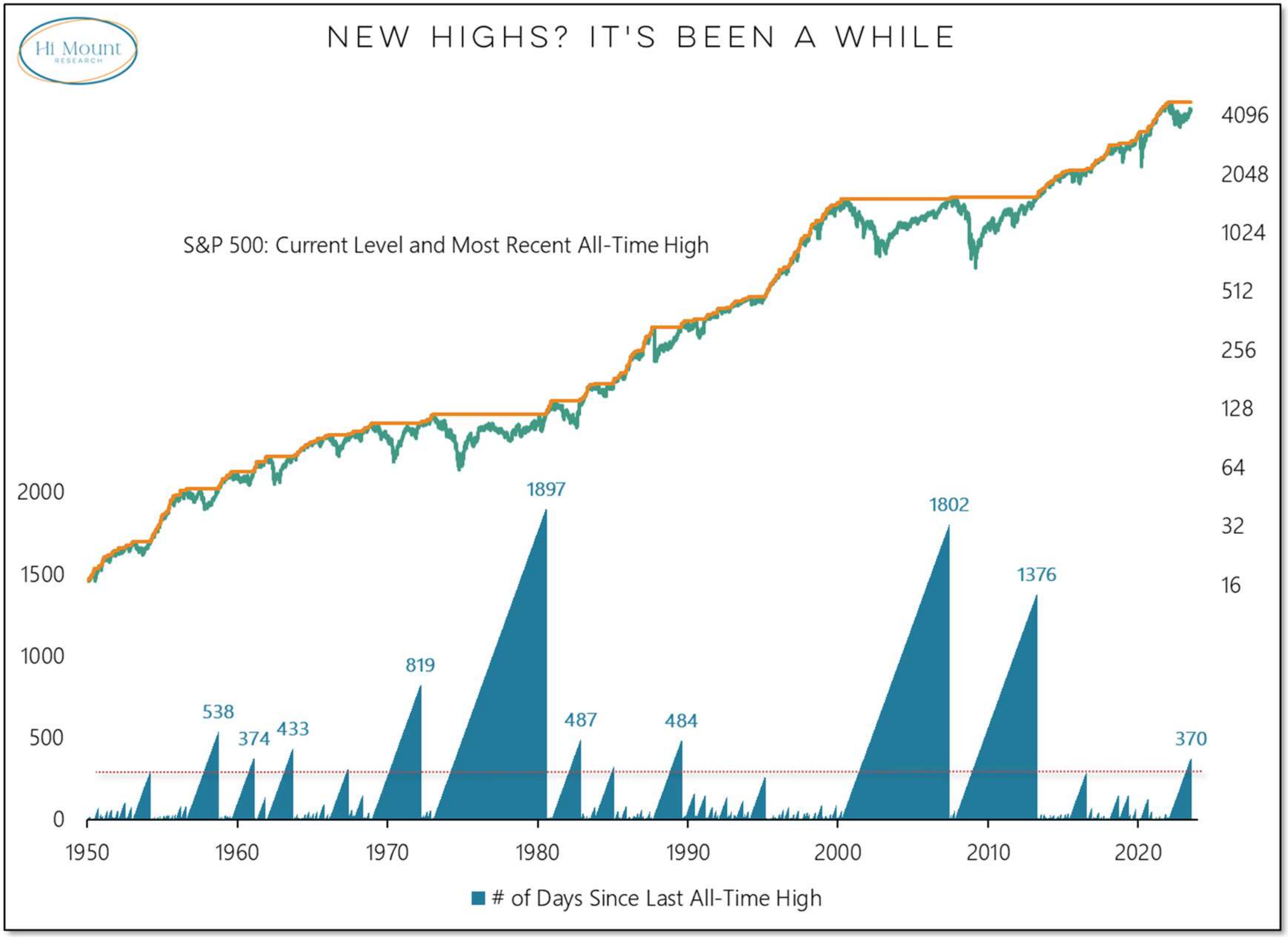
The current situation appears uncomfortably similar.



Secular turns can also be observed through shifts in the long-term trend environment.

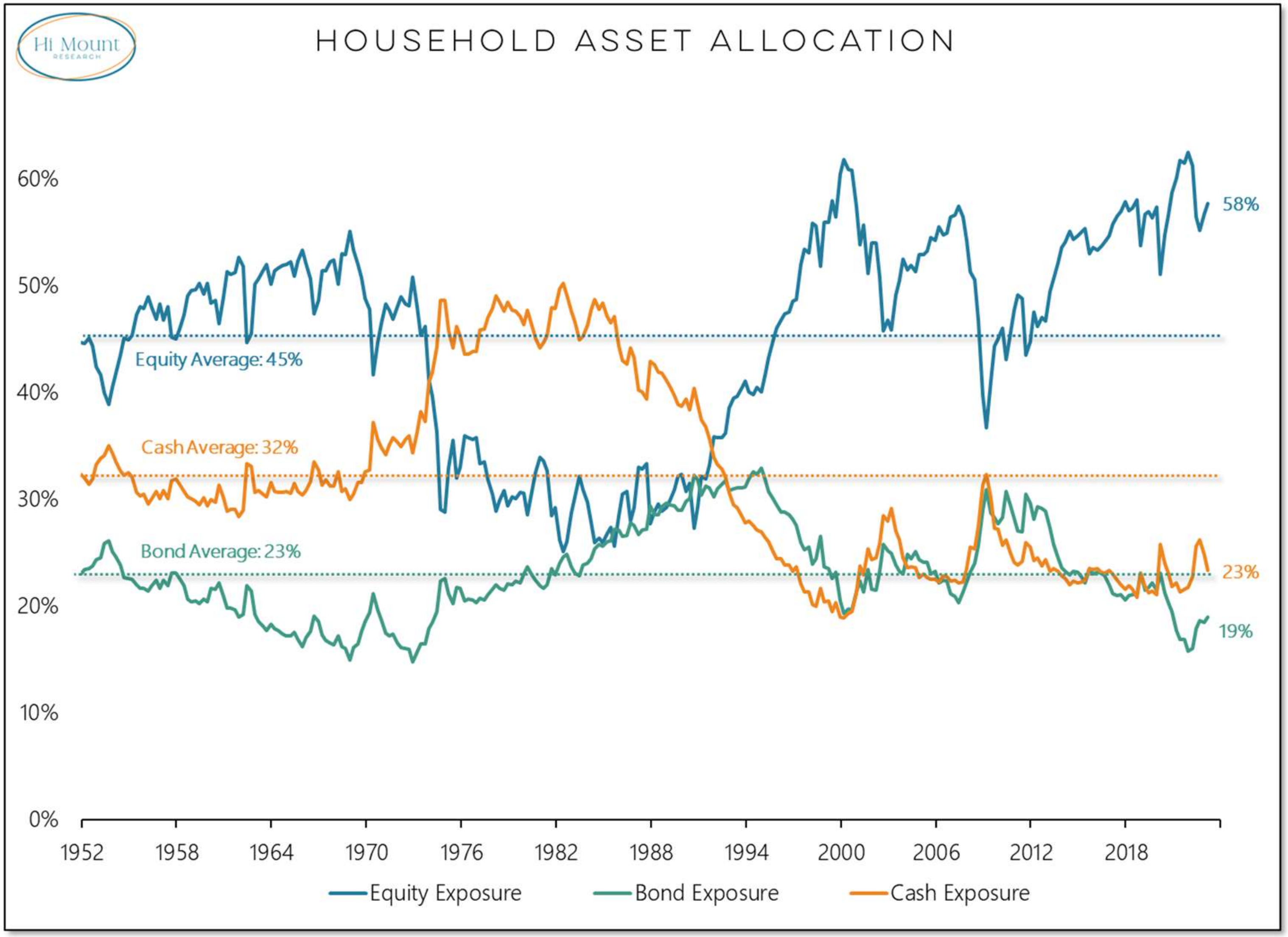
The S&P 500 had been in a rising trend environment more than 80% of the time in the five years prior to the 1968 peak. By the late, 1970's this had dropped to 35%. A similar pattern can be seen around the 2000 peak.

The current period is well on its way to echoing those previous shifts in trend.



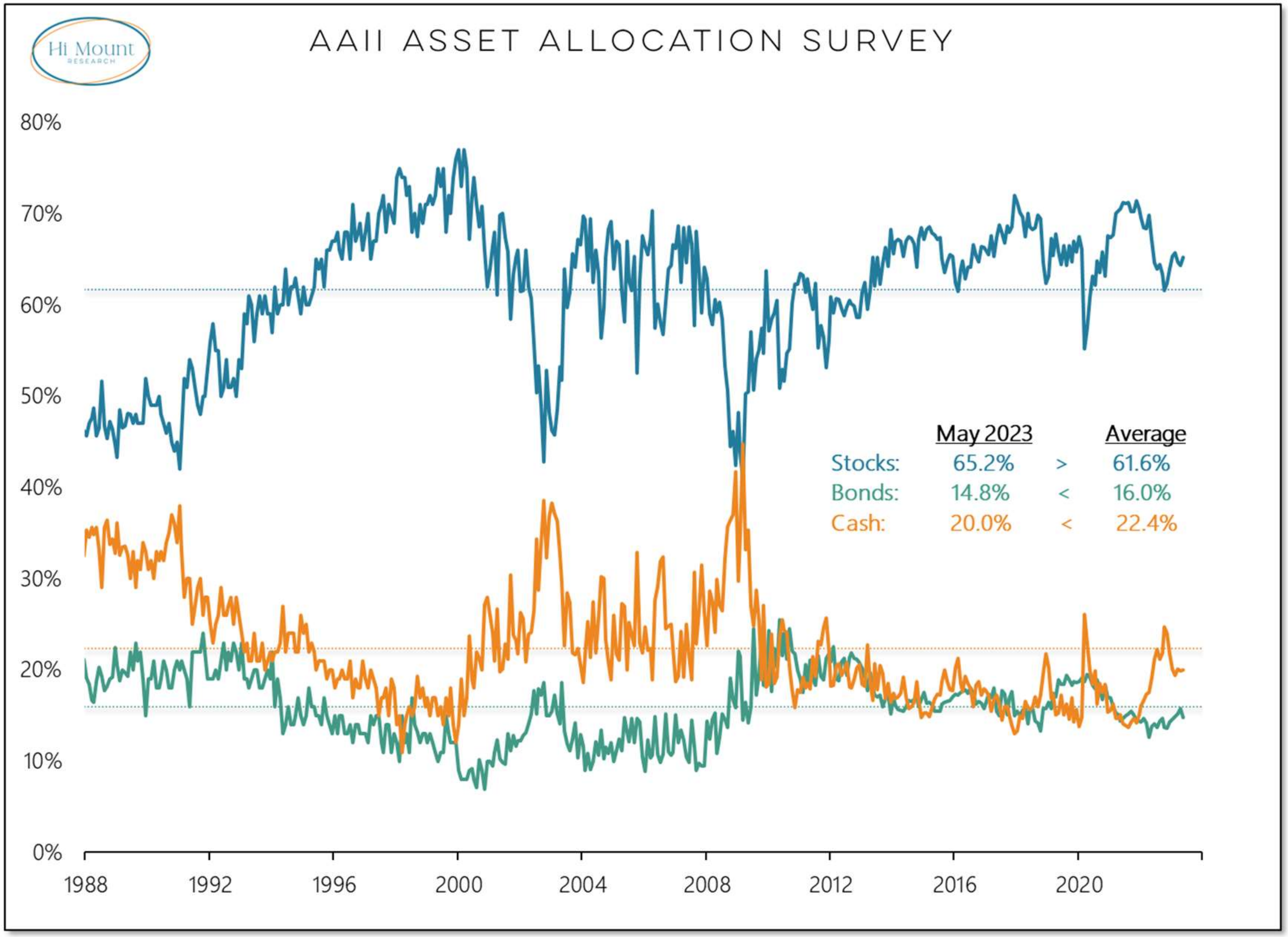
We can also observe shifting trend environments by looking at how long it takes the market goes without making new all-time highs.

The 370+ days since the January 2022 S&P 500 peak is the longest the index has gone without making a new high in nearly a decade.



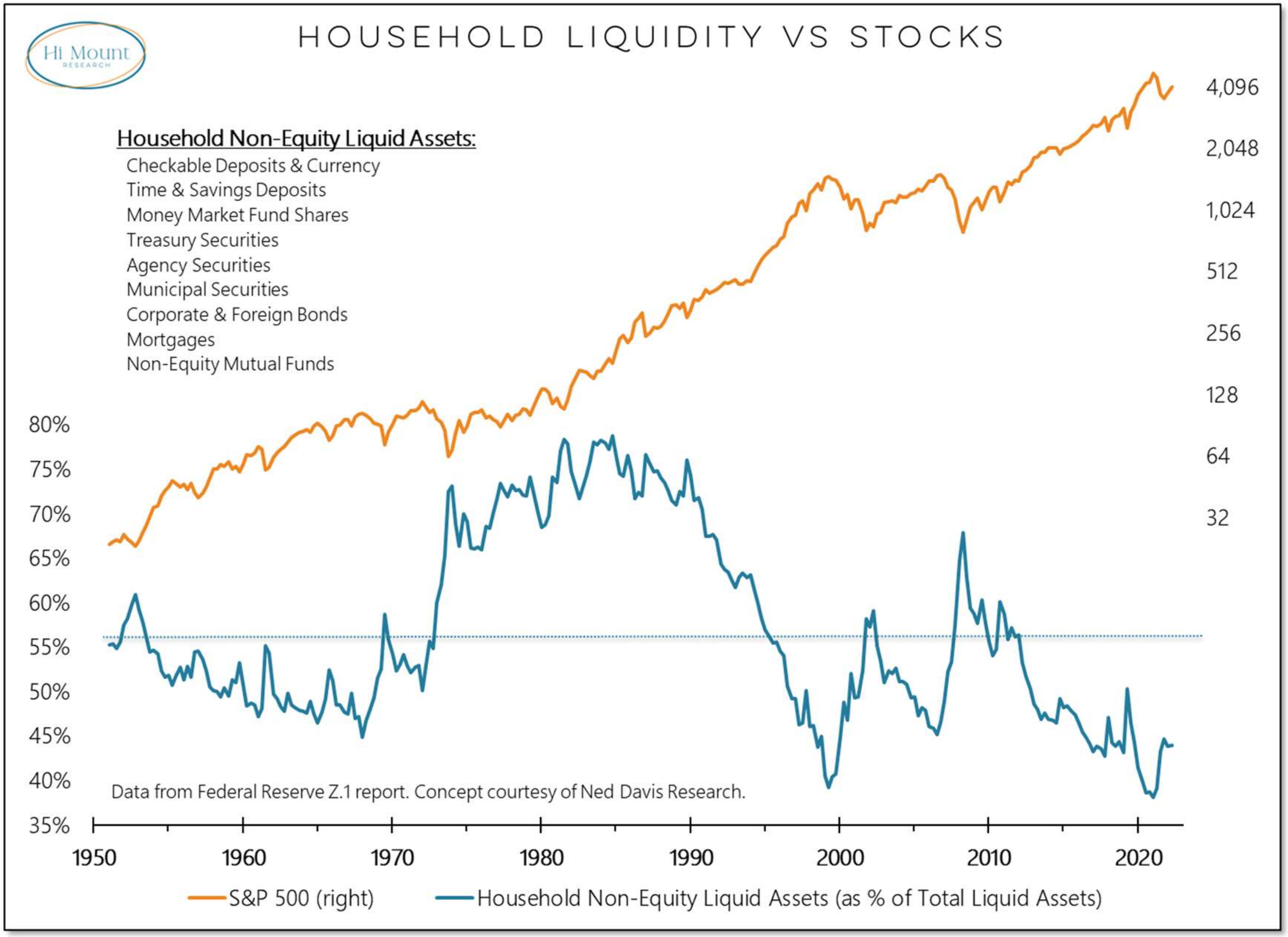
Secular bear markets typically breed fear and apathy on the part of investors. Equity exposure shrinks and while cash and bond allocations rise.

Despite the rampant (and record-setting) pessimism seen since the January 2022 peak, equity exposure remains historically high while exposure to bonds and cash has remained below average.



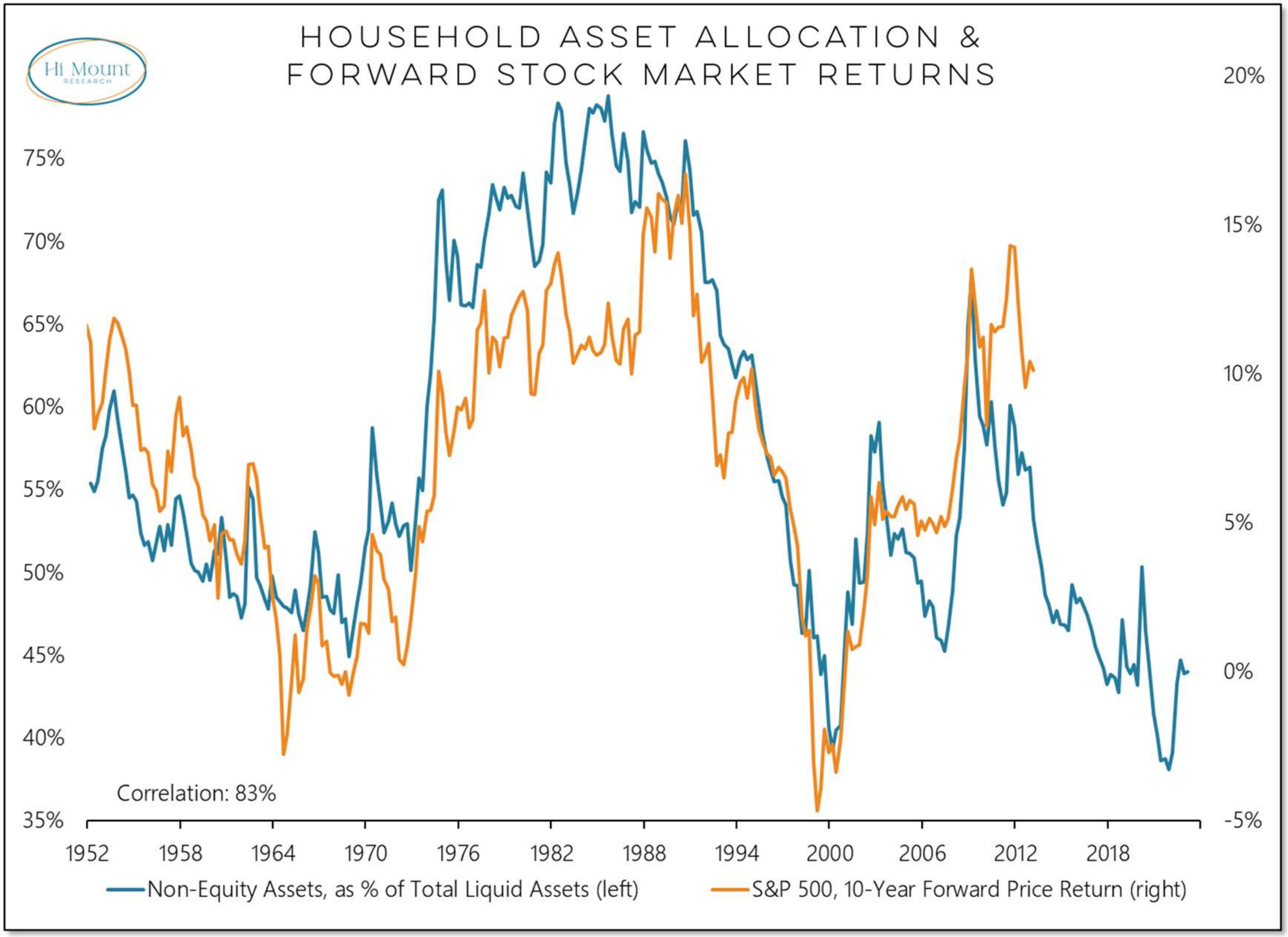
The quarterly asset allocation data from the Fed is confirmed by timelier (but also more disparaged) data from the AAII.

Investors have not thrown in the towel on stocks. While that provides a degree of price support during cyclical bear markets, it also limits secular progress.



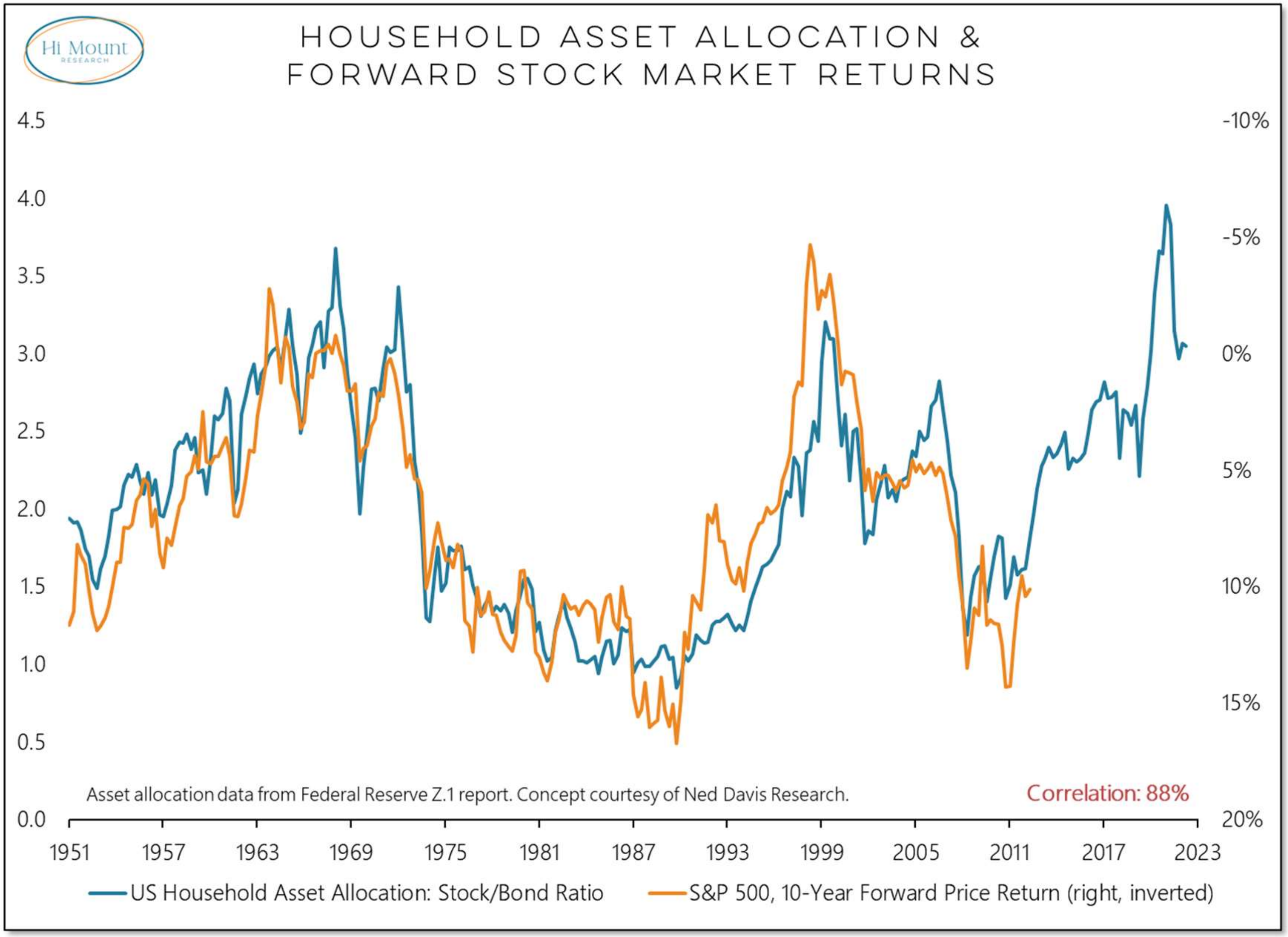
Secular peaks are marked by relatively low levels of household liquidity while elevated levels of liquidity provide fuel for extended bull market advances.

Currently, household liquidity remains historically low.



There is an 83% correlation between non-equity liquidity and forward stock market returns.

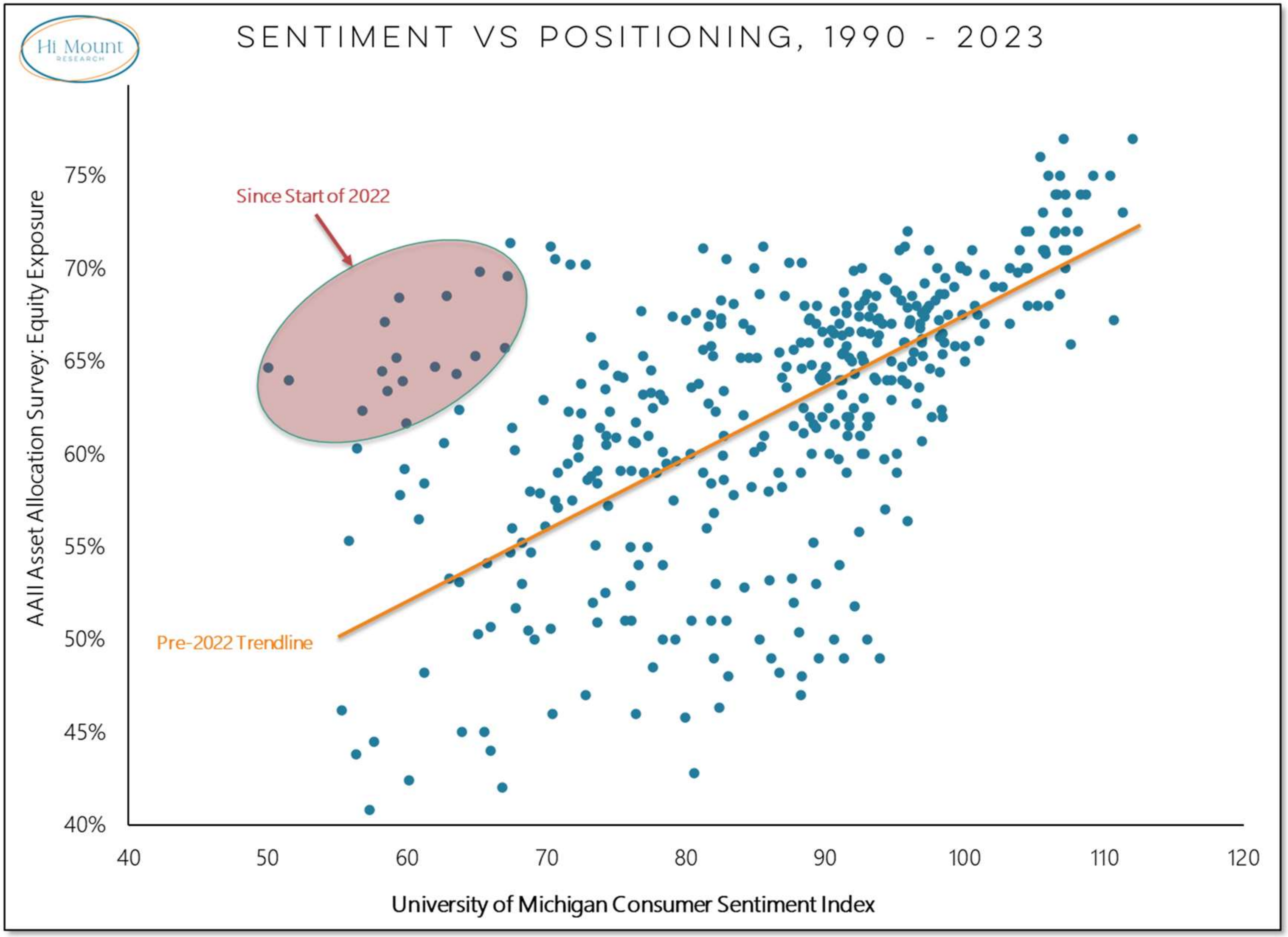
The current low levels of liquidity suggest stock market returns over the coming decade may dramatically fall short of what has been experienced over the past decade.



Households currently have three times as much exposure to stocks as bonds (rather than a 60/40 portfolio, its more like 75/25 if we just look at stocks vs bonds). There is an even stronger correlation between this ratio and forward returns than when we include cash in the conversation.

The re-allocation from bonds to stocks is fuel for equity market returns. That tank is closer to empty than full.

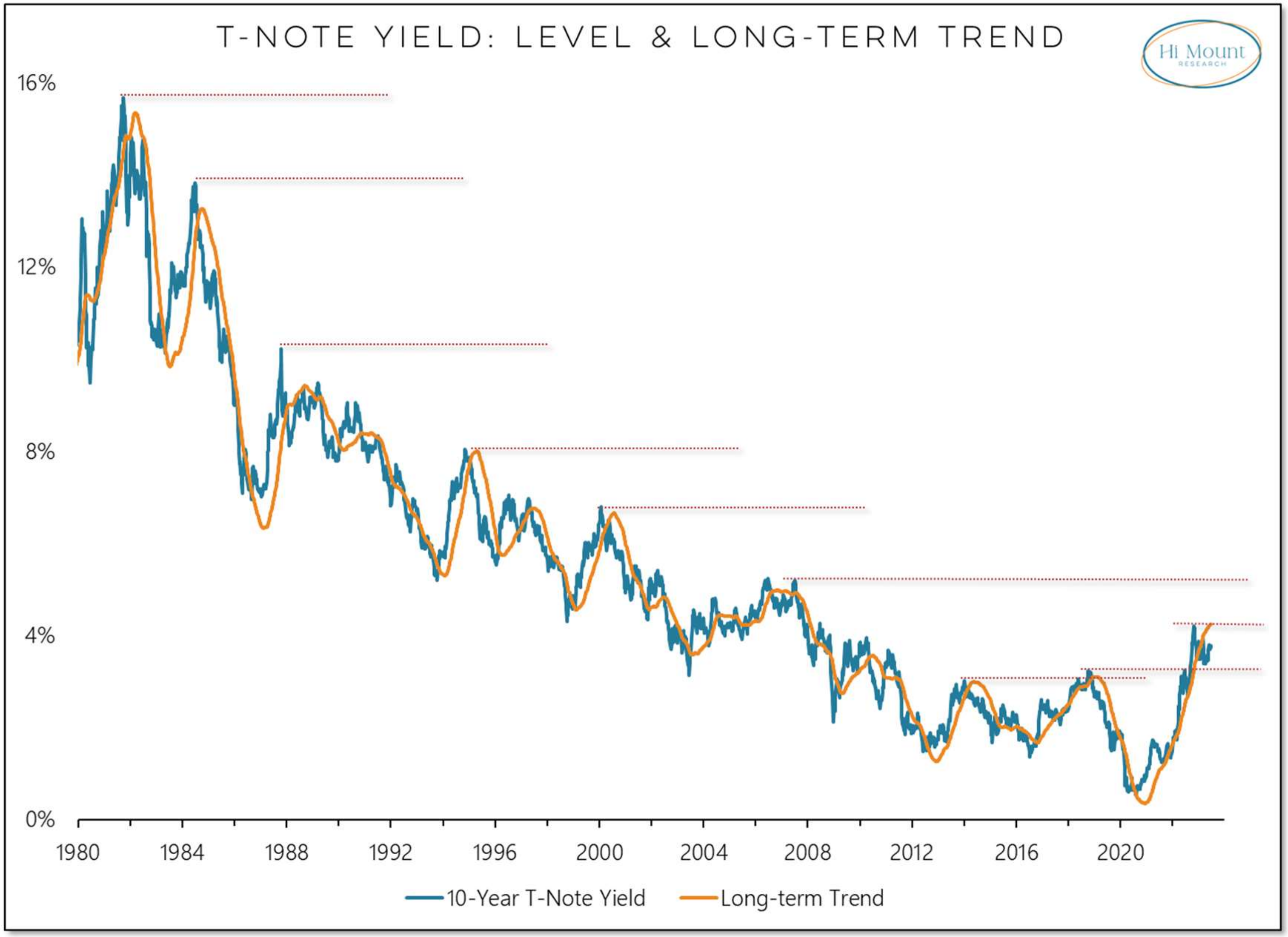
Again, this is like what was seen in the late-60s and late-90s, and not similar at all to what was seen in the late-80's or coming out of the Financial Crisis.



The relationship between sentiment and positioning has become historically unhinged.

Recent declines in sentiment have not been accompanied by comparable reductions in equity exposure.

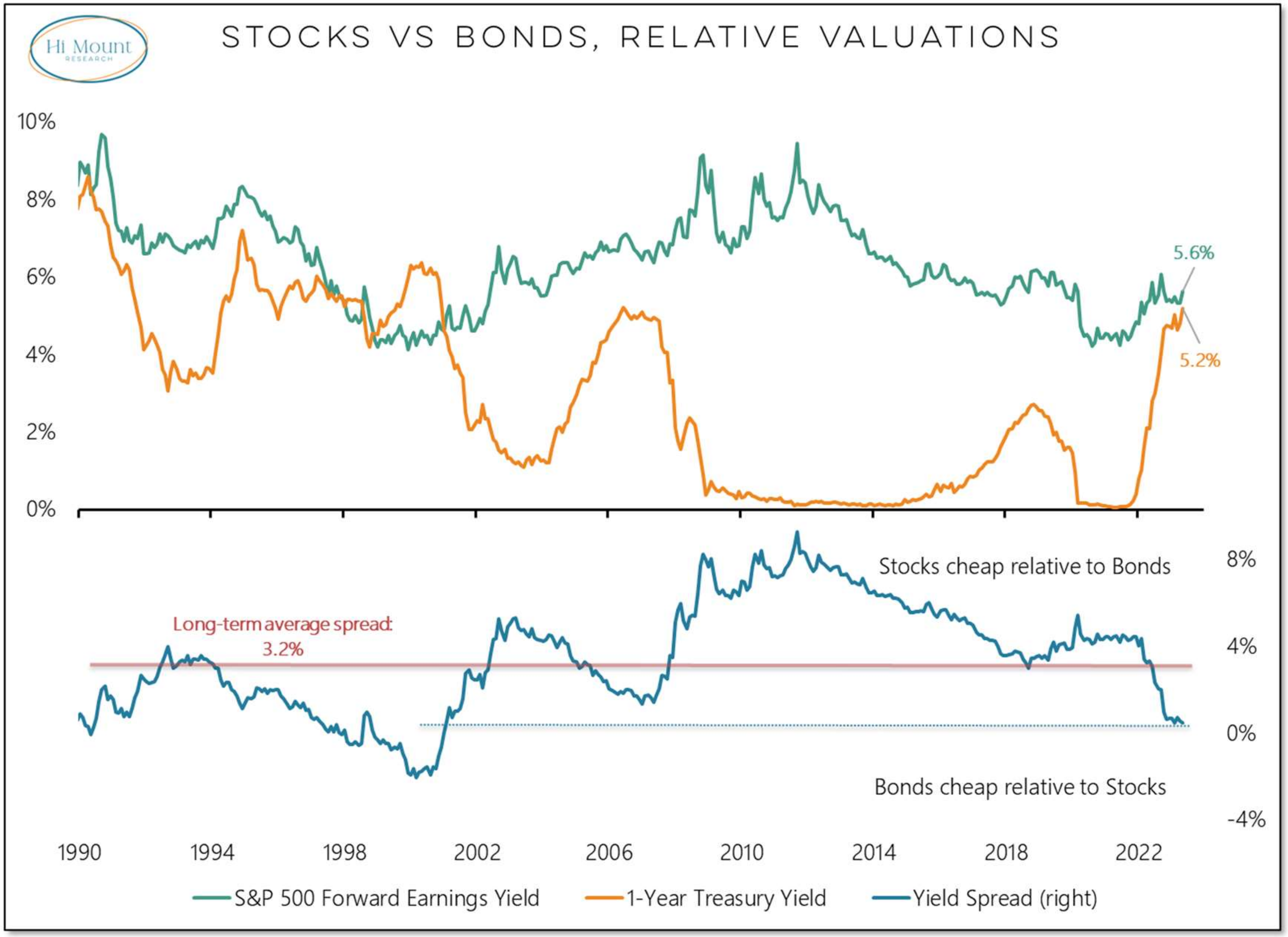
An improved secular setup requires investors actually abandoning stocks, and not just talking about doing so.



A secular shift that is already in evidence is that of the trend in bond yields.

The long-term trend in the 10-year T-Note is experiencing its most sustained rise since the 1960s.

After decades of lower highs in yields, investors are now witnessing higher highs.



The rise in bond yields means that even as absolute valuations have improved for stocks over the past two years, relative to bonds they are more expensive than at any point in the past 20+ years.

Investors have complained over the past decade about a lack of alternatives to stocks. That is no longer the case.

Hi Mount Research	BLUE HERON PORTFOLIOS	STATIC ASSET ALLOCATION						BLUE HERON PORTFOLIOS WITH DYNAMIC ALLOCATION
Equities	**Current Weight**	**100%**	**80%**	**60%**	**40%**	**20%**	**0%**	**71%**
US Large-Cap Growth	17.4%	17.4%	13.9%	10.4%	7.0%	3.5%	0.0%	12.3%
US Large-Cap Value	16.4%	16.4%	13.1%	9.8%	6.5%	3.3%	0.0%	11.6%
Mid-Caps	17.4%	17.4%	13.9%	10.4%	7.0%	3.5%	0.0%	12.3%
Small-Caps	1.0%	1.0%	0.8%	0.6%	0.4%	0.2%	0.0%	0.7%
Canada	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Emerging Markets	9.7%	9.7%	7.7%	5.8%	3.9%	1.9%	0.0%	6.8%
Europe ex-UK	17.9%	17.9%	14.3%	10.7%	7.1%	3.6%	0.0%	12.6%
United Kingdom	6.3%	6.3%	5.0%	3.8%	2.5%	1.3%	0.0%	4.4%
Pacific ex-Japan	3.9%	3.9%	3.1%	2.3%	1.5%	0.8%	0.0%	2.7%
Japan	10.1%	10.1%	8.1%	6.1%	4.1%	2.0%	0.0%	7.2%
Fixed Income	**Current Weight**	**0%**	**20%**	**40%**	**60%**	**80%**	**100%**	**29%**
T-Bills	15.4%	0.0%	3.1%	6.2%	9.2%	12.3%	15.4%	4.5%
ST Govt/Credit	13.2%	0.0%	2.6%	5.3%	7.9%	10.5%	13.2%	3.9%
LT Govt/Credit	11.0%	0.0%	2.2%	4.4%	6.6%	8.8%	11.0%	3.2%
Credit	14.3%	0.0%	2.9%	5.7%	8.6%	11.4%	14.3%	4.2%
High Yield	17.6%	0.0%	3.5%	7.0%	10.5%	14.1%	17.6%	5.2%
Munis	16.5%	0.0%	3.3%	6.6%	9.9%	13.2%	16.5%	4.8%
Global ex USD	12.1%	0.0%	2.4%	4.8%	7.3%	9.7%	12.1%	3.6%
Commodities		**0%**	**0%**	**0%**	**0%**	**0%**	**0%**	**0%**

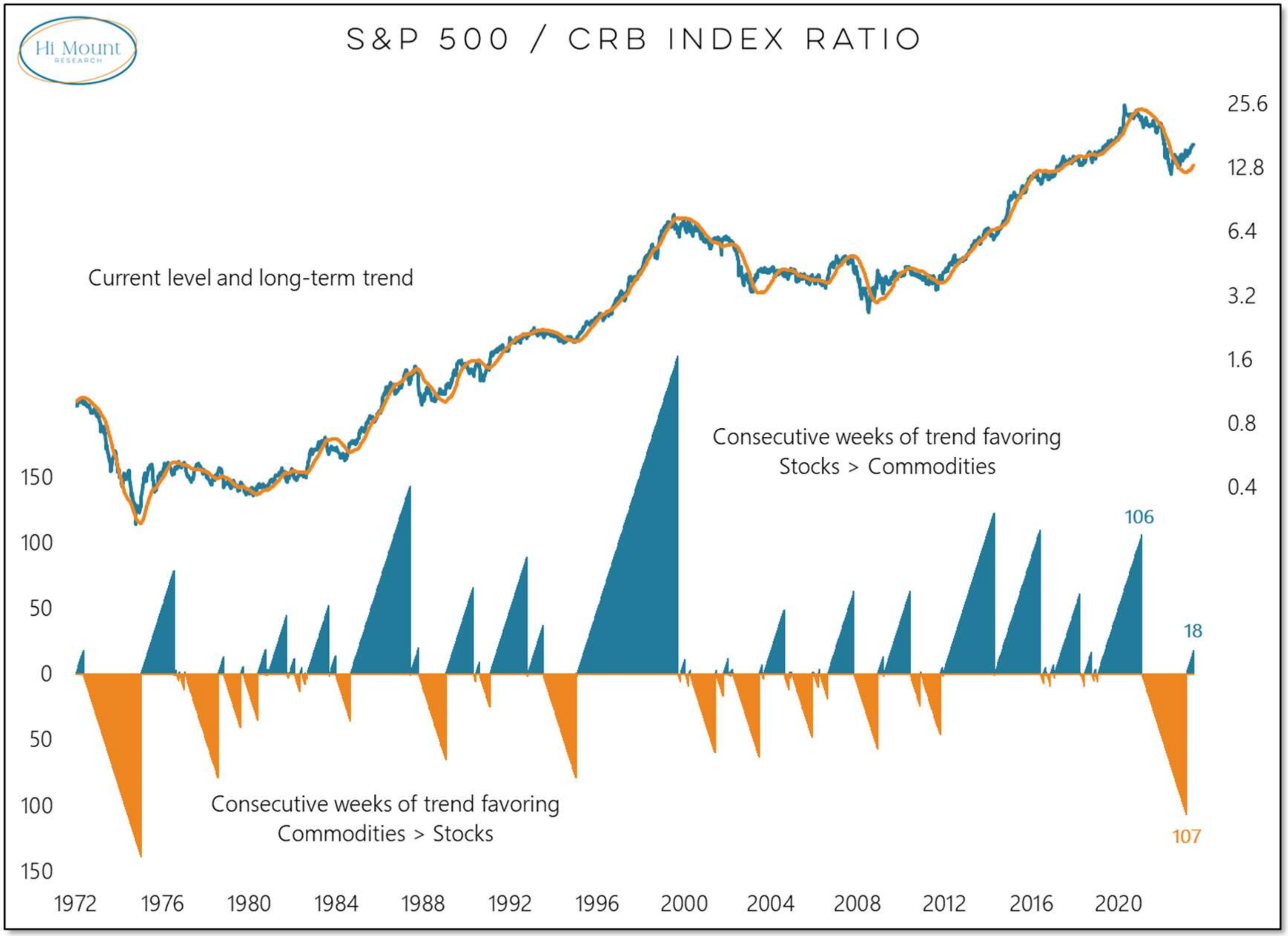
as of: 6/23/2023

While secular strength is often associated with a relentless trend higher for stocks, secular headwinds are more about churn than relentless weakness.

Static exposure during relentless trends works well as a strategy (or at least its shortcomings are not as obvious).

During periods of churn, static exposure can grind on investor nerves (and returns) and eventually wear them out.

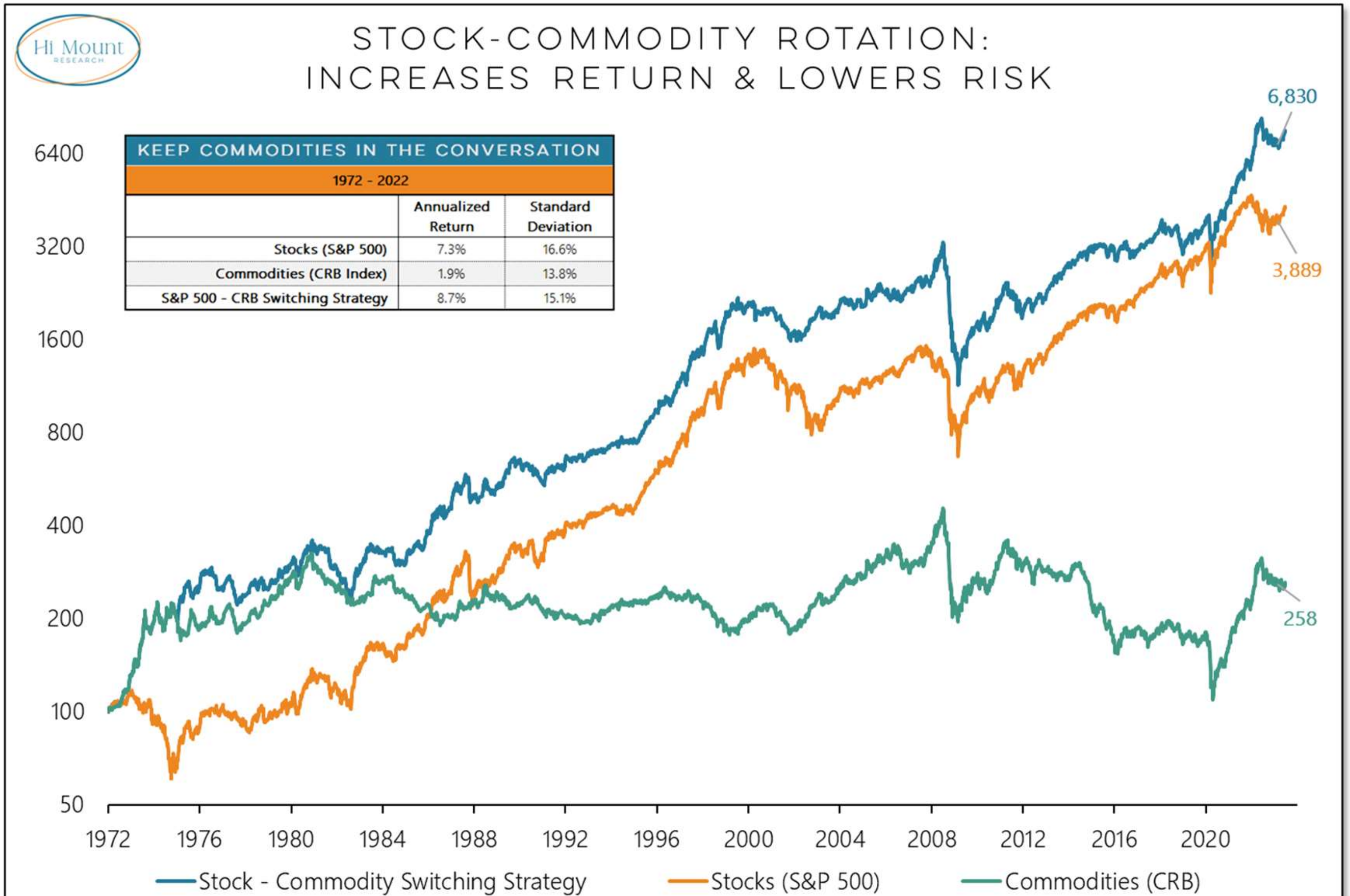
A dynamic approach to asset allocation (both within and across asset classes) can help investors adapt to reality and keep portfolios in harmony with what is actually taking place



Over the past decade, the ratio between stocks and commodities consistently favor stocks over commodities.

Commodities fell out of the asset allocation conversation, and few investors were positioned to benefit (either proactively or adaptively) to the most sustained strength in commodities we have experienced in 50 years.

The churn associated with secular headwinds means that asset class trends are not likely to be one-sided. This brings with it opportunities to adapt to new strength and rotate toward new leaders.



KEEP COMMODITIES IN THE CONVERSATION

1972 - 2022

	Annualized Return	Standard Deviation
Stocks (S&P 500)	7.3%	16.6%
Commodities (CRB Index)	1.9%	13.8%
S&P 500 - CRB Switching Strategy	8.7%	15.1%

Switching strategy shifts exposure between stocks and commodities based on the the direction of the long-term trend in the S&P 500/CRB ratio.
Data indexed to Dec 31, 1971 =100.

Dynamic asset allocation means diversifying exposure across time.

Using the example of stocks and commodities, allowing exposure to be in harmony with the underlying trend increases returns and reduces risks associated with remaining in stocks all the time.