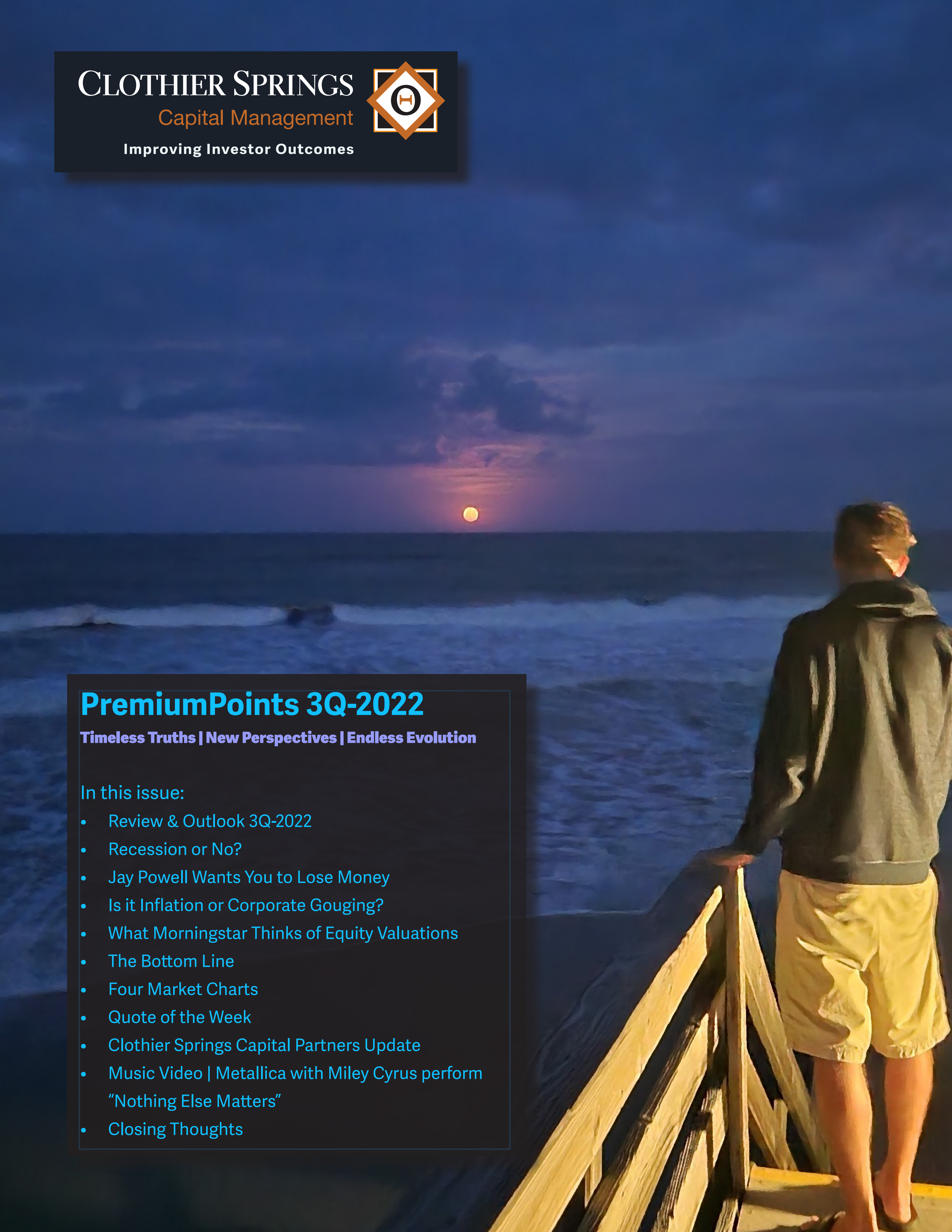

CLOTHIER SPRINGS
Capital Management
Improving Investor Outcomes

PremiumPoints 3Q-2022

Timeless Truths | New Perspectives | Endless Evolution

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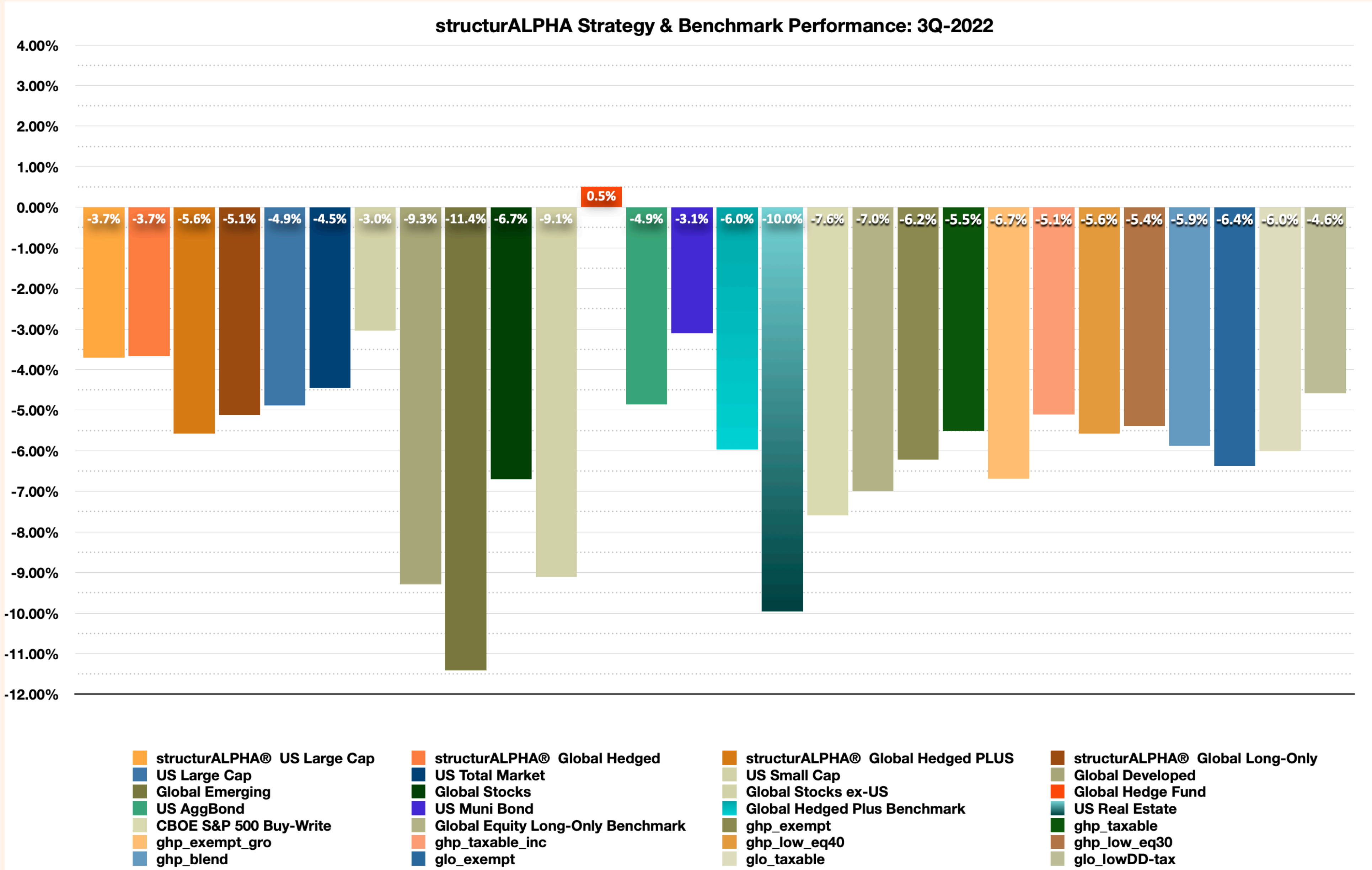


Review & Outlook 3Q-2022

Markets across the board continued to be under pressure in 3Q-2022 as the Federal Reserve continued to raise interest rates to cool the economy and constrain inflation. Mortgage rates above 7.0% have not been this high since 2008. Of course, higher rates cause the present values of all assets to decline...and that's what they are doing...declining.

A friend of mine in the business likes to quote: *"the cure for high prices is high prices."* True enough as consumers are free to change their spending choices and habits however they like. It seems to us that the Federal reserve is acting somewhat precipitously with their aggressive rate hikes. It takes time for things to take effect in our massive economy. Some prominent economists we follow make a strong case that enough is enough for now and the Fed should let what actions they have taken already and let a few more months of data to come in before they decide how to move forward.

Aside from the pain of falling prices, there is a welcome benefit from falling prices...income. Asset classes across the board now offer yields and dividend income the markets have not seen in quite some time. Income has historically been a significant component of stock returns. While there are other issues that will keep a lid on dividend income (see stock buybacks and executive compensation), any increase in yield will help total returns.

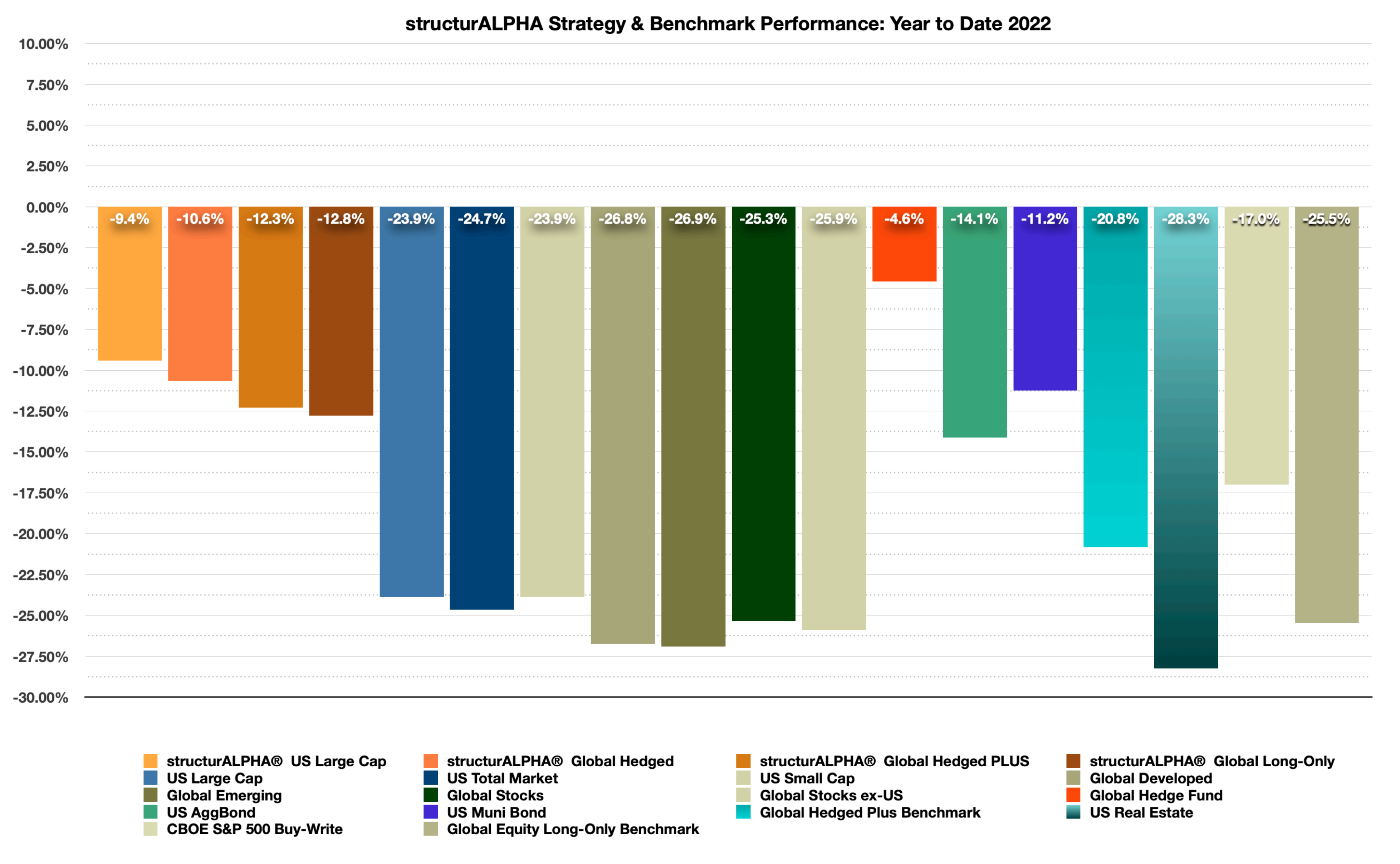
Recession or No?

Whether the aggressive rate hikes by the Federal Reserve in their effort to stem inflation ultimately slow the economy enough to cause a recession remains to be seen. Mortgage (30 year) rates now top 7.0%, up from the 3.0% a year ago. That is likely to cool off the housing market. Rising rates have also caused the U.S. dollar to appreciate and will make exports more expensive. Gas prices have fallen. Unemployment is quite low, yet wage pressures are almost insignificant (see next page) and are not the proximate cause of inflation. Rents for apartments have risen in response to demand and a dearth of single family housing. Will GDP slow or even decline?

Trying to triangulate all the moving parts is no mean feat. It could be that the markets have already priced in the bad news and are poised for their turnaround. Some of what we are seeing may be simple price resetting due to supply and demand. Some of it is clearly corporate gouging. As we write this (10-13-2022) the Dow Jones Industrial Average is up more than 800 points a little after midday after yet one more inflation statistic that came in a little hot this morning.

Consumers have choices although there is less competition due to years of corporate mergers and combinations. If the cure for high prices is high prices, consumers will make different choices. If they don't, perhaps inelastic demand is a factor in rising prices as well as reduced competition.

Regardless, we are all in uncharted territory as we navigate the rising rates, slowing economy, and shifting consumer demands. However, assets are cheaper than they have been in a long time and cheap inevitably leads to strong returns.



US Corporate Profits Soar With Margins at Widest Since 1950

- Business is passing on higher costs and then some, data show

From Bloomberg BusinessWeek 8-25-2022

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Jay Powell Needs Investors to Lose Money

Yes, that pain you're feeling is intentional. It makes the Federal Reserve's job easier.

Excerpt From the New Yorker

Is it Inflation or Corporate Gouging?

It should be noted that the September jobs report provided no evidence that the economy is suffering from a nineteen-seventies-style wage-price spiral, which is the inflation hawks' nightmare scenario. In September, average hourly earnings rose by ten cents. That's about 0.3 per cent, or 3.8 per cent on an annualized basis. And this wasn't a one-month aberration. Since the end of last year, the rate of wage growth has fallen slightly. The corporate profit rate, on the other hand, has recently reached its highest level in seventy years, as businesses of all kinds pass along higher prices to consumers, and then add in a little extra for themselves.

For some reason, you don't read about record corporate profits much, or hear about it very often from Federal Reserve officials, who remain determined to keep raising interest rates until something goes pop. Jerome Powell and his colleagues are hoping that this something will be the inflation rate, but it could just as easily be the entire U.S. economy, including the jobs market. That's why the stock market fell sharply on Friday—the Dow closed down more than six hundred points. After digesting the jobs report, investors don't think the economy is slowing down rapidly enough to dissuade the Fed: they are almost certainly right.

John Cassidy | The New Yorker | October 7, 2022

MARKET OUTLOOK | 4Q 2022

U.S. Stock Market Falls Back to Rare Undervalued Levels Following Recent Drop

MORNINGSTAR

What Morningstar Thinks of Equity Valuations

U.S. Stock Market has Over-Corrected to Downside

In our 2022 Market Outlook we noted that the U.S. stock market was overvalued coming into the year. The four headwinds we identified have been joined by additional new headwinds, including the appreciation of the U.S. dollar and expectations that Europe is entering a recession.

While these headwinds will pressure near-term earnings growth, according to our long-term valuations, the market has over-corrected to the downside and is trading deep into undervalued territory.

Based on a composite of the intrinsic valuation of the approximately 700 stocks we cover that trade on U.S. exchanges, we calculate that the broad U.S. stock market is trading at a price to fair value of 0.79. Growth stocks are the most undervalued, trading at a price to fair value of 0.75, followed by the value category trading at 0.77. Core stocks are trading closer to fair value estimate at 0.86.

Investors appear to be best positioned with a barbell-shaped strategy, overweighting both value and growth categories and under-weighting core. Across capitalization levels, large- and mid-cap stocks are trading near the broad market valuation, whereas small cap stocks are trading at the greatest discount to fair value at 0.62.

September 26, 2022

Size	Style: All	Value	Core	Growth
All	**0.79**	0.77	0.86	0.75
Large	0.79	0.78	0.87	0.75
Mid	0.78	0.75	0.81	0.76
Small	0.62	0.53	0.72	0.58

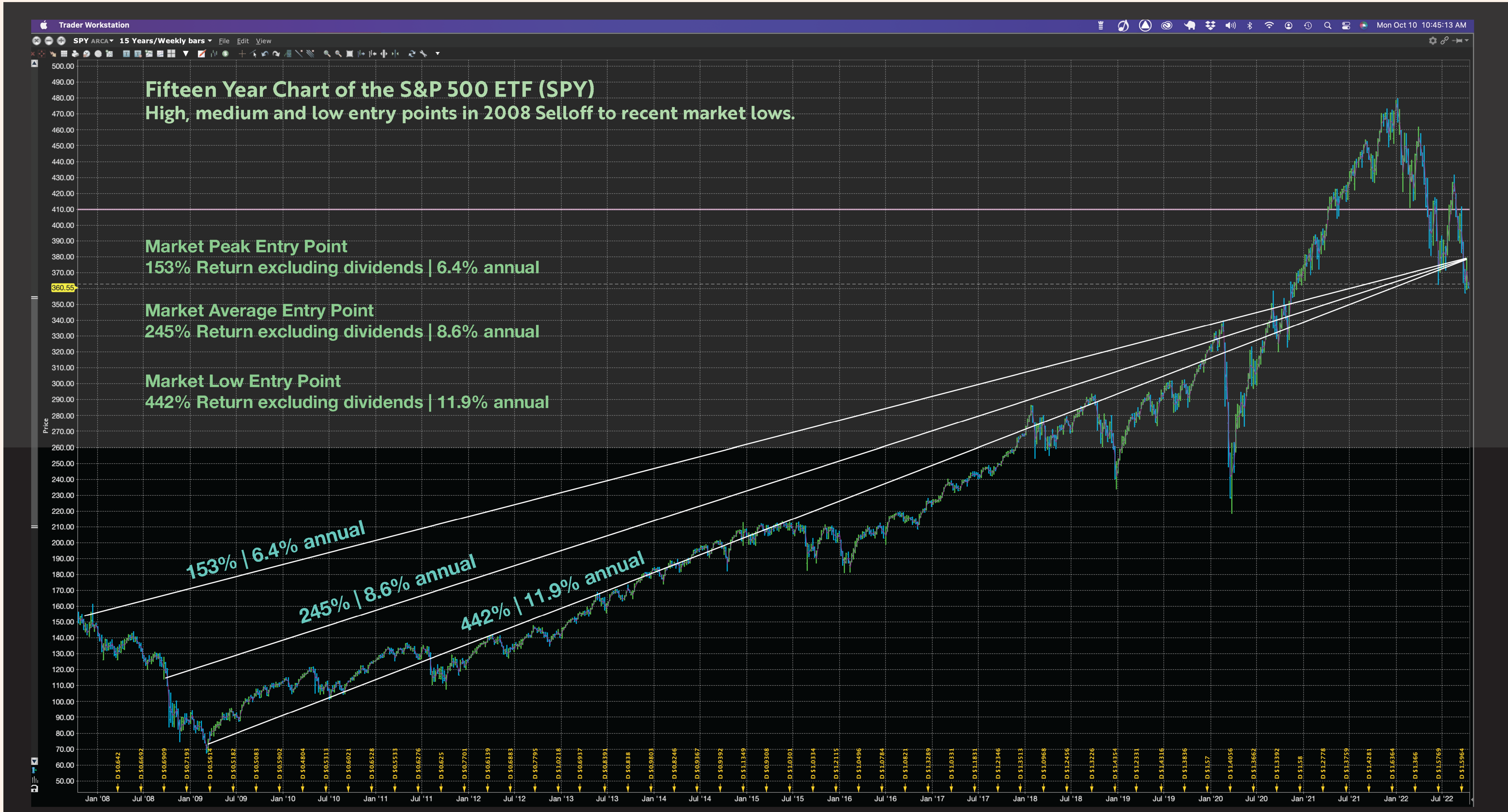
Overvalued
- ≥ 1.10
- 1.05 to 1.10

Fairly Valued
- 1.01 to 1.05
- 0.99 to 1.01
- 0.95 to 0.99

Undervalued
- 0.95 to 0.90
- ≤ 0.90

The Bottom Line

Valuations drive forward returns. Valuations are the single metric that reliably and strongly correlate (inversely) to forward returns. Lower valuations drive higher forward returns and higher valuations deliver lower forward returns. The exhibit above from Morningstar reveals a deeply discounted equity market. While short-term declines are unsettling, superior returns have historically resulted from undervalued markets. Investors with cash should be spending aggressively. Fully invested investors should hold fast. If history informs--and it does--forward returns will be above average.



15 Year Price Appreciation returns from various (entry) points in the Mortgage Meltdown market selloff of 2008-2009. As always, returns are best from market lows, regardless of the endpoint. Note that given enough time, all returns are strongly positive, even to recent market lows.

15 Year Price Appreciation returns from various (entry) points in the Mortgage Meltdown market selloff of 2008-2009. As always, returns are best from market lows, regardless of the endpoint. Note that given enough time, all returns are strongly positive. Returns from 2008 to recent market highs are quite strong. Remember, these returns do not include dividend income.

3 Year Price Appreciation returns from various (entry) points in the Covid Lockdown Panic market selloff of early 2020. As always, returns are best from market lows, regardless of the endpoint. Even over the past two-plus years, returns from 2020 peak to recent lows are positive. From the 2020 bottom (3-23-2020) they are very attractive.

3 Year Price Appreciation returns from various (entry) points in the Covid Lockdown Panic market selloff of early 2020. As always, returns are best from market lows, regardless of the endpoint. Over the past two-plus years, returns from 2020 bottom (3-23-2020) to recent highs are quite remarkable.

The point of these market chart and return exhibits is to help investors hold their nerve during market selloffs. Sure, market declines are unpleasant. And the news-flow has never been more noisy, conflicting or histrionic. But every down-tick in the markets make for better and better future returns.

Quote of the Week:

From the Bloomberg BusinessWeek Article of 10-11-2022 by Nishant Kumar:

Hedge Fund Managers Paid for Stockpicking Genius Aren't Showing Much of It

The traditional strategy of mixing long and short equity bets hasn't provided the bear market buffer that clients hoped for.

"Who thought it was a good idea to pay away 20% of profits to guys who simply went long tech stocks?" says Andrew Beer, founder of New York-based Dynamic Beta Investments, which attempts to replicate hedge fund-type returns at low cost. "The hedge fund fee structure has been a dream for managers and nightmare for investors."

Clothier Springs Capital Partners Update

The partnership remains fully invested and very close to our target allocation of 70% equity investments and 30% debt investments. We have tweaked our portfolio slightly to improve the monthly income we receive from all sources.

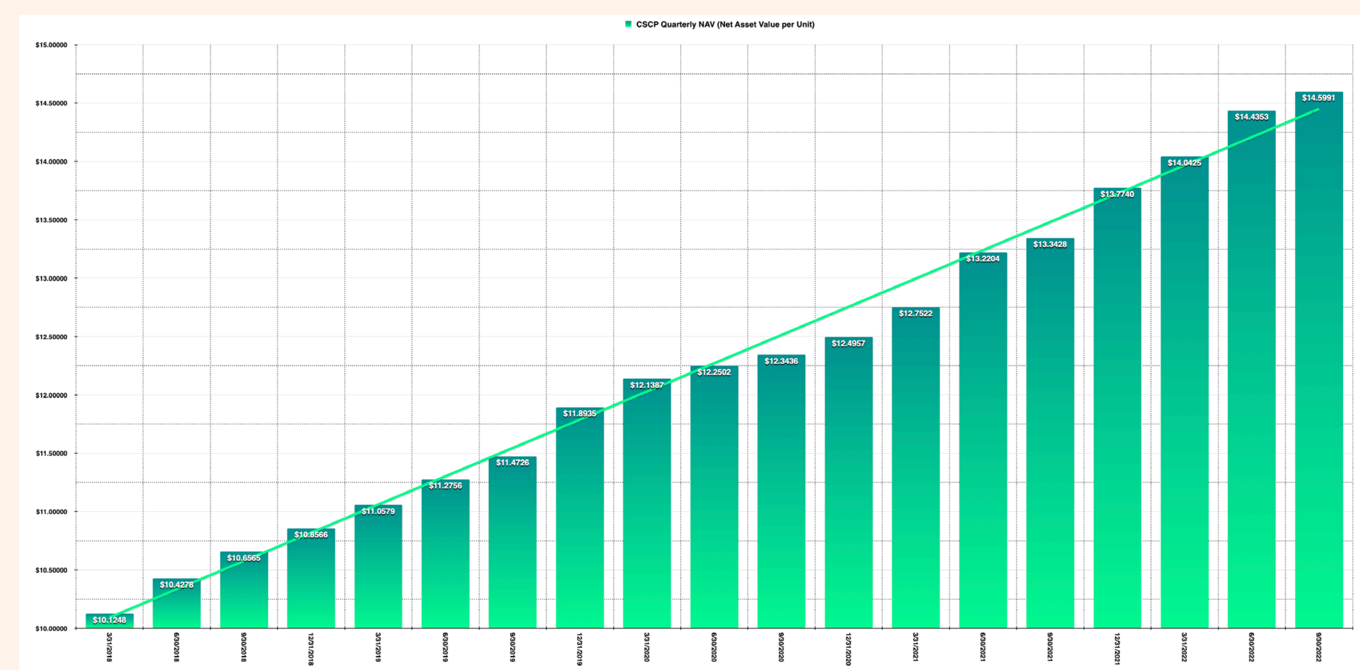
The stability of our partnership valuation has been a welcome volatility-reducing aspect of a portfolio through this recent market selloff. As a private non-registered security, it is not subject to the fluctuations of the public markets.

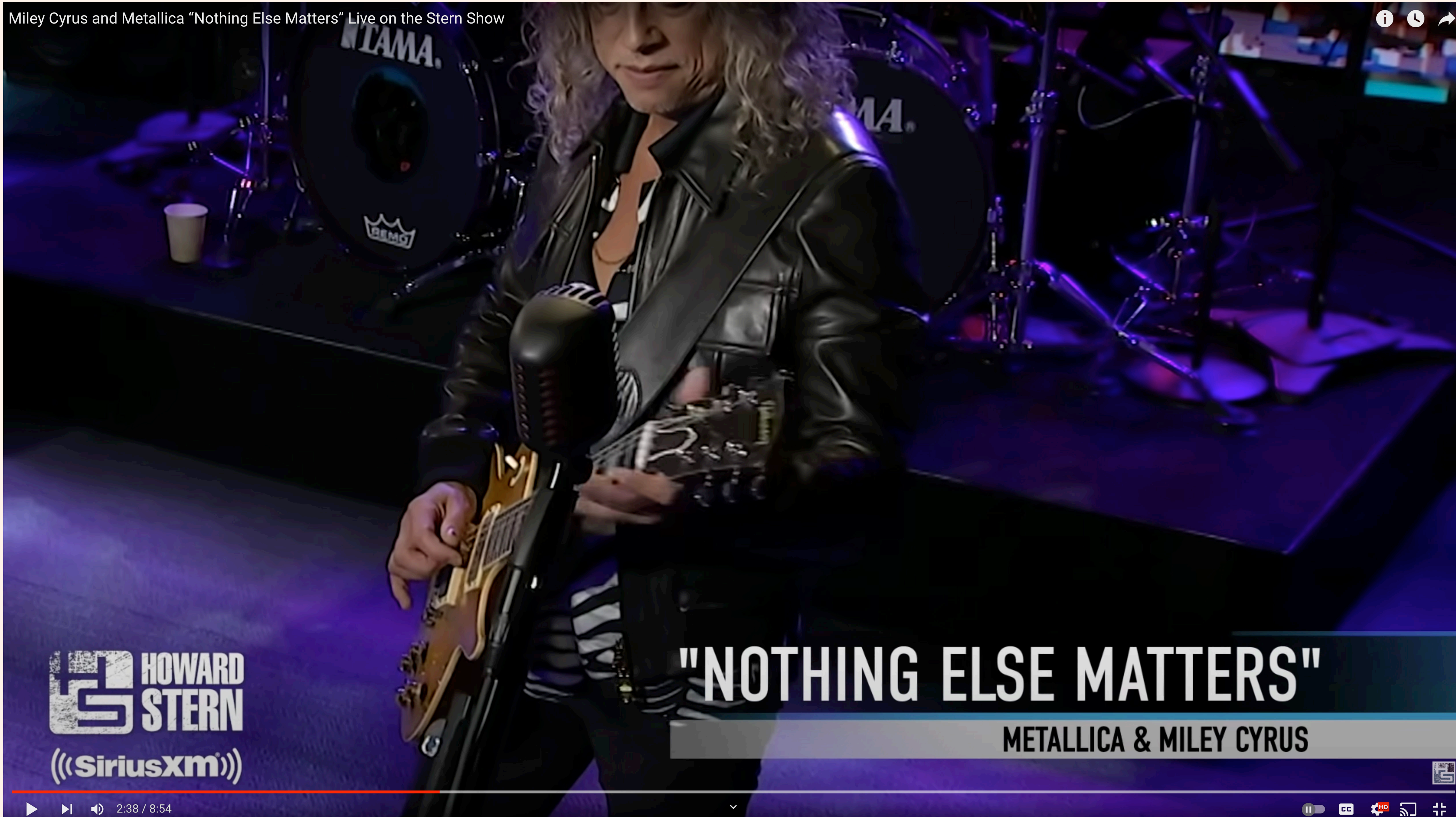
We have begun investing in First Trust Deeds which are essentially institutional hard-money loans collateralized by the development project the loan finances. These deeds pay us a 10% annual rate, with income distributed monthly. As is our self-selected mandate, we will concentrate these debt investments on projects that are single or multi-family housing and towards reasonable, affordable price points. Our Avid Realty-Pines at Woodcreek deal is for sale. Possible capital event during 4Q-2022 although the interest rate hikes have made valuations and financing a little more challenging.

Our investment in a hard money loan to White Fence Partners for a single family build in Phoenixville will close in late October or early November. We will get our money back and have to put that $280,000 back to work. That is also a loan at 10% annual. That cash will stay invested in debt instruments to maintain our allocation profile and our monthly income participations.

The partnership is still open to new investment (accredited investors only) and we see multi-family equity and debt deals weekly. We could put much more cash to use.

We are also considering launching a real estate partnership that would make monthly income distributions to investors. Please let us know if you have any interest in that.





https://www.youtube.com/watch?v=hBmSS8fDmek

Metallica with Miley Cyrus on the Stern Show from 2021 performing their iconic and haunting anthem "Nothing Else Matters."

Closing Thoughts

As we enter the 4Q-2022 it looks like the entire year will be a reset for investors. Down years are not without some small benefits: losses can be realized and used to minimize taxes. Rebalancing and repositioning can set the stage for better returns. And even though the Federal Reserve is probably acting too aggressively in raising rates, it is good that yield is back in the fixed income markets.

Yield (stock dividends, bond coupon and interest) provides spendable income. It also provides valuation support as yields become more attractive as asset prices drop, and investors seek to put cash to work and collect that now higher income.

The economy may ultimately slow down or even shrink (recession) as a result of the rapid rate hikes by the Fed. With markets across the board under significant pressure this year, it is quite likely that they have already discounted the slowing economy and factored in higher interest rates, and the selloff is already over. As the old Wall Street adage goes: "sell on rumors, buy on news."

In the fullness of time, investors who initiate positions now or remain invested during this selloff will be amply rewarded.

Enjoy the fall and the arrival of cooler weather. Break bread with family and friends. Sit around a bonfire. Play some loud music. Check out the live performance of Metallica with Miley Cyrus on the previous page.

Thomas F. McKeon, CFA | October 19, 2022