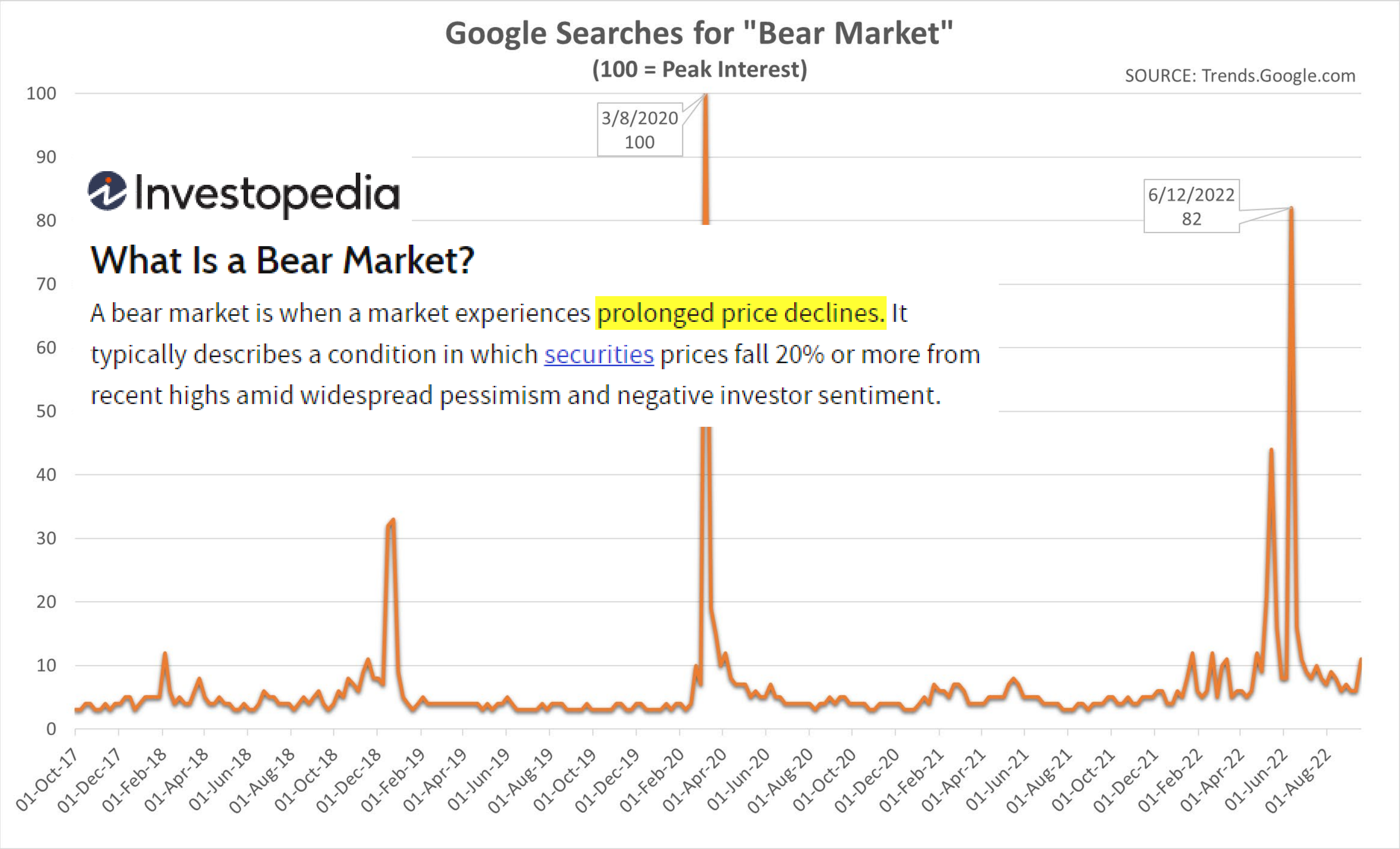
SEM WEALTH MANAGEMENT TM

Surviving a Bear Market

Using Scientifically Engineered Models

DATA THROUGH SEPTEMBER 2022

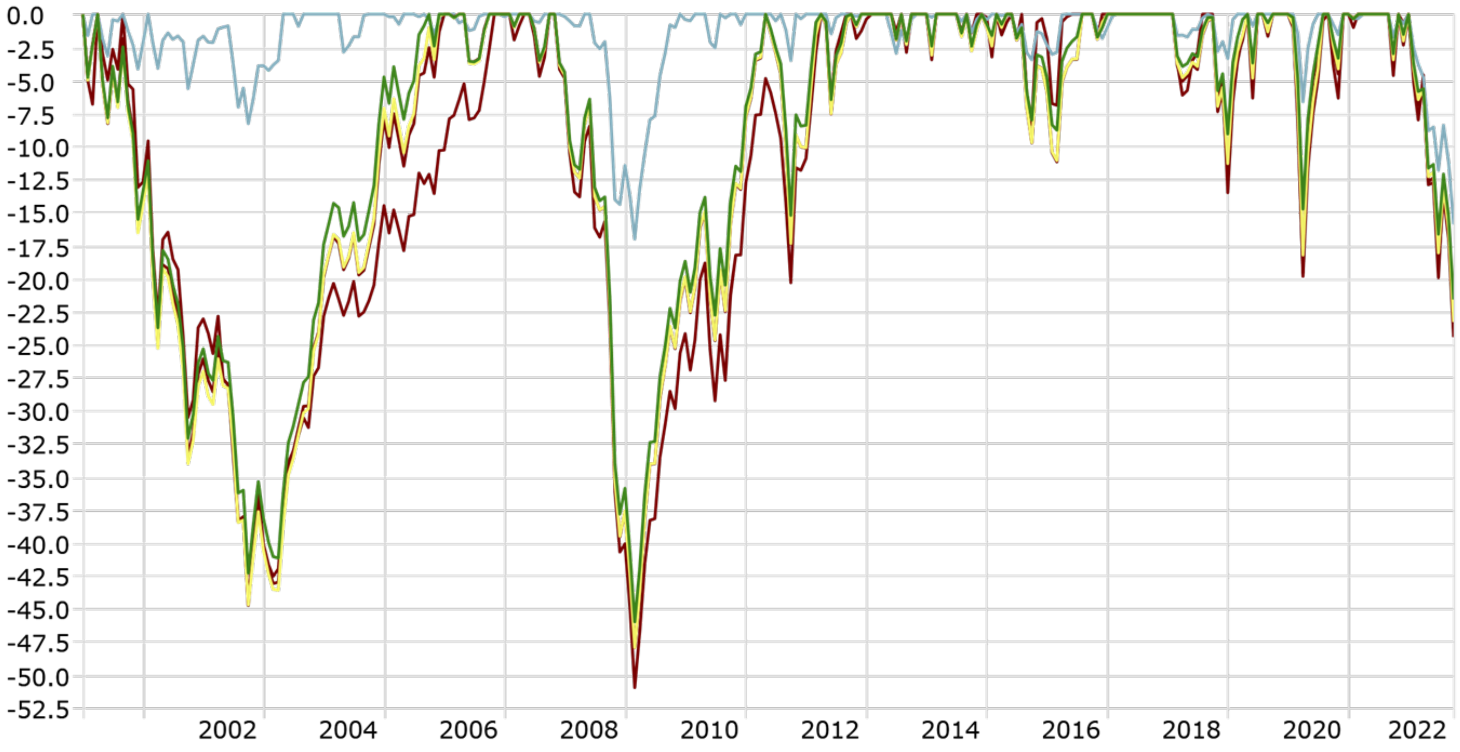
What is a Bear Market?



Not all bear markets are the same

Historical Drawdowns (% Change from Previous High Level)

Time Period: Since Common Inception (1/1/2000) to 9/30/2022



—Target Retirement Income —Target Retirement 2030 —Target Retirement 2040
—Target Retirement 2050 —S&P 500

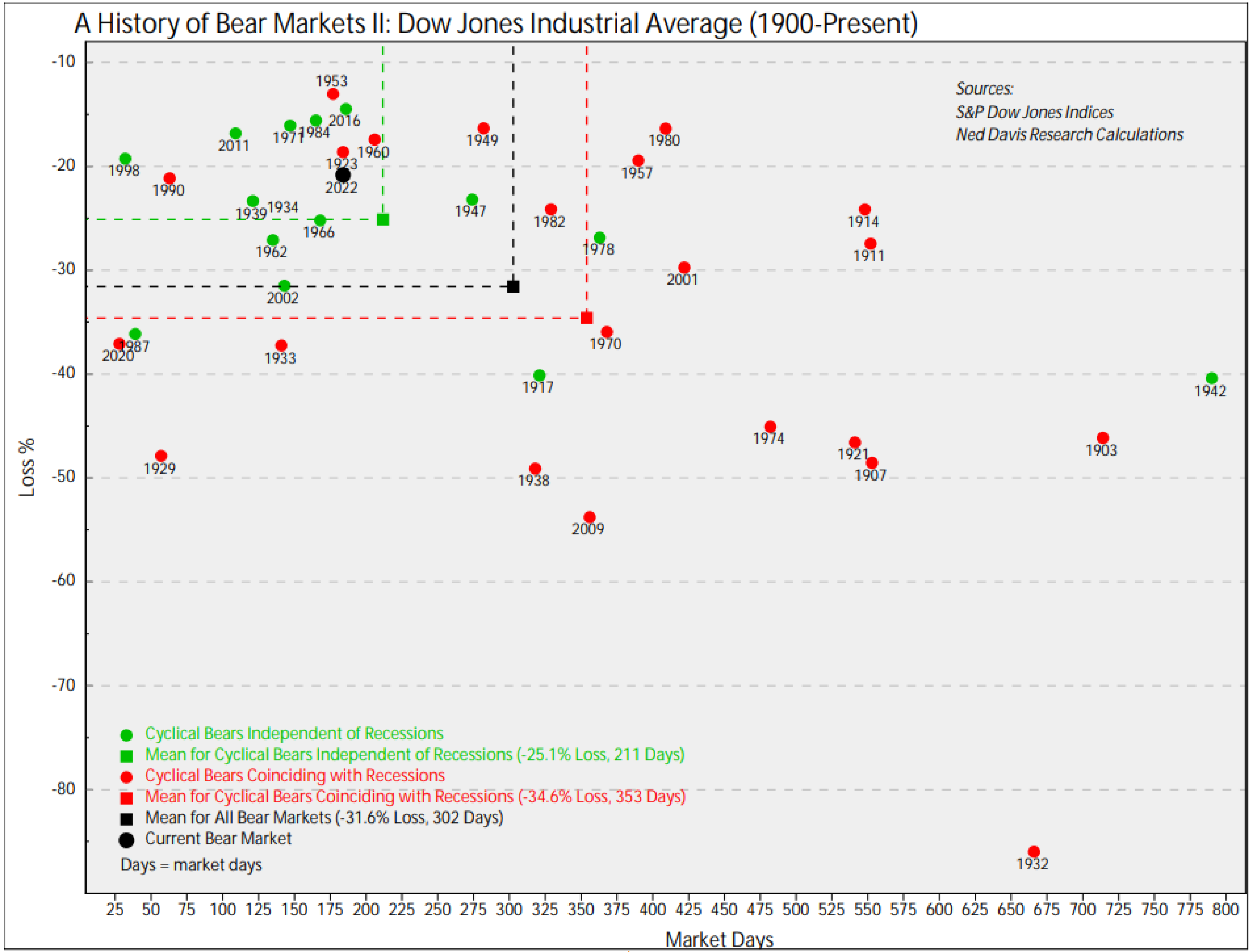
Returns are for the Vanguard series of Target Date funds from inception (June 2006) to present. Prior to inception, results are for the underlying Vanguard holdings based on the asset allocation targets of the specific fund. The S&P 500 Index is an unmanaged index of the 500 largest US based stocks. Investors cannot invest directly in the index and may incur additional fees trying to replicate leading to lower performance. Past performance is not a guarantee of future results.

Source: Morningstar Direct

Date	Loss %	Months of Losses	Month to Recover	Total Time
2000-2002	51%	25 (2.1 yrs)	49 (4.1 yrs)	74 (6.2 yrs)
2007-2009	55%	16 (1.3 yrs)	37 (3.1 yrs)	53 (4.4 yrs)
2020	35%	3 (0.3 yrs)	4 (0.3 yrs)	7 (0.6 yrs)
2022-????	24%+	9+??? (0.7 yrs)	????	????

Based on monthly performance of the S&P 500;
Past performance is not a guarantee of future results

A History of Bear Markets



Median Bear Market Loss & Duration

1900-2021

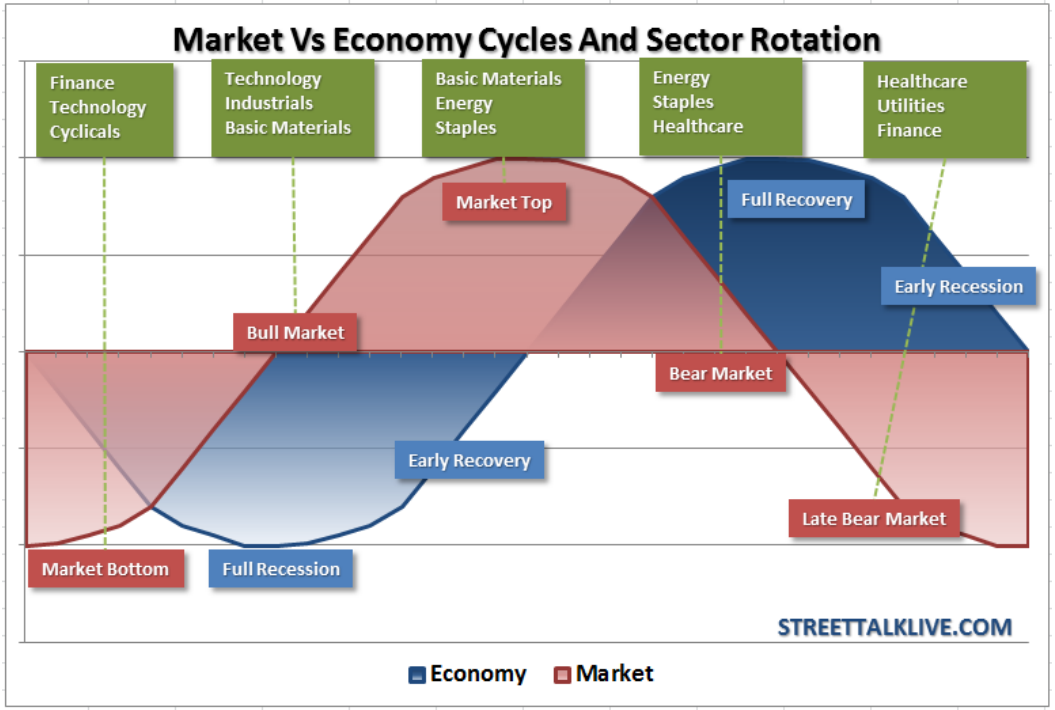
All Bear Markets: -27% / 11.6 months
During Secular Bulls: +20% / 7.8 months

During a Recession: -42% / 19.2 months
With no Recession: -25% / 8.5 months

SOURCE: Ned Davis Research

Economic Environment is Shifting

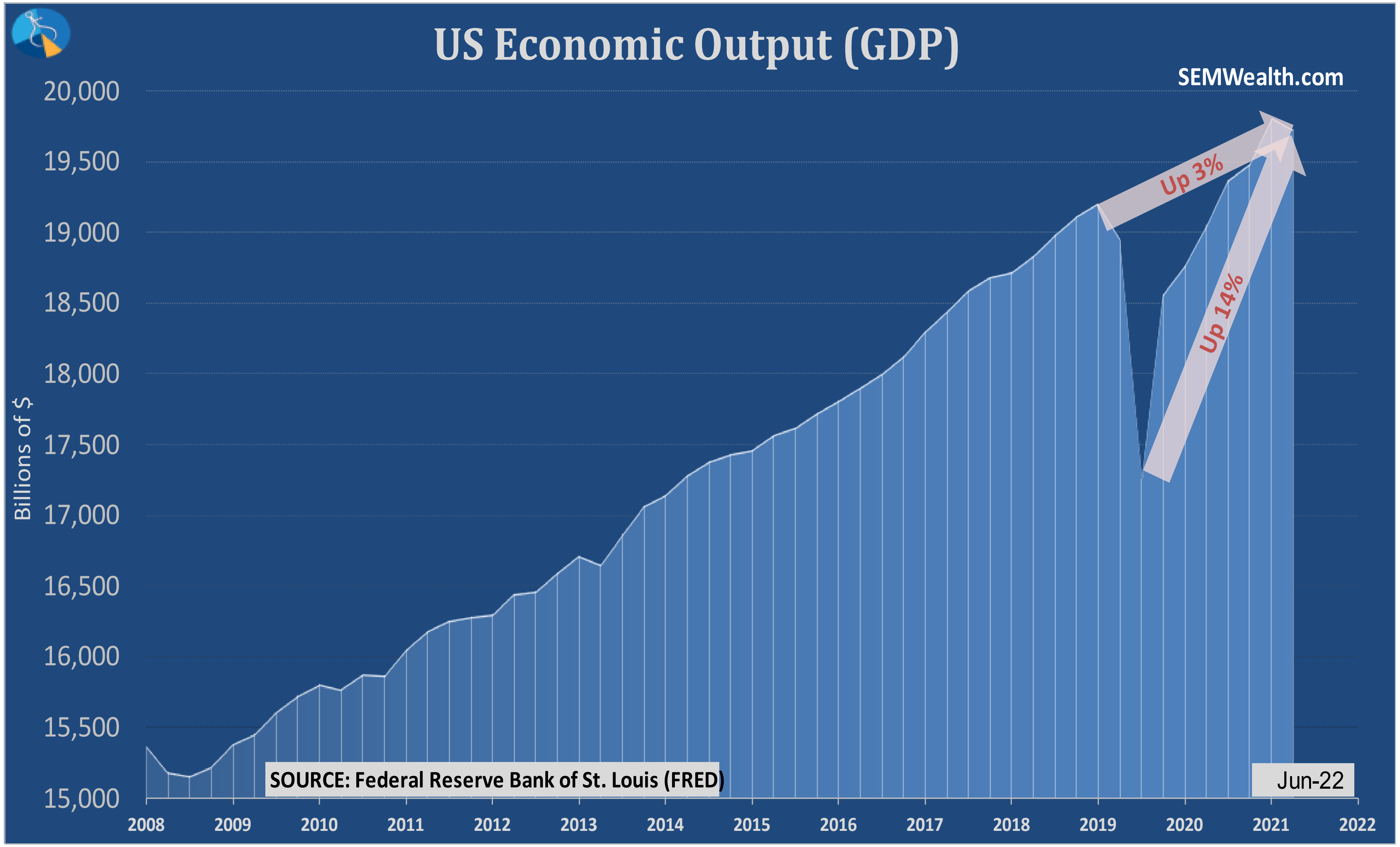
Leading Economic Indicator:	36 Month Trend:	GDP Indication:
Building Permits		↔
Consumer Confidence		↓
Consumer Goods Orders		↓
Business Activity		↔
Hours Worked		↑
Jobs		↑
Money Supply		↓
Stock Prices		↓
Vendor Performance		↔
Yield Curve		↓



2022 Q2

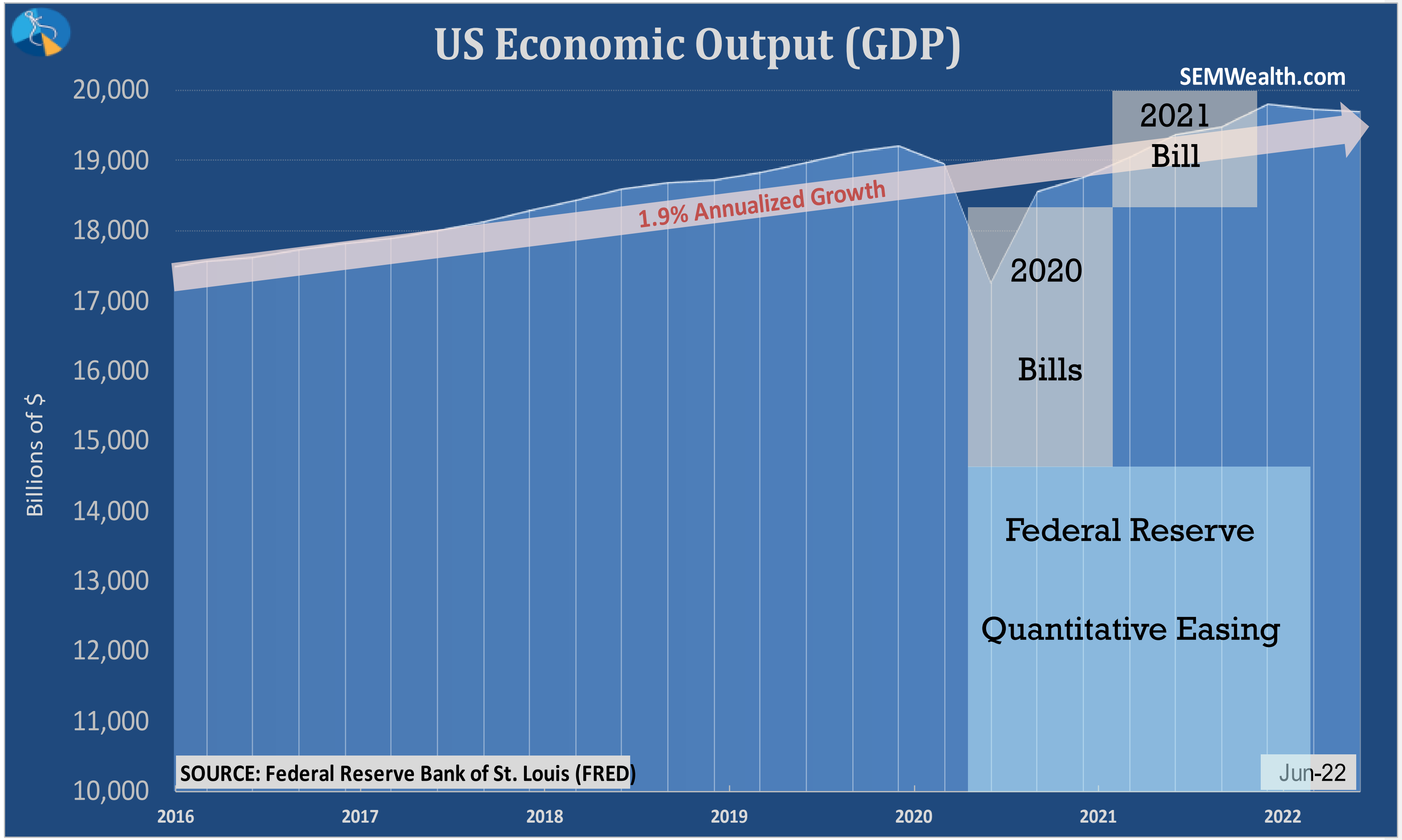
Are we in a recession?

- Focus has been on recovering to 2019 levels.
- The depth of the losses & the strong recovery has disrupted "normal" functions.
- There are **structural** changes that happened during COVID which changes "normal"



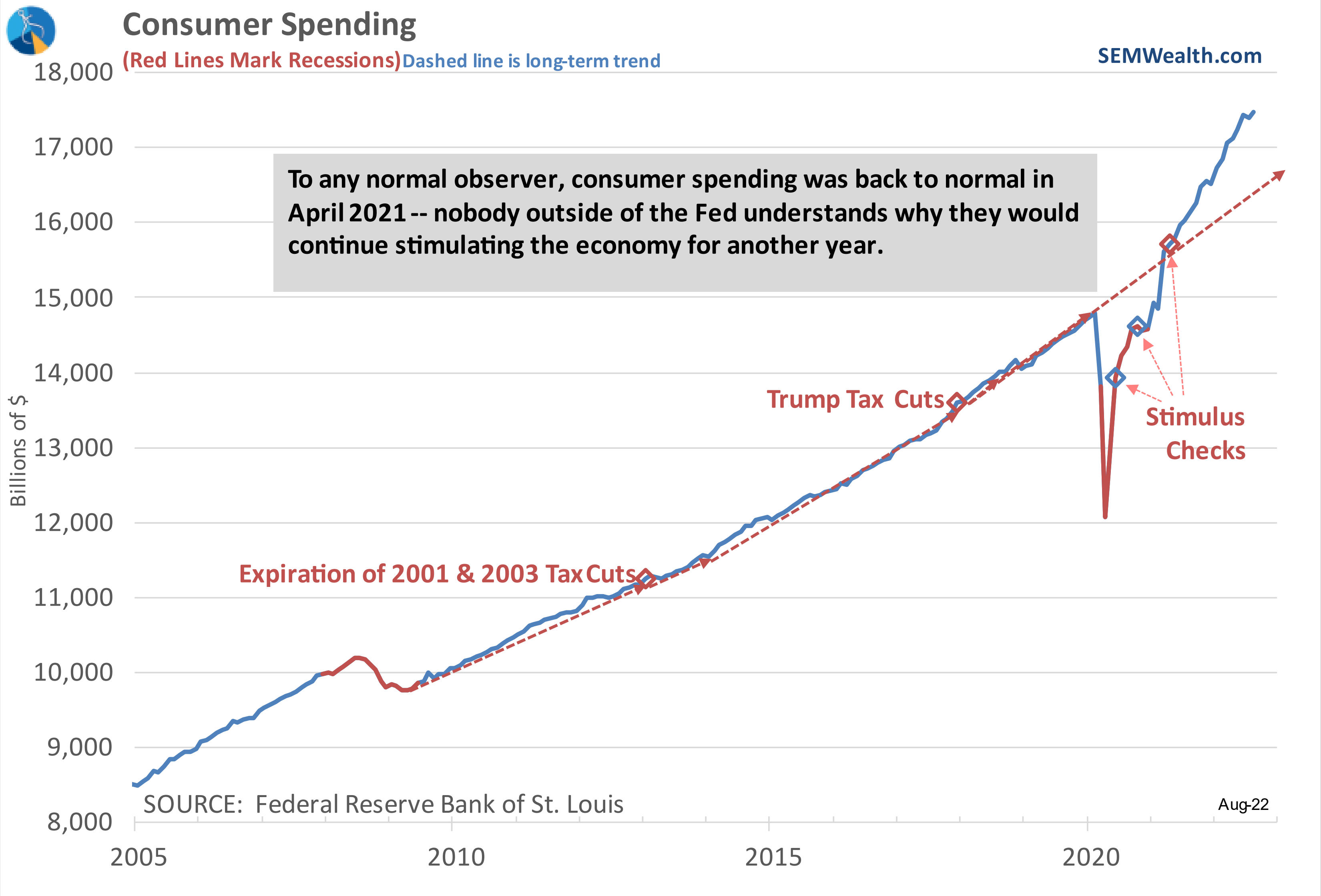
We are paying for the stimulus

- 2020 Stimulus Bills = $3.5 Trillion
- 2021 Stimulus Bill = $1.9 Trillion
- Total Stimulus from Congress = $5.4 Trillion
- Fed has created an additional $5.2 Trillion
- Total Stimulus has been 50% of GDP output



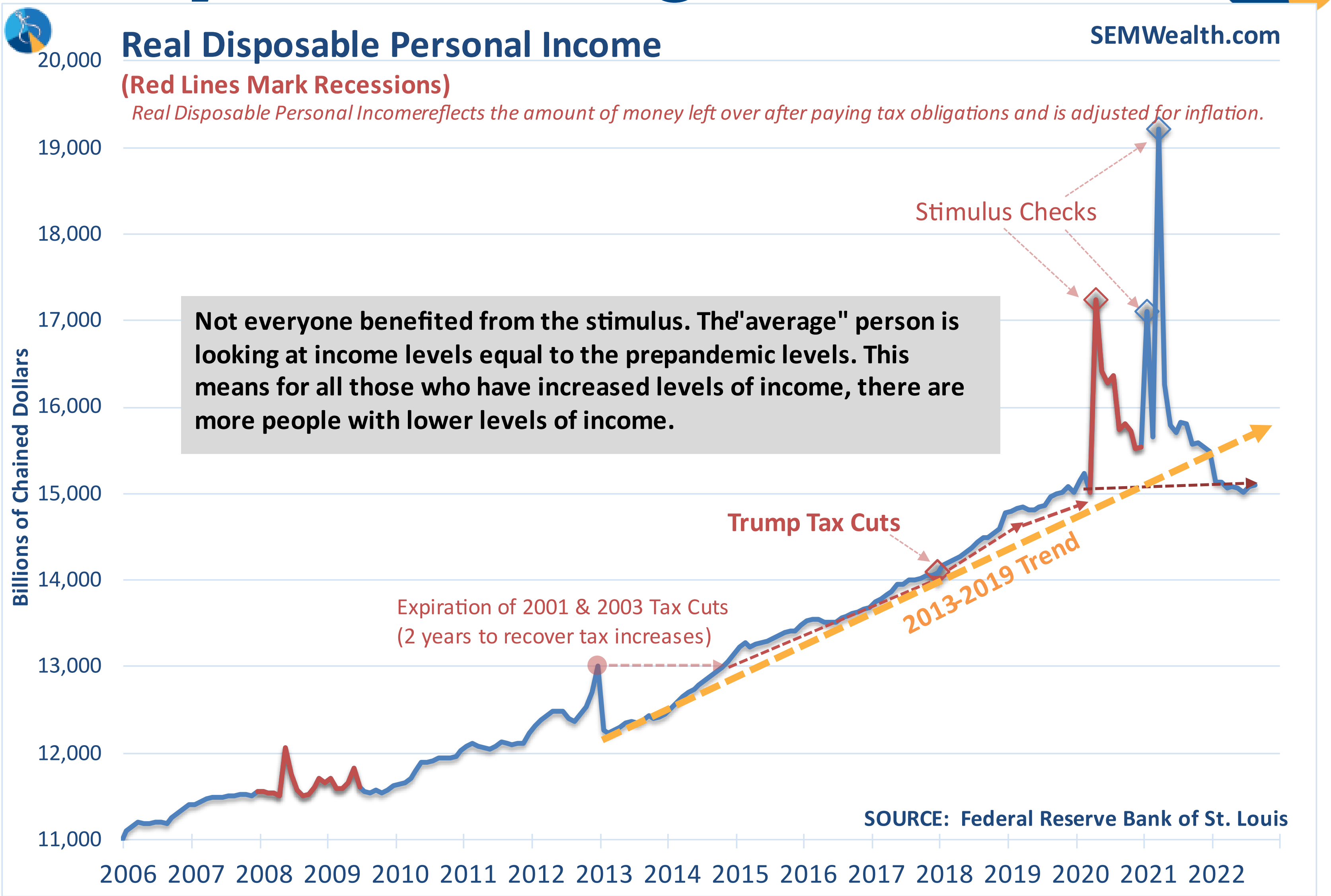
Consumer Spending is the key

- Consumer spending had slowed in 2019 as tax cuts wore off
- Current levels have **exceeded** the pre-COVID trend significantly



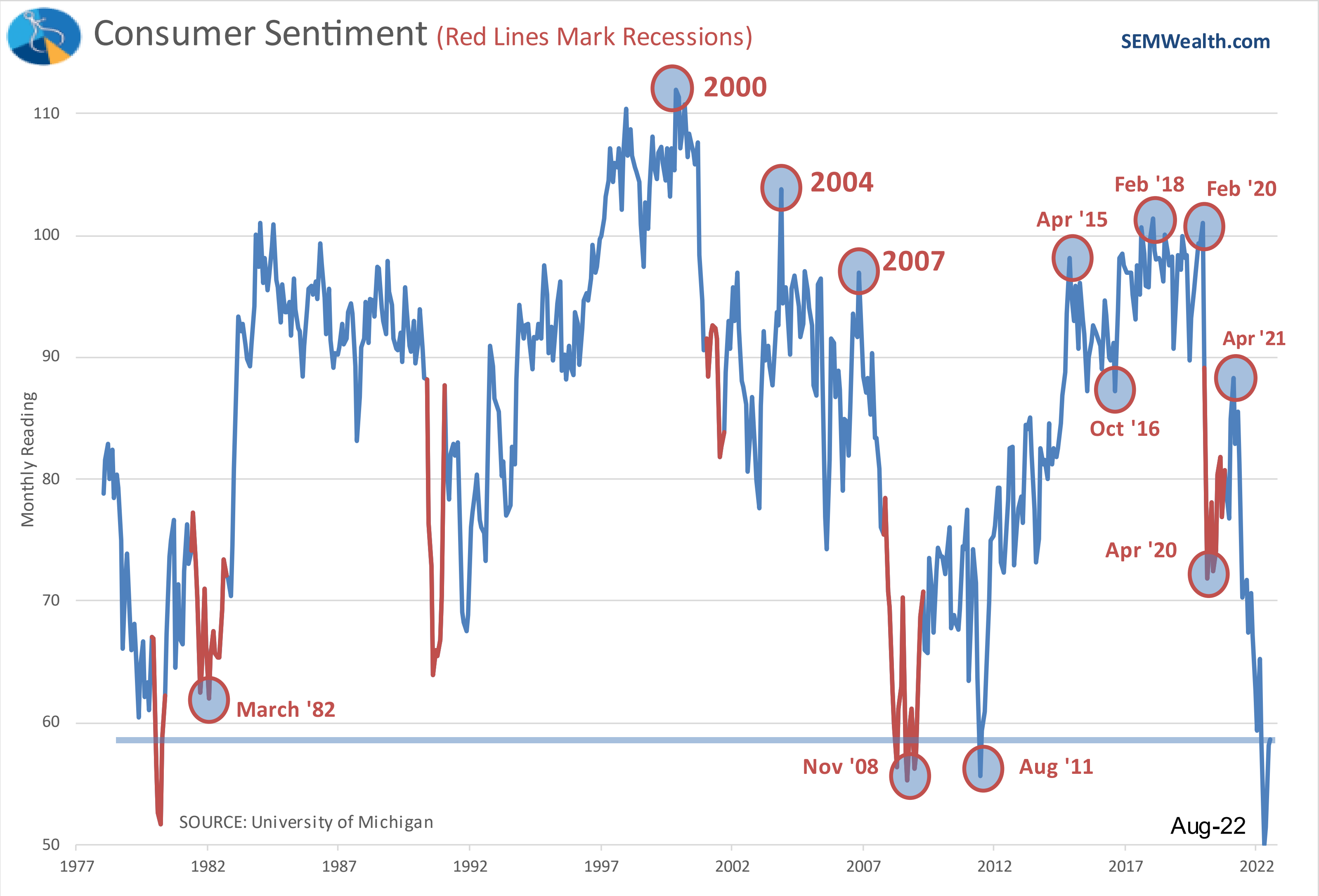
Incomes already declining

- Income growth had slowed significantly prior to COVID
- Current income growth is now **running below** the 2013-2019 trend



Consumers are pessimistic

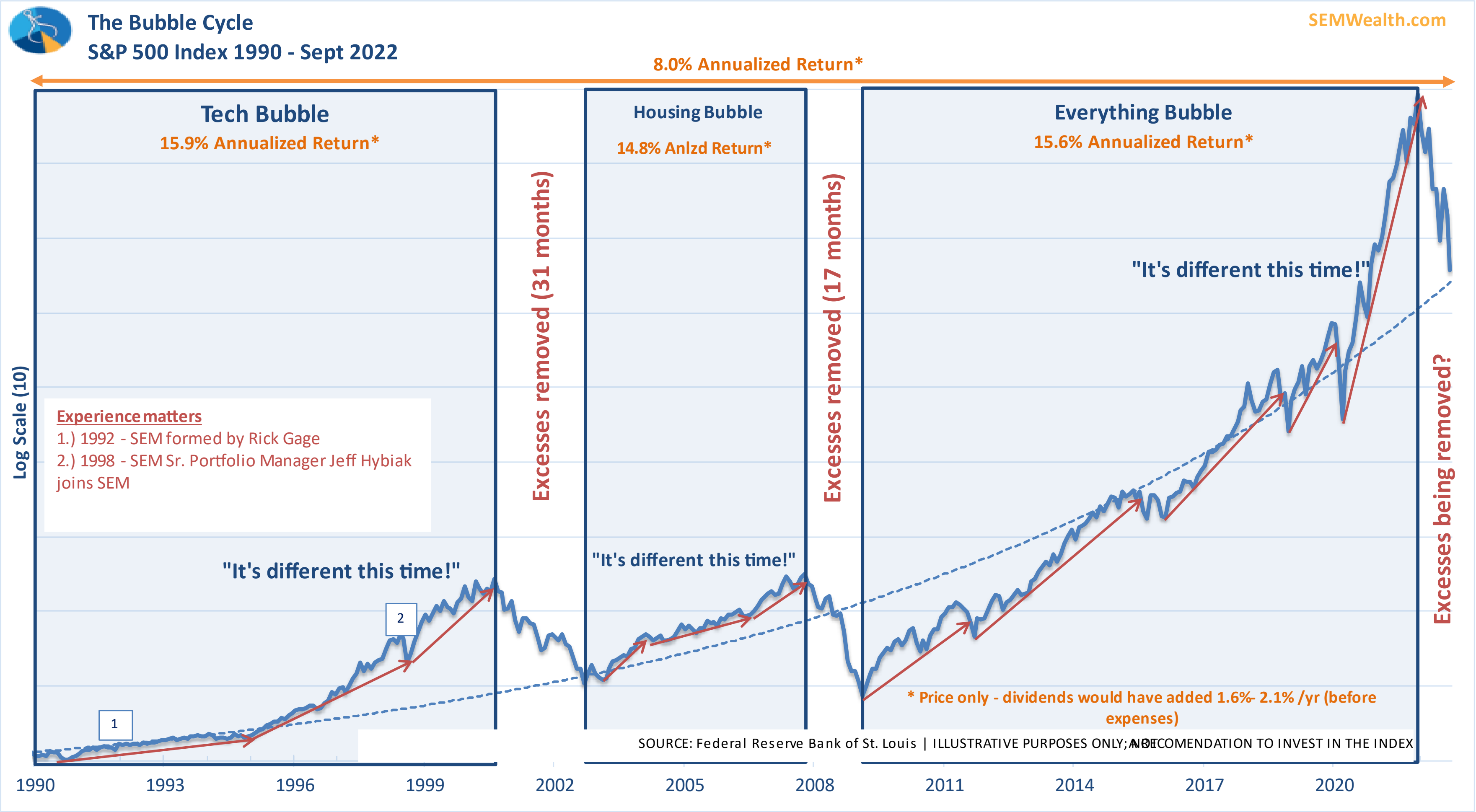
- Consumer Sentiment had hit its highest level since 2004 just before COVID
- Sentiment has plummeted this summer despite most of the economy being reopened



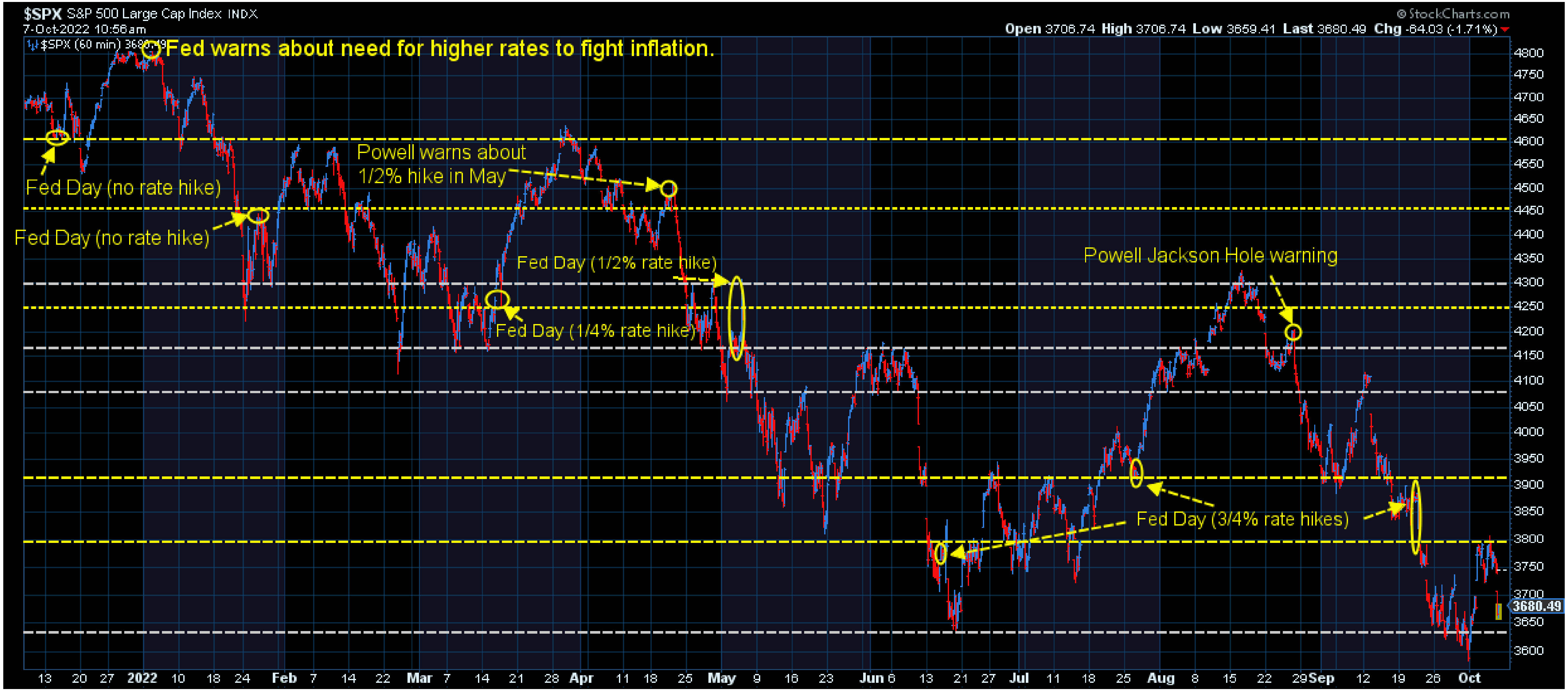
Long-Term Outlook

Investors often look at the past bear markets and with hindsight believe they could have avoided it. This leads to overconfidence in their ability to recognize the next looming bear market. In addition, the longer the market moves higher the more likely conservative investors are going to abandon their lower risk investments and move into riskier assets.

Stocks are a "mean-reverting" asset, meaning after prolonged periods above the long-term average, they will go through a sharp correction.

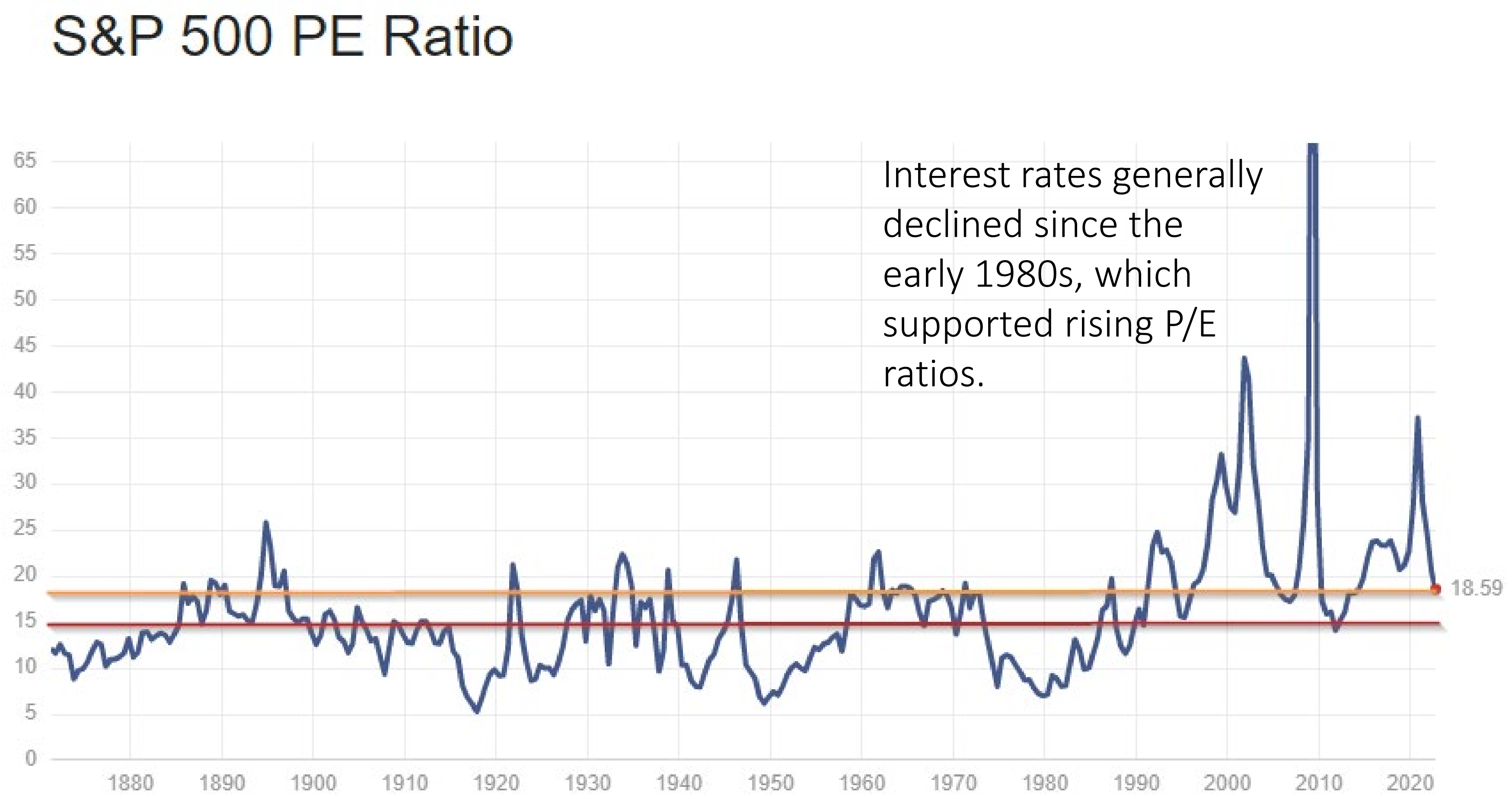


It’s been a tough year already



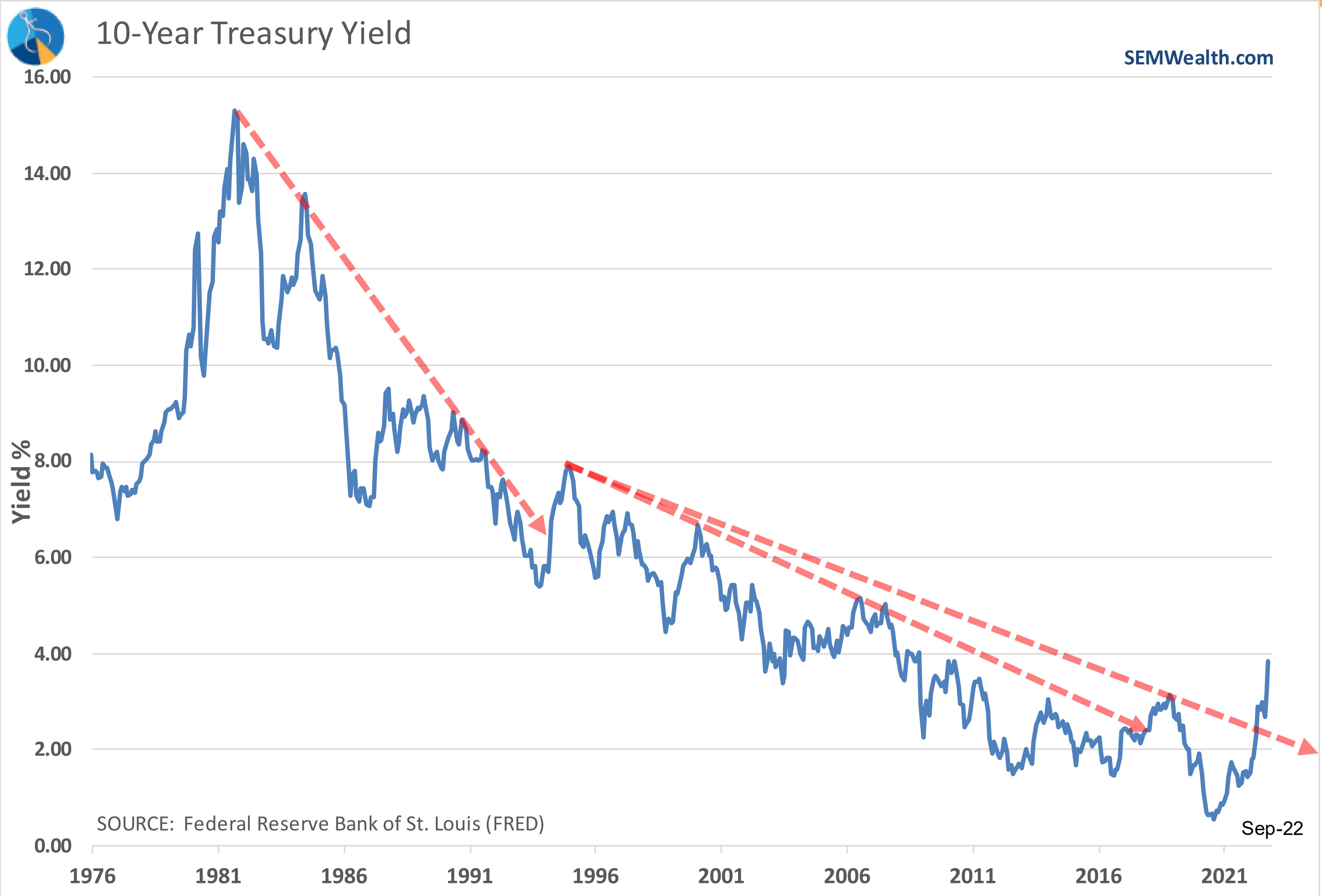
Valuations are still historically high

- Starting valuation levels are the number one determinant of long-term returns.
- High P/Es can be justified if interest rates are low and/or growth rates are high.
- Beginning of the year growth estimate = +10%
- September 2022 growth estimate = +0%



An “Unprecedented” Environment is a Real Possibility

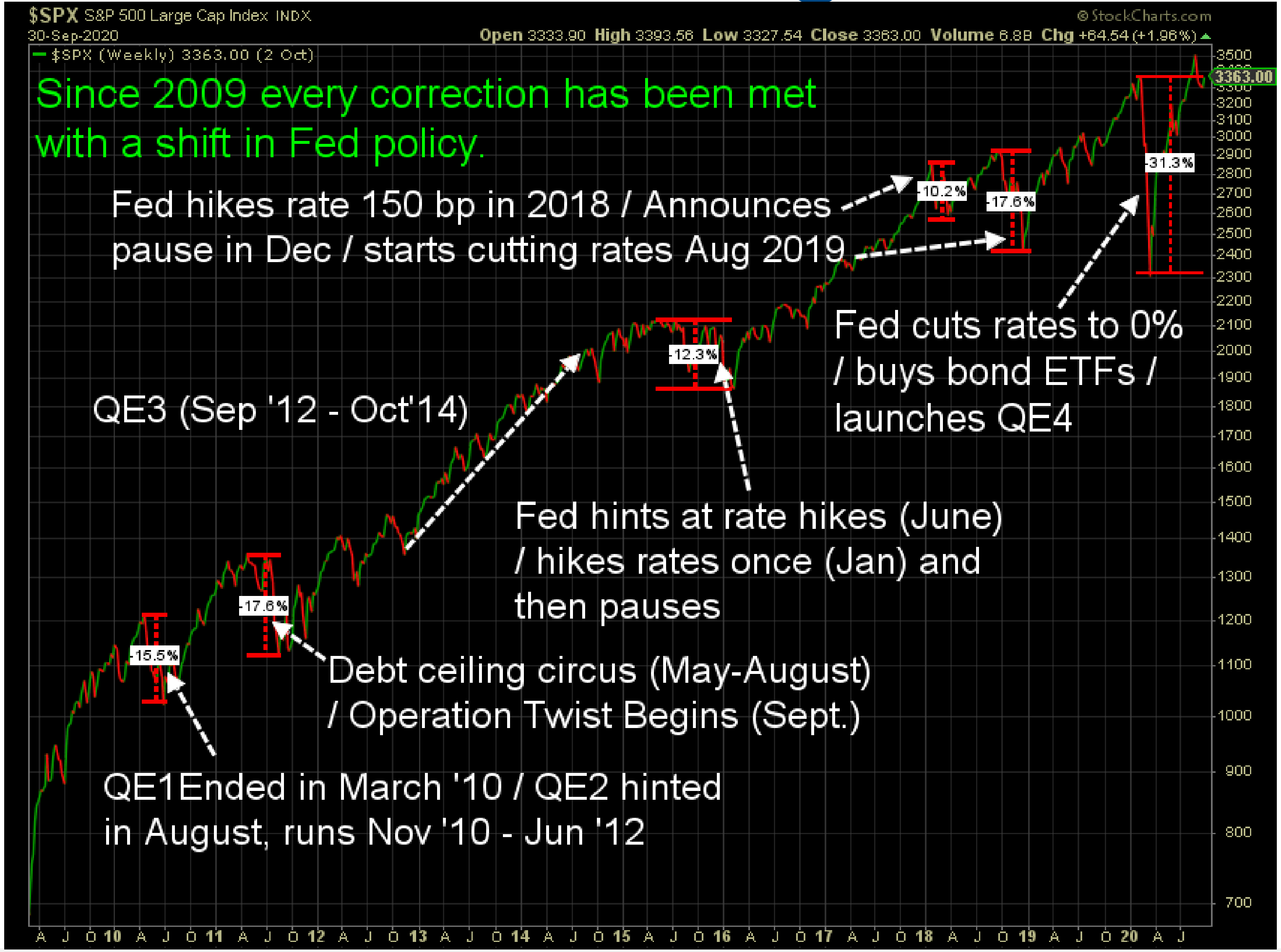
- Since 1984, interest rates have generally been declining. This has given bonds an underlying uptrend to help support traditional stock/bond portfolios.
- The downtrend has been broken; if the Fed loses control of inflation, we could see a spike similar to the late 70s/early 80s



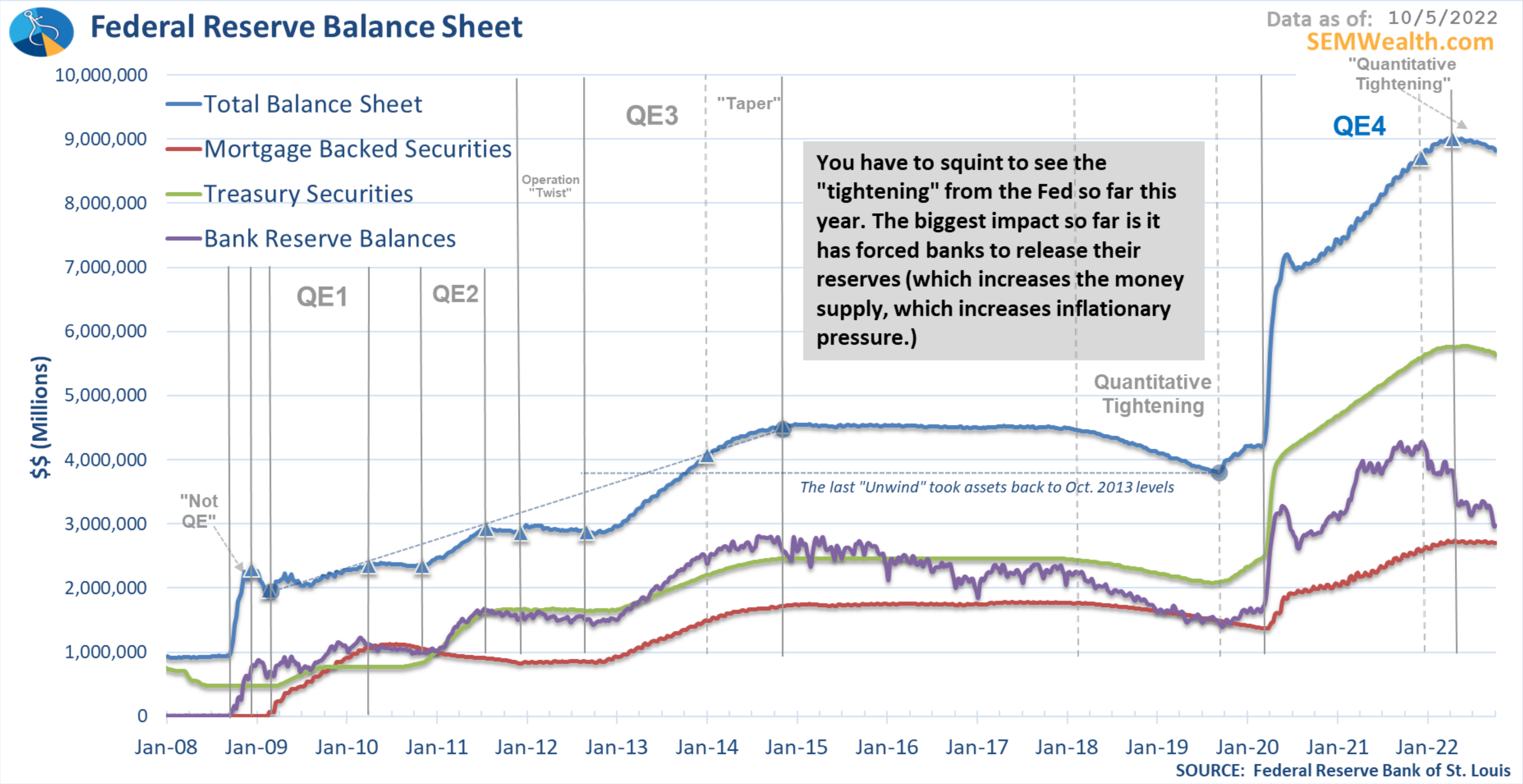
We're used to the Fed saving stocks

"The Fed Put"

- -15.4%
- -17.5%
- -12.2%
- -10.3%
- -17.5%
- -31.3%



We're used to the Fed Saving Stocks



Bear Markets Include Strong Rallies

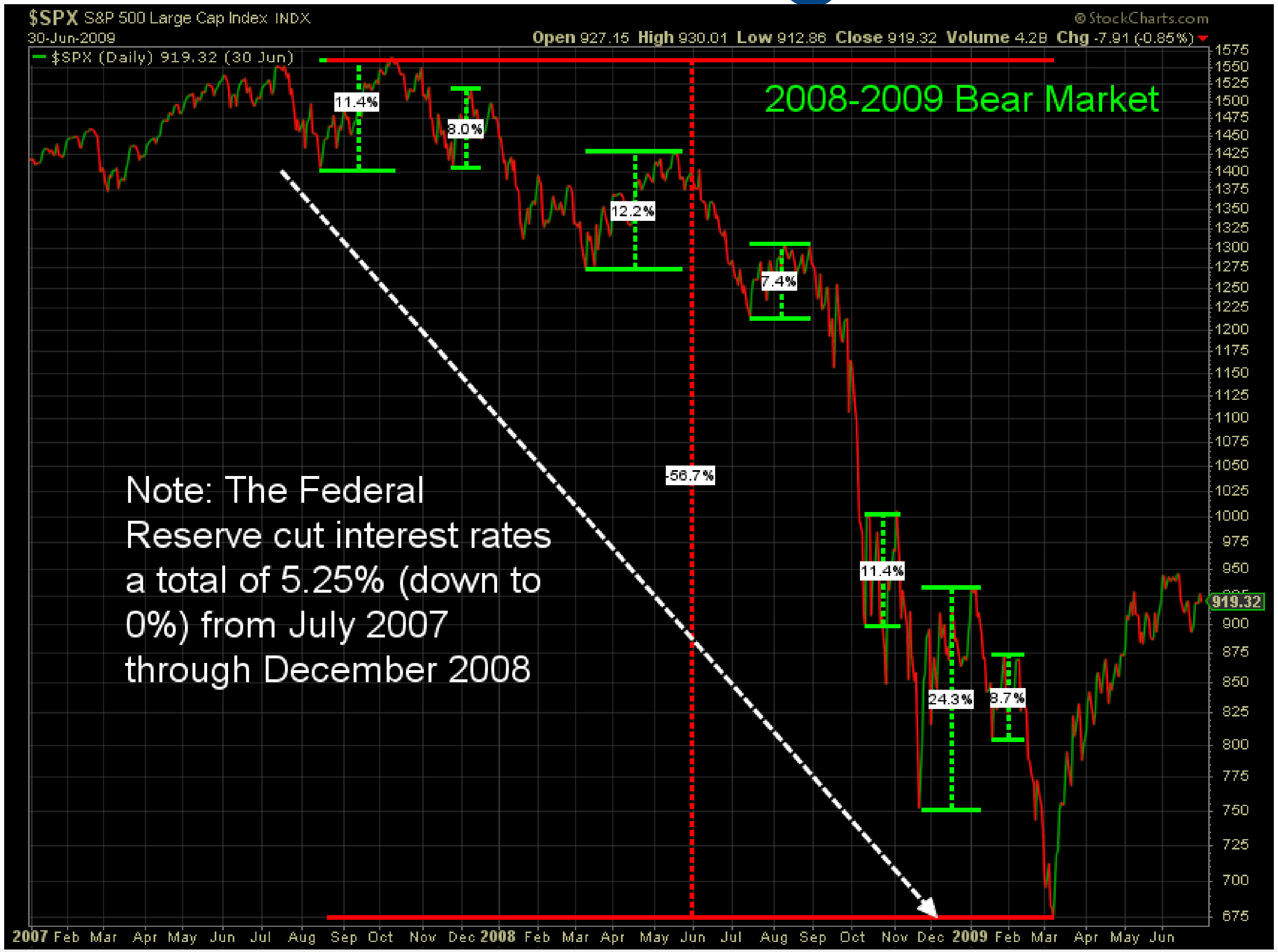
"The worst is over"

- 12.2%
- 7.7%
- 19.2%
- 21.6%
- 21.0%

Bear Markets Include Strong Rallies

"The worst is over"

- 11.4%
- 8.0%
- 12.2%
- 7.4%
- 11.4%
- 24.3%
- 8.7%



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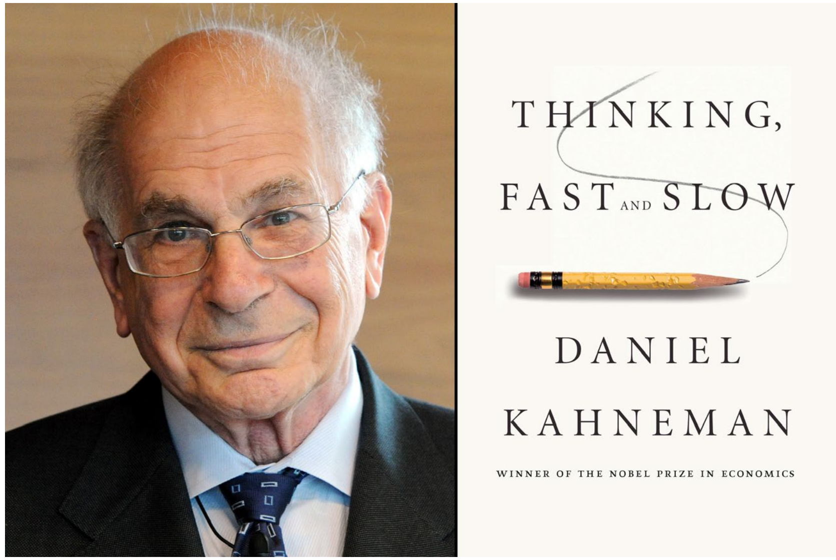
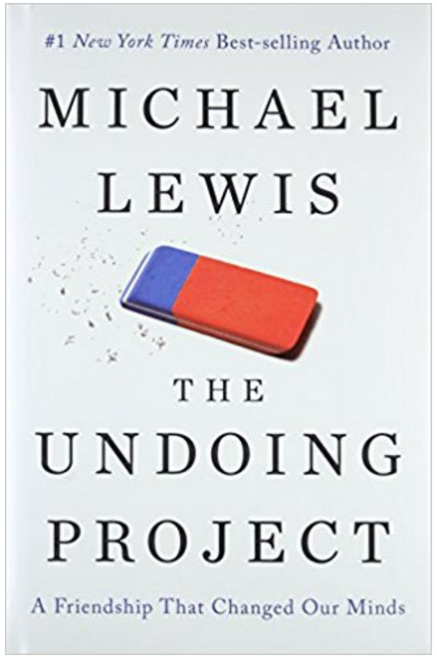
Traditional vs. Behavioral Finance

"Best" vs. Optimal

A "New" Approach?

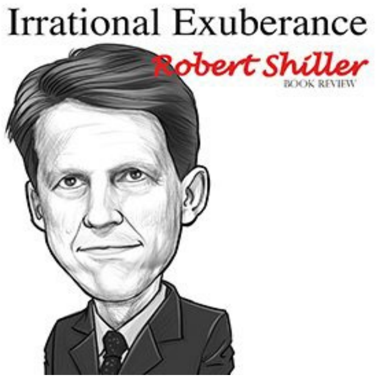




2002 Nobel Prize Winner - Economics

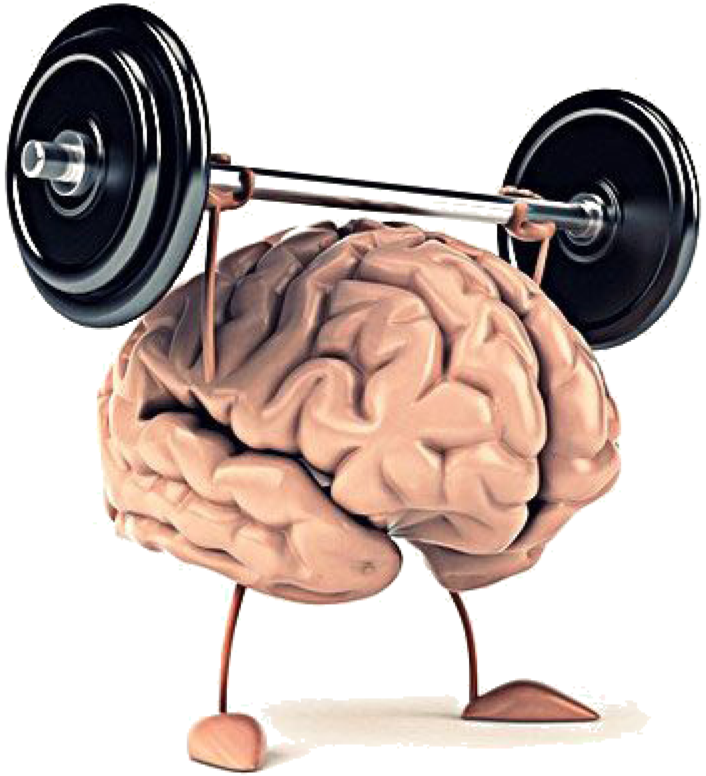
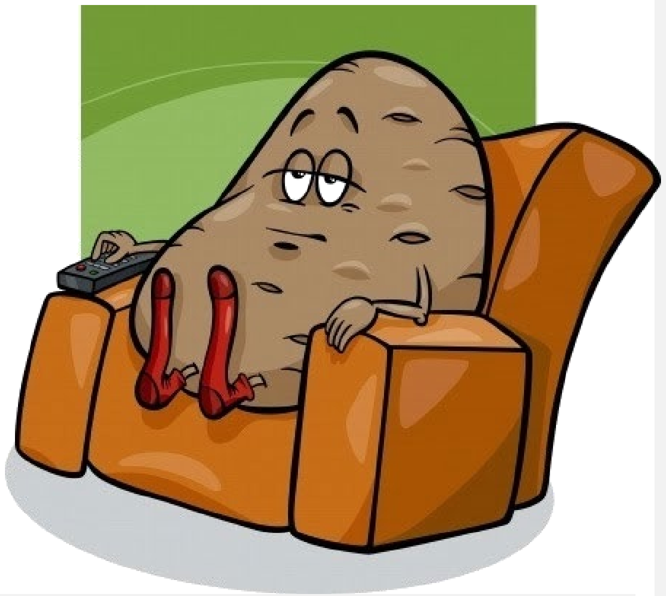
2017 Nobel Prize Winner - Economics

2013 Nobel Prize Winner - Economics



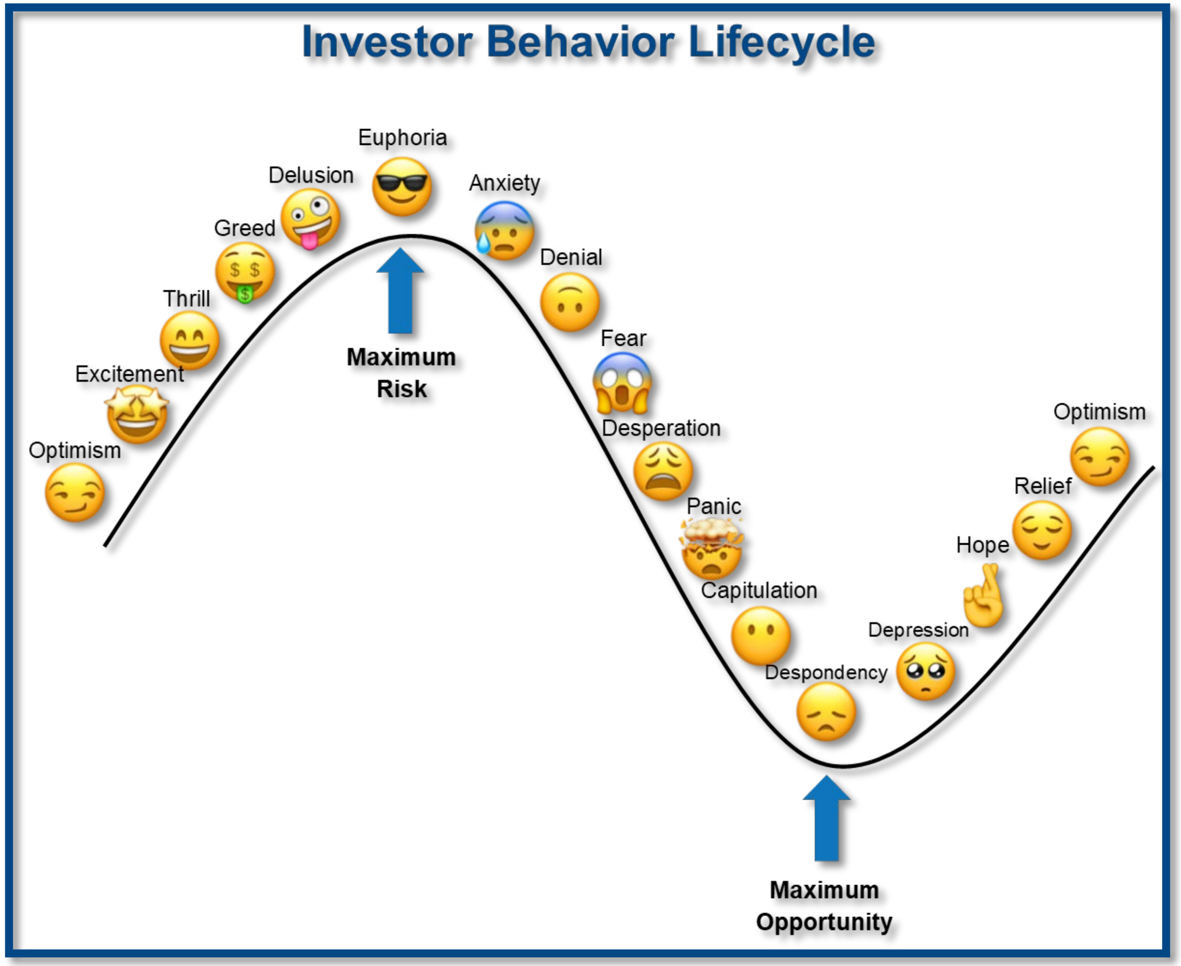
Econs vs. Humans

Your Two Brains

For more go to: tradersblog.semwealth.com/understanding-our-behavioral-biases-d31/

Understanding Investor Behavior



The stock market is a story of **cycles** & of the **human behavior** that is responsible for **overreactions** in both directions.

– Seth Klarman

For current market updates go to: tradersblog.semwealth.com

3 Steps to Prepare for a Bear Market

Using Behavioral Finance

1.) Obtain the risk pulse of every client

Take a triage approach – conservative clients first

Return seeking clients in 2021 may be the most nervous

Use an objective risk questionnaire that focuses on personality ➥

Understanding Your Clients' Personality

Personality Score

Conservative	Moderate	Growth	Aggressive

Bias Types

Emotional	Cognitive	Emotional

Common Biases

Loss Aversion	Regret Aversion	Hindsight	Availability	Conserv.	Confirm.	Represent.	Overconfidence	Illusion of Control	Self-control

Importance of Minimizing Losses

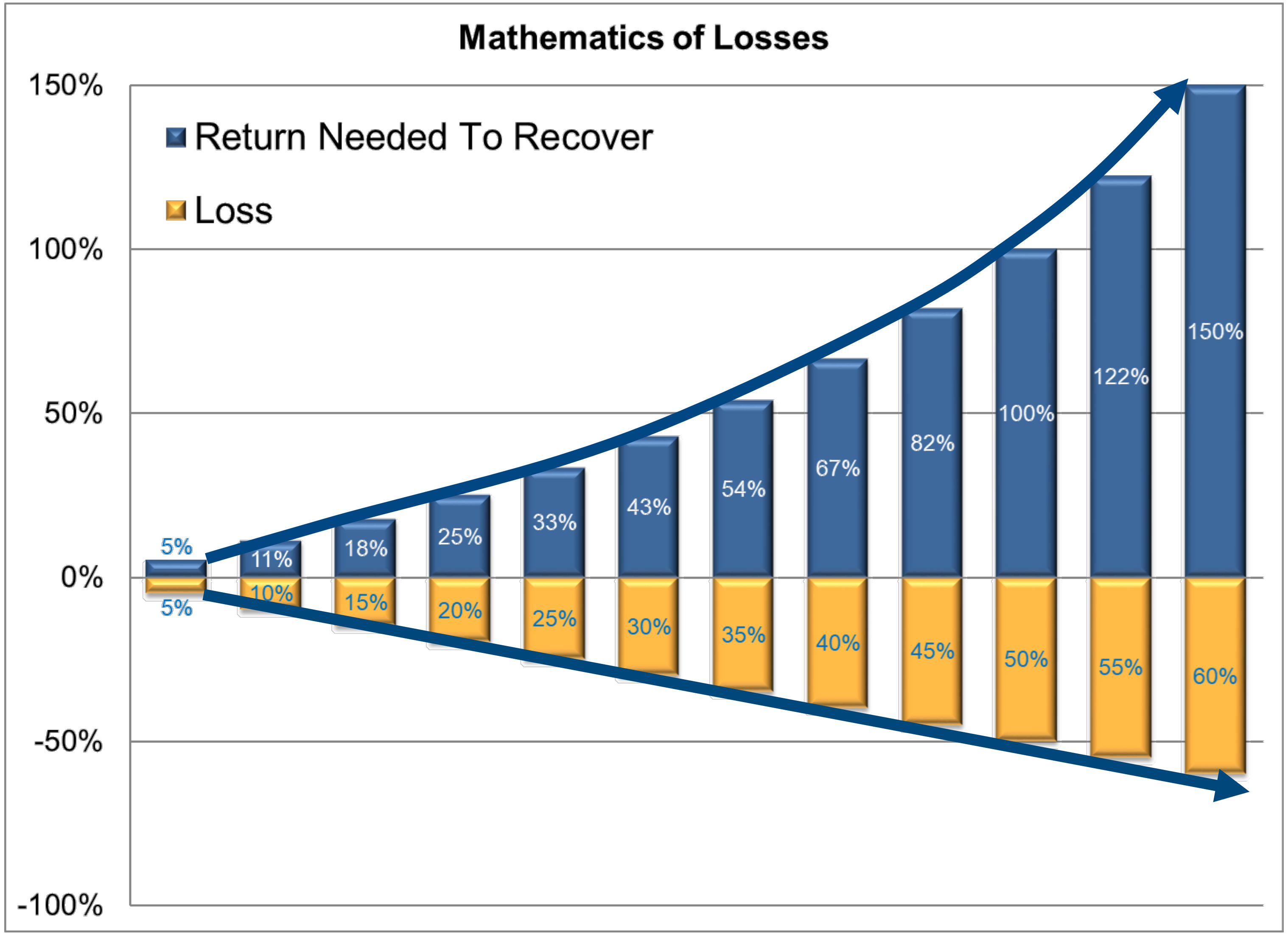
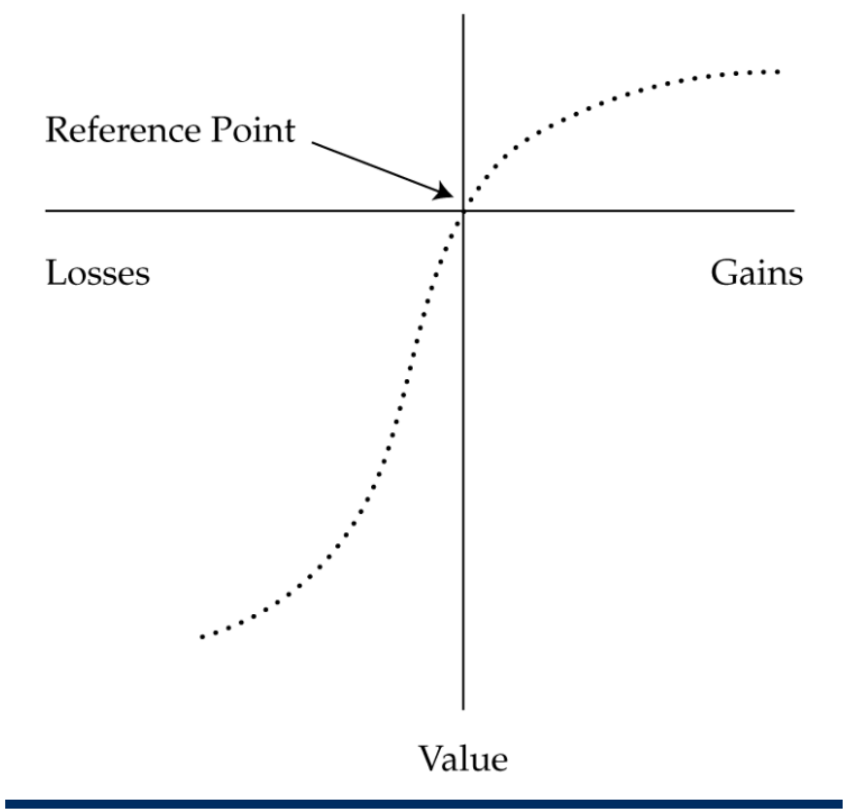


Exhibit 3. Value Function of Loss Aversion



Keeping your focus

Chance of seeing a "Paper Loss" based on how often you look

Every Day	Every month	Every quarter	Every Year	Every 3 Years
SEM: 46%	SEM: 36%	SEM: 29%	SEM: 16%	SEM: 2%
S&P 500: 46%	S&P 500: 36%	S&P 500: 33%	S&P 500: 26%	S&P 500: 24%

"Emotional" Units:

Paper Gain = 1

Paper Loss = 2

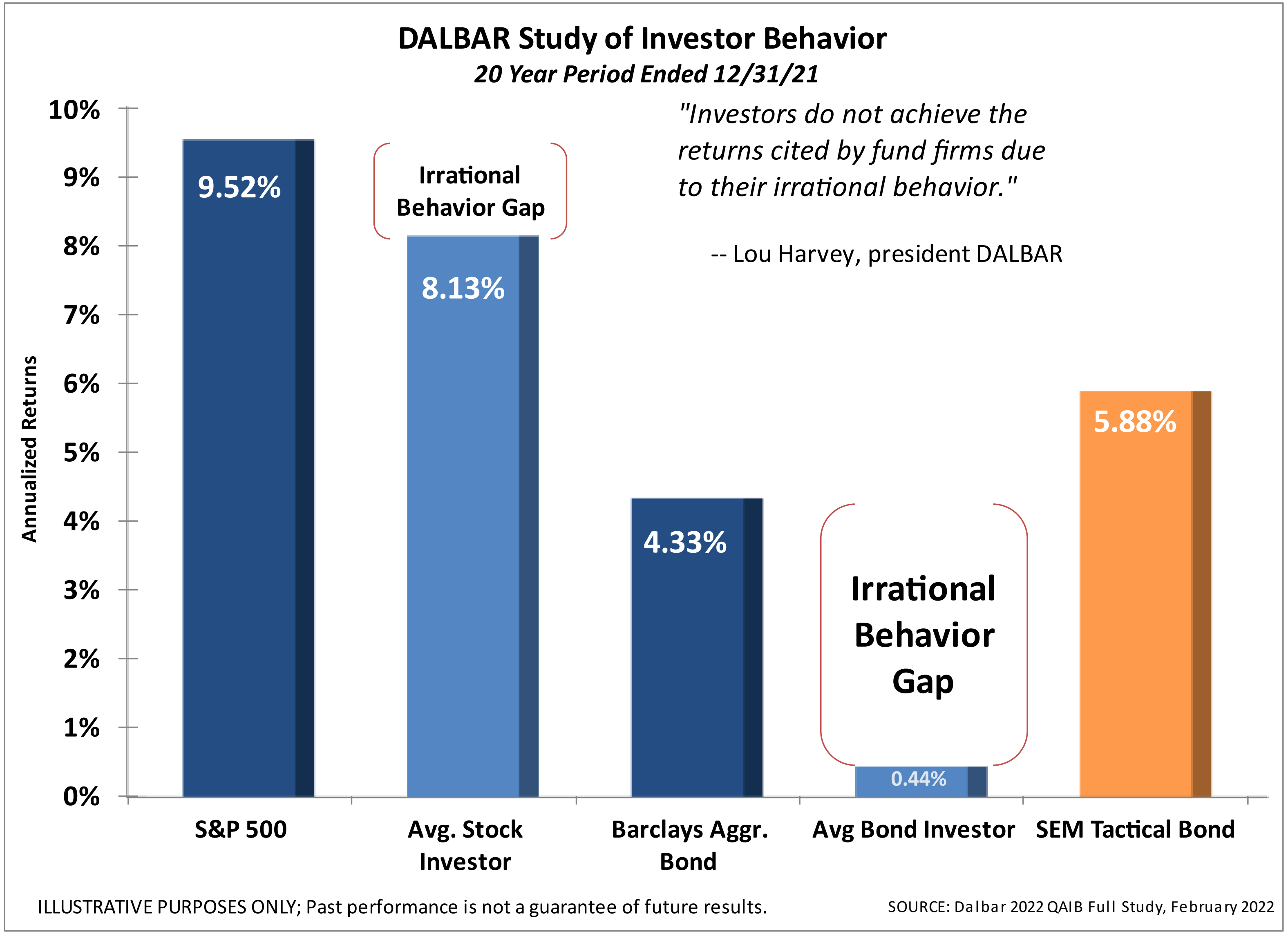
Lessons:

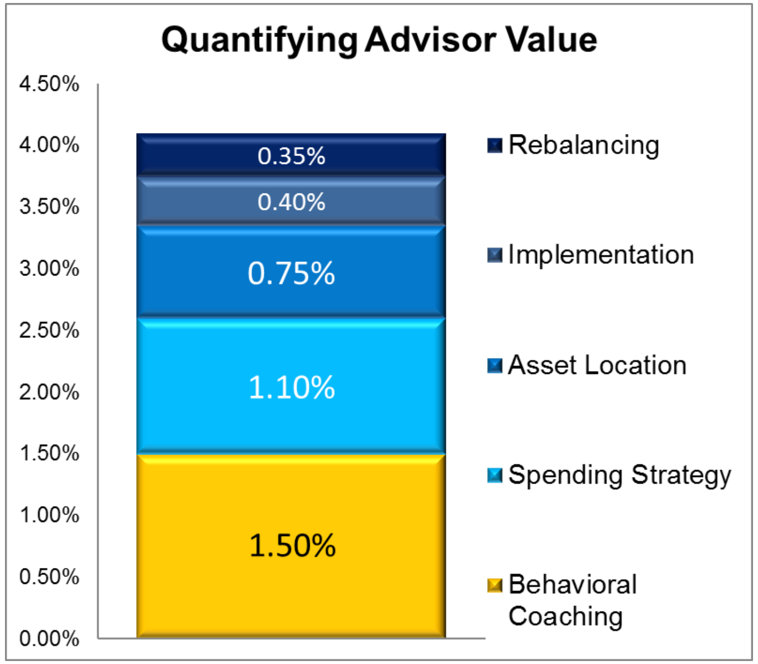
1.) Looking less leads to less emotions

2.) Reducing volatility leads to less emotions

Data for the period January 2000 – December 2020. SEM performance is of a hypothetical "balanced" portfolio comprised of 35% DIA, 30% AG-MOD, 25% TB, & 10% DAG including the maximum SEM fee and a financial advisor fee of 1% per year. The S&P 500 does not include any fees and assumes the full reinvestment of dividends. Past performance is not a guarantee of future returns.

The Cost of Behavioral Biases





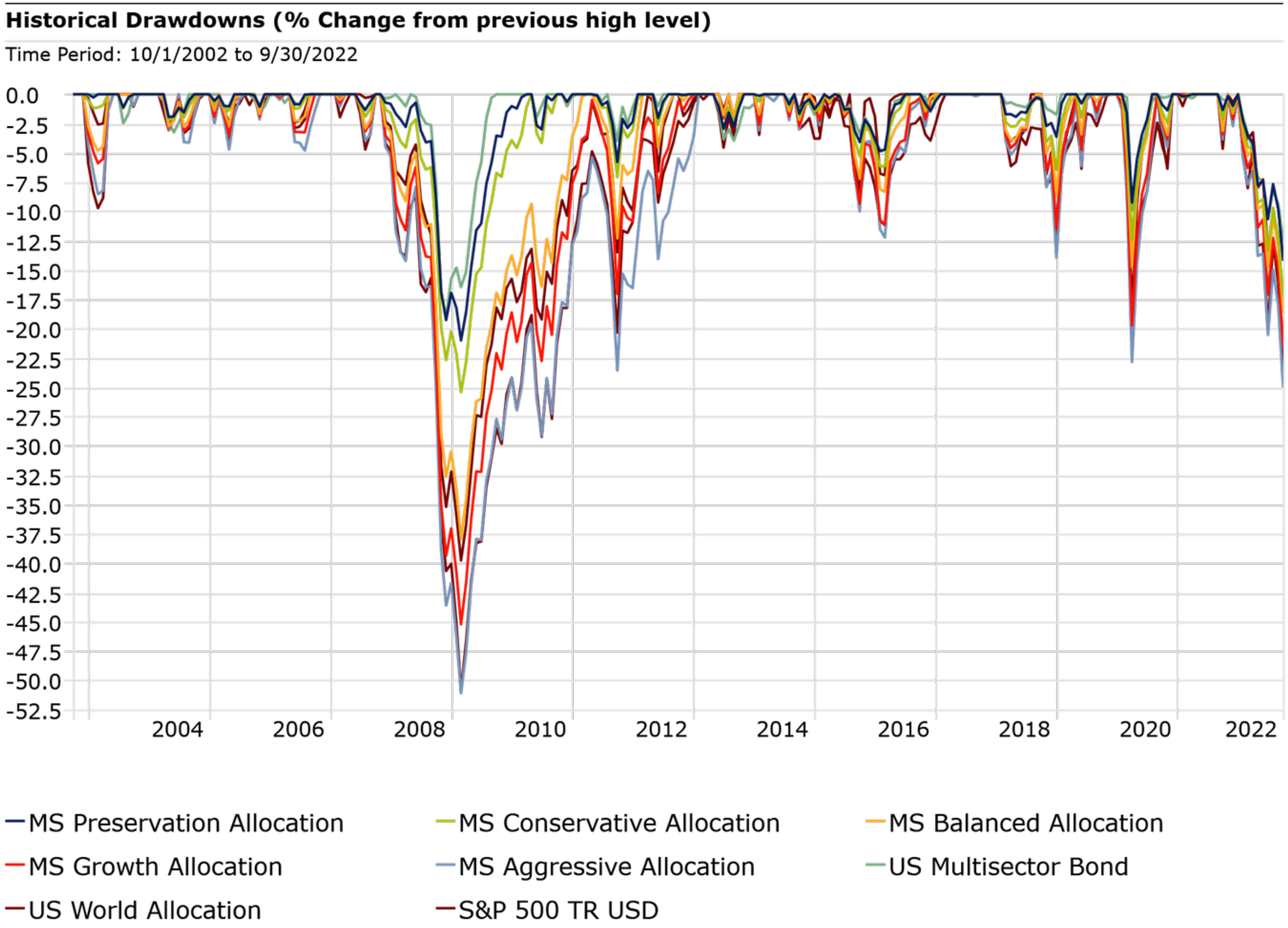
2.) Review the impact of a bear market

How much income is needed out of the investment portfolio?

Where are you taking the income from?

Run "worst case" scenarios in your planning software ➥

Not all bear markets are the same



Returns are for the Morningstar US Fund Categories. Past performance is not a guarantee of future results. The S&P 500 Index is an unmanaged index of the 500 largest US based stocks. Investors cannot invest directly in the Morningstar Categories or the S&P 500 index. Trying to replicate may incur additional fees and likely will not track above performance.

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Based on monthly performance of the S&P 500;
Past performance is not a guarantee of future results

3.) Develop a plan for any portfolio adjustments

Do the portfolios match the TRUE risk tolerance of each client?

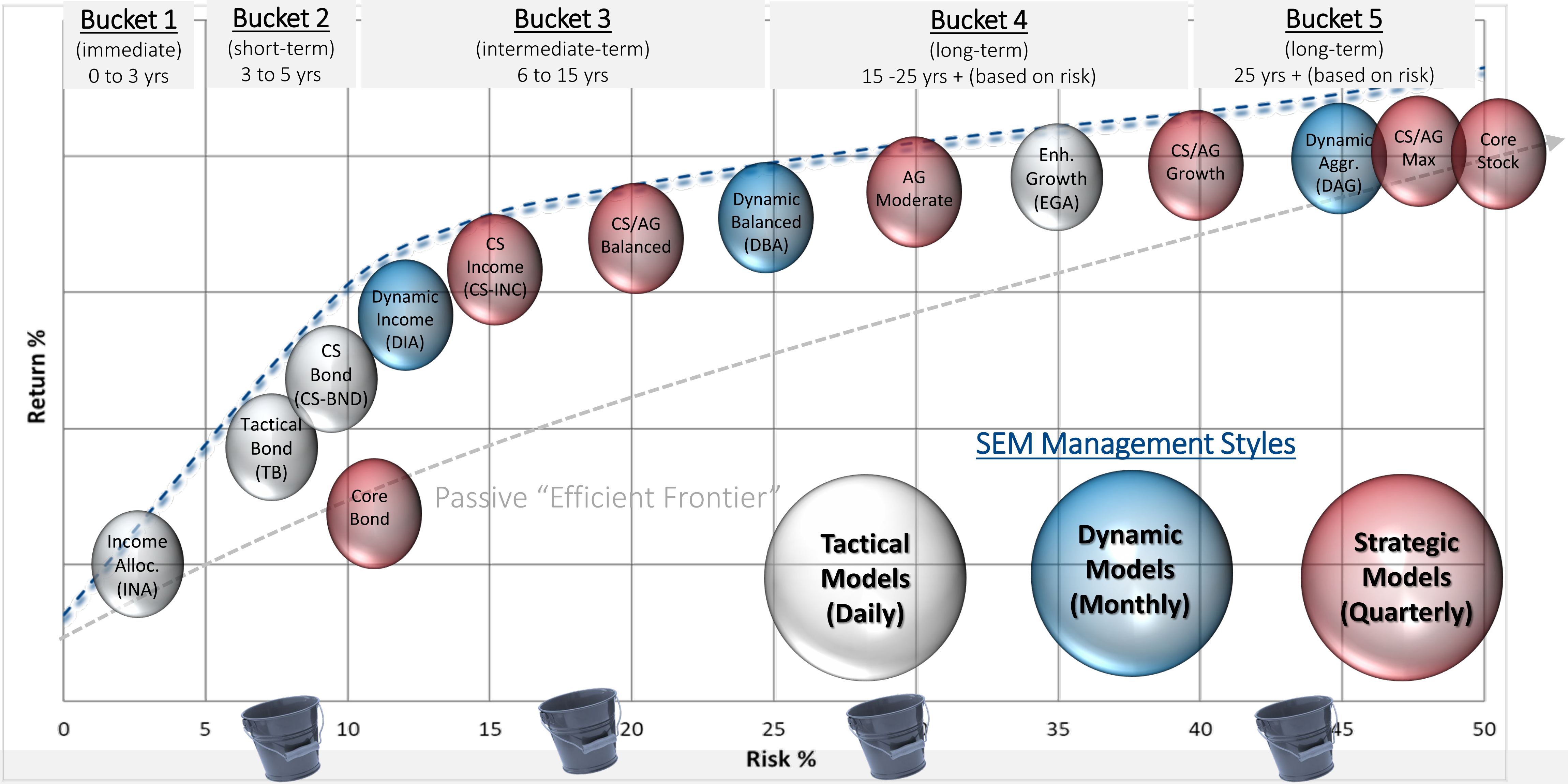
Are the clients' expectations properly established?

Are there components designed to help my clients stick to their plans?

Do my portfolios have plans in place to not have to be "right"?

When/how will I make adjustments? ➥

The bucket system helps



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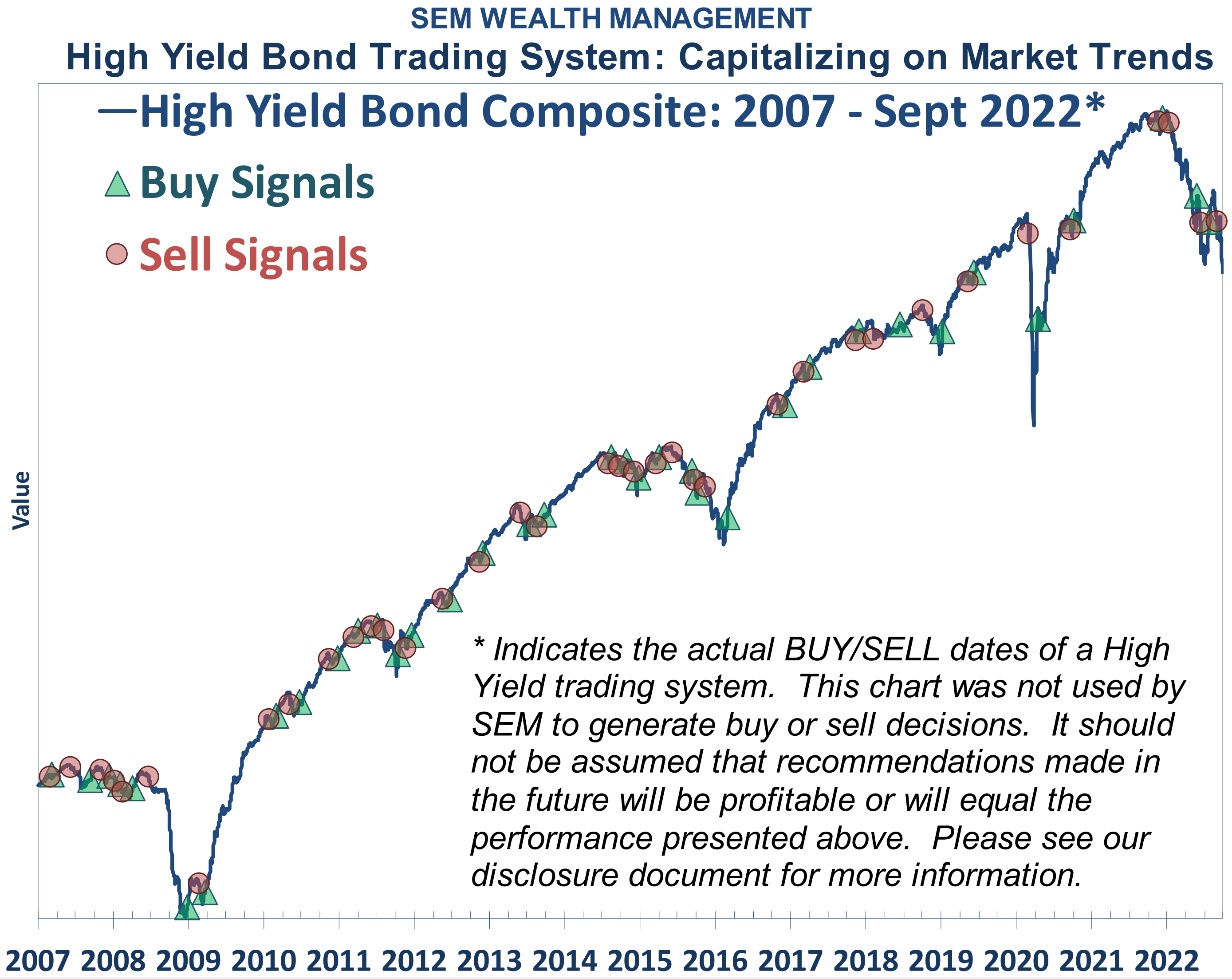
Tactical Bond (TB) / Cornerstone-Bond (CS-BND)

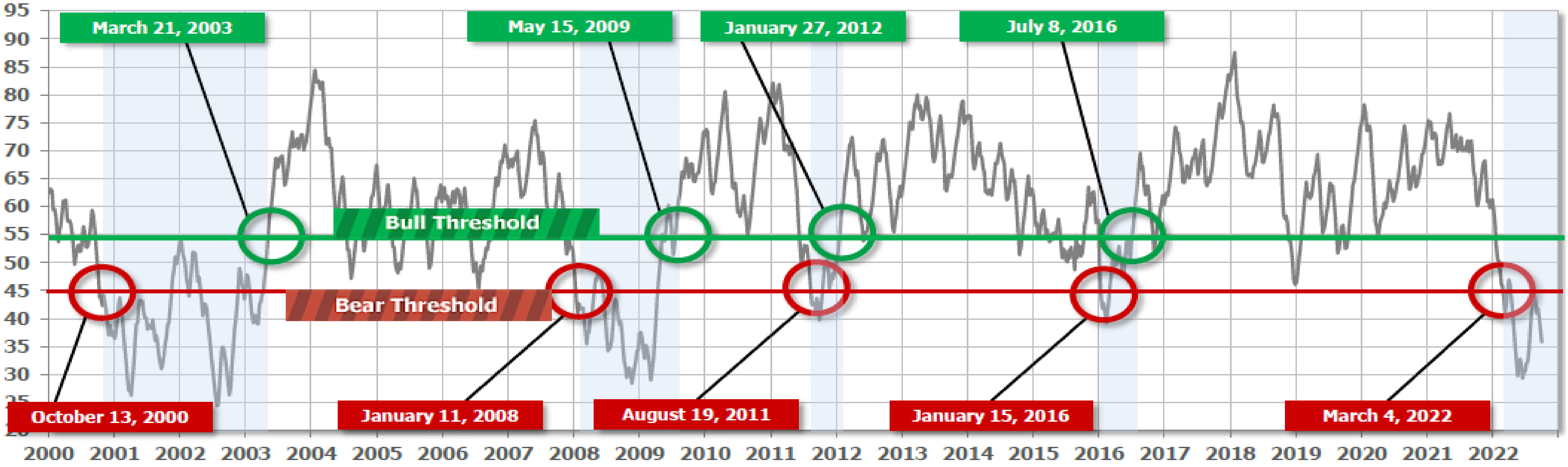
SEM's High Yield Bond trend following system has a real-time track record going back to 1992. This system has 3-5 different variations based on the market trends.

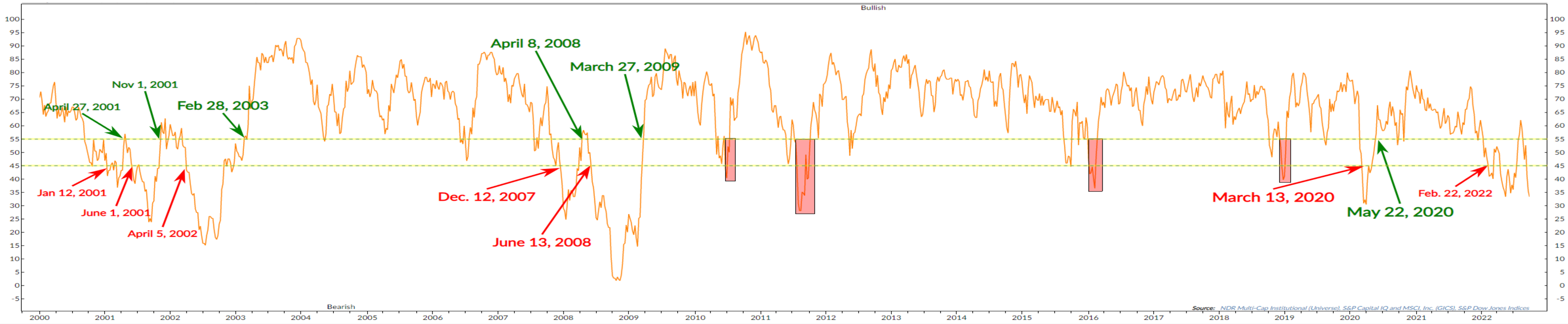
The chart to the right illustrates what Tactical Management is all about – follow a market index and invest in the index during rising trends & move to cash or other low-risk assets during falling trends.

The chart also shows the downside of Tactical Management – there will be many "bad" trades, but with proper discipline those are offset by the large winning trades that either generate strong returns or eliminate large losses.



Trends Still Matter





Dealing with Inflation

How we invest depends on the IMPACT of inflation

Above average growth

- Stocks will do well & help hedge inflation
  - AmeriGuard/Cornerstone
    - Growth outperforms value
    - Small outperforms large
- Treasury bonds struggle
  - Dynamic Income
    - Inverse Treasuries
- High yields & corporate bonds outperform
  - Tactical Bond / Dynamic Income
    - Overweight high yield

Average Growth → Declining Growth

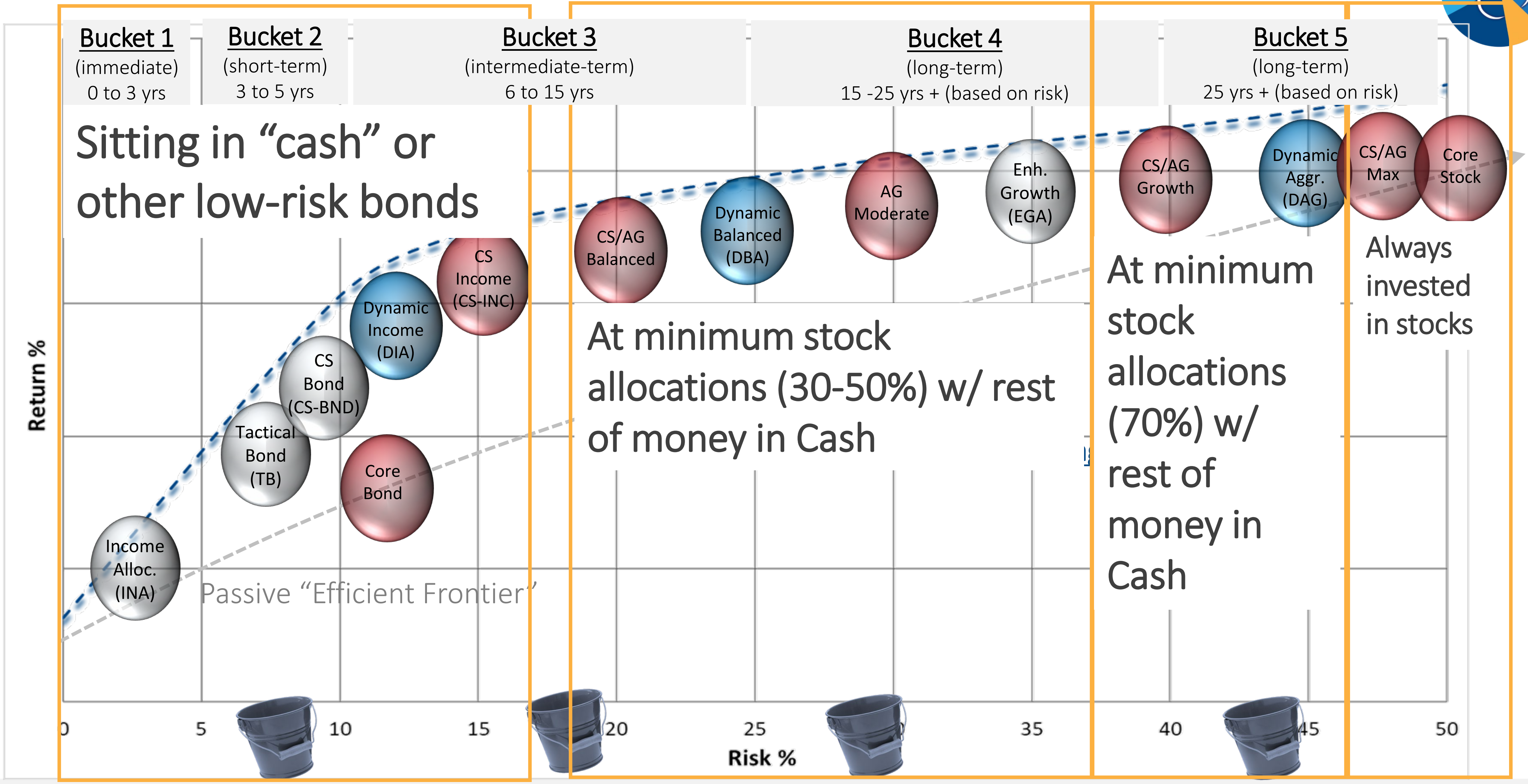
- Stocks may do "ok", but will be volatile
  - AmeriGuard/Cornerstone
    - Value outperforms growth
    - Large outperforms small
- Treasury bonds struggle
  - Dynamic Income
    - Inverse Treasuries
- High yields & corporate bonds slightly better than Treasuries
  - Tactical Bond / Dynamic Income
    - Overweight high yield

Declining Growth

- Stocks struggle
  - AmeriGuard/Cornerstone
    - Trend indicators reduce alloc.
    - Eliminate small cap
    - Invest in "materials" sectors
- Treasury bonds struggle
  - Dynamic Income
    - Stick to shorter-term bonds
- High yields & corporate bonds slightly better than Treasuries
  - Tactical Bond / Dynamic Income
    - Spend a lot of time in cash

SEM Signals Past 9 Months

Process in motion – Oct 2022 allocations



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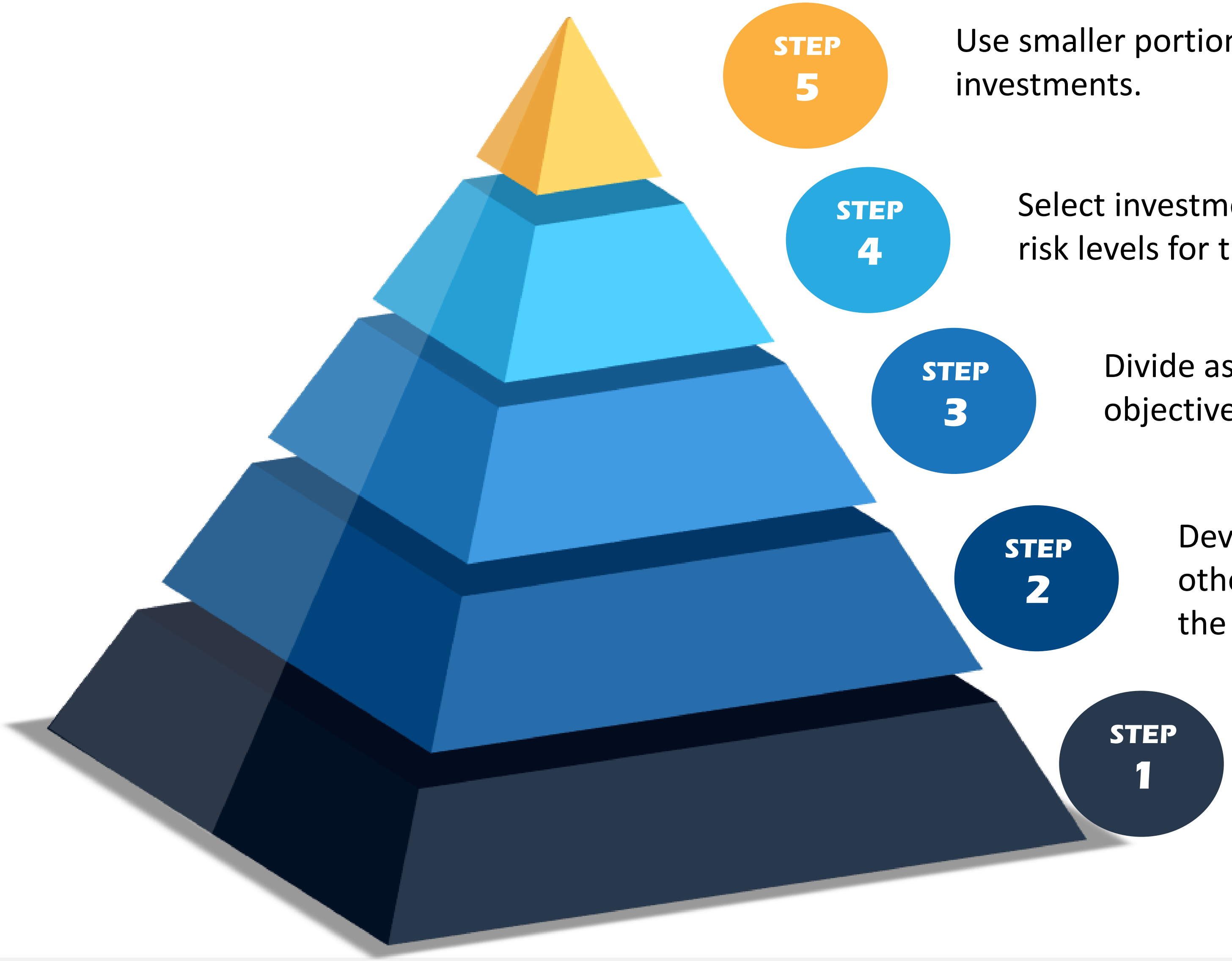
A Behavioral Portfolio Approach



Step 5: Use smaller portions of portfolio for concentrated or riskier investments.

Step 4: Select investments that align with specific objectives and risk levels for that layer.

Step 3: Divide assets into specific layers and set specific goals and objectives for each layer.

Step 2: Develop cash flow strategy taking into consideration cash and other low risk investments. This reduces short-term risk and the likelihood of making short-term, emotional decisions.

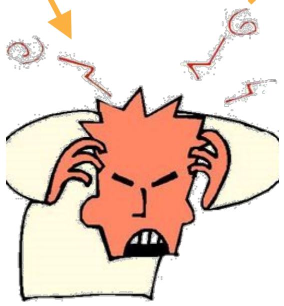
Step 1: Construct complete financial plan with specific goals and objectives.

Advisor Biases in Selecting Models

For Financial Planners, the investment allocation process can be the most difficult aspect. Mistakes in this phase can disrupt both the financial plan and cash flow strategies. Model platforms have created additional decisions that tend to accentuate our personal biases

Advisors are expected to:

1. Calculate probabilities of all future events & know impact of said events on investments / strategies
2. Understand cross correlations & event / environment specific correlations for each strategy



<u>Common Advisor Cognitive Errors :</u>

- Conservatism
- Confirmation
- Representativeness
- Illusion of Control
- Availability
- Hindsight

<u>Common Advisor Emotional Biases:</u>

- Overconfidence
- Self-control
- Status Quo
- Regret / Loss Aversion

For more information go to

SEMWealth.com