Harpswell CAPITAL ADVISORS, LLC

Table of Contents

Harpswell's Market Outlook	cover
Volatility & Returns	page 5
Treasury Yield Curve and the Fed	page 6
Investing for the Long Run	page 8
Maine Nonprofit CFO Luncheon Forum	page 12
Harpswell Flash Report	page 16

Harpswell's Market Outlook

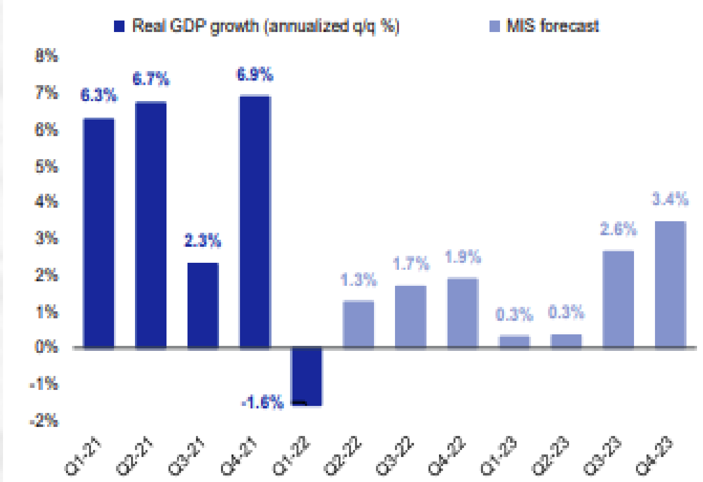
BOTH equity and bond markets are off to their worst start in decades. In fact, the S&P 500 is off to its worst start in over 50 years and the Barclays Bond Aggregate Index is down more than any year since 1973. Generally, when the equity markets are struggling, investors flock to bonds and that drives positive returns in the bond market. Conversely, when bonds fall (and interest rates rise) it's the byproduct of an overheating market and stocks do well. Thus, to have both stocks and bonds selling off to the degree of a double-digit drop is a rare phenomenon that has not occurred since the depression era.

The standard 60/40 portfolio (60% stocks and 40% bonds) was down 16.9% for the first half of 2022. That is extraordinary and it raises questions in the minds of investors about the virtue of diversification across asset classes. As we entered 2022 with exceptionally low interest rates, the asymmetrical prospects for rising rates began to put pressure on stocks. As the rising rate environment came to fruition, stocks began to sell off as rising rates translated to higher borrowing costs and (more importantly) higher discount rates. When interest rates rise, investors discount future earnings at a higher rate and therefore companies that are valued for significant future earnings growth get hit hard because those future earnings are now worth a lot less. Therefore, growth stocks, with presumably higher earnings in the future, were hit very hard.

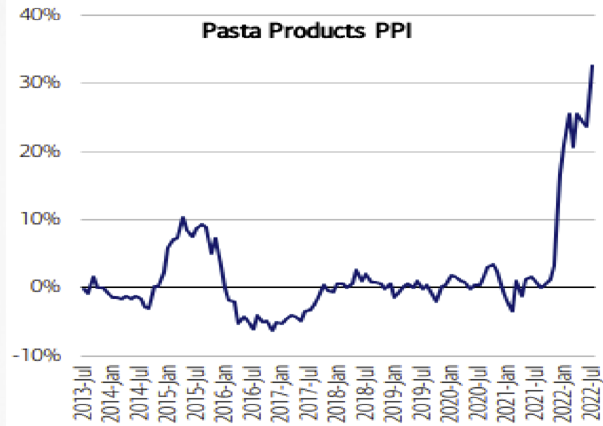
With no shortages of concerns, the markets are starting to climb the wall of worry despite a plethora of potential land mines. The markets recently verified Harpswell's view that interest rates are a key driver for stocks as rapidly escalating interest rates peaked on June 14th and equity markets began a slow progression upward and bounced off their lows on June 16th. Going forward, the primary focus will be on the economy (inflation, GDP growth, and the labor market) valuations, and politics. This is not to say other factors (e.g., war) won't come into play but we feel these are the variables to focus on.

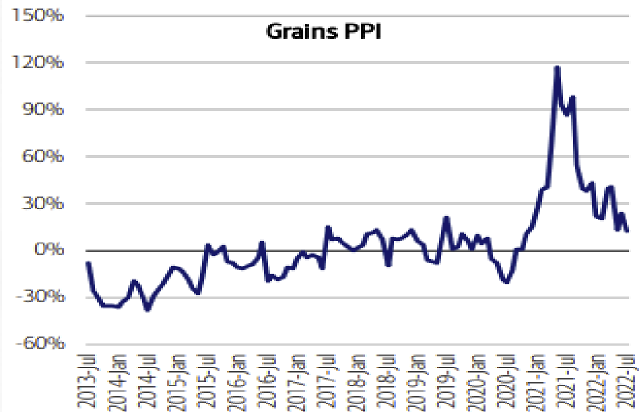
The Economy

The economy is the engine and lifeblood for the stock market, and it drives long-term growth and returns. As the chart below highlights, investors have expectations for slower economic growth in the near future. Equity markets tend to discount forward looking data and we feel this scenario is already baked into stock prices. In fact, we feel we are in an environment where bad news can be good news as it could help stifle inflation and it could lead the Federal Reserve to take a more dovish stance (i.e., less likely to raise rates).



Market Outlook *(continued from page 1)*





In addition to economic growth, inflation is another deep factor that influences the markets and the Federal Reserve Bank alike. In fact, the Federal Reserve's "dual mandate" suggests the labor market and inflation are its two primary areas of focus. We would suggest they have adopted a third mandate as they seem to have been pandering to the stock market for a good part of the last decade; we also feel this is a moral hazard that could foster much, much higher volatility in the future. Fiscal stimulus, rising energy prices, a repressed labor market and supply chain quagmires have all helped create the perfect storm for inflation. While we haven't seen this level of inflation since the 1970s, we are seeing signs of easing as inventories are building and prices are beginning to drop.

The labor market is a key driver for the economy. The key metrics for GDP growth are workforce participation and worker productivity so we do pay attention to the labor market. As the graph below highlights, the labor market has rebounded to pre-pandemic levels (albeit, we have forgone any growth). This is positive for markets across the board and we feel incremental data going forward will drive the markets up or down (hopefully up!).

(continue to page 3)

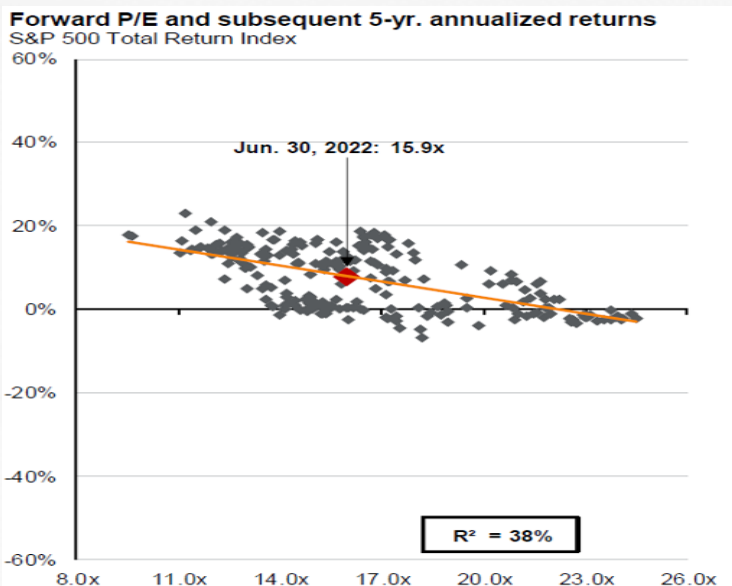
Market Outlook *(continued from page 2)*

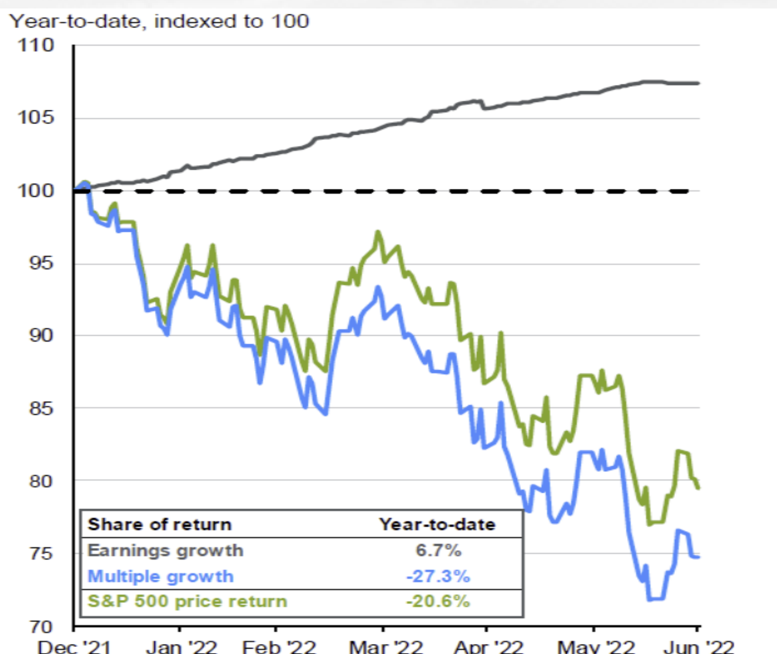
Worker productivity growth has proven to be the foundation of our economic prosperity over the last century. From the industrial revolution to the emergence of artificial intelligence, any incremental growth in productivity fuels economic growth.

Valuations

We entered 2022 with valuations at nosebleed highs and they have since returned to levels in line with the past 20 years. Currently the S&P 500 trades at 15.9X NTM earnings and we feel this is a comfortable level. The $64,000 question is: how much of the unsustainable fiscal and monetary stimulus policies have resulted in more of a sugar high rather than baseline growth. We will see!

As the following graphs indicate, valuations have come down to earth as a result of both earnings growth and dropping markets. While valuations and future returns do have a clear fundamental relationship, the expectations for 5-year returns is something we look at but don't bank on (r squared of 38%). This casual relationship would suggest we achieve low double digit returns over the next 5 years.





We will note that valuations look even more attractive for smaller cap names as well as value names. Harpswell is mindful of the dispersion in valuations and we do see some tactical opportunities. With that said, we recognize how important fundamental analysis is for smaller cap names and we rely more heavily on active high conviction managers for this space. In fact, approximately 40% of small cap companies have no earnings and we choose to avoid overexposure to speculative names.

Current P/E vs. 20-year avg. P/E

	Value	Blend	Growth
Large	12.9 / 13.7	15.9 / 15.5	21.3 / 18.5
Mid	12.4 / 14.4	14.3 / 16.3	19.9 / 20.3
Small	13.6 / 16.9	17.1 / 21.4	22.9 / 35.4

Current P/E as % of 20-year avg. PE

	Value	Blend	Growth
Large	94.0%	103.1%	114.9%
Mid	86.3%	87.7%	98.2%
Small	80.2%	80.0%	64.8%

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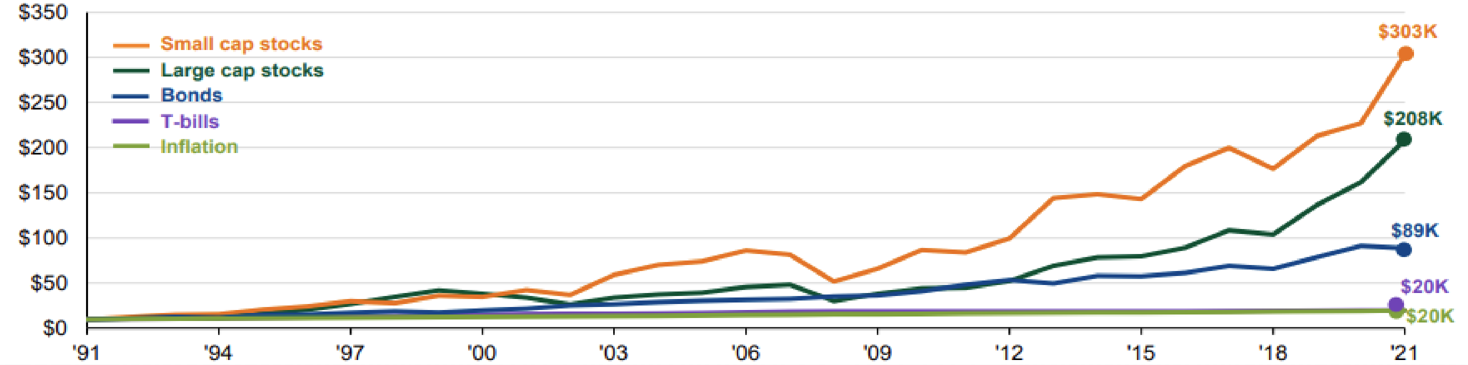
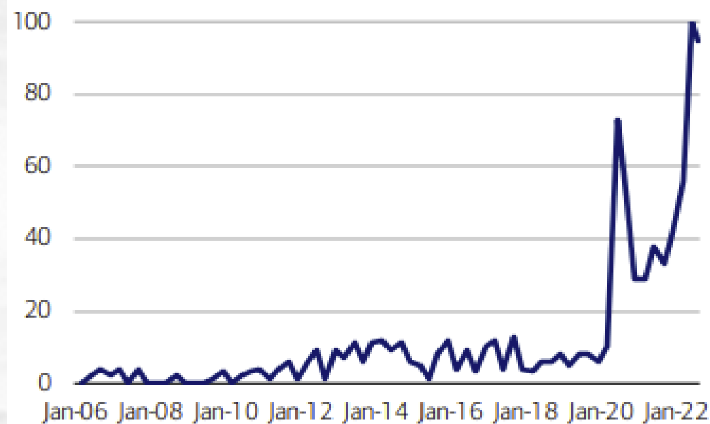
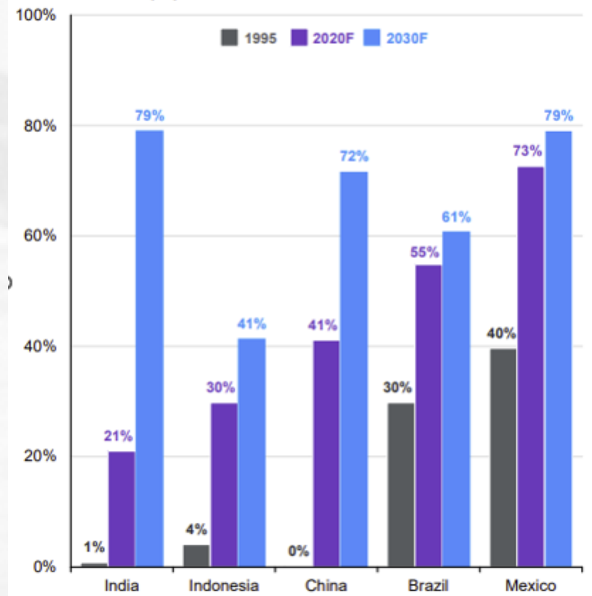
Market Outlook *(continued from page 3)*

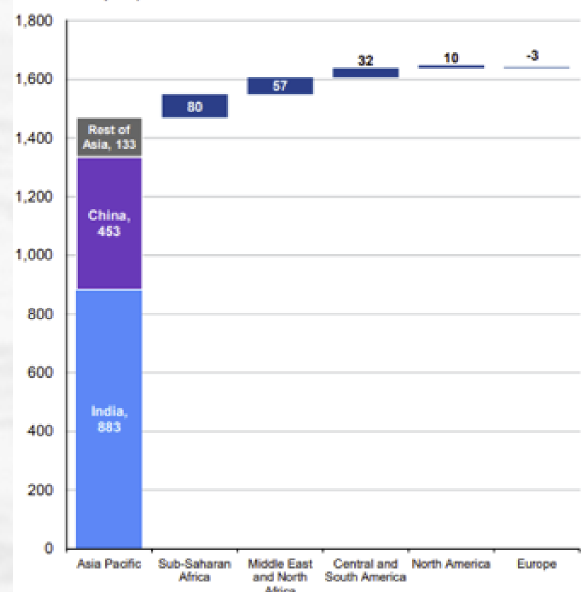


Another factor that lends to our smaller cap thesis relates to the notion that smaller cap companies are more leveraged on domestic sales. With onshoring becoming one of the biggest trends resulting from the supply chain and logistics difficulties, we feel smaller cap names will enjoy a slight tailwind associated with onshoring.



Harpswell sees international markets trading at moderate relative discounts to domestic stocks and sees higher growth and diversification merits in some international markets. Recognizing how the economy can drive future investment opportunities, we feel the growth in some emerging market countries' middle class is a very positive long-term trend. In addition to the social virtue of a growing middle class, it tends to help economies make the transition from a (cheap) manufacturing economy to a much more robust consumer economy.





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Market Outlook *(continued from page 4)*

Politics

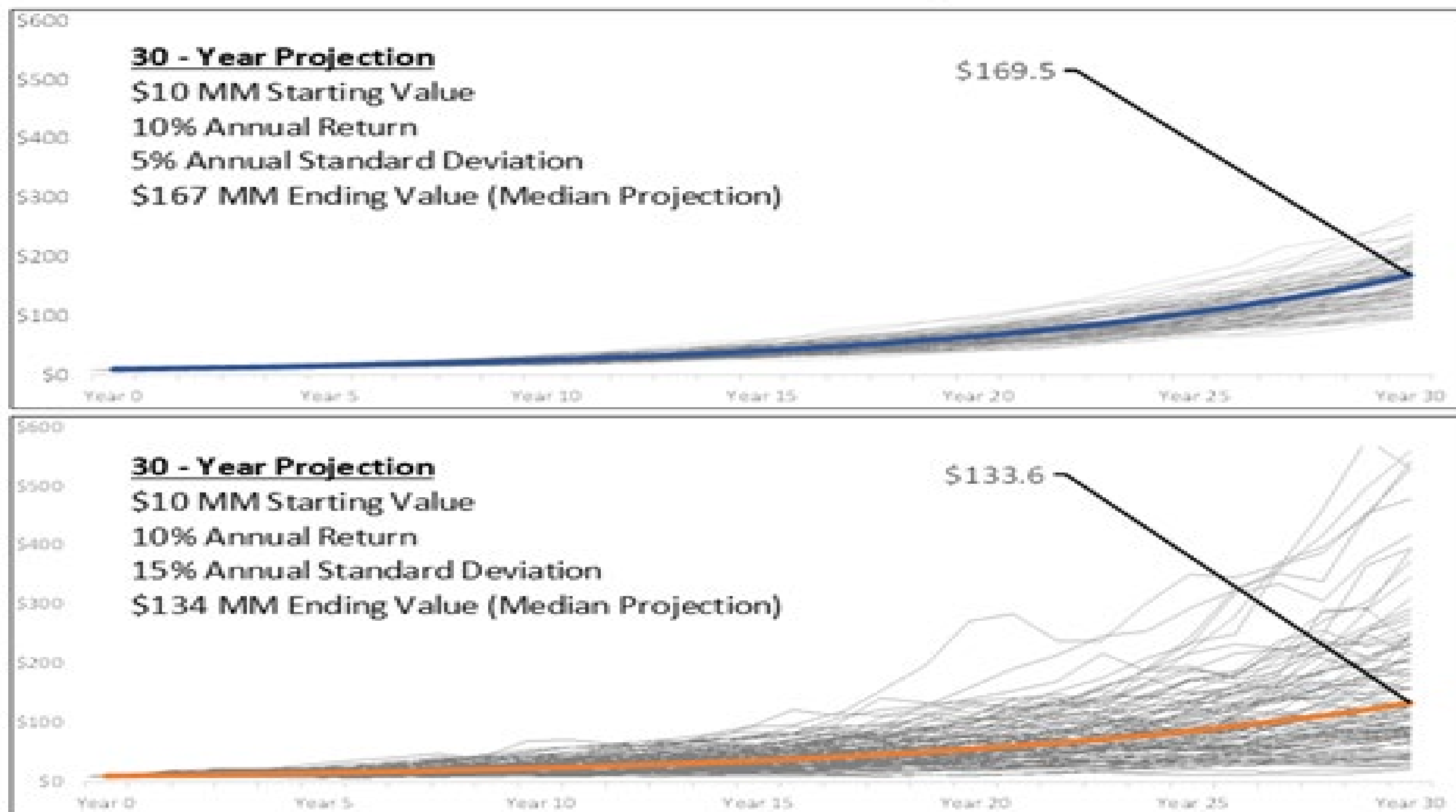
Needless to say, the mid-term elections will most certainly become a factor of our economy. Political outcomes can be hard to handicap and the markets are waiting for more clarity as to the outcome in 2022. Generally, markets appreciate gridlock and a shift in either the House of Representatives or Senate could be well received. With that said, expectations for fiscal policies and spending will also drive markets and gridlock could thwart major economic development initiatives enacted by the current administration and legislature. *

Volatility and Returns

You might expect two different assets that earn the same average return every year to have the same performance in the long run, even if one is more volatile than the other. You might reason that higher volatility doesn't matter because you can just ride it out as a buy-and-hold investor and eventually arrive at the same destination.

The math tells a different story, however. All else being equal, the high-volatility asset would lag the low-volatility asset over time. The simulation below projects the return on $10 million invested in an asset returning 10% per year, on average, with 5% annual standard deviation, compared to $10 million invested in an asset with the same 10% average return but with a 15% annual standard deviation. After 30 years, they do not arrive at the same destination: the high-volatility asset lags by $36 million.

Why does this happen? After all, up 35%, down 15% (a high-volatility asset) gives you an average of annual return of 10%, just like up 25%, down 5% (a lower-volatility asset) gives you an average of 10%. Shouldn't the two assets produce the same return in the long run?



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Volatility & Returns *(continued from page 5)*

The reason the low-volatility asset pulls ahead over time is because it's easier to recover from small losses than from big losses. If you have a 5% loss you only need a 5.3% return to break even, but if you have a 50% loss you need to follow that with a 100% return to break even.

Why Lower-Volatility Compounds to Higher Returns			
Starting Value	% Drawdown	Low Point	Return Needed to Break Even
$ 10.00	-50.0%	$ 5.00	100.0%
$ 10.00	-25.0%	$ 7.50	33.3%
$ 10.00	-15.0%	$ 8.50	17.6%
$ 10.00	-10.0%	$ 9.00	11.1%
$ 10.00	-5.0%	$ 9.50	5.3%

Holding on through volatility has become classic investing wisdom, but that's not because volatility doesn't matter. The reason investors should hold on through volatility is because being in high-volatility assets in the first place was (presumably) a strategic decision meant to achieve higher returns in the long run.

Hold on! Now we sound like an economist speaking out both sides of his mouth! We just got done explaining why volatility hurts your returns, now we're advocating high-volatility assets to generate returns in your portfolio. The key difference is that, in the real world, you don't usually find low-volatility assets and high volatility assets that have the same average annual return.

In the real world, unlike the hypothetical example above, higher-volatility assets tend to have higher average returns. The difference, called the risk premium, arises because buyers tend to bid down the return on the low-volatility investments (price up, return down) while sellers of high-volatility investments usually have to offer a return premium (price down, return up).

When sentiment in the market changes, that presents opportunities for tactical active management. For example, when the market is risk-averse, you can buy high-return investments at a discount, and when the market is complacent about risk, you buy low-volatility investments at a discount.

Strategically, your allocation between low-volatility / low-return investments and high-volatility / high-return investments depends on your time horizon and liquidity needs. While strategic considerations can change for many reasons (and we work diligently with our investment committees to stay aligned with their strategic goals) time horizon and liquidity needs should not be subject to swings in market sentiment. *

Treasury Yield Curve and the Federal Reserve

During 2022, investors and homebuyers alike have seen dramatic interest rate increases as the Federal Reserve (Fed) has positioned itself to aggressively address inflation. The Federal Open Market Committee (FOMC), a department of the Federal Reserve Board, meets periodically during the year to set monetary policy and adjust the Federal Funds rate based on market conditions. Over the past seven months, the FOMC raised its benchmark rate by 2.25% bringing it to 2.50% from 0.25%.

It's easy to forget that the FOMC was holding the federal funds rate at near zero into the first quarter of 2022. The Fed was also still buying billions of dollars of bonds every month to stimulate the economy and keep long-term borrowing costs low.

As the perception of inflation changed from transitory to persistent, the FOMC reversed course and began raising rates while curtailing its bond buying program. The result was higher across the board borrowing costs for businesses and consumers from credit card debt to mortgages. Chart 1 presents the FOMC rate increases by meeting dates. The next meeting date is scheduled for September 20th.

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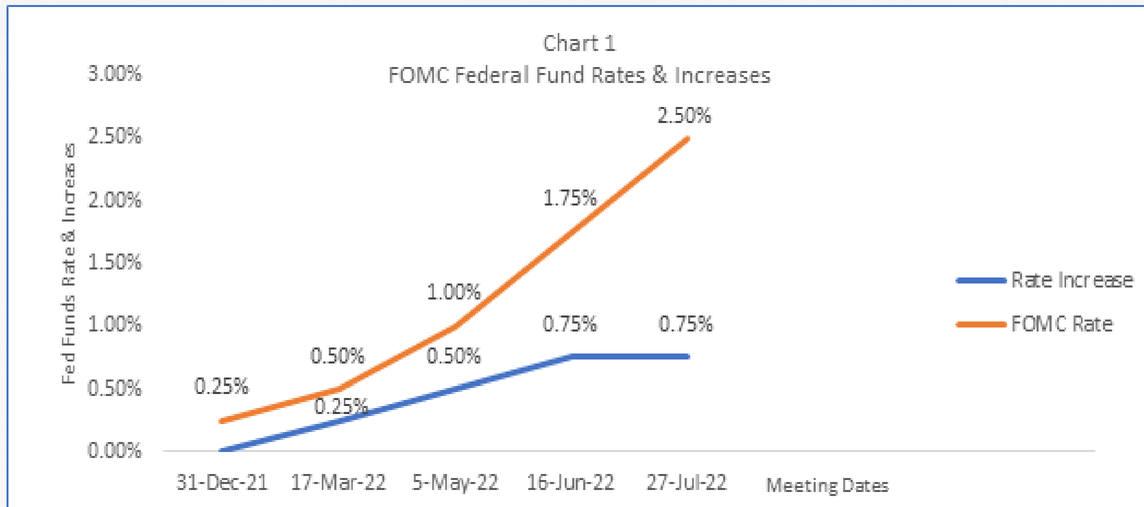
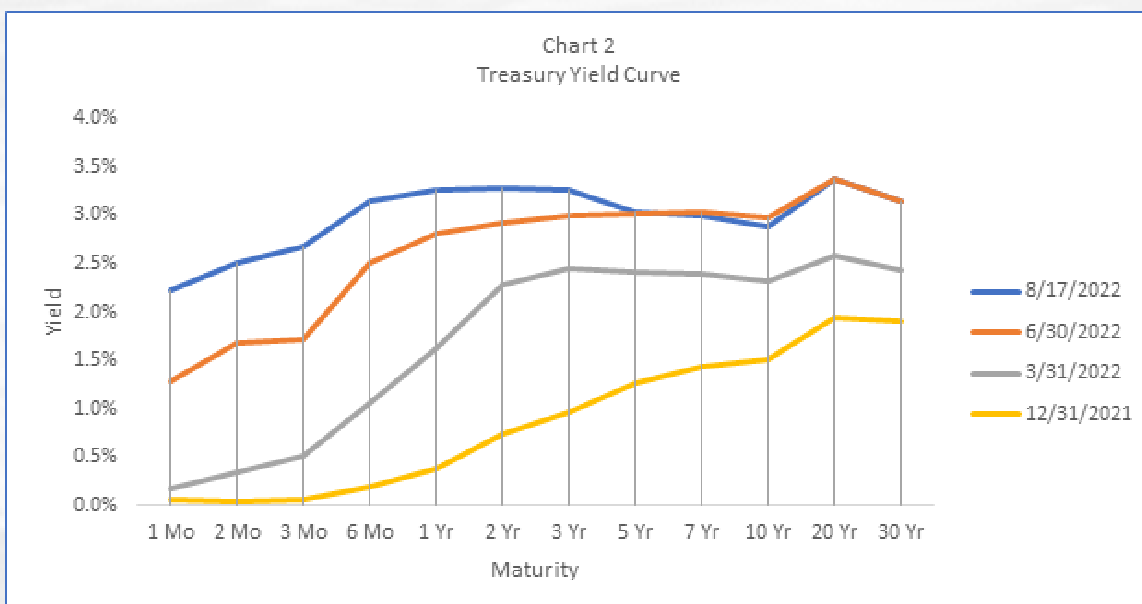
Treasury Yield Curve and the Federal Reserve *(continued from page 6)*



Following the first rate increase in March, all Treasury yields moved higher especially in the range of three months to three years. Mortgage rates increased significantly due to the combined effect of the rate increases and tapering of the Fed bond buying program.

Chart 2 presents the yield curve at the end of recent quarters except for the August curve which shows recent yields. The yield curve presents interest rates by maturity for Treasury securities.



Further rate increases in May and June by the FOMC moved short term yields higher but longer rates reacted more modestly, resulting in a flattening yield curve beyond two-year maturities. The last rate hike in July raised the Fed funds rate by 75bps but yields for maturities greater than five years remained unchanged.

Although the Federal Reserve Board remains concerned about inflation in the near term and will probably continue to raise the Fed Funds rate for the remainder of 2022, investors with a longer-term perspective expect inflation to moderate over the next year or two. The economy is slowing and may have already entered a recession which could eventually eliminate the need for future rate increases and may result in rate decreases in the longer term. Investors are looking for higher yields in the shorter time frames but less so for securities with longer maturities. *

Investing for the Long Run

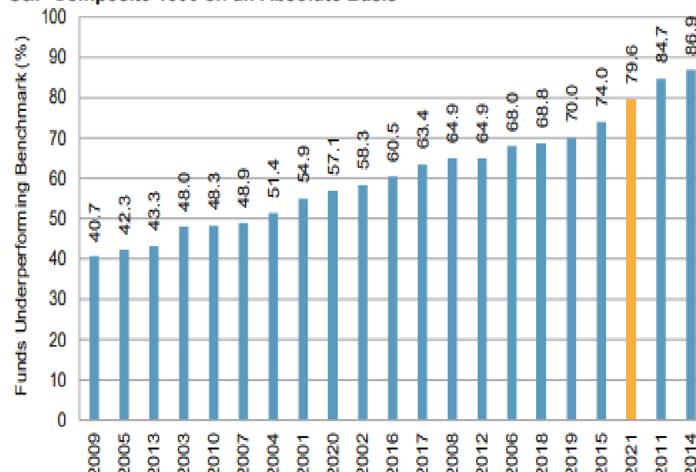
Harpswell recognizes some key tenets in successful long-term investing, and this is an ideal time to review them. They all essentially revolve around efficient means to stay invested, minimize fees and optimize diversification.

Passive and active investment funds

Harpswell's strategy embraces both passive (index) fund as well as our roster to talented high-conviction managers. Index funds bring a high level of diversification with a very low expense level. 2021 was a particularly good year to have embraced passive investing as a very high proportion of fund managers underperformed their respective benchmarks.

Stay Invested

Quite often the market generates attractive returns while there are clearly plenty of sources of potential danger. The notion that the market whistles by the graveyard reminds us that there are almost always reasons to fear the future but history suggests markets perform despite a wall of worry.



Market Timing Doesn't Work

You will never know when a great day or string of days in the market is around the corner. Trying to time the market all too often results in foregone opportunities. So long as investment policies are aligned with goals and appetite for volatility, investors should refrain from timing times to be in and out of the market. Getting one of the calls (to get in or out of the market) right is difficult; getting both right is a fool's errand.

(continue to page 9)

Timing the market

£600k
£500k
£400k
£300k
£200k
£100k
£0k

Investment value (£)

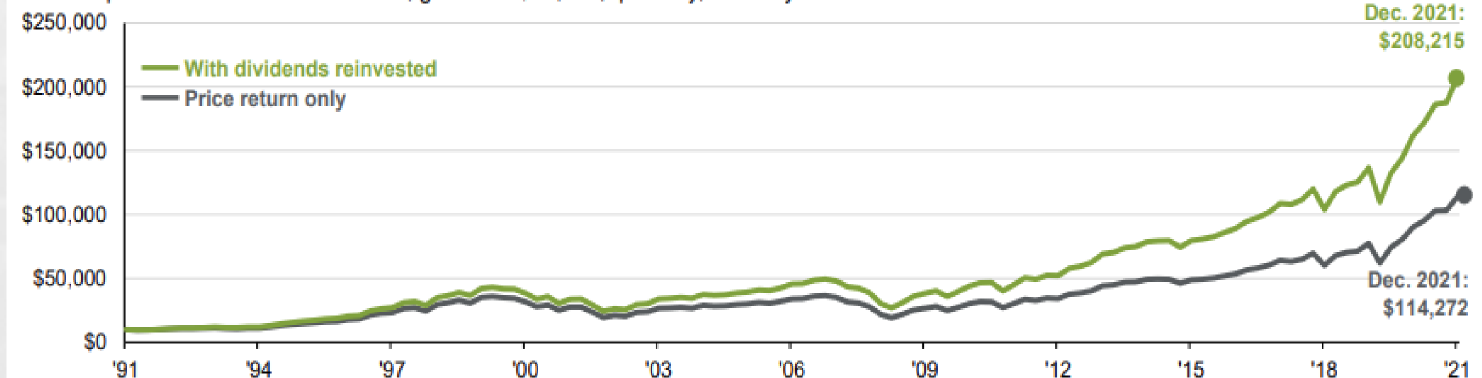
2002 2003 2004 2005 2006 2007 2008 2009 2010 2011 2012 2013 2014 2015 2016 2017 2018 2019 2020 2021 2022

Missed 10 best days | Missed best 30 days | Missed 50 best days | Staying invested

Source: Bloomberg, MSCI World £ TR (MSCI: please see important information), Dates 01/01/2020 to 19/01/2022 Chart shows performance of a £100,000 investment. Past performance is not a reliable indicator of future results.

Reinvest Dividends

Dividends are a key component of a total return-oriented stock portfolio. Once a taxable investor receives their dividend, they pay taxes on it and have less to redeploy back into the market. The optimal dividend strategy for the long run is for investors to reinvest dividends (and forego the distributions). With this election, each dividend yields more shares rather than a tax liability and cash drag.



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Investing for the Long Run *(continued from page 9)*

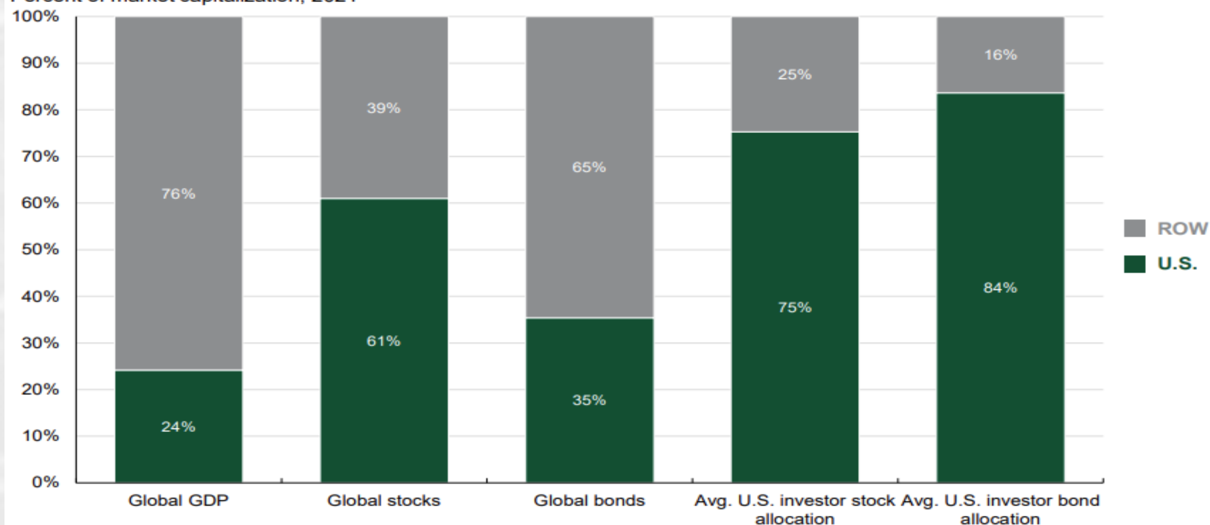
Diversification

Diversification helps to reduce volatility and optimize long-term returns. Harpswell embraces a high level of diversification across securities, geographies and asset classes. Part of the virtue of diversification is rooted in the Efficient Market Theorem that suggests investing across assets that have a correlation below 1 enables investors to take on an incremental risk level in each asset class all while lowering the portfolio's volatility. The theorem has its limits but we do subscribe to the philosophy.

2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2007 - 2021	
															Ann.	Vol.
EM Equity 39.8%	Fixed Income 5.2%	EM Equity 79.0%	REITs 27.9%	REITs 8.3%	REITs 19.7%	Small Cap 38.8%	REITs 28.0%	REITs 2.8%	Small Cap 21.3%	EM Equity 37.8%	Cash 1.8%	Large Cap 31.5%	Small Cap 20.0%	REITs 41.3%	Large Cap 10.6%	REITs 23.2%
Comdty. 16.2%	Cash 1.8%	High Yield 59.4%	Small Cap 26.9%	Fixed Income 7.8%	High Yield 19.6%	Large Cap 32.4%	Large Cap 13.7%	Large Cap 1.4%	High Yield 14.3%	DM Equity 25.6%	Fixed Income 0.0%	REITs 28.7%	EM Equity 18.7%	Large Cap 28.7%	Small Cap 8.7%	EM Equity 22.9%
DM Equity 11.6%	Asset Alloc. -25.4%	DM Equity 32.5%	EM Equity 19.2%	High Yield 3.1%	EM Equity 18.6%	DM Equity 23.3%	Fixed Income 6.0%	Fixed Income 0.5%	Large Cap 12.0%	Large Cap 21.8%	REITs -4.0%	Small Cap 25.5%	Large Cap 18.4%	Comdty. 27.1%	REITs 7.5%	Small Cap 22.5%
Asset Alloc. 7.1%	High Yield -26.9%	REITs 28.0%	Comdty. 16.8%	Large Cap 2.1%	DM Equity 17.9%	Asset Alloc. 14.9%	Asset Alloc. 5.2%	Cash 0.0%	Comdty. 11.8%	Small Cap 14.6%	High Yield -4.1%	DM Equity 22.7%	Asset Alloc. 10.6%	Small Cap 14.8%	High Yield 6.6%	Comdty. 19.1%
Fixed Income 7.0%	Small Cap -33.8%	Small Cap 27.2%	Large Cap 15.1%	Cash 0.1%	Small Cap 16.3%	High Yield 7.3%	Small Cap 4.9%	DM Equity -0.4%	EM Equity 11.6%	Asset Alloc. 14.6%	Large Cap -4.4%	Asset Alloc. 19.5%	DM Equity 8.3%	Asset Alloc. 13.4%	Asset Alloc. 5.7%	DM Equity 18.9%
Large Cap 5.5%	Comdty. -35.6%	Large Cap 26.5%	High Yield 14.8%	Asset Alloc. -0.7%	Large Cap 16.0%	REITs 2.9%	Cash 0.0%	Asset Alloc. -2.0%	REITs 8.6%	High Yield 10.4%	Asset Alloc. -5.8%	EM Equity 18.9%	Fixed Income 7.5%	DM Equity 11.8%	EM Equity 4.8%	Large Cap 16.9%
Cash 4.8%	Large Cap -37.0%	Asset Alloc. 25.0%	Asset Alloc. 13.3%	Small Cap -4.2%	Asset Alloc. 12.2%	Cash 0.0%	High Yield 0.0%	High Yield -2.7%	Asset Alloc. 8.3%	REITs 8.7%	Small Cap -11.0%	High Yield 12.6%	High Yield 7.0%	High Yield 1.0%	DM Equity 4.1%	High Yield 12.2%
High Yield 3.2%	REITs -37.7%	Comdty. 18.9%	DM Equity 8.2%	DM Equity -11.7%	Fixed Income 4.2%	Fixed Income -2.0%	EM Equity -1.8%	Small Cap -4.4%	Fixed Income 2.6%	Fixed Income 3.5%	Comdty. -11.2%	Fixed Income 8.7%	Cash 0.5%	Cash 0.0%	Fixed Income 4.1%	Asset Alloc. 11.7%
Small Cap -1.6%	DM Equity -43.1%	Fixed Income 5.9%	Fixed Income 6.5%	Comdty. -13.3%	Cash 0.1%	EM Equity -2.3%	DM Equity -4.5%	EM Equity -14.6%	DM Equity 1.5%	Comdty. 1.7%	DM Equity -13.4%	Comdty. 7.7%	Comdty. -3.1%	Fixed Income -1.5%	Cash 0.8%	Fixed Income 3.3%
REITs -15.7%	EM Equity -53.2%	Cash 0.1%	Cash 0.1%	EM Equity -18.2%	Comdty. -1.1%	Comdty. -9.5%	Comdty. -17.0%	Comdty. -24.7%	Cash 0.3%	Cash 0.8%	EM Equity -14.2%	Cash 2.2%	REITs -5.1%	EM Equity -2.2%	Comdty. -2.6%	Cash 0.7%

Source: Bloomberg, FactSet, MSCI, NAREIT, Russell, Standard & Poor's, J.P. Morgan Asset Management.

The merits for international diversification are anchored in the fact that US equity markets comprise a majority of the global stock market yet the US only represents a fraction (24%) of global GDP.



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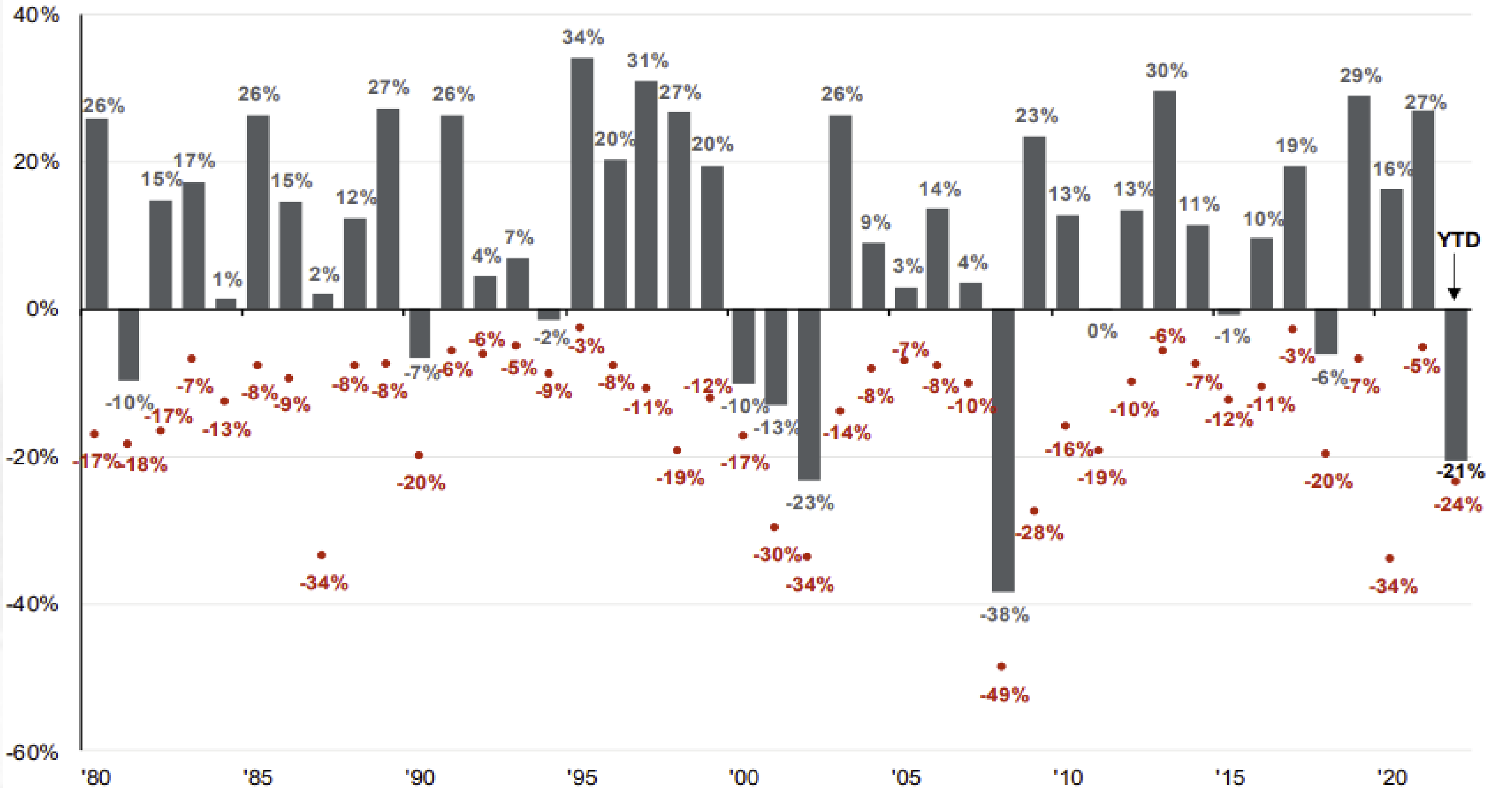
Investing for the Long Run *(continued from page 10)*

Stay the Course

The market generally experiences a selloff throughout the year yet a majority of the time, it ends up in positive territory. While quite often it is hard to envision a market rebound as levels fall, sticking with your strategy is paramount to successful long-term investing.*



The Maine Nonprofit CFO Luncheon Forum, 2022

Thursday, May 26th

A forum designed to bring together thought leaders in Maine's nonprofit sector, to speak on timely and impactful topics.

Harpswell Capital Advisors and Northeast Bank recently partnered to host The Maine Nonprofit CFO Luncheon Forum in the Washington Room at Pineland Farms in New Gloucester. Thank you to all who attended and to our distinguished presenters! ***We also wish to extend a special thanks to Jennifer Hutchins for taking on the role of moderator!***

Hosts of Event:

Jack Moore, Managing Partner, Harpswell Capital Advisors

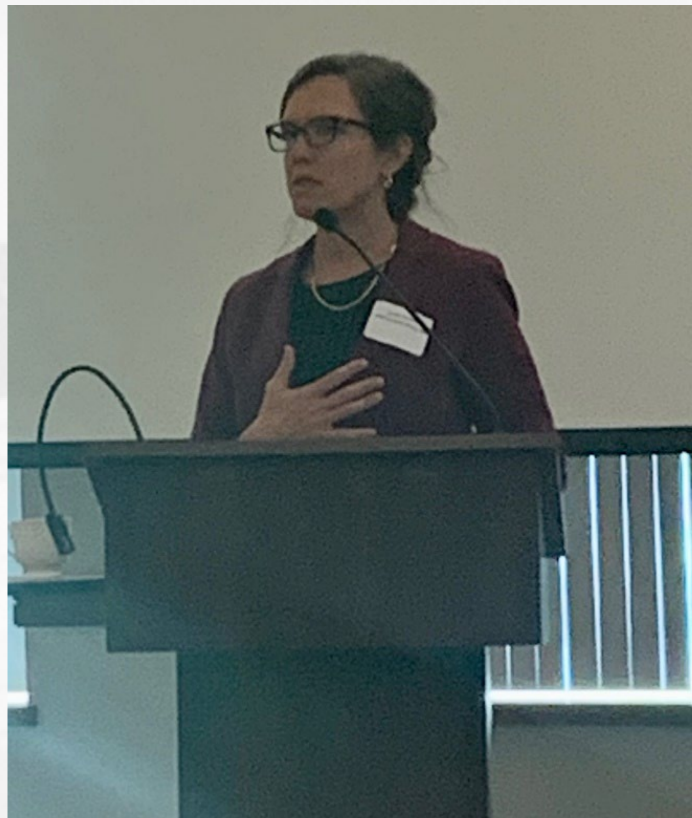
Harpswell's nonprofit clients serve many missions and have diverse sources of revenue. Harpswell works closely with CFOs and investment committees to assess a host of financial considerations related to sustainability and fulfilling the mission of each institution.

Lucie Hannigan, Director of Business Banking, Northeast Bank

Northeast Bank has many years of experience in helping nonprofits to manage their operating cash cycle. The Business Banking Team is proud to provide dedicated service and modern banking solutions for nonprofits.

Moderator:

Jennifer Hutchins, Executive Director, Maine Association of Nonprofits



The Maine Nonprofit CFO Luncheon Form was moderated by Jennifer Hutchins, Executive Director of the Maine Association of Nonprofits. Over the last 27 years, MANP has helped over a thousand 501(c) organizations to strengthen their leadership and financial sustainability. MANP provides everything from financial management training to leadership development programs.

Jennifer began the event with a message: for Maine's nonprofits to thrive, all three sectors of our economy - the public, private, and nonprofit – need to thrive together, and forums like these can make that a reality.

(continue to page 13)

The Maine Nonprofit CFO Luncheon Forum, 2022 *(continued from page 12)*

Presenters:

Michael Komich, Senior Vice President for Finance and Operations, Cheverus High School

Health Insurance Captive: How one institution very meaningfully cut their healthcare expenses

Cheverus High School is an inclusive Jesuit private high school. Michael Komich, SVP for Finance and Operations at Cheverus, presented on a topic of great interest to all employers - the use of a Health Insurance Captive to reduce costs for the school's 150+ employees and insured family members.

In a Group Captive health arrangement, a group of employers comes together to create an insurance plan. The employers combine partial self-funding with re-insurance, which means they pay premiums into the captive (which they created) to cover predictable, smaller claims and they buy re-insurance (from an outside insurance company) to create a stop-loss for the unexpected, million-dollar claims.

In Cheverus High School's case, the school added a layer of self-insurance, covering small claims in-house before dipping into the Group Captive pool. That works like a deductible to further decrease the premium. From the employee's perspective, all their claims are being paid as if by an outside insurance company. The big difference is that their premiums are only increasing by low single digits per year – compared to double-digit increases in typical small-employer plans.

Employer ownership of the Group Captive is what allows them to control costs. One of the major issues driving costs in our healthcare system, as Mr. Komich explains, is that most of us are only about 15% literate in the terminology of medicine and the healthcare system. That means when we approach the system as consumers, we usually don't know what we're buying or what our options are.

In a Group Captive plan, the employer can provide the employees with the ability to shop around for their healthcare among different providers and, when it's possible, obtain equivalent care at lower costs. The plan can even pass along part of the savings to the participant as an incentive! The benefits are more than just financial, as the structure of a Group Captive allows employers like Cheverus to create tailored, HIPAA-compliant incentive programs to reduce medical risks and increase overall wellness.

(continue to page 14)

The Maine Nonprofit CFO Luncheon Forum, 2022 *(continued from page 13)*

Anthony Jaccarino, Program Officer, Maine Health and Higher Educational Facilities Authority

Tapping the Maine Bond Bank: A source of funds with advantageous rates and liquidity

The Maine Health and Higher Educational Facilities Authority (MHHEFA) provides eligible borrowers with access to capital by issuing low cost, tax-exempt bonds. Anthony Jaccarino, Program Officer for MHHEFA, presented to the forum on the state-sponsored financing option that many organizations are not aware they qualify for.

As Mr. Jaccarino explains, the Maine statute governing MHHEFA provides a fairly flexible definition of "eligible borrowers". Broadly speaking, an organization needs to have a health care or education component, a building, and revenue.

Many nonprofits that are not operating heath care or post-secondary education facilities can qualify based on having some type of education program that may be tangential to their core activity.

Under Mr. Jaccarino's leadership, MMHEFA has adopted a method for lowering the cost of access called "barbelling". As an example, when a large borrower closes on a $200+ million deal, MHHEFA will seek to invite smaller, $2 million borrowers to be tacked on to the issue. That lowers the up-front costs for small borrowers, making MHHEFA financing much cheaper than a bank loan in many instances.

Another benefit of financing with MHHEFA is that the term of borrowing in the tax-exempt bond market is measured in decades, not years. While a bank note typically requires repayment in less than 10 years, a bond issue is repaid over 30 years. So, instead of having to pay the up-front costs of a loan three times, the bond borrower gets away with paying it only once.

MHHEFA is seeking to extend the reach of its financing and encourages nonprofits to find reach out and ask if they are eligible to participate.

(continue to page 15)

The Maine Nonprofit CFO Luncheon Forum, 2022 (continued from page.14)

Hilary Robbins, Hilary Robbins Consulting

Financial Sustainability: Revisiting your business model for impact in a new era

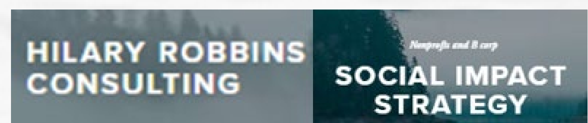
Hilary Robbins Consulting has partnered with over 50 nonprofits in Maine, developing solid financial strategies to strengthen organizations. Ms. Robbins spoke at the forum on the timely subject of how CFOs can help their organizations adapt to chaotic times and continue their impact in a new era.

Ms. Robbins has a singular ability to break down strategy and turn it into something relevant and actionable for nonprofits. In the nonprofit world, the accounting tends to get sidelined, because no one considers profit and loss to be driving the activity. The statements are being prepared, but they don't have any use except to help the nonprofit comply with regulations.

That's a mistake, according to Ms. Robbins. The financials should be used for more than just external reporting. They are a powerful tool that CFOs can use to educate leadership and inform strategic decisions.

In Ms. Robbins A-B-C system for nonprofits (Articulate & Align the mission and values, Build the right business model, and Cultivate & Communicate strategy), the CFO's role is to communicate the full story about the organization's income and expenses, and to highlight the activities and the cost centers that affect financial sustainability.

When is the right time for an organization to think about strategy? Ms. Robbins advises nonprofits to revisit the strategy discussion even during chaotic times. Things that worked before won't always work going forward through rapid change. Just like when you're starting out or scaling up, rapid change is when you need to revisit the business model and make sure it's ready for a new era. *



Harpswell
CAPITAL ADVISORS, LLC

June 2022 Flash Report

Overview: The CPI was reported at 8.6% this month on a year-on-year basis — higher than expected. The capital markets reacted negatively to the news as recession fears continued to grow. Food price increases are at forty-year highs along with rising energy costs. In reaction to the report, the Fed raised its benchmark rate by 75bps, increasing the Fed Funds rate to between 1.5% - 1.75%. Higher interest rates have resulted in higher costs for consumers to get a mortgage, obtain a loan to buy a vehicle or to carry a balance on a credit card. The housing market is already seeing the effects as it begins to cool. Further exacerbating the inflation picture is the continuing war in the Ukraine and ongoing supply chain issues. Oil supplies remain constrained as demand surged, adding to the problem. However, experts see signs of demand destruction as historically high gas prices begin to impact driving habits.

Equities: Domestic – June was a difficult month for equities as recession fears weighed on investors as the Fed vowed to aggressively fight inflation.

S&P 500 lost 8.3% in the month, resulting in a 20% shortfall YTD. Energy and Materials were down significantly although all sectors ended with losses. Lg Value lost 8.7% while Lg Growth fell 7.9% bringing the YTD losses to 28.1%.

The **R2000 lost** 8.2% in June resulting in a 23.4% loss for 2022. In the month, Small Growth was down 6.2% while Value fell 9.9%. Growth has lost 29.3% in 2022 compared to a loss of 17.3% for Value.

International – EAFE was down 9.3% in June. The Dollar surged as interest rates rose, lowering returns by 3% in the month and by 8.4% YTD. Germany, France and Italy all had double digit losses in the month.

Emerging Mkts lost 6.6% in June resulting in a 17.5% decline YTD. The stronger Dollar negatively impacted returns by 2.1%. China posted a 6.6% gain in the month, partially offsetting losses in other regions. In 2022, China has lost 11.2%. Latin America had a difficult month, falling 17% with Brazil down 19% although the country's results remained positive for the year by 2.9%.

Fixed Income: Short term rates continued to rise in June following the Fed's 75bp rate increase and the prospect of continued rate increases in the foreseeable future. The spread between the 2 Yr. and 30 Yr. **Treasuries** was only 23bps as the yield curve continued to flatten.
The **90 Day T-bill** rate rose by 59bps to 1.63%**.** The **10 Year Treasury** yield rose by 15bps to 3.01% and the **30 Yr. Treasury** yield closed at 3.18%, 22bps higher.

Municipal yields moved modestly higher in June, following the rise in Treasuries. The **1 Year Municipal** yield rose by 6bps to 1.64%. The **30 Year Municipal** yield was higher by 35bps to 3.3% trading at a 7bps or 2% premium versus the **30 Year Treasury.**

International: **German** rates remained positive, rising to a 0.61% yield for the **2 Year Bund** and a 1.33% yield for the **10 Year**. The **UK 10 Year Gilt** yield rose by 13bps to 2.2%. The **Japanese 10 Year Gov't** bond yield was unchanged to yield 0.2% in June. The **2 Year** Yield became slightly less negative by 2bp to close at -0.07%.

High Yield bonds lost 6.7% in June, closing with an average yield of 6.7%. The Aggregate Bond Index fell 1.6% in the month as longer rates moved higher, reflecting an approximate yield of 3.6%. Duration is 6.6 years. The Index has lost almost 10.4% in 2022.

	1 Month	3 Months	YTD	1 Year	3 Years	5 Years
Domestic Equities						
Dow Jones	-6.6%	-10.8%	-14.4%	-9.1%	7.2%	10.0%
S&P 500	-8.3%	-16.1%	-20.0%	-10.6%	10.6%	11.3%
Russell LG Value	-8.7%	-12.2%	-12.9%	-6.8%	6.9%	7.2%
Russell LG Growth	-7.9%	-20.9%	-28.1%	-18.8%	12.6%	14.3%
Russell 2000	-8.2%	-17.2%	-23.4%	-25.2%	4.2%	5.2%
NASDAQ	-8.7%	-22.3%	-29.2%	-23.4%	12.2%	13.5%
MLP Index	-14.0%	-7.4%	10.0%	4.3%	0.1%	-0.3%
REIT Index	-7.1%	-14.7%	-19.2%	-5.9%	5.3%	6.8%
International Equities						
EAFE	-9.3%	-14.3%	-19.3%	-17.3%	1.5%	2.7%
EAFE Small Companies	-10.9%	-17.5%	-24.5%	-23.6%	1.5%	2.1%
Emerging Markets	-6.6%	-11.3%	-17.5%	-25.0%	0.9%	2.6%
China	6.6%	3.5%	-11.2%	-31.7%	-0.4%	2.3%
Fixed Income						
US Agg	-1.6%	-4.7%	-10.4%	-10.3%	-0.9%	0.9%
US High Yield	-6.7%	-9.8%	-14.2%	-12.8%	0.2%	2.1%
Municipal Bonds	-1.6%	-2.9%	-9.0%	-8.6%	-0.2%	1.5%
Currencies						
EURO	-2.5%	-5.7%	-8.0%	-11.7%	-2.8%	-1.8%
British Pound	-3.7%	-7.5%	-10.2%	-11.9%	-1.5%	-1.4%
Japanese Yen	-5.3%	-10.6%	-15.2%	-18.2%	-7.4%	-3.6%
Commodities						
Bloomberg Commodity	-10.8%	-5.7%	18.4%	24.3%	14.3%	8.4%
S&P GSCI Crude Oil	-5.7%	10.0%	54.9%	65.2%	1.7%	6.4%
Gold	-2.1%	-7.6%	-1.5%	1.3%	7.0%	6.6%

Commodities: WTI Crude Oil fell by $8.8/barrel to $106.1/barrel in June. Recession worries and concerns over demand destruction resulting from higher fuel prices as well as continued lockdowns in China due to Covid weighed on energy prices. The US continued the release of 1 million barrels of oil per day although global supplies remain tight as the war in the Ukraine continued. **Gold** prices fell again by $32/oz to close at $1807/oz. similar to last month's price movement. Investors are reacting to rate hikes by the Fed which has resulted in a much stronger Dollar and higher Treasury yields, increasing the opportunity cost of holding gold and depressing prices.

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Index Definitions

The S&P 500 Stock Index is an unmanaged market capitalization index of 500 US equities generally considered to be representative of US stock market activity. The Morgan Stanley Capital International World Index is a market capitalization-weighted equity index of over 1,500 stocks traded in 22 world markets. The NASDAQ Composite Index measures all NASDAQ domestic and non-U.S. based common stocks listed on the NASDAQ Stock Market. The Index is market value-weighted. The SB World Bond Index is a market capitalization weighted index of 18 Government bond markets composed of sovereign debt denominated in the domestic currency. The Lehman Aggregate Index is a benchmark index made up of the Lehman Brothers. The Hennessee Hedge Fund Indices® are calculated from performance data obtained from publicly available information, internally developed data and other third party sources believed to be reliable. MSCI EAFE is a stock market index that is commonly used as a benchmark for the performance of major international equity markets. The MSCI Emerging Market Index is an index created by Morgan Stanley Capital International (MSCI) that is designed to measure equity market performance in global emerging markets. The Russell 1000 seeks to track the investment results of an index composed of large- and mid-capitalization U.S. equities. The Russell 2000 seeks to track the investment results of an index composed of small-capitalization U.S. equities. The Russell 2500™ Index measures the performance of the small to mid-cap segment of the U.S. equity universe, commonly referred to as "smid" cap. The Barclays Capital Global Aggregate Bond Index is designed to be a broad based measure of the global investment-grade, fixed rate, fixed income corporate markets outside the United States. The Barclays Capital US Gov/Credit bond Index measures the performance of U.S. Dollar denominated U.S. Treasuries, government-related and investment grade U.S. corporate securities that have a remaining maturity of greater than one year.