July 2022

Dear Clients and Advisors,

During a very challenging market environment, Corbyn's investment approach helped insulate client portfolios in both equity and fixed income strategies from the more extreme volatility experienced by many investors. Throughout the first half of the year, mounting economic and geopolitical uncertainties, combined with rich asset valuations, higher inflation, and increasingly restrictive monetary policy led to historic price declines in many market indices. For example, the S&P 500 experienced its worst first half of the year since 1970 (-20%) and the Nasdaq since 2002 (-30%). Fixed income securities, in stark contrast to their reputation as safe havens, also suffered large losses, with the Bloomberg U.S. Aggregate Bond Index (often considered the bond market equivalent of the S&P 500) dropping by 10.3%, its worst first half since its inception in 1975.

Markets are struggling to gauge the impact of myriad economic and geopolitical uncertainties on corporate earnings and asset prices. The Federal Reserve (the "Fed") is in the process of reversing the substantial monetary stimulus provided during the pandemic by raising the Federal Funds rate to its highest level in several years in an aggressive effort to slow what has become persistently higher-than-expected inflation. The resulting decline in consumer purchasing power and increase in borrowing costs have caused investors to reexamine prior expectations for economic activity and security valuations. The market volatility stemming from this shift in sentiment creates a very uncomfortable environment for many. Through our years of investing, we have learned that when dealing with volatile markets, emotional responses can be detrimental. By staying grounded in a long-term investment discipline, we strive to avoid the pitfalls of emotional investing and methodically take advantage of market turbulence to ensure that our clients are well-positioned for the subsequent recovery and the long term. We believe our discipline helped the portfolios perform better than the overall markets during the first half of the year and leave them in a good position for the future.

Fixed Income

Fixed income markets continued their pullback during the quarter with significant volatility, as investors weighed the combination of persistently high inflation and a more hawkish Fed against fears that higher interest rates could eventually cause a recession. Longer duration bonds suffered the greatest losses in the second quarter as the 10-year Treasury yield rose from 2.34% to 3.01% (representing a 5.6% price decline) and the Bloomberg U.S. Aggregate Bond Index fell 4.7%, adding to the first quarter's 5.9% decline. Fortunately, Corbyn-managed fixed income portfolios, despite being down slightly during the quarter, again outperformed the broader bond indices as our defensive positioning in the shorter duration and higher quality portion of the high yield market successfully created less volatile portfolios.

The Fed, already having become increasingly hawkish going into the end of the first quarter, grew more concerned during the second quarter after key inflation indicators came in hotter than expected. As a result, the Fed raised the Federal Funds rate by 50 basis points at the May meeting and another 75 basis points in June with current expectations anticipating further significant Fed Funds rate increases in the second half of the year. The move in rates drove a huge shift in the policy-sensitive 2-year Treasury bond, driving its yield from 2.33% up to 2.95%.

At the same time, concerns about a Fed-induced recession and global slowdown have gained traction, sparked by weakening consumer spending, shortfalls in corporate earnings and a pullback in metals and other economically-sensitive basic materials prices. These fears caused sentiment across the credit markets to turn increasingly cautious and credit spreads widened over the course of the quarter. As a result of both higher yields and credit spreads, the Bloomberg U.S. Corporate High Yield Index is now down over 14% year-to-date.

As we look forward, we continue to see attractive opportunities in the short-duration, high-yield fixed income markets. The expectation for further increases in the Federal Funds rate, against a backdrop of growing fears of recession, has created volatility, but, using our careful security selection process, we are excited to be able to add securities to client portfolios at substantially higher absolute yields and wider spreads than in recent years. While the size and shape of a potential recession remains unclear, we have focused on bonds of businesses with balance sheet flexibility and resilient business models that are capable of withstanding both a significant economic slowdown as well as continued turmoil in the capital markets.

Equities

For years, we have discussed the potential risks associated with the euphoria created by easy monetary policy and ultra-low interest rates. Investors, searching for aggressive returns and often overvaluing "growth at any price" companies, bid up certain sectors of the market to exorbitant levels. Watching this exuberance around high growth companies with little earnings was admittedly frustrating; however, the first half of 2022 reminds us of what often follows these types of markets. As in virtually every prior case of stock market excesses, the most inflated asset classes decline the most once uncertainty creeps back into the financial markets, while investors that maintained a more rationale discipline weather the volatility far better. With the recent era of very low interest rates and easy money seemingly coming to an end, we are, not surprisingly, seeing the greatest declines in securities of companies that previously benefited the most.

Since our founding nearly fifty years ago, keeping a long-term perspective has been one of Corbyn's investment hallmarks. This can be particularly difficult during challenging markets when it is human nature to want to "cut and run." But history has shown that trying to time the markets is a difficult proposition that most often leads to lower long-term returns. That does not mean, however, that a passive approach is the answer. Whenever there is market volatility, positive or negative, we act to improve the quality of our portfolios. We are looking for opportunities to capitalize on the current market volatility by trimming position sizes on strength and adding to positions on weakness, while searching for interesting long-term investments that may be getting overly punished. We see our core fundamental principles becoming increasingly relevant now as the capital markets begin a path toward normalization, with less "easy money" Fed policies. We continue to prioritize companies with secular or company-specific demand drivers and market leading positions that can better offset general macroeconomic softness and preserve profitability.

Strong balance sheets and high free cash flow generation allow a capable management team to create shareholder value from a position of relative strength. Combined with our keen attention to fair valuation, these types of investments should position the portfolios with a certain margin of safety, helping to provide a level of protection during market volatility and allowing for solid participation in an eventual market recovery.

Unfortunately, we do not possess the proverbial crystal ball about short-term movements in the markets. However, we are encouraged that the equity markets seem to be continuing to return to an environment where fundamentals are more strongly driving security performance. As a result, our fundamentally-driven investment process, in equities and fixed income, should lead to solid long-term, compounding returns for our clients. The portfolios are packed with securities of companies that, we believe, are in the enviable position of being able to create value over time, even if it is not immediately reflected in the current price. As economic and monetary conditions change, investors seem to be more attracted to reasonably-priced securities, of any market capitalization, of well-managed companies with strong balance sheets, profitability and free cash flow generation.

We know these are challenging market times and are here to help in any way possible. Please contact us at any time to discuss your investment portfolio or how we may be able to help you navigate this rapidly changing market landscape.

Respectfully,

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