October 2022

Dear Clients and Advisors,

While not immune to pervasive market pressures, Corbyn's conservative, fundamentally-driven investment philosophy drove continued year-to-date outperformance relative to broad market indices during the third quarter, highlighted by positive performances from most of our fixed income investments. Macroeconomic issues drove much of the market action during the quarter as expectations for monetary policy and its resulting impact on interest rates and economic growth whipsawed dramatically over the summer. As a result, bond and stock prices were both volatile and highly correlated during the quarter, ultimately resulting in a third consecutive quarter of declines for most stock and bond market indices. While useful in providing context, outperforming market averages is of little consolation to us given the magnitude of year-to-date declines across asset classes, and we are working intently to ensure all Corbyn accounts are well-positioned for the long term.

The third quarter started on a high note as equity and fixed income markets rallied amidst better-than-feared second quarter corporate earnings reports and isolated data reports indicating that inflation may have peaked. This stoked hopes that the Federal Reserve (the "Fed") would slow the pace of interest rate hikes, thus diminishing the likelihood of a painful economic correction. However, this optimism subsequently faded as ensuing data indicated that employment markets remained tight and high rates of inflation stubbornly persisted. Separately, global growth concerns were exacerbated by continued intermittent lockdowns in China to combat small outbreaks of COVID and the growing energy crisis in Europe precipitated by the Russia/Ukraine conflict. The equity market decline accelerated and Treasury yields surged higher following the Fed's meeting on September 21. In addition to the widely expected 75 basis point federal funds rate increase (for a total increase of 150 basis points during the quarter), the Fed increased forward guidance for the terminal fed funds rate to a higher-than-expected range of 4.375%-4.875%. Fed commentary indicated a clear priority for a "higher for longer" rate environment to tame inflation even at the expense of lower economic growth. Once again, these comments ignited fears of a potential interest rate-driven recession, resulting in valuation compression across the equity market, higher corporate bond credit spreads, and the highest Treasury yields in over ten years.

Fixed Income

Corbyn's fixed income strategy performed much better than the broader bond market indices during the quarter, delivering flat to slightly positive returns, while the Bloomberg US Aggregate Bond Index dropped by 4.75%, bringing its year-to-date performance to a loss of 14.61%. The high yield corporate bond market fared better during the quarter, with the Bloomberg US Corporate High Yield Bond Index down only 0.65%, although the index is still down 14.74% for the year. Corbyn's focus on shorter-duration securities of higher-quality high yield issuers has continued to drive portfolio performance that has been far more stable than the major bond indices during this period of sharp volatility in the fixed income markets.

In addition to the significant moves in absolute Treasury yields, the yield curve continued to invert, with the 2-year Treasury ending the quarter yielding 4.28% while the 10-year moved to 3.83%, with the 45-basis point difference equaling one of the largest inverted yield curves in more than 20 years. This dynamic reflects the market expectation that the accelerated pace of monetary tightening will ultimately lead to lower economic growth, pushing the Fed to ease monetary policy and pivot to lowering rates.

Despite a less active new issue market, the fixed income accounts had several holdings redeemed by issuers during the quarter, driven largely by company-specific catalysts, including both event-driven (M&A) and organic credit improvement. These redemptions provided funds during the quarter that allowed us to further capitalize on market weakness and the higher yielding environment. While we expect the market to remain volatile for at least the balance of the year, we are excited about the attractive return opportunities we see in the short duration high yield market. With prevailing absolute yields higher than what has been available in many years, combined with wider spreads over Treasury yields, potential total returns are far superior to those available during the last several years. Importantly, however, we continue to utilize our bottoms-up fundamental analysis and issue-specific underwriting to identify what we believe are attractive risk / return opportunities, given the current challenging macroeconomic backdrop.

Equities

The third quarter, as well as all of 2022, has been a difficult period for equity market investors. The equity holdings within the Corbyn portfolios performed relatively in line with the broad market indices during the third quarter, but on a year-to date basis have performed much better than the 24% decline experienced by the S&P 500. This equity performance, combined with varying degrees of equity exposure within the various Corbyn mixed asset account strategies, helped to reinforce the value of a balanced approach to investing, as the bonds held within the portfolios helped to buffer the accounts from the severe market turbulence.

Equity market participants are currently struggling with two fundamental questions – what will corporate earnings be and how should these earnings be valued? Virtually every company is experiencing some level of pressure on its business, whether it be from slower discretionary consumer spending, continued supply chain disruptions, or high raw material and labor inflation, just to name a few. As a result, investor confidence in the ability of a company to meet earnings expectations is lower than normal, resulting in a reduction in the price an investor is willing to pay for future projected earnings. Further complicating the valuation issue is the recent increase in interest rates. Higher interest rates not only compete for investor dollars, they also serve to exert downward pressure on business valuations as future cash flows are discounted at higher rates. This valuation adjustment has been felt most acutely in the severe declines seen within the highest-growth and most-speculative areas of the equity market, which we have avoided, and continue to avoid.

The dramatic breadth of the price declines within the equity market this year has resulted in companies within virtually all sectors and industries trading at lower prices. While part of this price correction is a function of higher interest rates, it is quite likely that the current lower valuations are already "pricing in" a significant amount of future earnings risk. In addition, signs of extreme negative investor sentiment and fatigue are beginning to show up in certain data, which can be a key signal that market prices are already discounting much of future bad news. In this type of environment, market timing, with a "wait-for-the-bottom" mentality, can be self-defeating, especially when taking a longer-term investment view. One only needs to look back at past negative events (recessions, the COVID pandemic, etc.) to see that markets typically bottom before economic conditions trough, in anticipation of an improving future.

As fundamentally-driven investors, broad-based declines with little company-specific differentiation can be frustrating in the short term, but often do not alter longer-term trends and results. Continuing to scrutinize the sustainability of company-specific fundamentals and catalysts is at the forefront of our daily efforts and is of paramount importance. In that regard, we remain confident that our investments in well-run, domestically-oriented companies with strong balance sheets and solid underlying businesses should continue to provide a degree of near-term insulation and strong long-term returns. In addition, in contrast to much of the last several years, the recent uncertainty has reduced valuations significantly, and we are actively searching for new investment opportunities where the market may be overreacting. We are prepared to be patient but will always look for ways to improve the portfolios in our efforts to maximize long-term success.

We appreciate your trust in Corbyn during this challenging year. Please reach out to us at any time as we all navigate these rough waters.

Respectfully,

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