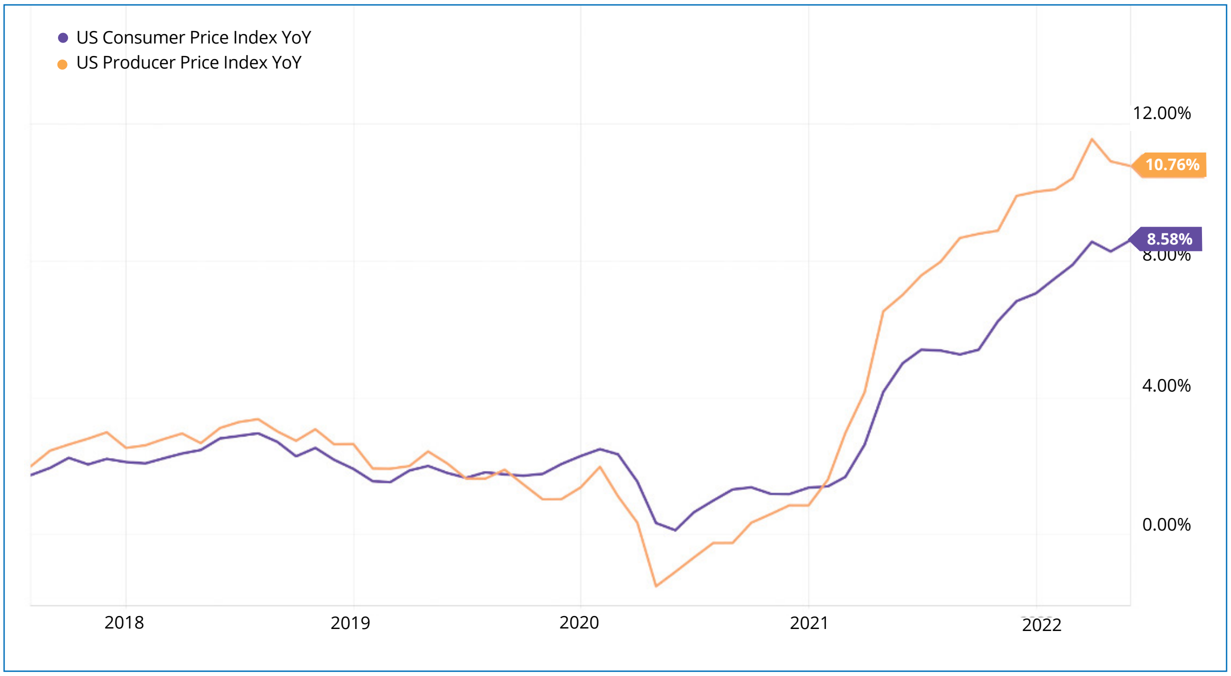
Q2 2022

Risk Matters. Defense Matters. Discipline Matters.

WHAT HAPPENED:
SECOND QUARTER 2022

Financial markets finished 2021 on a high note for both equities and fixed income. Six months later, equities finished the worst half of a year in more than fifty years while most fixed income sectors had double-digit declines.

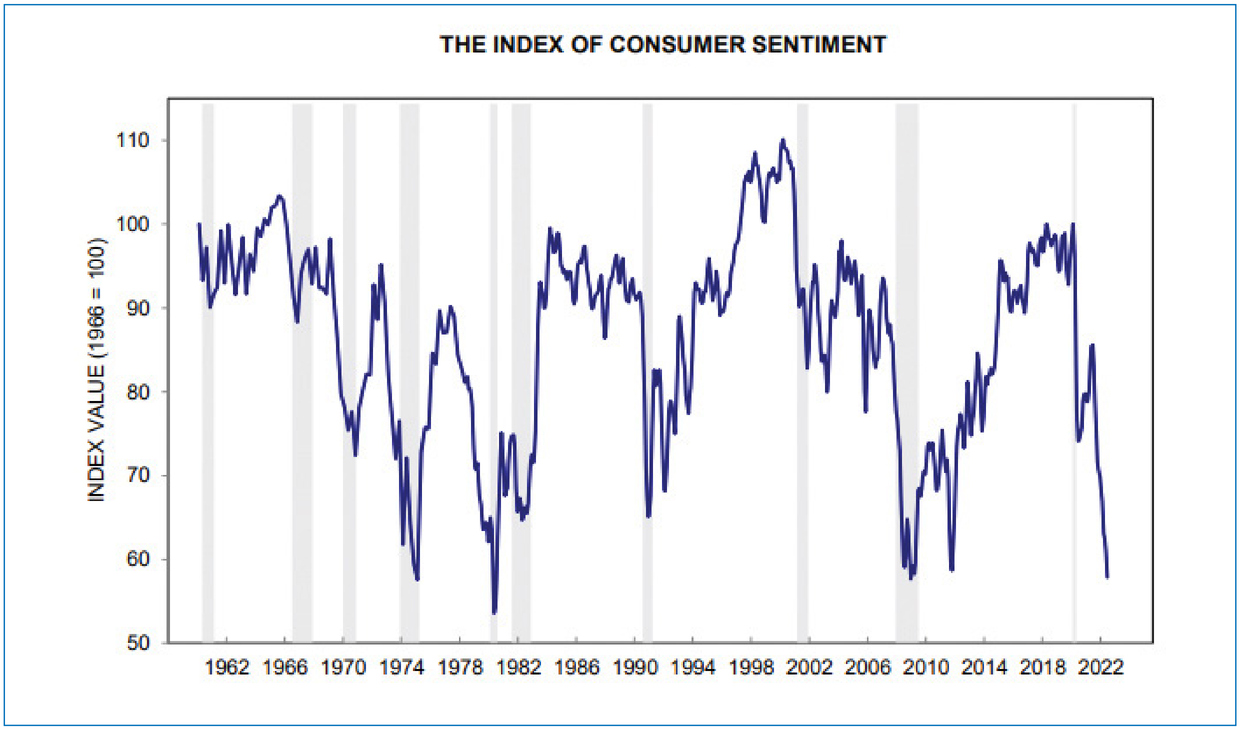
The Federal Reserve (the "Fed") ignored rapidly rising inflation in 2021 and early 2022. But even the Fed was shocked by the inflation numbers released in June. Consumer prices rose 8.6% year-over-year, the highest rate since the 1980's. Producer prices rose double-digits. The spike in inflation forced the Fed to raise the Federal Funds Rate by 0.75% in June and it has signaled it will do the same at the July meeting.



Source: YCharts

Financial markets and the Fed both came to the realization in the first quarter that the Fed waited too long to act and now must be aggressive to 'catch up.' The Fed is now in a full retreat from their stimulus of the past several years. They will now rapidly reduce their Treasury positions and markets now expect at least a 3.25% Fed Funds rate at year-end.

In the meantime, consumers' confidence in the future has been badly damaged by the surge in inflation. The University of Michigan surveys consumers on a monthly basis, measuring their feelings about their financial health, the economy's health, and the prospects for long-term growth. As seen below, U.S. consumers' views on their finances and the economy are not just low, but at the lowest level in more than forty years. This is concerning.



Source: University of Michigan

The Fed's sudden and sharp change in policy has since led markets to worry more about a potential recession than inflation. 10-year Treasury yields peaked at 3.5% in mid-June but closed the month below 3%. Commodity prices, according to the Bloomberg Commodity Index, fell 15% in June alone. Both are signs that investors are worried about a recession. The risk premium that investors receive for High Yield Corporate Bonds jumped up sharply early in July. This also suggests that investors are worried about an economic downturn and the potential for future bond defaults.

WHAT WE DID:
INVESTMENT DISCIPLINE MATTERS

Volatility in financial markets remained high in the second quarter as both equity and fixed income asset classes had a second negative quarter in a row.

Fixed income-oriented Strategies were mostly or fully allocated to cash at the end of the first quarter due to Sell signals from rising interest rates. The Conservative Allocation Strategy and the Moderate Allocation Strategy had lower cash allocations primarily due to their positions in equities. The Ocean Park investment team, as always, reviewed each position in our Strategies on a daily basis last quarter, looking both for Sell signals in any of our positions as well as new Buy signals to purchase. Continued losses in both equities and fixed income during the second quarter resulted in many more Sell signals than Buy signals during the second quarter. As a result, all of our Strategies again ended the quarter with significant cash levels.

The first half of 2022 was a strong test of managers' abilities to mitigate large drawdowns. There were very few places to hide, as fixed income and equity asset classes fell sharply and commodities and other sectors that moved up in the first quarter gave back some of their gains in the second quarter.

Ocean Park's process was successful mitigating drawdowns in the second quarter and year-to-date. All of our Strategies have negative returns for the quarter and year-to-date but have generally outperformed their benchmarks by large margins.

As we move forward in the second half of 2022, financial markets are likely to remain volatile as markets are faced with several continuing issues: a Federal Reserve that suddenly turned hawkish, inflation that is not just high but the highest since 1980, and the largest war in Europe in over 50 years. Ocean Park's tactical, rules-based investment approach to managing portfolios is well-suited to react to changes in future market conditions, whether they are positive or negative.

HIGHLIGHTED STRATEGY:
OCEAN PARK TACTICAL BOND STRATEGY

This Strategy uses a rules-based approach to shift between high yield corporate bond funds and long-maturity Treasury bonds, depending on the trends in the High Yield Corporate Bond (HYCB) funds.