SEM's Quarterly Newsletter

ENCORE

Fall 2022

Nowhere to hide

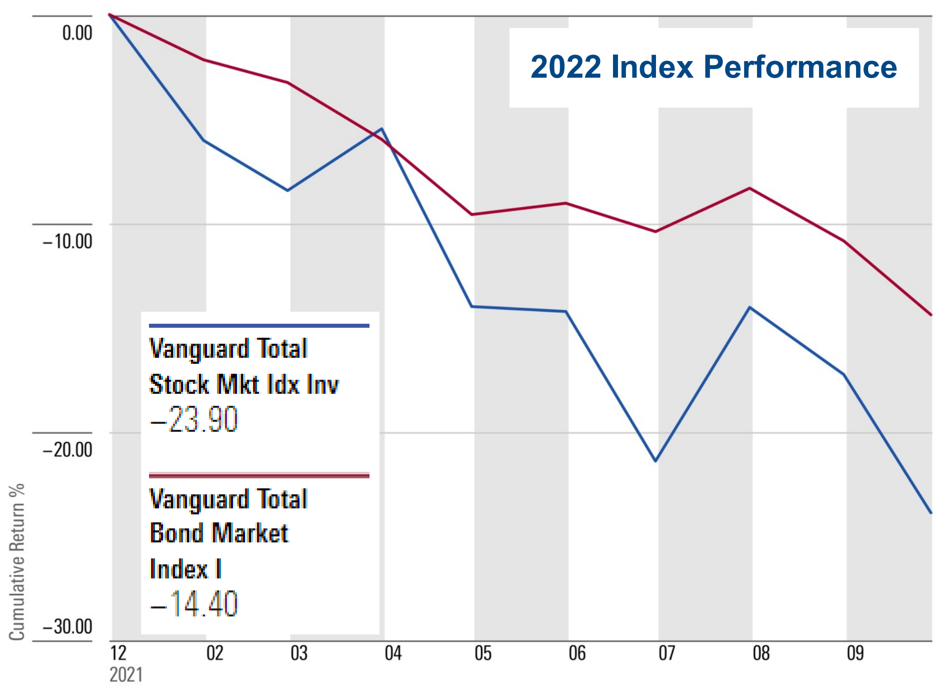
If we were to cover all of the various things which moved the market this year—why they happened, what it means for the future, where we see things going, this newsletter could be dozens of pages. Instead, this chart sums it up. Stocks and bonds are both declining, something which has not happened over this long of a timeframe since the 1970s.

This is a new environment for most, which makes our quantitative approach especially useful.

For over 30 years our data driven approach has helped us navigate all types of markets. The markets are moving quickly. We will continue to watch the markets daily and adjust accordingly.

For the latest updates throughout the quarter go to:

TradersBlog.SEMWealth.com



SOURCE: Morningstar Direct | Results are the monthly returns in 2022 through 9/29, including dividends of two Vanguard Index Funds with dividends reinvested | Past performance is not a guarantee of future results. This is not a recommendation of SEM to buy or sell these funds. They are used as an illustration of the performance of the overall US Stock and Bond markets.

How bad can it get?

A year ago we wrote about the many questions facing the market. It is probably hard to remember, but back then seemingly every asset class was rising, and it was a surprise when the market was lower even for one day. Our main concern back then was whether or not the economy, which benefited from massive stimulus in 2020 and 2021 via both Congress and the Federal Reserve could stand on its own. We also pointed out how the market was significantly overvalued when compared to historic norms.

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-????	20%+	9 (0.7 yrs)	????	????

SOURCE: Morningstar Direct; Results are monthly numbers and include dividends; Past performance is not a guarantee of future results

Our core belief is human behavior drives stock and bond prices. Due to our natural behavioral biases, we will see overreactions in BOTH directions. This leads to strong bull markets which go up too far, too fast relative to the underlying fundamentals, followed by strong bear markets which go down too far, too fast relative to the underlying fundamentals. The market was long overdue for a bear market.

The question now is how bad will it get and how long will it last. The table to the left looks at the past three bear markets. Going back to 1900 research from Ned Davis Research (NDR) shows the average bear market sees a decline of 27% which lasts nearly 12 months. Breaking it down further NDR found a stark difference between bear markets which included a recession and those which did not. With no recession, the average loss was 25% over 8.5 months, but **if a recession also occurred, the average loss jumped to 42% and lasted for 19.2 months.**

Surviving a Bear Market

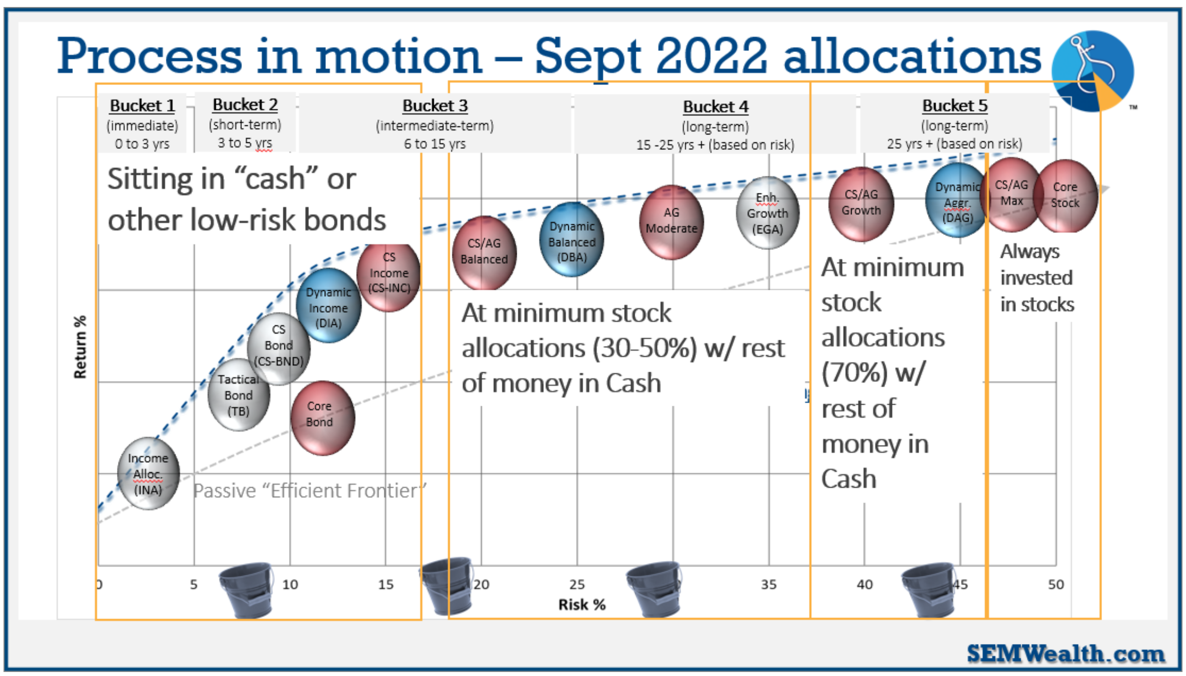
On the surface, all bear markets are caused by different things. Most of us remember the tech bubble bursting or the financial crisis created by the housing bubble which leads us to compare the current environment to those past two bear markets. When we find things that are "not as bad as back then", our brains are programmed to believe the market will not be as bad as those past bears. This is a mistake.

In fact, all bear markets are caused by the same thing — human emotions. This means we can follow a data-driven approach to help us monitor the bear market because humans naturally make predictable mistakes. It doesn't mean we can miss all of the downside and jump back in when the market has reached a bottom. It does mean we can take steps to structure our investment portfolios to survive a bear market. This allows us to take advantage of the bull market on the other side.

Knowing bear markets are an inevitable part of investing, there are three things you can do to help survive a bear market:

1) **Know your true risk tolerance** — go to **Risk.SEMWealth.com** to take our short risk and objective questionnaire.
2) **Review the impact of a bear market** — We are firm believers in financial planning and using that as the basis for all investment decisions. Most financial plans can be put through a stress test to see if a bear market dramatically changes your plan. If you do not have access to this or want a second opinion, let us know at SEMWealth.com/Contact and we can assist.
3) **Develop a plan for any portfolio adjustments** — It may seem like it's too late to sell anything with the market down so much, but all bear markets bring counter-trend rallies. In fact, according to Ned Davis Research, 47 of the 50 biggest stock market rallies occurred inside a bear market. Based on history, we should expect several 10-20% rallies before the bear market reaches the ultimate bottom. If you have too much risk in your portfolio, the time is now to develop a plan.

If you are an SEM client, know we have already taken action throughout the year to survive this bear market. We are proponents of a "bucket" system which places money you need sooner in lower risk investment models. This leaves longer-term money in higher risk/higher potential return models. The illustration to the right highlights how we are positioned across our buckets. The key is we have a plan no matter which way the market goes next.



In case you missed it, please watch/read Navigating the Bear at

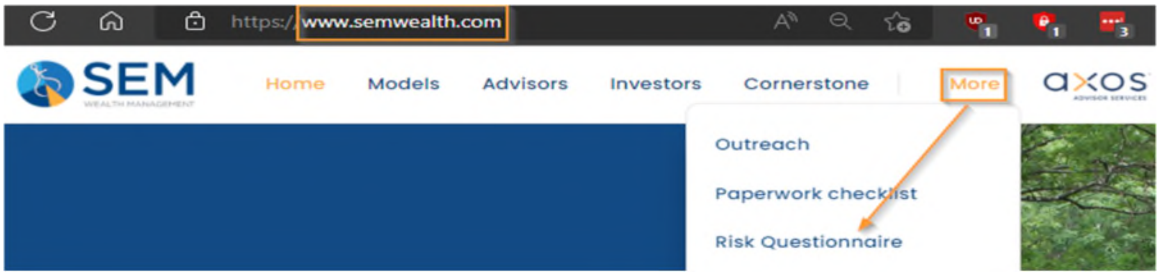
TradersBlog.SEMWealth.com/navigating-the-bear

What is *ENCORE*?
ENCORE is a Quarterly Newsletter provided by SEM Wealth Management. ENCORE stands for: **E**ngineered, **N**on-**C**orrelated, **O**ptimized & **R**isk **E**fficient. By utilizing these elements in our management style, SEM's goal is to provide risk management and capital appreciation for our clients. Each issue of *ENCORE* will provide insight into investments and how we managed money.

The Importance of "Suitability"

Each year the Securities & Exchange Commission (SEC) Rule 3a-4 requires SEM to request certain financial information from any client accounts we manage. In previous years SEM has mailed a 1 page form for clients to complete, sign, and return. This information is important for the management of your account, and we request clients to contact their financial advisor within 90 days if there are any changes to their financial situation.

This year we are asking clients to complete the information online through our website. Your responses will be shared with your financial advisor and reviewed to ensure the investments match the financial profile. To do this clients can go to **risk.semwealth.com** or click on the "**Take Our Risk Questionnaire**" at **SEMWealth.com.**



If we do not receive a completed questionnaire by 12/10/2022 we will assume your information on file is current.

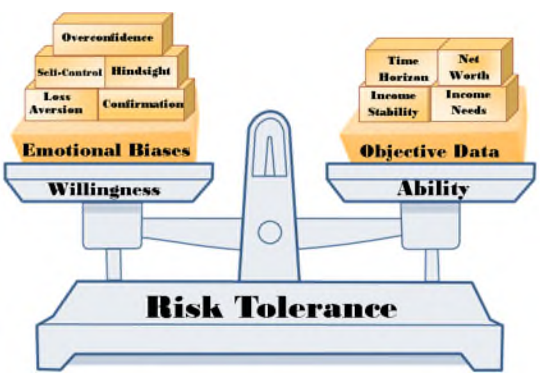
Creating a Customized Solution

Every investor has a unique set of circumstances that makes it difficult to find a pre-packed solution. SEM offers a wide range of investment models that are designed to be risk efficient for a broad range of investors. The key to long-term investment success is allocating your assets to the portfolio that best suits YOUR individual needs.

Step 1: Determine Your Time Horizon

Investing involves risk. Risk is essentially the volatility of returns during the time it is invested. While over the long-run an investment may have superior returns, over short periods of time the returns may be negative. The shorter the time horizon, the less risk a portfolio should have. Keep in mind different portfolios may have different time horizons based on the purpose of the funds. For investors taking income from their portfolio, separating the income portion into its own portfolio is a popular strategy.

Step 2: Determine Your Risk Tolerance



Risk tolerance is generally thought of how much risk an investor is WILLING to take. This is certainly an important determinant, but it is typically driven by EMOTIONS. Often investor feelings toward risk fluctuate with the direction of the market. The more important determinant is the ABILITY to take risk. The ability to take risk is determined by data, not emotions. While time horizon is one portion of a portfolio's ability to take on risk, other determinants are based on the individual situation.

There are numerous questionnaires, including SEM's, available to determine the WILLINGNESS to take risk. Your advisor can look at your overall situation to help you determine your ABILITY. Like Time Horizon, portfolios can be separated into different portions based on the purpose and objectives for that money.

Step 3: Understand Your Personality

Too often our industry places clients in portfolios using a pre-determined model based on age. Our behavioral approach understands that even if you have time on your side and the ABILITY to take on risk, if you are invested in a portfolio that does not fit your overall investment personality there will be times where you are not comfortable. Typically when we are not comfortable we are more likely to make an emotional decision.

Step 4: Determine Your Customized Portfolio Blend

SEM's Risk Questionnaire generates a blend that matches your time horizon, risk tolerance, and personality. It is designed to be a starting point with additional adjustments to be made to make the portfolio fit into the overall financial plan. You may already be in an optimized, custom blend of SEM models, but when you submit your questionnaire results SEM will send them to your advisor to review your portfolio and how it compares to your results. Upon review your advisor may work with SEM and possibly recommend a change to your investment allocations.

INVESTMENT POLICY STATEMENT

I. Scope and Purpose

CLIENT SUMMARY: This Investment Policy Statement (IPS) governs the accounts held in the attached statements. The client provided their current financial situation, including net worth, tax bracket, emergency assets, and annual income. The client may have also provided a personality profile to help identify possible areas to address when managing the account. The personality traits and experience of the client may impact the evaluation of the account as well as the types of investments that are appropriate.

RESPONSIBILITIES: The investment advisor is listed on the statement and has contracted with SEM Wealth Management to manage this account. It is the responsibility of the client and advisor to communicate any relevant changes to SEM immediately. The IPS should be reviewed at least annually. SEM will contact client once a year to confirm the current data included in this IPS.

CUSTODIAN: The custodian of the account will provide a monthly or quarterly investment statement approximately two weeks after the end of the period. The statement will include information regarding the activity in your account including security transactions and fee information. In addition to the printed statement, you may view your investments online at any time.

ADDITIONAL INFO: SEM's management fee is reported on your custodian statement. You should verify the fees charged for the management of your account match the agreed upon fees when you opened the account. To add money to your account, **make the check payable to the custodian** and send directly to SEM or your advisor. SEM or the advisor should be contacted for distributions from the account to ensure the proper forms are used.

II. Governance

ADVISOR RESPONSIBILITIES: The investment advisor and the client are responsible for selecting the appropriate SEM investment program allocation, taking into consideration the objectives, risk tolerance, time horizon, and any other relevant factors. In addition, the client's entire portfolio of investments should be taken into consideration when selecting an SEM investment program. **Client is responsible to report any significant changes in their financial circumstances to advisor immediately**. Advisor will then notify SEM and evaluate whether those changes necessitate a change in the investment program.

SEM RESPONSIBILITIES: Your advisor should have worked with you to determine which programs fit best with the overall return and risk objectives listed on the front. It is SEM's responsibility to manage all accounts in a given program in the same fashion and to remain consistent to the structure outlined at SEMWealth.com/Models. If SEM makes any material changes to the models SEM will notify the client and investment advisor of the changes. SEM may also suggest changes to the investment models selected based on reported changes in the client's personal financial situation.

III. Return and Risk Objectives

SEM is utilizing information provided by the client. Client should **go to Risk.SEMWealth.com to update the objectives**.

ASSET ALLOCATION: For a current asset allocation, log into your account online or check your account statement. For a full description of SEM's investment programs, please see the Models section of SEMWealth.com.

RISK: By nature investing is a risky endeavor as future results are not guaranteed. **In order to hit the stated return objectives, some risk will have to be taken**. In general, a reduction of risk also means reduced potential returns, which may necessitate an adjustment to the client's financial plan. The stated risk tolerance is a level the client would become uncomfortable with the portfolio. Exogenous events outside of SEM's control may cause the portfolio to exceed those losses. If the client becomes uncomfortable with the level of risk in the portfolio they should contact their advisor immediately to discuss their discomfort. During those times it is important to understand the impact emotions have on investment returns. In general, investors tend to reduce their risk tolerance during market losses and increase it during periods of rising stock prices.

INVESTMENTS: SEM utilizes mutual funds & ETFs to implement the selected investment program(s). Some of these funds will include the use of leverage and derivatives, but their use is taken into consideration with the overall portfolio allocation. SEM will also use a money market or other cash equivalent account at times. For additional details on SEM's management style, please consult our Disclosure Document which was provided with the opening of the account and is available at www.SEMWealth.com.

MISC ITEMS: Client may set up one-time or periodic distributions from the account. SEM will redeem the money pro-rata based on the current investments of the program. Client reserves the right to place reasonable restrictions on the management of the account, but this may limit SEM's ability to meet the return and risk objectives of the program. SEM does not vote proxies on behalf of clients.

IV. Evaluation and Monitoring

BENCHMARK: Each model factsheet lists the appropriate benchmark for the model. The purpose of a benchmark is to provide a comparison of a portfolio of unmanaged assets with a similar objective as the investment program. Investment markets move in cycles and in order to fully evaluate SEM's model(s), it is **important to compare it to the benchmark performance over a full market cycle (5-7 years, which includes both a bull and a bear market.)** In addition, the S&P 500 Index, while a popular benchmark in the media is not an appropriate benchmark for any of SEM's programs. The S&P 500 index only includes the top 500 US based companies. In order to reduce risk to a level to meet the stated risk tolerance levels, SEM must include a much broader range of assets than those in the S&P 500 Index.

PERFORMANCE REPORTING: The monthly or quarterly statement will provide performance for the overall account as well as for the individual investment models. **Client is encouraged to compare their portfolio performance to the benchmark of that model(s) over multiple time horizons**. If a model is meeting or exceeding its benchmark over those time horizons and client is unhappy with results, they are encouraged to consult with their advisor about moving to a higher returning SEM investment portfolio, taking into account the risks of that investment. Careful consideration should be taken to understand the role each investment model plays in the OVERALL CLIENT PORTFOLIO.

RISK ASSESSMENT: SEM's materials contain several return-risk metrics. One of our preferred risk statistics is the maximum drawdown as it shows how much the investment allocation has lost historically. The client's risk tolerance should be at least as high as the historic maximum drawdown number. Client and advisor should reconcile their risk tolerance to the Maximum Drawdown of the specific model and overall investment portfolio periodically. **When evaluating returns, client and advisor should consider the tradeoff between higher returns and higher Drawdown levels**.

REBALANCING: SEM will rebalance the portfolio to the model allocation each time a new allocation signal is generated or at least once a quarter. All accounts in each program are managed in a similar fashion and rebalanced simultaneously. Cash flows into or out of the account may impact short-term performance depending on market conditions.