Pittenger & Anderson, Inc.
REGISTERED INVESTMENT ADVISOR

P&A's Quarterly Letter

Quarter 4- December 31, 2022

Dear Friends and Clients,

Two thousand twenty-two was the toughest environment we've been through since P&A's founding in 1995, and quite possibly in our entire careers in the investment business. Historically, when stocks are having a bad year, bonds either hold their own or increase in value. That was not the case in 2022. Stocks, as measured by the S&P 500, closed the year down 18% while the Bloomberg Aggregate Bond Index, finished lower by 13%. This marked only the third time since 1926 that both stocks and bonds were down in the same year. You can blame inflation, the Federal Reserve, continued supply chain issues, excessive government spending, investor complacency…the list goes on.

The key story of 2022 from an economic and market standpoint for us was the Federal Reserve and inflation. For the better part of a decade, the Fed maintained an easy money policy, meaning they continued to pump dollars into the economy, while holding interest rates at or near zero, both of which are highly stimulative to the economy. Think gasoline on the fire or pedal to the metal.

Even as inflation began its ascent, the Fed remained hesitant to take away the proverbial punch bowl. At first, they said inflation was "transitory," meaning they didn't expect it to last. Months later, they acknowledged that inflation would be here longer than expected, and to counteract its persistence, they would need to hike interest rates more aggressively and for longer than the market expected. Rising rates act as a brake on the economy, and in 2022 the Fed slammed on the brakes.

In the end, the Fed's key interest rate gauge went from zero in January to 4.25%-4.5% by December, the fastest relative rise in interest rates ever. This had all sorts of knock-on effects for what had worked much of the past decade, specifically high growth stocks. When interest rates rise, the future value of a company's earnings must be discounted at a higher rate, which means their present value—or the price an investor is willing to pay—becomes less.

Expectations

Markets are driven by many factors: fear and greed, company earnings, interest rate levels, general economic conditions, consumer and investor sentiment, but above all they are driven by expectations. Whenever you see a big move in the markets, it's often driven by a resetting of expectations. In other words, expectations weren't confirmed by reality, so an adjustment needed to occur. You see this with a company's stock after they report earnings. For example, analysts expect a company to earn $3 per share and quarterly revenue to be $4 billion. The company reports $2.95 in earnings and $3.95 billion in revenue and their stock is down 12% in after-hours trading. Perception wasn't reality.

There are periods of time where good news is good news, good news is bad news, bad news is good news, and bad news is bad news. Sometimes this changes on a weekly or monthly basis. For example, in 2022, we went through several periods where bad news was good news because the markets interpreted that the Fed wouldn't have to raise rates as much as expected. We also went through periods where bad news was perceived to mean the economy was weakening, and while that meant the Fed might be able to lighten up on the economic brakes, it also meant that the economy was weakening, and what if the Fed can't get us to the soft landing they're targeting?

When life gives you lemons, make lemonade.

For those of you who are newer clients—within the last 3-5 years let's call it—with taxable brokerage accounts (individual, joint, trust), you likely saw us aggressively realize losses throughout the year. This is called tax loss harvesting and it looks like this… Say a portfolio owns a stock and it's down 20% from the purchase price. Say the investment manager likes another similar stock within the same industry just as much, so they sell the stock that is down 20% and purchase the comparable stock. The benefit to taking the loss while remaining invested in the market comes from transferring the loss from the portfolio to the tax return. Realized losses carry forward indefinitely, until future capital gains exhaust these losses. Taxpayers may also use up to $3,000 of realized losses per year against their ordinary income.

If you didn't see this activity in your account in 2022, you've likely been a long-time client who has a mature portfolio. Congratulations! That means all or almost all your investments are still at a gain, even a large gain from where they were purchased.

We view ourselves as legacy managers, meaning we don't care to sell great companies just because the market moves against them in the short-term. Our preference is to stick with them. A mature portfolio gives us the runway to do that. One important note for all clients with individual stock positions…we like to invest in profitable companies; businesses that make money, many of whom return a portion of their earnings to investors in the form of dividends.

A silver lining of the large increase in interest rates in 2022 is that cash once again has value. At that time, the 3-month U.S. Treasury was yielding 3.26%. As of this writing, the yield is now 4.64%. Over that same time, the 6-month T-bill went from 3.89% to 4.81%. If you're sitting on a pile of cash in the bank and you want it to work harder for you, let us know. We can help.

Your team

I'd like to commend our staff for all the work they did on behalf of you, our client, in 2022. I can tell you it's much more fun to come to work when the markets are trending higher, but we really earn our keep when times are tough. While you likely know or have contact with a Lead Advisor or Principal at our firm, I want to highlight the work done by our Service Advisors. In alphabetical order, they are Audrey, Elizabeth, Ema, Kristin, and Soren.

Whether it is setting up new accounts, ensuring every penny transfers over from a client's old custodian, tracking required minimum distributions (RMDs), facilitating Qualified Charitable Distributions (QCDs), assisting clients who are funding a new car or vacation--the list literally stretches into the dozens if not hundreds of tasks--our Service Advisors ensure that all operational tasks are tracking as they should. If you don't know who your Service Advisor is at P&A, we encourage you to ask your Lead Advisor to make the introduction. Our SAs keep P&A humming along.

Planning & service

While 2022 was a very difficult year from an investment return standpoint, our team worked their tails off attending to client cash needs, assisting with charitable requests, and providing great client service across the board. Here is a handful of ways we helped our clients in 2022:

- Required Minimum Distributions (RMDs) processed for P&A clients = 175
- Medicare drug plan/SHIP review meetings held for P&A clients = 67
- Number of clients for whom we updated their financial plan = 204
- Charitable contributions to a donor-advised fund (DAF) made by P&A clients = $1,143,000

Some of those numbers are down from the previous year, while some are up. The point being there's a lot that goes on behind the scenes in the way of client service, and this list just scratches the surface. We're all disappointed in the returns of the market, but we must continue to focus on what we can control. I'm proud of our team's efforts across the board.

With the passing of the Secure Act 2.0—there are a number of changes to the retirement planning landscape. One example…if you turn 72 in 2023 you will not need to take a required minimum distribution (RMD) in 2023. The RMD age has been pushed back to 73 years of age starting in 2023. Having an advisory firm who is on top of all these changes is paramount.

Now, a story about advertising, traditions, and perceptions…

When we opened the doors at P&A, I bought lunch for a couple friends of mine in the advertising business because I wanted help heading the company in the right direction. The best advice that fell out of that meeting was to underwrite on Nebraska Public Radio, which we've done for a long time now. NPR has provided great exposure for us and typically generates two or three valuable referrals annually. Most of these clients are the "millionaire next door" types, which is right in our wheelhouse.

A second development occurred in the mid-to-late 2000s, when we began to focus more on our digital presence. Our website had gone through a couple iterations already and we realized its potential to deliver prospects to our door. Around the same time, Google created a service called Google Analytics, which allows website owners to count the "hits" or pageviews generated by visitors to each page of their website…very valuable information. Now we were able to see which pages garnered the most attention, which ones didn't, and where visitors on our site traveled to.

Traditions…

Dan and I have always been devout fishermen as well as card players. Our card game of choice has always been 4-Point Pitch using Hollywood scoring (three games scored simultaneously).

Pitch is a card game that hails from the Upper Midwest—Kansas through the Dakotas, east to Illinois, then west back to Nebraska. We have a collection of fishing buddies from this region. They like to play pitch but aren't always fans of Hollywood scoring.

The rules of pitch are pretty much a hometown affair, so you need to figure out how the locals expect to play the game before you shuffle the deck. Few states, let alone two towns, agree. One summer night on a Canadian fishing trip, some of the guys got into a heated Hollywood scoring argument. One of the guys asked for a reference, at which time I said, "It's all on our website!" That stopped the argument for a while but also forced me to write the rules of 4-Point Pitch when I arrived home. It also became a standing joke. Every argument was resolved with an "It's on the P&A website!" cat call.

Publishing our rules of pitch turned out to be timely. Over the years, we've received website hits from a lot of "out of territory" card players. We even had one guy from New Jersey call me up to discuss Hollywood scoring over the phone. We didn't ask for nor expect this notoriety but there's no downside to being a long-distance pitch expert.

About this time, a couple of interesting things happened. We decided to bring the maintenance of the P&A website back in-house. We had used a communications firm for several years but weren't able to update or make changes on our own. A very clumsy process. One of the changes we made was to streamline the website to better address the value we bring to clients and to define for whom we wanted to work. A casualty of this process was my beloved pitch page on the website. I wasn't very happy, so I lobbied to have the page returned to the site under a "Just for Fun" section. JFF also included recipes, book & movie reviews, travel reviews, and more.

As I mentioned, we use Google Analytics. One day, our team noticed that over the last 60 days, the 4-Point Pitch page on our site had a lot more traffic than our HOMEPAGE!! How could this be? Our team said this would confuse Google as to what we were, a 4-Point Pitch reference or an investment management and financial planning firm?

Kind of like the fisherman explaining how big the fish was that he caught, here's my recollection of what happened next. I picked up the phone and called Google, which is kind of like calling Tesla and asking for Elon Musk…you need a lot of patience. Google finally answered and here is what they said:

- P&A: What happened to our financial services search ranking?
- Google: We now view you as a 4-Point Pitch site.
- P&A: How do we get back to the top of the financial services search page?
- Google: Get more hits to your financial services pages.

The only upside here was our confirmation as a 4-Point Pitch expert. I voiced my concern to our staff and a resolution was quickly at hand. The Hollywood scoring and 4-Point Pitch rules would be transferred to our blog instead of being a static page on our site. This had the double benefit of getting us back on the first page of search results for what we do for a living, while allowing us to retain our #1 Google search ranking for all things 4-Point Pitch.

Perceptions…

As you know, being a card table referee is not our primary line of work. P&A is a registered investment advisor, offering investment management and financial planning services to our clients. We hold ourselves to a fiduciary standard of care and charge one transparent management fee—our sole compensation. We offer the services described in our Form ADV (attached in the back of this report) and then tell our clients, "It's your job to get as much work out of us as you can."

Over the years we have found that these chores are simplified when we become involved and much easier to untangle should something go wrong…please let us help. In our former lives, Dan and I were stockbrokers, compensated transactionally every time we were asked to perform, which made the client hesitant to ask for our help.

Changing our business plan as well as our identity proved to be more difficult than we had imagined. Ten years after we opened the doors we were still being introduced by friends and long-term clients as stockbrokers. The stockbrokers, on the other hand, used that same timeframe to rename themselves as…you guessed it…financial advisors. Hats off to them; it was a good move on their part. Being called a financial advisor is far superior to being called a stockbroker. Our official title is Registered Investment Advisor, under which we are held to the aforementioned fiduciary standard of care for our clients. So, while stockbrokers became financial advisors, they didn't change their standard of care.

A fiduciary standard has fewer conflicts of interest and is <u>not</u> more expensive for someone like P&A to maintain. We believe our competitors could do the same thing. Maintaining a transactional and a fiduciary business plan would be conflicted, complicated and very hard to understand…we want no part of doing that. To that end, we have pledged to analyze and compare the cost of a P&A fiduciary relationship to any transactional or other relationship employed by competitors. This is part of our client onboarding experience related to retirement accounts. We also do a cost comparison when you roll over a 401k or IRA held elsewhere, even if you're already an existing client.

Simply put, you can't give unbiased advice for a transaction if you benefit from the results. It is my sincere hope to announce in this venue someday that the playing field has been leveled and it is safe to go back into the water. In today's environment, there are still too many sharks.

Conclusions…

No doubt you have heard the admonishment, "Be careful what you wish for…you just might get it." This letter is a pretty good look at that. The way we dealt with advertising had a fairly profound effect on some of the traditions we enjoy. Modifying both impacted a change in how our business plan was perceived, a rather long-term issue which we continue to be frustrated with.

Changing our business plan in 1995 was not done in "willy-nilly" fashion. It was done with very specific goals in mind.

1) We wanted an independent custodian that would provide us with a daily electronic download, utilizing the efficiencies and economies of the internet.
2) A fiduciary approach eliminating conflicts of interest.
3) A fee-only model that would streamline and simplify our approach.
4) Software that would generate performance and facilitate client inquiries.
5) Competitive pricing that would deliver savings for the client and P&A, a win-win relationship.

Charles Schwab became our custodian of choice at zero cost. Eliminating our previous employer, solidified the fiduciary approach and made doing fee-only business a piece of cake. Our first software provider was Advent, a decision that delivered the goods in a big way and lasted 15 years. Better IT and competitive pricing was a handshake deal; we compared new business plan to old, divided the advantage by two, gave half to the client in the form of lower prices and invested the rest in software and people.

The world according to P&A

As we discussed in the opening, last year was hugely disappointing. As we look to 2023—and more importantly, beyond—we "love" stocks. (For the new reader, our three levels of affection for stocks are "like," "really like," and "love.") Will there be ups and downs in 2023? Yes, there always are when investing. Will the economy weaken in the first half of the year? That seems to be underway now. Will there be a recession? Of course, there will be one, but no one knows when. Maybe we're already in one. If so, it doesn't change our investment process or philosophy. We focus on delivering long-term results to our clients. That means adding value whenever and wherever we can. We'll stay the course because that's the only way this works over the long-term. Anyone who tells you otherwise is most likely interested in selling you a product.

As always, we're here to help. If you or someone you know is going through a money-in-motion event, whether that's a retirement, business sale, or inheritance, and you want to get your ducks in a row, please reach out to us. We'll sit down with you (or them) and visit about your (or their) unique circumstances and then put together a proposal for how we can help. As with any referral situation, these meetings are completely confidential and handled with great care.

Until next time…

James S. Pittenger Jr. CFP®
Chairman/CEO