SUMMER 2022 | VOL. 30 | NO. 3
QUARTERLY PERSPECTIVE

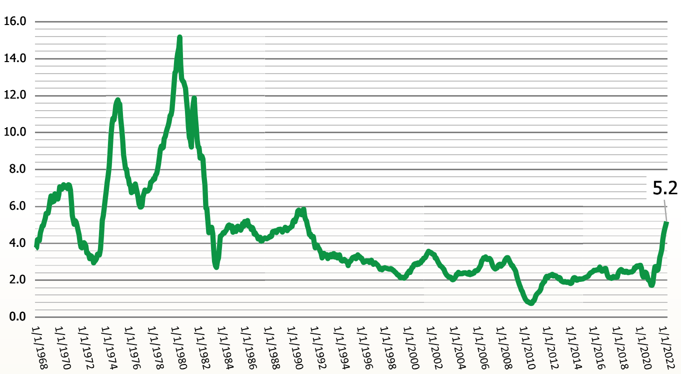
DVI
DAVID VAUGHAN INVESTMENTS

Will Williams *Chairman, President & CEO*

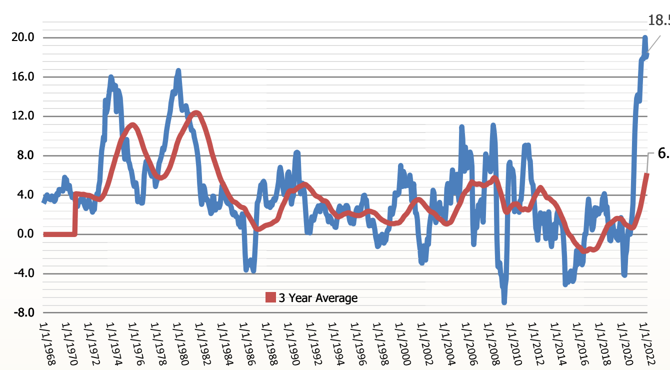
INFLATION - A STICKY SITUATION

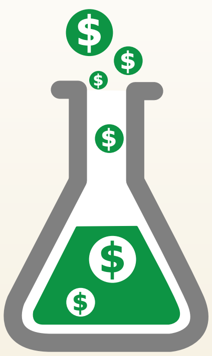
Many Years ago, the Federal Reserve Bank of Atlanta analyzed the components of the Consumer Price Index (CPI) and allocated them into two distinct buckets: (1) Flexible CPI and (2) Sticky CPI. The impetus behind this division was the realization that each CPI price component has unique characteristics in terms of both price volatility and frequency of price adjustments. By carving out products and services which tend to be far more volatile (Flexible CPI), the remaining index components (Sticky CPI) generally have a greater long-term inflation impact—and may even afford more predictive value regarding future inflation expectations. As the contrasting graphs below clearly depict, Sticky CPI tends to be far less volatile than Flexible CPI, and (with occasional exceptions) produces a much smoother trend line.

STICKY – CONSUMER PRICE INDEX



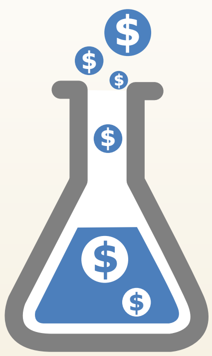
FLEXIBLE – CONSUMER PRICE INDEX





Sticky CPI Components

- Food - Dining Out
- Rent of Primary Residence
- Medical Care Services
- Recreation
- Education



Flexible CPI Components

- New Vehicles
- Motor Fuel
- N Gas and Electricity
- Lodging – Away from Home
- Meat, Poultry, Fish

Source: Federal Reserve Bank Atlanta

A FIRST HALF TO FORGET

To say that the first half of 2022 has been challenging for investors would be an understatement. During Q2, the S&P 500 (-16.45%) posted one of its three worst quarterly performances in 20 years – surpassed only by Q4 2008 in the midst of the financial crisis, and Q1 2020 when COVID lockdowns drove the market lower. It's interesting to note that during the financial crisis, the index bottomed on March 6, 2009 at 666. And do you know where the year-to-date S&P 500 low sits? At 3,666! Let's hope that's no coincidence and again signals that the devil's work is done with this market.

Most surprising to me, however, is that the first half of 2022 delivered the worst six-month performance for the S&P 500 in over half a century (since 1970). Nevertheless, my "Half Full" mindset certainly appreciates the impressive accomplishment of a 52-year market run between record six-month lows.

Looking ahead

As we look for indicators of where the market may head in the second half of the year, a number of fundamentals are on our radar. As I shared last quarter, corporate earnings and revenue growth will be critical. Reports from the first quarter largely met and in many cases even exceeded expectations. With the Federal Reserve having now raised their Fed Funds target rate to a range of 1.50% - 1.75% (and an additional 0.75% increase widely expected in July), gauging the impact of these higher rates on corporate earnings and revenue growth will be top of mind. Company results for the 2nd quarter are just now beginning to trickle into the market, and will prove a key data point for consideration. If corporate earnings show signs of softening, it's likely the market will further adjust lower.

Any signs of inflation moderating will also be critical. The current cycle of interest rate hikes isn't likely to cease until the Fed sees clear evidence that consumer and industrial prices are leveling off or even declining. The old adage 'Don't Fight the Fed' is quite clear in our minds. As long as the Fed continues tightening, financial markets will be facing a persistent headwind.

Lastly, there's the ever-present specter of recession. In fact, we possibly may already be in recession. Since the measurement is backward looking, we never know for certain until after the fact. By definition, a recession is "a period of temporary economic decline during which trade and industrial activity are reduced, generally identified by a fall in GDP for two or more successive quarters." I emphasized 'temporary' because recessions are historically very short-lived. The emphasis on 'fall' is for an even more important reason. If economic growth goes from 5% to 3% in successive quarters, we have a decline of 2% (a fall in GDP). Yet by all measures, the economy is still growing.

Michael Cembalest, Chairman of Market and Investment Strategy for J.P. Morgan Asset Management, suggests equity markets historically are already rising by the time a recession is underway. Historically, there's a 3-6 month lag between the time equity markets bottom and when GDP bottoms. Remember, the stock market is always forward looking (as the table below demonstrates).

Heading into the second half of 2022, we remain vigilant for attractive investment opportunities, but always within the context of our first priority – risk management. Preserving capital in declining markets never goes out of style.

Waiting for Godot: the opportunity cost of waiting for economic recovery before investing

Equity Market Bottom	GDP Bottom	Days in Between	Equity Market Return by the Time that GDP Bottomed	Equity Market Return by the Time that GDP Started Rising Again
3/31/2020	6/30/2020	91	20%	30%
2/28/2009	6/30/2009	122	25%	44%
10/31/1990	3/31/1991	151	23%	22%
7/31/1982	9/30/1982	61	12%	31%
9/30/1974	3/31/1975	182	31%	50%
12/31/1957	3/31/1958	90	5%	13%

Source: Bloomberg. JPMAM. 2022.the context of our first priority – risk management. Preserving capital in declining markets never goes out of style.

DVI ANNOUNCES PROMOTIONS

STEPHANIE RICKETTS

NEW CORPORATE OFFICER

The Board of Managers of David Vaughan Investments officially appointed Stephanie Ricketts, CFP® as an Officer of the company at the first quarter meeting. Stephanie is an industry veteran with over 25 years of experience in the financial services industry. She joined DVI in 2007 and quickly established herself as a hard-working and knowledgeable Senior Relationship Manager. As Director of Client Services, she has also shown strong leadership skills by overseeing Associates in both the Peoria and Winter Park offices.

"The Board of Managers and I are pleased to recognize Stephanie's recent promotion as a Corporate Officer and to celebrate her new status as a DVI shareholder," said Will Williams, DVI's Chairman, President & CEO. "Over the past several years, Stephanie has taken on the management responsibility of our growing Client Services Department and has provided superior leadership and direction to that group during extraordinary operating conditions. Moreover, she continues to provide our clients thoughtful insight and strategic financial advice as a Senior Relationship Manager. Stephanie is a welcome addition to DVI's leadership team and we look forward to her positive impact on the firm well into the future."

JEFF HUIZENGA

DIRECTOR OF WEALTH STRATEGIES

DVI is pleased to announce the promotion of Jeff Huizenga to a newly created role as Director of Wealth Strategies. Over the past decade, DVI has increasingly moved in the direction of serving larger and more complex high-net-worth clients. We have recognized the growing importance of our ability to provide thoughtful and insightful strategic advice to these clients. As we continue to enhance and broaden the scope of these capabilities, Jeff will spearhead DVI's ongoing efforts to develop and train the firm's Relationship Managers and Portfolio Managers in the successful execution of sophisticated wealth management solutions.

"In the eight years that Jeff has been with our organization, he's emerged as a true innovator and thought leader in the area of complex estate and wealth transfer strategies," noted Will Williams, DVI's Chairman, President & CEO. "The Board and I are thrilled to recognize his many accomplishments, and look forward to better leveraging his expertise and passion around these topics of increasing interest and importance to our clients."

"Jeff's ongoing commitment to invest in his professional career (maintaining a CFP® designation and recently earning his Master's in Financial Services) is inspiring," Williams added. "We're confident he will prove an invaluable resource for DVI clients in the years to come."

Will Williams
Chairman, President & CEO

'UNAPOLOGETICALLY VALUE'

Last year in a Quarterly Board meeting, Chief Investment Officer Brian Christensen made it very clear to all in attendance that DVI continues to be *'Unapologetically Value'* in our equity strategy investment orientation. It wasn't offered as an excuse for not owning the handful of high-flying growth stocks that dominated headlines and performance in 2021, but rather a timely and meaningful reminder of the importance of sticking to one's knitting. Our journey here at DVI has been heavily influenced by our founder's mandate that we treat our clients' assets as if they were our own – and by all means, to DO NO HARM. Discipline, especially in the face of significant investment headwinds, is never easy. But it's been the cornerstone of our professional credibility and value proposition since the firm's inception back in 1977. The tide has now turned in 2022. Many of the stocks that led the charge in 2021, have experienced major declines. The Russell 1000 Growth Index, recognized as the predominant benchmark for large cap growth stocks, was down nearly 30% for the first half of 2022.

Here at DVI, the same discipline that yielded the Unapologetically Value tag line is now focused on separating the wheat from the chaff among this universe of fallen angel growth companies. Valuations have come crashing down for many. In some cases, those lower valuations now meet the parameters we've set for prudent long-term portfolio holdings.

At first blush, this rapid turn of events can seem a bit awkward. After all, just 12 months ago we wrote these companies off as unfit for investment, and now we're embracing them as potential equity model additions? As we continually remind our clients, however, this is far from a contradiction. Many of these companies we would have loved to invest in, but simply couldn't wrap our head around or justify the crazy valuations the market had conferred upon them.

The advantage of a Value investing mindset is the academic discipline it provides; allowing us to embrace a contrarian perspective and to acquire companies which – for the moment – are dramatically out of favor. As famed investor Warren Buffet has often remarked, "Price is important."