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DVI
DAVID VAUGHAN INVESTMENTS

QUARTERLY PERSPECTIVE

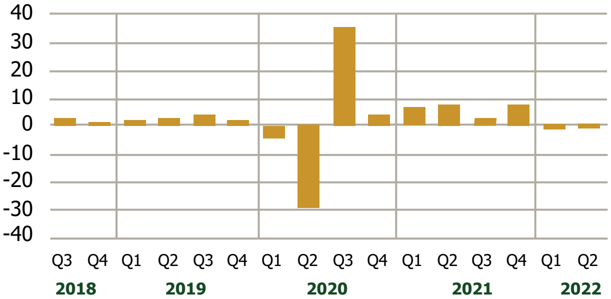
THE DREADED 'R WORD'

Will Williams
Chairman, President & CEO

The Bureau of Economic Analysis' (BEA) recent third and final estimate of second quarter GDP came in at an annual rate of -0.6%; this following a -1.6% decline in Q1. While the National Bureau of Economic Research has yet to officially declare that we are in a recession (generally two successive quarters of negative growth meets their definition), there's no question that the U.S. economy has been contracting through the first half of 2022.

Why does the word *recession* create such fear in the investment community? Typically, economic slowdowns precipitate meaningful declines in corporate earnings—the primary driver of stock prices. Yet from a practical standpoint, recessions are a common and essential part of healthy economic cycles. In fact, over the past century the U.S. has experienced 16 recessions at a pace of about one every six years and with an average length of 13 months. Fortunately, the duration of economic expansions (averaging 59 months) tends to vastly exceed the duration of economic recessions by a factor of five.

Real GDP: Percent Change from Preceding Quarter



U.S. Bureau of Economic Analysis   Seasonally Adjusted at Annual

History of Economic Recessions

	Peak		Through		# of Months Peak to Trough
1	October 1926	(1926Q3)	November 1927	(1927Q4)	13
2	August 1929	(1929Q3)	March 1933	(1933Q1)	43
3	May 1937	(1937Q2)	June 1938	(1938Q2)	13
4	February 1945	(1945Q1)	October 1945	(1945Q4)	8
5	November 1948	(1948Q4)	October 1949	(1949Q4)	11
6	July 1953	(1953Q2)	May 1954	(1954Q2)	10
7	August 1957	(1957Q3)	April 1958	(1958Q2)	8
8	April 1960	(1960Q2)	February 1961	(1961Q1)	10
9	December 1969	(1969Q4)	November 1970	(1970Q4)	11
10	November 1973	(1973Q4)	March 1975	(1975Q1)	16
11	January 1980	(1980Q1)	July 1980	(1980Q3)	6
12	July 1981	(1981Q3)	November 1982	(1982Q4)	16
13	July 1990	(1990Q3)	March 1991	(1991Q1)	8
14	March 2001	(2001Q1)	November 2001	(2001Q4)	8
15	December 2007	(2007Q4)	June 2009	(2009Q2)	18
16	February 2020	(2019Q4)	April 2020	(2020Q2)	2
			Average in Months		**13**

Source: NBER

As economists and market analysts evaluate the current economic landscape, most believe we are indeed in the midst of (or at least headed towards) a mild

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HURRY UP TO SLOW DOWN

U.S. financial markets are gradually adjusting to the unprecedented pace of interest rate hikes, as the Federal Reserve (Fed) strives to contain the current rate of inflation. It's clear what the Fed is fighting:

- The 50-year historical average for the Headline Consumer Price Index (CPI) is 4.0%;
- Since March 2022, every monthly CPI print has exceeded 8% (with June posting a 9.1% reading);
- However, slight declines in July (8.5%) and August (8.3%) may signal a new downward trend.

We're all experiencing the effects of this rampant inflation—with widespread price increases impacting nearly all aspects of our daily lives. But as the chart below demonstrates, the pace of this inflation fight has accelerated to levels not seen since the Fed began targeting an Effective Federal Funds Rate in the early 1980s.

Financial markets rarely if ever respond positively to such extreme policy shifts enacted over short periods of time. With the exception of the Energy sector and a few Agricultural Commodities, markets across the globe have suffered significant declines to date in 2022.

When Will it End?

My best guess—markets will begin to settle just as soon as it becomes apparent the Fed is nearing the end of its course on hiking interest rates. Ideally, this will occur without significant damage to corporate earnings growth; providing a strong base for markets to begin the road to recovery.

Additionally, we're entering a seasonal period that has very positive implications for the stock market. Midterm elections have historically proven to be strong catalysts for stock prices. The chart below measures rates of return for the S&P 500® before and after all fifteen midterm elections since 1962.

As you can see, the midterm elections in 1962, 1966, 1970 and 1974 all proved to be pivot points for the market following significant declines earlier each year. Similar to today, these also occurred during a period where interest rates were climbing (e.g., the yield on the 10-year U.S. Treasury note rose from 3.68% in May 1961 to 7.68% by June 1970).

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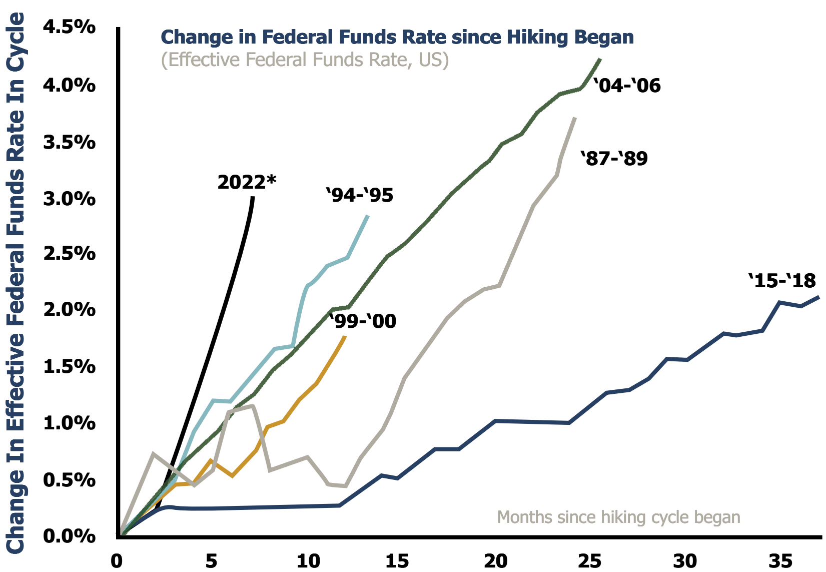
The Fed is Hiking Further & Faster than Any Time in Modern History



*The 2022 line reflects the new September hike, with 0.75% added to the August reading

Source: Federal Reserve

2022 Client Survey Results

Overall Client Satisfaction

4.84

Our core philosophy is to always put our clients needs first. Our overall client satisfaction score of **4.84** out of five is the best measure of our success in delivering on that promise.

Future Learning Focus

69% of clients expressed interest in learning more about Income Tax Planning Strategies.

60% of clients say they are interested in learning more about Estate and Gift Tax Planning.

Brian Christensen, CFA
Senior Vice President & CIO

Midterm Election Stock Market Performance since 1962

Year	President	Party	Before Midterm Election: S&P 500 Price Return Nov 1-Oct 31 (12 mo. before election)	S&P 500 Price Return Nov 1-Jan 31 (3 mo. after election)	S&P 500 Price Return Nov 1-Apr 30 (6 mo. after election)	S&P 500 Price Return Nov 1-Oct 31 (12 mo. after election)
1962	John F. Kennedy	D	-17.6%	17.1%	23.5%	30.9%
1966	Lyndon Johnson	D	-13.2%	8.0%	17.2%	17.1%
1970	Richard Nixon	R	-14.4%	15.1%	24.8%	13.0%
1974	Gerald Ford (Nixon)	R	-31.8%	4.2%	18.1%	20.5%
1978	Jimmy Carter	D	0.9%	7.3%	9.2%	9.3%
1982	Ronald Reagan	R	9.7%	8.7%	23.0%	22.3%
1986	Ronald Reagan	R	28.5%	12.3%	18.2%	3.2%
1990	George Bush	R	-10.7%	13.1%	23.5%	29.1%
1994	Bill Clinton	D	1.0%	-0.4%	9.0%	23.1%
1998	Bill Clinton	D	20.1%	16.5%	21.5%	24.1%
2002	George W. Bush	R	-16.4%	-3.4%	3.5%	18.6%
2006	George W. Bush	R	14.2%	4.4%	7.6%	12.4%
2010	Barack Obama	D	14.2%	8.7%	15.2%	5.9%
2014	Barack Obama	D	14.9%	-1.1%	3.3%	3.0%
2018	Donald Trump	R	5.3%	-0.3%	8.6%	12.0%
Midterm average			**0.3%**	**7.3%**	**15.1%**	**16.3%**
Non-Midterm average			**10.7%**	**2.9%**	**4.2%**	**6.4%**

Data source: U.S. Bank Asset Management Group research, Bloomberg, October 31, 1961-December 31, 2022

As Big David was fond of saying, 'this too shall pass.' Our primary focus will always be on risk management; while striving to be opportunistic whenever and wherever any market dysfunction arises. Thank you for your continued confidence in DVI.

THE DREADED 'R WORD'

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recession. If the two consecutive quarters of negative Real GDP growth aren't convincing enough, the state of fixed income markets (i.e., the ongoing negative yield spread between long-term [10-year] and short-term [2-year] Treasuries) offers further evidence. The Fed has rapidly increased short-term rates in an effort to squelch inflation. But fixed income investors are continuing to price long-term rates based on an assumption that economic growth is declining and inflation has peaked.

Crisis of Confidence

Looking at the big picture, there appears to be quite a disconnect between existing economic fundamentals and the way markets are responding to the current fact pattern. At DVI, we believe this gap is attributable to the great uncertainty inherent in today's economy. Investors simply don't have any confidence that the economy will be able to achieve a soft landing. In their minds, what

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Key Areas of Satisfaction *(5 Point Scale)*

We are proud that DVI clients rate our firm as a **4.89** in friendliness, courteousness and kindness.

With an average rating of **4.80**, DVI clients agree they would gladly recommend us to families, friends and colleagues.

Our clients are extremely confident that DVI takes time to understand their unique financial priorities and concerns **(4.72)**.

With DVI as their trusted advisor, most clients express a strong feeling of financial "Peace of Mind" **(4.70)**.

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lies ahead is a more severe and longer-duration economic decline. Year-to-date stock market index declines have been severe—more in line with the investment performance experienced during the 2008-2009 Great Recession. In effect, current expectations are baking in a significant decline in corporate earnings.

Year to Date

Index	YTD Return	Index Maximum Drawdown From YTD High	Average Member Maximum Drawdown From YTD High
S&P 500	-25%	-24%	-33%
NASDAQ	-32%	-33%	-47%
RUSSEL 2000	-26%	-27%	-46%

Source: Charles Schwab & Co, Bloomberg

Unfortunately, markets are always burdened by a *"wall of worry."* This time is no different due to a host of valid economic concerns, including:

- The Fed raising short-term interest rates at an unprecedented pace;
- Persistent higher inflation rates and their potential long-term impact on wage inflation;
- A European energy crisis that could potentially fuel a severe recession; and
- A strengthening U.S. dollar negatively impacting our exports.

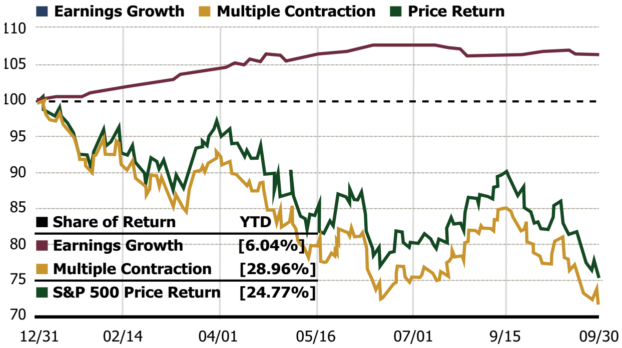
Additionally, the significant geopolitical risk associated with the War in Ukraine can't be ignored.

P/E Multiple Contraction

By using the S&P 500® to evaluate the components of market return for 2022, this crisis of confidence becomes even more apparent. Despite all the economic headwinds, corporate earnings continue to be **positive** on a year-over-year basis. Because of all the uncertainty, however, investors just aren't willing to pay a premium for those earnings. All of the recent decline in stock prices (and more) can be attributed to Price/Earnings multiple contraction. In effect, it's the equity investor equivalent to being on strike. They simply refuse to pay a premium for future corporate earnings until at least some of the *wall of worry* items referenced above can be assuaged or resolved.

S&P 500 Earnings & Valuations

Year-to-Date Percentage Change



Source: Factset

Under market conditions such as these—when there's a seemingly large disconnect between expectation and reality—our natural bias is to assume much of the bad news is already baked into investor sentiment. If corporate earnings can therefore continue to hold their own and we can catch a break or two on a few of these macroeconomic factors, perhaps we're closer to the end of this Bear market rather than somewhere in the middle. We continue to focus our efforts on improving the overall quality of our investment portfolios, while maintaining the courage to capitalize on investment opportunities as they arise.

DVI / MCB Partnership Update

10 BILLION

In the fall of 2017, David Vaughan Investments, LLC (DVI) and Morton Community Bank (MCB) entered a strategic partnership; marching forward together to enhance the the financial well-being of their clients. Five years later, despite uncertain times and economic headwinds, both financial institutions have grown and prospered to represent one of the largest privately held bank and investment advisory firms based in Illinois. (As of 12.31.2021, MCB Total Assets $ 4.9 Bln & DVI Assets under Advisement $ 4.6 Bln)