Capital Markets Commentary and Quarterly Report: 4th Quarter 2021

Capital Markets Highlights

The U.S. stock market[1] finished a very strong year with a powerful 4th quarter rally. October got the quarter off to a good start, benefitting from good earnings reports from the summer period and optimism about COVID containment. November looked to be flattish, until news of the Omicron variant broke the Friday after Thanksgiving, causing a brief but sharp sell-off. However, December resumed the upward march, as many of the most visible and potentially impactful risks appeared less dire than initially feared.

In Q4 2021, stock market gains were broad-based. Economic growth appears to have reaccelerated during the quarter. The Conference Board is estimating GDP growth of +6.5% for the period vs. Q3's +2.3%. Reopening activity, with a lower COVID impact during much of the quarter, and pent-up seasonal holiday demand all helped. Full year 2021 growth is now estimated to be around 5.6%, well above the trendline GDP growth rate of around 2% since 2000, and the best yearly growth rate since 1984.

2021 was a year that favored large-cap stocks over small-caps, and U.S. stocks over most all international stock markets. The stock market's double-digit return trounced fixed income results which were modestly negative to marginally positive. Treasury yields, while still at historically low levels, rose significantly across the yield curve, vs. a year ago. For example, the 2-year Treasury yield ended 2021 at 0.73% compared to 0.12% at the end of 2020 and the 10-year rate ended 2021 at 1.51% vs. 0.91% at the end of 2020.

Looking ahead, after years of strong stock market returns, we remain cautiously optimistic on U.S. stocks but expect returns in 2022 to be more modest than in 2021 and anticipate high single-digit returns, in line with the market's historical results. A white paper we wrote in 2021 studied market returns over rolling 10-year periods since 1961 and what they may suggest for the subsequent 3, 5, and 10-year periods. Spoiler alert - strong returns generally may lead to average to subpar returns, especially so for Growth stocks, but a very strong decade doesn't predestine the market to poor returns in upcoming periods. Based on this study[2] (which we would be happy to send on request), we believe that future returns likely will be modestly below the long-term average annualized returns during the next 3, 5, and 10 years, though the study suggests they will likely still be positive and in the high single-digits, and better than prospects for fixed income from current levels.

We are optimistic about the outlook for Matrix's portfolios in 2022. Our portfolios sell at a significant discount to the overall market's P/E multiple with good earnings and dividend growth prospects in

[1] All references to the stock market are the S&P 500 unless otherwise noted.
[2] Study based on quarterly and annual returns of the S&P 500 Index for the period 1961 to September 2021 (60¾ years and 204 rolling 10-year observations). For this study, we use the S&P 500 Index as representative of the U.S. stock market.

the coming year. We believe the portfolios should be very well suited to navigate the more challenging environment we foresee in 2022.

As we said last year during a time of great uncertainty, the market is unpredictable in normal times and can act irrationally during periods of extreme stress. The best way to address that is to have an allocation to the stock market that is appropriate for the long-term, which includes both good and bad times.

Reviewing our Predictions for 2021

It was a good year for the stock market and Matrix's portfolios, and we got a lot of the big picture thoughts right in last year's year-end letter.

At the end of 2020, we said we were guardedly optimistic about the market and quite optimistic about Matrix's portfolios. We thought that when the virus was brought under control, the economy would rebound strongly, accelerating as the year progressed.

We were hopeful that the new Biden presidency and an evenly divided U.S. Senate would allow for several favorable legislative actions to stimulate the economy, like additional COVID relief packages and an infrastructure program, but likely result in restraining a meaningful increase in taxes. Another positive for markets we anticipated was the chance that our global trade policies would be less adversarial and more consistent, providing additional economic tailwinds. We were very encouraged that then-President-elect Biden had clearly stated that his top priorities were solving the health care crisis and growing the economy.

Once in office, President Biden got a $1.9 trillion American Rescue Plan passed in March, and a $1.2 trillion bipartisan infrastructure bill in November, and fears of higher taxes were not realized in 2021.

We expected the Federal Reserve to keep interest rates low for the upcoming year and thought intermediate and longer-term bonds might drift higher as the year progressed as investors reacted to an improving economy and signs that inflation could be picking up. We believed that equities were more attractive than fixed income and expected global interest rates to trend higher in 2021.

Both of these things turned out more or less as expected. Frankly, we thought intermediate and longer-term interest rates would end the year higher than they did and are perplexed that they remained so low.

Most importantly, we believed that Matrix's portfolios were well-positioned to show strong performance in 2021. Our conviction that the previous year's underperforming sectors (Health Care and Financials), where we had significant holdings, would be strong performers in 2021, turned out to be accurate.

While we were upbeat about the market for 2021 and were correct directionally, the biggest miss in our outlook was that we didn't anticipate the 20%+ gains for many areas of the market (a good problem to have).

Our 2022 Outlook

We expect another positive year for the stock market but with more modest returns, in line with historical averages of high single-digit gains.

We look for another solid year of economic growth, less robust than 2021, but above average. This belief is based on expectations that we will learn to live with COVID, that economies around the world will improve in 2022, that supply chain issues will work themselves out over the year, and inflation will remain elevated but begin to settle down as the year unfolds.

It will be a more challenging year for stocks with more ups and downs because overall market valuations are high and interest rates are almost certain to rise as the Fed stops buying bonds and plans to raise short-term interest rates. We believe equities will again be more attractive than fixed income in 2022.

We continue to believe that Value stocks are poised to show solid absolute performance and favorable relative performance vs. the overall market. Growth stock valuations are high, and earnings comparisons are tough. Value and high-quality dividend stocks should benefit from the combination of attractive valuations, economic sensitivity in an expanding economy, and good current and growing dividend income.

The risks to the economy and stock market we see in 2022 are more COVID outbreaks and the disruptions they cause to economic activity, higher inflation than expected, and significantly higher interest rates. Geopolitical risks are unpredictable but ever-present, particularly with China and increasingly Russia.

In summary, we are looking for another positive year for stocks albeit with periods of volatility. We believe the government and Federal Reserve are on the same page, working towards a common goal of a growing economy and strong job growth. Even with a gradual rise in interest rates, we think there is a very healthy backdrop for corporate earnings growth. We are less optimistic about fixed income returns in 2022, as we believe interest rates will rise, but believe bonds have an important place in balanced accounts, providing stability and a modest income during periods of stock market declines.

Large Cap Value Strategy

Matrix's Large Cap Value portfolio (LCV) had a solid 4th quarter and an exceptional year. For the quarter, the LCV portfolio trailed the Russell 1000 Value Index and the more Growth/tech-weighted S&P 500 Index, but handily outperformed both indexes for the year.

In Q4, the sectors contributing the most to the portfolio's return (multiplying sector weighting by performance) were Technology and Health Care. The Communications Services, Consumer Discretionary, and Utility sectors detracted from Q4 performance.

Using the same methodology, Financials, Technology, Communication Services, and Health Care were the best performing portfolio sectors for all of 2021. The Utility sector detracted the most from performance in 2021.

During the quarter, we added to positions in Becton Dickinson, Comcast, FedEx, Fiserv, and Zimmer Biomet.

We sold the position in Pinnacle West after a very disappointing rate case outcome.

Looking ahead, even after strong results in 2021, we believe the LCV portfolio is well-positioned for further gains in 2022 as the economy recovers from COVID.

Among sectors, we continue to think Financials are very well positioned to show strong earnings growth from higher interest rates and loan growth while credit quality remains very high. We also like Health Care in 2022. Valuations are very reasonable and there is pent-up demand for medical care that was deferred during COVID. We are especially optimistic in 2022 for our investments in Communications Services, a sector that was particularly hard hit in Q4, 2021 on concerns over the challenges from disruptive technologies. Valuations in this sector for names like Comcast and ViacomCBS are compelling. Both are very well-managed companies with growing revenue, earnings, and dividends. Comcast is buying back its stock and consistently raises its dividend. At ViacomCBS, there has been insider buying by the Chairwoman and the CEO.

Technology has been a great place to be invested and our names have done very well. We continue to expect good earnings growth from our investments in this sector but after years of market leadership, we have more modest expectations in 2022. Within Technology, we believe our names still have a good risk/reward.

We are comfortable having a small position in Energy with exposure to just the strongest companies with a shareholder orientation that are best equipped to manage through this very cyclical sector facing a dramatically different future.

The companies in the portfolio showed very good operating results in 2021 under very trying circumstances and, we believe, remain significantly undervalued. On December 31, the LCV portfolio's P/E multiple was 16.8 times estimated 2022 earnings[3], which is more than a 20% discount to the S&P 500's 21.4 times earnings with a higher dividend yield, 1.80% vs. 1.27%[4].

Dividend Income Strategy

The Matrix Dividend Income portfolio (MDI) had a strong 4th quarter and a very solid year. The portfolio's performance was nicely ahead of the Russell 1000 Value Index for the quarter while lagging the more Growth/tech-weighted S&P 500 Index.

[3] Source: Bloomberg
[4] S&P 500 Index dividend yield is represented by the SPDR S&P 500 ETF.

For the full 2021 year, the MDI portfolio performed generally in line with the Russell 1000 Value Index but trailed the S&P 500. We were pleased, that after providing better downside protection than the market in September's sharp sell-off, the portfolio showed good all-weather performance by rebounding so strongly in the 4th quarter.

The thesis behind the Matrix Dividend Income strategy places paramount importance on a company's commitment to paying a dividend, and then sustaining and growing it over time. The stocks in the portfolio have strong financial positions, cash flows, and solid ongoing profitable franchises that should enable continuity and growth of their dividends even during a sharp recession.

In the 4th quarter, six stocks in the portfolio increased their dividend by an average of 8.2%. For 2021 in total, over 96% (25 of 26) of the companies in the portfolio increased their dividend, with an average raise of 6.5%. The portfolio had a 2.87% current dividend yield at 12/31/21, which compares very favorably to the 2.24% yield on the Russell 1000 Value, 1.27% yield on the S&P 500[5], and the 1.51% yield on the 10-year Treasury.

The sector contributing the most to the portfolio's return (multiplying sector weighting by performance) in the 4th quarter was Technology, followed by Health Care, and Consumer Staples. Communication Services was a notable laggard in the quarter. We think our two holdings in this sector, Comcast, and Verizon, offer solid upside potential in 2022.

Using the same methodology, Financials, Technology, and Health Care were the sectors that contributed most to the portfolio's return for 2021. Communication Services was the sector detracting most from performance for the year.

In the 4th quarter, we started a new position in Unilever, a London-based multinational consumer products company with good management, strong brands, and significant emerging market exposure. The company is taking steps to improve profitability and as part of that process is reshaping its portfolio towards higher growth and higher-margin businesses. Most recently, it sold its global Tea business (the Lipton, PG tips, Pukka, T2, and TAZO brands) for €4.5 billion and added to its growing Prestige Beauty business with the acquisition of Paula's Choice. The company is a steady single-digit earnings grower with a 3.7% dividend yield on 12/31/21. Unilever's share price has significantly underperformed the market and its peer group, creating a good investment opportunity.

We sold our entire position in the Arizona-based utility Pinnacle West after a very disappointing rate case outcome and used the proceeds to add to our position in Comcast. We trimmed our positions in PepsiCo and Merck into price strength and added to our holding in Amgen. Finally, late in the quarter, for tax-exempt accounts, we started to reduce the Consolidated Edison holding into strength and started a new position in another utility, American Electric Power.

We are optimistic about the portfolio's prospects in 2022. We look for solid earnings and continued dividend growth in the upcoming year. Dividend Income stocks in general have been out of favor during the economic recovery and lagged the strong market gains since March 2020. Although MDI

[5] S&P 500 Index dividend yield is represented by the SPDR S&P 500 ETF.

achieved nice absolute returns in 2021, we believe there is a lot more runway for further gains, even in an environment where we expect overall market returns to slow in the coming year.

Some of our larger sector exposures like Financials and Health Care should perform well as we learn to live with COVID and resume more normal activities. We believe our Communication Services sector investments in Comcast and Verizon are very attractive at current prices while our Consumer Staples investments provide portfolio stability with steady growth and dividend increases.

In summary, we look for a year where our dividend stocks become more highly valued as investors seek steady, growing income-generating investments in a market environment we expect to be more challenging and volatile.

The portfolio should have more downside protection than the S&P 500 Index, defending well during periods of market turbulence, while still allowing for meaningful appreciation over time.[6] We also think the highly diversified, all-weather MDI portfolio is well-positioned to have favorable performance in the stronger economy and rising interest rate environment that we anticipate over the next few years.

On December 31, the MDI portfolio's P/E multiple was 15.7 times estimated 2022 earnings[7], which is more than a 25% discount to the S&P 500's 21.4 times earnings, and very attractive on an absolute basis.

Bonds

Overall, the bond market had a difficult year with most bonds modestly negative to marginally positive for the year. Returns for Treasuries were negative as rates rose across the yield curve. The 2-year Treasury yield ended 2021 at 0.73% vs. 0.12% at the end of 2020, the 5-year was 1.26% vs. 0.36%, the 10-year rate ended 2021 at 1.51% vs. 0.91%, and the 30-year was 1.90% vs. 1.65% over the same periods.

We expect more of the same (higher interest rates) in 2022. With the economy continuing to grow, unemployment at 3.9%[8], and inflation running at 6.8% in November, Federal Reserve Chairman Powell said in December that "We (the Federal Reserve) are phasing out our purchases (of Treasury securities and agency mortgage-backed securities) more rapidly because, with elevated inflation pressures and a rapidly strengthening labor market, the economy no longer needs increasing amounts of policy support. In addition, a quicker conclusion of our asset purchases will better position policy to address the full range of plausible economic outcomes." That includes increases in short-term interest rates in 2022.

Matrix bond portfolios are structured with a rising interest rate environment in mind, focusing on high-quality corporates, U.S. Treasuries, agencies, and municipals (where appropriate) with nearer-

[6] Since the portfolio's inception (1/1/11).
[7] Source: Bloomberg.
[8] December 2021 unemployment rate.

term maturities. Although we expect rates to move higher, we believe the yield offered by short-term maturities should offset any movement lower in bond prices, and the income is significantly better than the exceptionally low rates paid in money market accounts.

With our conservative shorter-term positioning, our taxable bond portfolios were modestly negative for the quarter and the year, in line with their benchmarks. Tax-exempt bond portfolios were generally modestly positive for the quarter and year, also in line with their benchmarks.

If the economy continues to grow and inflation stays above 3% in 2022 (things we expect), we think intermediate and long-term rates will rise in 2022, resulting in sub-par returns for most bonds.

In that case, our shorter-term focus should continue to be beneficial in protecting the portfolio. If rates move up as we expect, we plan to modestly extend maturities to take advantage of better yields as our shorter-term bonds come due.

Balanced Accounts

Balanced accounts benefitted in the quarter and year from having an allocation to equities at the higher end of our targeted range. For tax-exempt accounts, where stock appreciation pushed the equity allocation above the high end of our targeted range, we began a modest scale back to the high end of the range during the fourth quarter. If stocks remain at current levels or move higher, we expect to scale back taxable accounts in a similar manner this quarter.

We continue to believe that stocks are more attractive than bonds, but that bonds play an important role in balanced accounts, providing income and stability during periods of stock market turbulence.

Tax Mitigation

As we mentioned in several letters last year, we were more active than usual in 2021, taking gains in investments that reached our targets. We did our best to offset gains with losses but had very few positions with meaningful unrealized losses.

Actions during the 4th quarter and earlier in the year lowered your potential realized capital gains, while maintaining the integrity of the portfolio, allowing it to fully participate in the strong 2021 stock market.

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We want to thank you for trusting us with your investments and wish you all a happy and healthy 2022. Please contact us with any questions or comments. Best regards.