knightbridge CAPITAL

2022 Year End Review & Outlook

Where Are We Now? 2022's Challenges Create Opportunities in 2023 and Beyond.

Were financial markets as bad as it felt during 2022?

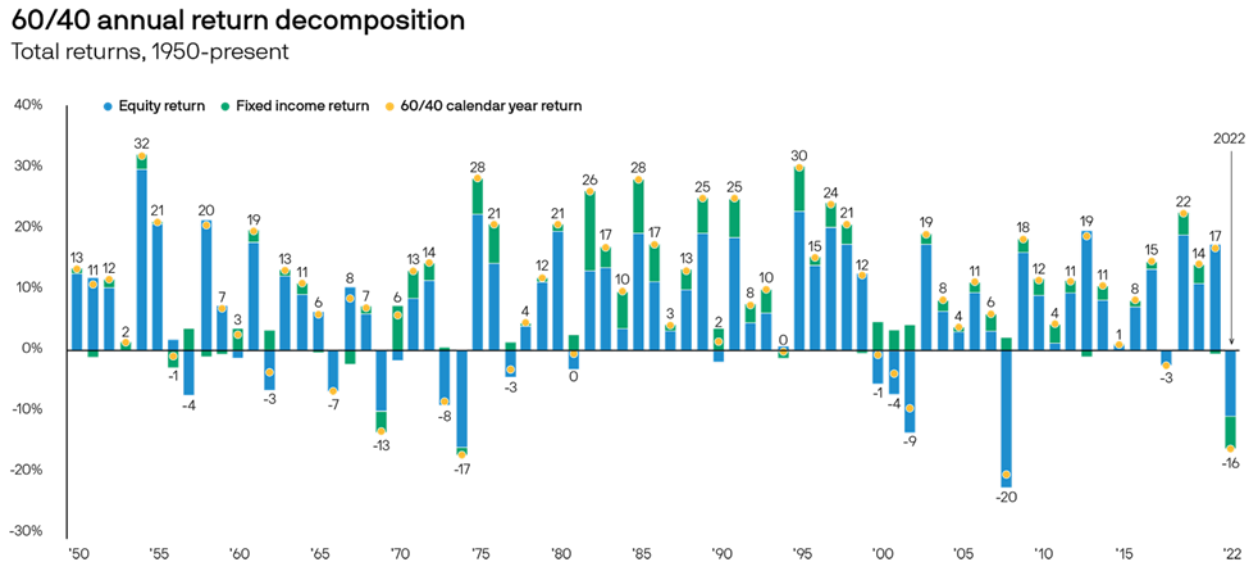
- *Financial markets faced significant challenges in 2022, but the situation could have been much worse as financial markets bottomed in October before mounting a significant rally into year-end.*
- *The Federal Reserve was forced to take a strong stance against record amounts of stimulus and pandemic stresses that led to pricing pressures and resulted in decades-high inflation.*
- *A strong Q4 provided some relief and has likely set the stage for an improved return scenario moving forward, giving investors ample reason for renewed optimism.*

2022 may have appeared worse than it actually was as a variety of factors, including decades-high inflation, increased volatility, geopolitical tensions, and broad economic uncertainty combined to reprice nearly all asset classes and remind investors of intrinsic risks in financial markets. These factors introduced levels of ambiguity to the markets that had not been seen in the years of calm that followed the COVID-19 pandemic. As a result, asset price fluctuations became more prevalent as market sentiment declined, offering proof that elevated inflation and volatility can flareup in unpredictable ways and without supporting data.

Throughout 2022, financial markets around the world experienced a sell-off as rising wages and supply constraints led to increased prices for almost all goods and services. Strong demand and limited manufacturing capabilities resulted in significant inflation, reaching levels not seen in four decades. Subsequently, the Federal Reserve took action by raising the Federal Funds Rate by an unprecedented 425 basis points (or 4.25%) in just nine months, bringing it to a level of 4.25-4.50%. This sudden and significant increase in interest rates caught investors off guard, causing a violent reaction in financial markets and punishing nearly every asset class. Overall, 2022 was by far the most challenging year for equity markets since 2008, and one of the most challenging years ever recorded in fixed income markets.

Despite the many challenges faced in 2022, performance across financial markets could have been much worse. A rally in equities and fixed income during the fourth quarter, due to better than anticipated economic growth, hints of disinflation, and an increasing expectation for the Federal Reserves to end their pattern of rate increases provided a much-needed lift to markets. This sets the stage for an improved return scenario for both equities and fixed income that may unfold in the coming months and years.

Exhibit 1



How might financial markets behave moving forward?

- Volatility will likely continue throughout 2023 and beyond, as the Federal Reserve withdraws from financial markets and a number of unresolved issues affecting the global economy and geopolitics remain unresolved.

- The challenging environment of 2022 likely resulted in a reset for both equity and fixed income markets, setting the table for the next phase of the economic and investment cycle.

- Expectations for long-term capital market assumptions have significantly improved, returning to historical levels.

- Fixed income markets should offer both an improved yield profile and increased defensive properties.

While financial markets have the potential to recover from the downturn of 2022, it is likely that elevated volatility will be present during the first half of 2023 and potentially well beyond. There are numerous unresolved issues impacting the global economy and geopolitics that are expected to affect financial markets throughout the year. Despite the potential market-moving effects of these concerns, there is cause for optimism that these challenges will create opportunities toward the end of 2023 and moving forward. The most significant area of opportunity is expected to be the Federal Reserve concluding its policy on interest rate increases. It is important to note, the Federal Reserve is challenged with striking a balance between keeping inflation under control and not slowing the economy too much. Fed policy is watched closely by market participants and is often foundational to the behavior of financial markets.

It appears that both equity and fixed income markets have experienced a reset following the tumultuous ride of 2022. Historically, challenging market environments have been followed by improved performance in subsequent years, as demonstrated by the S&P 500 only recording consecutive down years twice in the last half-century. Additionally, the broader fixed income market has only experienced this phenomenon of back-to-back down years once (in 2021 and 2022) during the same period.

Long-term capital market assumptions have significantly improved since the end of 2021, returning to historical levels. Equities are expected to return to mid to high-single digit percentage levels over the next decade or so, driven by low-to-moderate global GDP growth, more favorable valuations both domestically and abroad, and looser monetary policy across major central banks as heightened inflation trails off. Fixed income returns in the mid-single digit percentage range appear more attainable in the coming years than at any time over the past decade, as higher yields and a pricing reset serve to drive improved return expectations.

What is the recommended approach for portfolio positioning given the potential for a shift in Fed policy and the uncertainty of the macro environment?

- Our outlook for allocation to equities and fixed income remains neutral, as we believe that the risk/reward balance has become more favorable following the challenges of 2022.

- Both value and growth strategies may be effective moving forward, our predisposition is to straddle both by employing a "core" approach.

- There are numerous opportunities in a market that appears to favor individual security selection over macro allocators (i.e. “stock and bond pickers”).

We maintain a neutral stance on our allocation to equities and fixed income, as we believe that the risk/reward balance has become more favorable for both asset classes following a challenging 2022. An anticipated shift in Fed policy, likely to occur around the midpoint of 2023, along with an uncertain but improving global macro environment, renews optimism for a return to normal with respect to broad asset class performance.

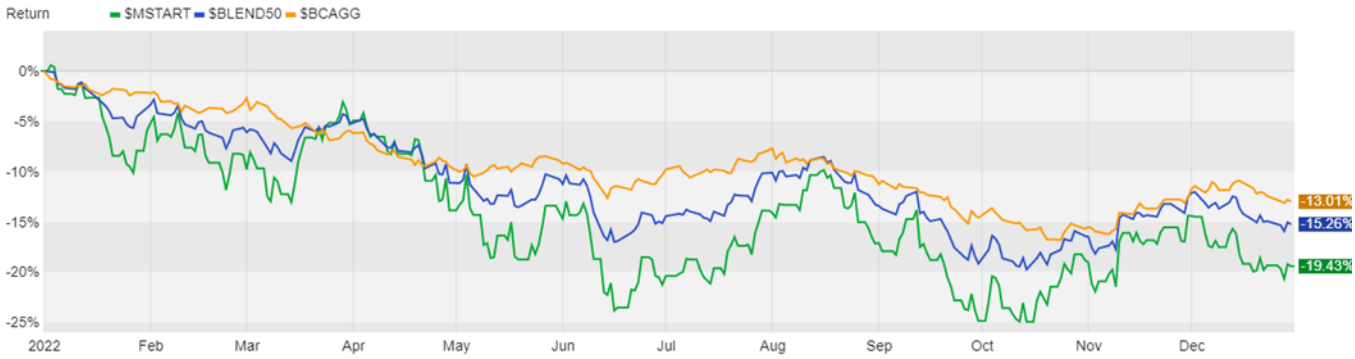
While we believe that the recent value-over-growth paradigm may have some potential in an environment of elevated interest rates, we also recognize the importance of strong long-term secular growth opportunities that may provide meaningful returns over a market cycle. Therefore, we do not over-tilt our active strategies towards either growth or value, instead opting to straddle the "core" and add value through security selection.

In our view, both domestic and foreign equities are entering a market that favors "stock picking", particularly in the US, where this trend is more pronounced, and to a lesser extent, abroad, where markets are likely to move more in tandem given lower valuations. Similarly, in fixed income, the recent repricing has created opportunities across the medium and longer end of the Treasury curve, in municipals where state and local budgets are in good shape, and in investment grade where significant dislocation was experienced in 2022.

Appendix Data:

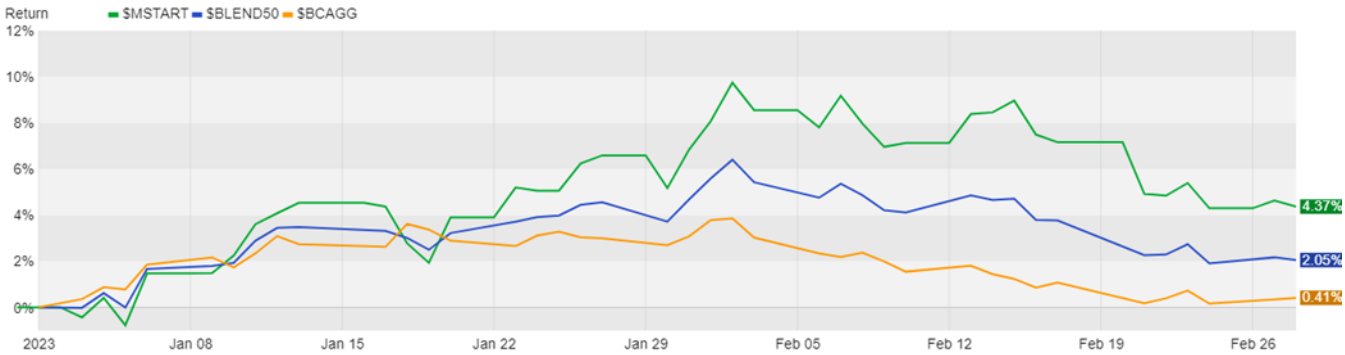
2022 Index Performance

- US Equity Broad Market Performance (Morningstar US Market Index)
  - ◊ Bottom: October 14th = -24.94%
- Asset Allocation Performance (US 50% stocks 50% Bonds)
  - ◊ Bottom: October 14th = -19.75%
- US Fixed Income Performance (Barclays US Aggregate Bond Index)
  - ◊ YTD Bottom: October 24th = -16.82%



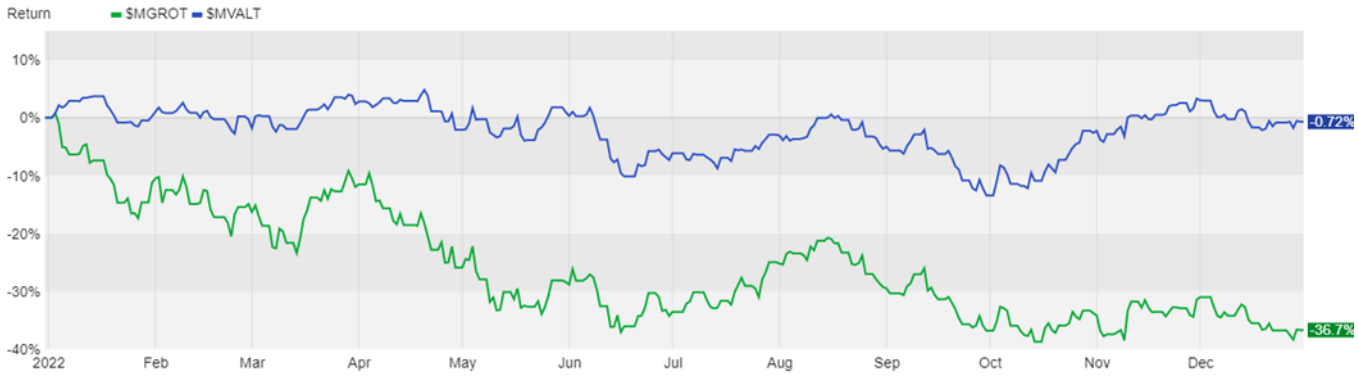
2023 Index Performance through February 28th

- US Equity Broad Market Performance (Morningstar US Market Index)
- Asset Allocation Performance (US 50% stocks 50% Bonds)
- US Fixed Income Performance (Barclays US Aggregate Bond Index)

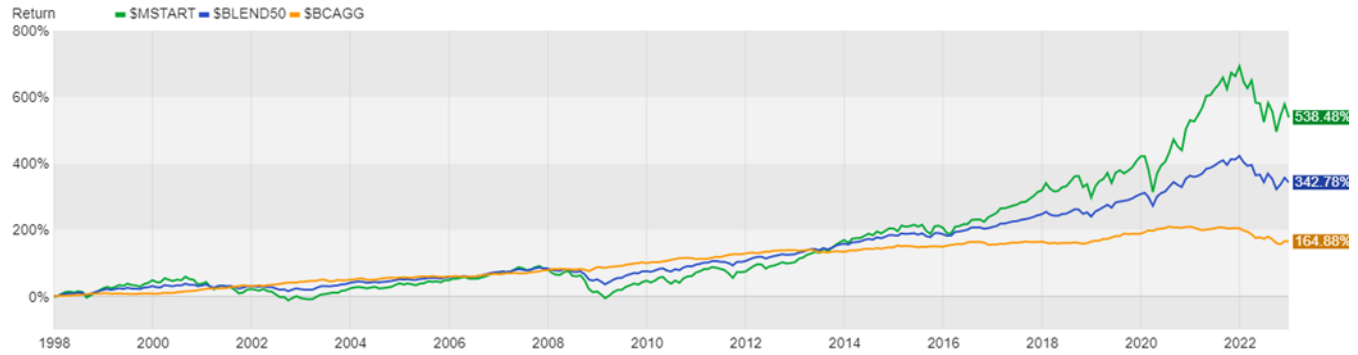


2022 Index Performance – Growth vs. Value

- US Equity Broad Market Performance (Morningstar US Growth Index)
  - ◊ Bottom: October 14th = -38.70%
- Asset Allocation Performance (Morningstar US Value Index)
  - ◊ Bottom: September 30th = -13.43%



The Longview – 25yrs ending December 31, 2022



Vanguard Capital Market Assumptions (Market perspectives: February 2023 (vanguard.com)):

Asset-class Return Outlooks

Our 10-year annualized nominal return projections are shown below. The projections listed below are based on the September 30, 2022, running of the Vanguard Capital Markets Model® (VCMM). Please note the figures are based on a 2-point range around the 50th percentile of the distribution of return outcomes for equities and a 1-point range around the 50th percentile for fixed income.

Equities	Return projection	Median volatility
U.S. equities	4.7%–6.7%	17.4%
U.S. value	4.7%–6.7%	19.8%
U.S. growth	3.1%–5.1%	18.6%
U.S. large-cap	4.7%–6.7%	17.1%
U.S. small-cap	5.0%–7.0%	22.9%
U.S. real estate investment trusts	4.9%–6.9%	20.1%
Global equities ex-U.S. (unhedged)	7.4%–9.4%	18.8%
Global ex-U.S. developed markets equities	7.2%–9.2%	17.0%
Emerging markets equities (unhedged)	7.0%–9.0%	26.4%

Fixed income	Return projection	Median volatility
U.S. aggregate bonds	4.1%–5.1%	5.6%
U.S. Treasury bonds	3.7%–4.7%	5.8%
U.S. credit bonds	4.7%–5.7%	5.3%
U.S. high-yield corporate bonds	6.6%–7.6%	10.4%
U.S. Treasury Inflation- Protected Securities	3.2%–4.2%	5.0%
U.S. cash	3.4%–4.4%	1.4%
Global bonds ex-U.S. (hedged)	4.0%–5.0%	4.4%
Emerging markets sovereign bonds	6.4%–7.4%	11.0%
U.S. inflation	**2.0%–3.0%**	**2.3%**

The probabilistic return assumptions depend on market conditions at the time of the running of the VCMM and, as such, can change with each running over time.

IMPORTANT: The projections or other information generated by the Vanguard Capital Markets Model regarding the likelihood of various investment outcomes are hypothetical in nature, do not reflect actual investment results, and are not guarantees of future results. Distribution of return outcomes from the VCMM are derived from 10,000 simulations for each modeled asset class. Simulations are as of September 30, 2022. Results from the model may vary with each use and over time. For more information, see the Notes section.

Source: Vanguard Investment Strategy Group.

Exhibit 1: Source FactSet, Standard & Poor's, Robert Shiller, Yale University, Bloomberg, Ibbotson/Strategas, J.P. Morgan Asset Management. The 60/40 portfolio is 60% invested in S&P 500 Total Return Index and 40% invested in Bloomberg U.S. Aggregate Total Return Index. S&P 500 returns from 1950 – 1970 are estimated using the Shiller S&P Composite. U.S. fixed income total returns from 1950 – 1975 are estimated using data from Strategas/Ibbotson. The portfolio is rebalanced annually. Guide to the Markets – U.S. Data are as of December 31, 2022.