NOTTINGHILL
INVESTMENT ADVISERS, Ltd.

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Quarterly Update

SCORECARD

	One Year	Three Years	Five Years	10 Years
S&P 500 Index	-18.11%	7.66%	9.43%	12.56%
10-Year Treasury Note	-16.06	-3.18	-0.26	0.68
Gold	-0.27	6.16	6.94	0.89

All multi-year returns are annualized, and all returns are associated with time periods ending December 31, 2022

2022 — Challenging on Many Fronts

Restoring some sort of equilibrium never was going to be easy after the economic shock of COVID. Those who thought otherwise were deluding themselves. But, those with the authority and power could have facilitated the equilibrium-restoring process. Instead, too much monetary ease from the Fed and way too much spending on the fiscal side amounted to pouring gasoline on a spring-loaded economic fire. The result: too many dollars chasing too few goods, and a 2022 inflation problem looking for a solution. That attempt at a solution was the story of 2022 as the Fed began raising short-term interest rates and telegraphed Board intent not to waver until the job is done. What exactly does that mean, and how much economic damage ultimately will be sustained? These are the key questions as we enter 2023.

After a remarkable rebound from the 2020 market lows and a very good 2021, U.S. equities stumbled in 2022. The investment return of the broadly based S&P 500 Index was -18.11%, with individual stock performance ranging all over the lot. At one end of the spectrum, Value/Yield stocks and the much-maligned Energy sector in particular were standouts, while Growth/Technology stocks at the spectrum's other end languished. When the latter were all the rage in 2019-2021, we warned that we had seen this movie before and that the aftermath likely would be painful. That "aftermath" began in 2022. If history is any guide, this unwinding of the aforementioned Growth excesses will not be a short-term phenomenon. But, we should not dwell exclusively on the stock market. The bond market also stumbled in 2022. Our proxy for the bond market, a Treasury note maturing in 10 years, provided an investment return of -16.06%, one of the note's worst annual outcomes on record and certainly not much of an offset to a stumbling stock market. Gold? At -0.27%, clearly the performance champ among the principal asset classes. However, the phrase that applies best to 2022 is "challenging on many fronts."

THE CURRENT SITUATION — The Fed Will Finish the Job

- **Worldwide Economy**
  Proving once again how interrelated the industrial economies and their central banks are, post-COVID, the monetary and fiscal spigots all were thrown open together, and the inflation genies subsequently all came out of the bottle together. Now, they all must be put back in the bottle, all at the same time. The various monetary authorities will succeed in taming inflation, probably this year, but at what cost to the worldwide economy? That is the question.

- **Equities**
  Make no mistake, 2022 was a struggle, but stock selection always matters. The investor who continued to emphasize the old Growth/Tech market leaders had a far different 2022 experience than the investor who emphasized the market's Value side. We expect Value's outperformance to continue. Emerging markets? Godot and a seemingly endless wait come to mind, but valuations have become even more compelling. Two thousand twenty-three just may be the year Godot finally appears, and the EM markets reward our patience.

- **Interest Rates**
  They will continue to go up, but by how much? The answer, according to the Fed, is data-dependent, and the line to be walked clearly is a fine one. We take comfort, however, in a belief that the Fed will make every effort not to harm the economy unduly.

A tough year. A tough year because both the stock and the bond markets went down together. On several occasions, we mentioned that these two markets can go down together and that, in fact, this phenomenon occurs about 5% of the time. Two thousand twenty-two was one of those 5% times. The odds of that happening again in 2023? Small indeed. Not zero percent, but small indeed.

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Now, a few words about gold...

ABOUT THE FIRM

Nottinghill Investment Advisers, Ltd., is a registered investment adviser founded in May 1996. A long history of achievement.

Nottinghill is a team of seasoned professionals serving taxable and tax-exempt investors, as well as other investment advisers. Asset management and otherwise serving asset management clients are the Firm's only business. The twin results: commitment and focus.

Nottinghill is a manager of large capitalization equity and widely diversified balanced portfolios. The Firm can serve in a specialized role, or as a client's sole adviser.

Nottinghill's equity and balanced investment strategies constitute the Firm's Yield Plus Approach to investing. The Yield Plus Approach is a straightforward, all-encompassing investment philosophy and a set of well-defined investment processes Precision and discipline.

A long history of achievement. Commitment and focus. Specialization, or single-manager responsibility. Precision and discipline.

Nottinghill is your ideal partner as you go down the financial path ahead.

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The Barbarous Relic

The Total Portfolio Management (TPM) portfolios we manage are three-legged stools. Three points determine a plane—three legs signify stability. The first and most important TPM leg is the Equities sector, U.S. and emerging markets equities. The second leg is U.S. Fixed Income in the form of three specialty funds and a Treasury ladder. And finally, the third leg is the Alternatives Group, three asset classes including gold.

Humankind has had a fascination with the barbarous relic from about the time our ancestors were rubbing two sticks together to make a fire. Since then, gold has been used to adorn ears, necks, wrists, ankles, clothing, etc.; gold has been used to cap teeth; gold has been used in numerous industrial processes; gold has been used to treat disease; and, gold in an investment sense has been used as an alternative to fiat currencies and as a store of value.

Gold in the Modern Monetary/ Investment World — A (Very) Brief History

In the pursuit of gold, chariots, wagons, and tanks have rolled on land, and ships have plied the seven seas for centuries; but, for these purposes, let's focus on gold in the monetary/investment world of the modern era. Let's start with something called the Executive Order 6102.

The year was 1933, and the Great Depression was raging. More than one economist, along with FDR, believed that gold was being hoarded, thereby stalling growth and prolonging the cataclysm. The solution: Executive Order 6102, which called upon U.S. citizens to deliver by May 1 all but a small amount of their gold coins, bullion, and certificates in exchange for $20.67 per troy ounce. Jewelers, dentists et al. were exempted, however, the Order clearly freed up a lot of the public's stash. One big problem was that the price of Treasury gold for international transactions subsequently was raised to $35 per ounce, so all of those law-abiding citizens suffered an immediate loss of over $14 per ounce. Then, along came the Gold Reserve Act of 1934, which changed everybody's official exchange rate to $35. That's where it stayed until the so-called Nixon Shock, when things really started to unravel.

The Nixon Shock of August 15, 1971, was a major policy enactment in response to 1970's 6% inflation rate, a worsening trade balance, and an accelerating demand for Treasury gold in exchange for overseas dollars. Wage and price controls, the economics equivalent of leeches as a cure for disease, were slapped on the American economy for 90 days, and, right out of the Smoot-Hawley playbook, a 10% surcharge was levied on all imports. Oh, and the gold window was closed, thereby ending the convertibility of overseas dollars into gold. The latter move, of course, ended anything like a fixed value for gold, and subsequently, Gerald Ford signed mid-70s legislation legalizing gold's ownership (as of December 31, 1974). By then, the real market price was far above $35 per ounce. In fact, the Engelhard industrial bullion quote of that date was $182. Still, gold went on to enjoy a very prosperous five-year run as this now-freely traded asset reached $512.40 per ounce on December 31, 1979.

Catch up time in the 70s, but really, how has gold done over the years?

Take a look at Figure 1. The Hallelujah 70s were followed by, as we say, "sub-par results" in both an absolute sense and relative to both U.S. common stocks and a 10-year Treasury note. Why? Well, according to the learned treatises, nothing stirs up the price of gold quite like economic calamity and particularly inflation, and there was no economic calamity or inflation during the healthy Reagan/Bush/Clinton growth years. But, what about the 00s? They hardly prove the reverse. Gold had a very good decade, but once again, no inflation. Economic calamity? There was the early-decade Tech bubble and aftermath, however, even factoring in the September 11 tragedy, "economic calamity" may be a stretch. 2008-2009? That qualifies, but gold's reputation as a safe haven toward which everyone runs during such times is not supported by the 2008-2009 facts. More specifically, gold was essentially flat over the period of maximum nail-biting, say, mid-2008 until March 2009. That's a lot better than the equity market did, but no, all the running was in the direction of another market…the Treasury market.

Figure 1

Asset Class Investment Returns 1975 - 2022

	Annualized Investment Return		
	Gold*	**S&P 500 Index**	**10-Year Treasury Note**
1975 - 1979	**23.00%**	14.82%	3.99%
1980 - 1989	**-2.36**	17.55	11.96
1990 - 1999	**-3.20**	18.21	7.38
2000 - 2009	**14.49**	-0.95	6.26
2010 - 2019	**3.05**	13.56	4.70
2020 - 2022	**6.16**	7.66	-3.18
1975– 2022	**4.92**	11.86	6.46

*Engelhard industrial bullion

So, where does that leave us? Despite an inability to prove the opposite (the 00s), there's a fair amount of centuries-old evidence supporting the proposition that accelerating inflation and economic calamity in general, alongside a weak dollar caused by one or the other, support a rising gold price.

Combining the catch-up 70s with the decidedly ho-hum 80s and 90s, and then tacking on the very gold-friendly 00s and the last 13 years, we get an annualized 48-year investment return of 4.92%, less than half the return of the S&P 500 Index and a lot less than the return from even a 10-year Treasury note.

Humphrey Bogart and Walter Huston went all the way to the Sierra Madre for 5% per year? Why own gold?

Two reasons, and the first is quantitative. The performance of gold does not correlate well with the performance of the two traditional financial asset classes: equities and fixed income securities. That goes for the entire 48-year period, as well as most sub-periods of any length. This lack of correlation means that gold brings some diversification firepower to the party, and the result is a less volatile pattern of total portfolio investment returns. Hence, gold...good diversifier.

But, the "good diversifier" label means nothing if we're talking about a depreciating asset/asset class or one with generally poor prospects. Such does not appear to be the case with gold, and that is the second reason to own it. Gold traditionally has been a good offset to a dollar depreciating against a basket of domestic goods and services and the currencies of our trading partners. The first phenomenon is called inflation, which probably will be with us for a while at some level. The currency issue? The dollar has been strong versus others for several years now, and currently is showing signs of (probably sustainable) fatigue.

Gold...good diversifier, decent prospects.

How much and how?

Gold's policy weighting in all of our Total Portfolio Management (TPM) Baseline portfolios is 33% of the Alternatives Group, or 5% of total portfolio assets (see Figure 2). This is hardly a policy bet that will produce great wealth or save a sinking ship. This is a policy bet that will benefit the portfolio in one type of economic environment. That's what intelligent investing is all about. Intelligent investing is the art of combining several assets or asset classes, all of which do well in a different type of economic environment. If we knew with certainty what the future was going to be, we would buy the asset or asset class most in tune, and go to sleep. But, we never have that luxury. A Fundamental Belief underlying TPM is that the future is unpredictable and diversification is very important. Gold at 5% makes sense in a well-diversified portfolio structure.

Figure 2

Total Portfolio Management —
Baseline Portfolio Construction

Equities		**65%**
U.S. Large Company Value	45%	
U.S. Large Company Growth	15	
U.S. Smaller Company	20	
Int. Emerging Markets	20	
U.S Fixed Income		**20%**
Total U.S. Bond Market	75%	
Intermediate Treasuries	25	
Alternatives Group		**15%**
EM Government Bonds	33%	
Gold	33	
Real Estate	33	
Total		**100%**

How to own gold? That was a considerable challenge. Scalability was a problem with coins; weight and transportability were problems with ingots; transaction costs, gauging purity, and secure storage were problems with both. Along came Exchange-Traded Funds (ETFs), and many of these problems went away. All at once, gold could be bought and sold in size throughout the trading day, at commission levels comparable to equity trades. Transportability, storage of the asset, and the continual evaluations of its purity became the responsibility of the ETF's sponsor. Of course, none of that came free of charge, but the Funds' expense ratios were and continue to be far from exorbitant. The only caveat – and we preach this to our TPM clients all the time – is that ETF shares must be backed by physical gold. If the gold ETF is designed only to track the price of gold, we are not interested.

Five percent of total portfolio assets; gold ETFs.

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A frequently asked question around here: "Should I own gold?" Yes, you should, at about the 5% level. Let's summarize a few thoughts on the barbarous relic.

First, gold has stirred our emotions since men and women began walking upright. Always fascinating and mystical, always revered, frequently the basis for conflict.

Second, if we fast forward to the 20th century, the hoarding of gold was considered a Depression-prolonging villain by FDR et al., and gold ownership was restricted severely. That came to an end on December 31, 1974, when Americans once again could own gold for investment purposes and the final nail was driven into the old fixed exchange rate coffin.

Third, from that date until the end of 2022, gold (Engelhard industrial bullion) provided an annualized rate of return of 4.92%, comfortably ahead of inflation but below the return provided by U.S. equities and 10-year Treasuries. And, the advance has been far from straight-line. The 70s were just fine; the 80s and 90s far from it; the 00s very rewarding; 2010-2022 OK.

Fourth, gold may have been moving in fits and spurts, but those fits and spurts have not correlated well with U.S. equity or Treasury prices. Gold is a diversifying asset class.

But fifth, a good diversifier with poor prospects doesn't quite cut it. With gold, on the other hand, the metal's prospects for several reasons seem to be well above-average.

And finally, the virtues of ETFs as a way to own gold are considerable. The shares of gold miners? Clearly, the price of a gold is a large factor in their performance, however, there are other factors, e.g., overall stock market health and its causative factors. As a result, we prefer to own the metal – we know exactly what we are getting.

Make no mistake, we remain positive regarding U.S. equities, for a number of well-considered, quantifiable reasons. The bond market? Not as positive, but that doesn't mean bonds of a certain kind don't have a place in a well-diversified portfolio. They do because bonds will (continue to) do well in a certain kind of economic environment.

Same with gold, and owning it at the 5% level never has been easier.