



**NOVEMBER 2021
PORTFOLIO
UPDATE**

Dear Solas Wealth clients,

"The more we value things outside our control, the less control we have." — Epictetus

It is our observation that an investor's timeframe is inversely related to volatility. As markets decline and volatility rises, even a long-term investor's focus has a strong tendency to shorten, and sometimes dramatically. In September, the S&P 500 experienced a peak-to-trough decline of 6.1%, its largest since 2020.

After a run of near-record-low volatility in the equity market, September's decline caused some investors, who prior to September felt in control of achieving their financial targets, to rethink their goals altogether. Couple these conditions with the inflation picture and the geo- and domestic-political landscape, and an individual's negative reflexive response to conditions outside of their investing timeframe can compound.

In this Monthly Note we discuss the value of selecting appropriate timeframes for making allocation decisions and illustrate this point by highlighting how our investment process reacted to the September drawdown and October's rebound in stocks. The timeframes you select to manage market exposure drives not only performance, but investor behavior, taxes, costs, and tracking error to your benchmark. Which variable do you solve for? When designing strategies for advisors, we consider all these factors and ultimately prioritize the variables in a way that we think optimizes for the advisor-client experience.

But first, below are the asset classes utilized in our portfolios and their model-driven exposure heading into November.

Current Asset Allocation Adjustments – November 2021

		← Less Exposure More Exposure →				
		Strategic Only	Underweight	Baseline Allocation	Overweight	Max Allocation
Equities	U.S. Large Cap				■	
	Foreign Developed		■			
	Emerging Market		■			
Quasi-Equity	Real Estate			■		
Bonds	U.S. Treasury	▼				
	International Treasury	■				
	Inflation-Protected				▲	
	Short-Term & Cash Equivalents				▼	
Alternatives	Hedge Strategies	■				

Square indicates no change month-over-month. Arrows indicate increase/decrease month-over-month.

Adjustments can vary across Strategies depending on each Strategy's objectives. What's illustrated above most closely reflects allocation adjustments for the Growth Strategy.

At a Glance: Allocation Adjustments for November

U.S. Equities: Exposure will be unchanged due to continued positive trends.

International Equities: Exposure will remain constant. Intermediate-term downtrends are dancing around the point of flipping to uptrends, but both foreign developed and emerging market asset classes continue to be significantly weaker than their U.S. counterparts.

Real Estate: No change. Exposure is at its baseline allocation, and there are uptrends in both timeframes.

U.S. and International Treasuries: Exposure will decrease to its minimum allocation, as long duration bonds in the U.S. enter downtrends over the intermediate timeframe. All other duration segments have continued downtrends across all timeframes.

Inflation-Protected Bonds: Exposure will increase to overweight, as the intermediate-term uptrend re-forms and the long-term trend remains up.

Short-Term Fixed Income: Exposure will decrease by returning some of the previous allocation to inflation-protected bonds.

Alternatives: Exposure will not change due to continued downtrends in gold.

Asset Level Overview

Equities and Real Estate

After experiencing their first monthly decline of 2021 in September, U.S. stocks staged a broad, sustained rally in what is traditionally feared as a seasonably weak period. The result thus far has been a steady dose of 5%+ monthly returns across the major indexes and segments. Large- and mega-cap stocks are once again leading the way and making new all-time highs (SPY).

International equities have likewise rebounded after having not so long ago appeared to be on the brink of long-term downtrends. Not only have long-term uptrends remained in place, but now both developed and emerging markets look to be on the cusp of intermediate-term uptrends. Despite the short-term improvements, international markets have continued a long trend of underperforming U.S. equities. Thus, while U.S. stocks enjoy 20% or better returns for the year, foreign developed markets remain in the single digits, with emerging markets barely positive.

Benefitting from the continued rise in inflation, real estate also bounced back in October, resuming its status as the top performing asset class in 2021 thus far. Though not yet back to the early September peak, uptrends remain solidly entrenched as this collection of stocks nears an impressive 30% return for the year.

Fixed Income and Alternatives

The phrase, “fixed income is hot garbage,” has become a common repost among the Solas team, as downtrends accelerated in October, extinguishing any hope of positive attribution in the short-term. All duration lengths for both U.S. and international Treasuries now show downtrends across all timeframes, except for inflation-protected bonds, which rallied late in the month to regain uptrends over all timeframes. As a result, all fixed income instruments not indexed to inflation will remain at their minimum allocation and lowest possible duration. Bonds indexed for inflation will return to overweight status, as they take on a portion of the allocation from weaker segments.

After muted reactions to inflation for much of 2021, gold experienced a positive month for October. However, the rise was not quite enough to establish an intermediate-term uptrend. Given the existence of continued long-term downtrends, the result will be minimum allocations to this asset class.

Three Potential Macro Catalysts for the Recent Trend Changes

Pain at the Pump: The price of crude continues to hold near multi-year highs as investors closely watch inventory and supply data. Saudi Aramco warned that companies need to invest more in production as spare capacity across the world rapidly shrinks. CEO Amin Nasser said a pick-up in aviation next year could accelerate the issue. Blackstone Co-Founder Stephen Schwarzman has a more pessimistic take, saying the shortage of energy could become so severe that it leads to social unrest, particularly in emerging markets.

Not Transitory: Uncomfortably high inflation will grip the U.S. economy well into 2022, as constrained supply chains keep upward pressure on prices and curb output, according to economists surveyed this month by *The Wall Street Journal*. Economists' inflation projections are up dramatically from July, while short-term growth outlooks are lower. Economists see inflation at 5.25% in December, on average, just slightly less than the rate that has prevailed since June. Assuming a similar level in October and November, that would mark the longest inflation has been above 5% since early 1991.

When the Check Comes Part Deux: Treasury Secretary Janet Yellen said the debt-limit deal enacted by Congress will allow the government to keep paying its bills through Dec. 3. In a letter to Capitol Hill leaders, Yellen said the deal, “provides only a temporary reprieve,” and urged lawmakers to take further action to ensure the government can continue to borrow money. Odds are that we see another extension rather than a resolution of the issue.

Another Example of Why Timeframes Matter

In September, we saw the first decline greater than 5% in a year, which aroused investors from their low volatility slumber. Not surprisingly, we noticed an uptick in the number of client meetings meant to address concerns. Though mostly reasonable, there were a few outlier examples of clients who thought a move to cash was perhaps warranted. As bull markets do, equity prices quickly recovered, rebounding from lows, and erasing the pullback – with some even making new all-time highs in the process.

September and October reminded us of a topic we have frequently discussed over the years: timeframe selection. In other words, when designing an optimal investment strategy for a financial goal, nothing is more important than selecting the right timeframe(s) for making allocation decisions/changes.

Almost all clients we engage with recognize the importance of limiting downside while capturing as many market opportunities as possible. They also appreciate that managing downside may come with certain limitations. React too quickly and downside is averted but at the cost of potentially missing on sharp rebounds, like October, with the added sting of realizing gains that could have otherwise been deferred. React too slowly and market declines might cause an overreaction and risk permanent loss of compounding.

Solas’ strategies are designed for clients seeking to hit that “sweet spot” between too quick and too slow. Said another way, we strive to make our strategies “behaviorally friendly.” This process starts by having rules for tactical shifts that are responsive enough to minimize downside in meaningful bear markets like the tech bubble of 2000–2002 or the Financial Crisis, but disciplined enough to ignore what may turn out to be a harmless correction.

The following graph illustrates the process. Using SPY as a proxy for U.S. equities, you will notice its price (black bars) drop from the previous peak in early September to the low October 4. The graph is overlayed with the two moving averages that represent our intermediate-term time frame: the red line (10-day average) and blue line (100-day

average). The moving average lines show how these timeframes responded, converging in mid-October but never materially threatening the intermediate-term trend.



Source: Barchart.com, 7/27/2021 to 10/26/2021

Conversely, a shorter-term system would have indicated a trend change in mid-October and missed out on a portion of the recovery, while realizing taxable gains and causing turnover in the portfolio. Our more patient process ignored the 6% decline and fully participated in the rebound.

In case you're wondering, longer-term systems barely nudged toward an exit and ultimately never came remotely close to triggering a trend change.

Seeking the Optimal

Almost all investment strategies are gauged on before-tax returns over 1-, 3-, 5-, and 10-year windows. But what about the fact that most investors need to care about after-tax performance over horizons lasting 30, 40, 50, or more years? And what if those shorter-term windows do not include a meaningful bear market to consider the real risk of investing?

While we are confident that our strategies will stand up just fine over the traditional comparison periods, we admit that it is ultimately not what we are solving for. Rather, our goal is to offer you investment strategies that help maximize opportunities over the long haul.

Best,

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S&P 500 Index – a market-capitalization-weighted index of the 500 largest U.S. publicly traded companies.

SPDR S&P 500 ETF (SPY) – an exchange-traded fund (ETF) that tracks the Standard & Poor's 500 (S&P 500) index. It does this by holding a portfolio of stocks in companies that are included in the S&P 500.