

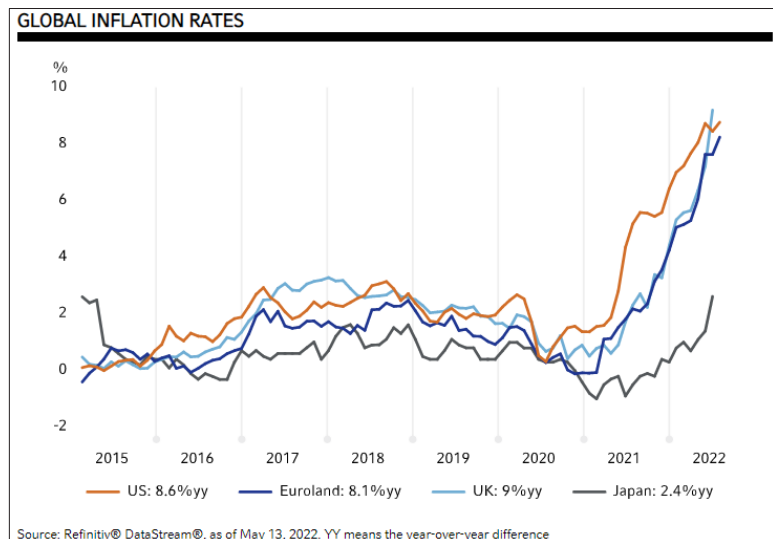


Market Update: Q3 2022

The first half of the year proved challenging for investors, as ongoing concerns with inflation, interest rate hikes and the war in Ukraine weighed on investor sentiment and drove down stock and bond prices globally. Year to date (YTD) through June 30, 2022, the broad US stock and bond indices were down 20% and 10%, respectively. While we have seen some of these concerns subside over the last month and markets regain ground, we expect this volatility to persist as markets fluctuate between fear (recession risks) and greed (recovery optimism). Our portfolios have not been immune from this volatility, but we have been reassured by the financial strength of our core equity holdings and continue to see them well positioned for the future.

Inflation Still Tops the List

Underneath the volatility of the last 18 months has been the significant rise in the prices of goods and services. Most economists consider a certain amount of inflation a sign of a healthy economy, where consumers and businesses are incentivized to spend or invest today rather than hoard cash. In 2021, higher inflation was considered a positive. The thought was that inflation would temporarily balance out supply and demand as the economy reopened and would encourage people to return to the workforce. Inflation has been stickier than expected, with the headline inflation rate based on the Consumer Price Index topping +9.1% in June 2022.



With interest rates still historically low, the

Federal Reserve and other central banks have been pushed to accelerate the pace of interest rate hikes to slow the economy. YTD, the Federal Reserve has raised interest rates by 2.25% and plans for more increases over the next six months. Along with moving interest rates higher, the Fed began reducing the size of its bond holdings. If the Fed meets its target to cut its \$9 trillion bond portfolio in half over the next three years, this would be the equivalent of raising interest rates by another 4%.

We are starting to see signs that these measures are working. Higher interest rates have pushed up borrowing costs and sales on big-ticket items such as cars and homes, which are down YTD. Prices for cars and homes remain elevated, but there are clear signs that the price increases are coming down. Only time will tell if the necessary slowdown in the economy will result in a recession. While US gross domestic product fell in Q1 and Q2 this year, a strong corporate environment with low unemployment is a clear sign we are not currently in a recession, but recession risks continue to

Market Update: Q3 2022 (continued)

rise. Outside the US, the outlook is more troublesome, as high food and energy prices hit emerging markets particularly hard. China continues to deal with virus-related lockdowns, and Europe's large industrial base faces potential energy rationing.

No Major Changes to Stocks

While the risks of recession have increased, we do not plan to make significant changes to our stock portfolio. Selectively, we have used the volatility to increase smaller growth stocks at much lower prices and have reallocated dollars between stocks. Many of the stocks that have been hit the hardest YTD do not meet our quality screen and are not in our portfolio. In addition, we have been impressed by the majority of the stocks in our core equity portfolio. Most companies have met or beaten their earnings expectations YTD and trade at lower valuations. The resiliency in these businesses has given us confidence that they can continue to manage through the current inflation, generate strong earnings and return capital to our clients through dividends and buybacks. We know stock prices can react quickly to changes in investors' current sentiment, but we still believe outperformance is generated by identifying these long-term winners rather than timing short-term trades.

Cash and Bonds

Here we have been more active. All portfolios at the firm include a cash/bond component. The amount we allocate to these more-stable assets will vary depending on a client's risk tolerance and cash needs. As interest rates (both short-term and long-term) fell during COVID-19, we worried about the diversification benefits of bonds and the impact from the inevitable rise in rates. This led us to increase cash positions and shorten the duration of the bond portfolio. This was difficult to explain to clients when stocks were advancing 30% and the bond portfolio was projected to yield under 1.5%.

One of the benefits of the sharp increase in interest rate hikes is that it has given us the opportunity to both lower cash weights and selectively add to the duration of our bond portfolio. For risk-free Treasuries, we are now able to generate 3% yields in bonds five years and below, and we are seeing much higher yields for intermediate corporate and muni bonds. We know rates can go higher from here, but unlike in the last two years, we now see bonds as a much better asset class.

We hope you enjoy the final days of this hot summer, and we welcome any questions you have on your portfolios.



Hemenway Trust Company Is Moving!
As of September 1, our address will be

**23 Keewaydin Drive, Suite 400
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Our phone numbers and email addresses will remain the same.

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