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CAPITAL MANAGEMENT

Enhanced Equity Income
Q4 2022 Commentary

Market Review:

Following declines in each of the first three quarters of 2022, US equities rebounded in the 4th quarter with the S&P 500 returning 7.6% and the Russell 1000 Value up 12.4%. Equity markets were up sharply in October and November, driven in part by talk of another potential Fed pivot, as some investors anticipate the central bank to slow or pause interest rate increases in 2023. However, the rally faded in December, as concerns grew about a slowing economy and a potential recession.

For the full year, US stocks posted their biggest declines since 2008, as the S&P 500 dropped 18.1% while the Russell 1000 Value was down 7.6%. Likely the most significant development impacting financial markets in 2022 was the sharp pivot by the Federal Reserve, and central banks worldwide, away from the ultra-low interest policies that have been in place since the 2008-2009 financial crisis. Although central bankers were gradually lifting rates in the 2017-2018 timeframe, persistently low inflation allowed them to quickly pivot back to their low interest rate regimes, particularly after the onset of Covid-19 in 2020. In 2022, with inflation running in the high-single digits, central banks were left with little choice but to aggressively raise rates. Starting at a near-zero level at the beginning of the year, the Fed Funds rate was 4.25%-4.50% by the end of the year, the highest level since 2007. The dramatic shift in interest rate policy had the most severe impact on high-multiple, long-duration Growth stocks, as reflected in the performance of the Russell 1000 Growth index, which was down 29.1% for the year. Energy (+65.7%) was by far the best performing sector, following 2021 when the sector was up 54.7%. Communication Services (-39.9%) was the worst performing sector in 2022, driven down by media and entertainment stocks.

For the 4th quarter, Energy was the best-performing sector, up 22.8%. OPEC+ upended global markets by cutting daily oil production by two million barrels, roughly twice consensus expectations. Leading Energy companies also reported another strong quarter of earnings, with higher cash flows and returns to shareholders. Industrials (+19.2%) was the 2nd best performing sector, as transportation and capital goods stocks rallied partly on economic optimism and the anticipation of a Fed pivot. Materials (+11.8%) was the next best performer, as commodities prices rallied, including copper, gold and other metals. Consumer Discretionary (-10.2%) was the worst performing sector, brought down in the quarter by outsized weights in Tesla and Amazon, both of which sharply declined. Communication Services (-1.4%) was the next worst performer, as leading media and entertainment stocks declined on disappointing earnings.

The Consumer Price Index (CPI) increased 7.1% in November, below consensus expectations and down from 7.7% in October and 8.2% in September.[1] The Fed raised interest rates 0.5% in December but forecast a higher-than-expected peak rate in 2023 of 5.1%. Acknowledging the lag between monetary policy actions and their full impact on the economy, Powell said it makes sense for the Fed to slow the pace of increases and monitor inflation and other economic data. In the mid-term elections, Democrats fared better than widely anticipated, as they retained a Senate majority and only narrowly lost the House of Representatives. The split Congress should result in gridlock, a scenario that has historically favored stock market performance.

[1] https://www.bls.gov/news.release/cpi.nr0.htm

Income and Options Summary:

Options writing remained challenging throughout the remainder of 2022, due to continued decreased volatility from the absence of larger, unexpected market corrections. The CBOE Volatility Index (VIX) remained in a pronounced, long-term downtrend from the high it recorded in late September.

Despite the options environment, the strategy met its goal of 3.5% from options premiums and earned a total income of 7.2% in 2022. The balance of 3.7% was received from dividends. At year-end, the strategy's current yield was 3.9%. In the representative account, the average call returned a premium of 19.2% annualized, and a called (total) annualized return of 92.4%. At year-end, 25 of the 33 names held in the portfolio had declared dividend increases, at an average increase of 7.6%

During 2022, the Financials, Energy, and Materials sectors provided the most call-writing opportunities for the strategy. Call options were written at an average of 4.2% out-of-the-money during both the 4th quarter and the year. Thirty percent of the contracts exposed by the 149 positions written in the representative account were assigned in 2022.

Performance Analysis:

During the quarter, the sharp outperformance of the value style began in late October and continued to diverge from growth as the year ended. As economic data confirmed that the rate of inflation might have peaked, momentum growth leadership failed to re-establish itself, pending EPS reductions and other recessionary concerns. The style's relative strength was the longer-term continuation of a period of outperformance that began with the announcement of the Pfizer vaccine approval on 6 November 2020. In 2022, the divergence of the two styles occurred in early January, and value tracked ahead of growth throughout the entire year.

The Enhanced Equity Income composite recorded a very strong year of relative performance, returning +.8% net versus -11.4% from its primary benchmark, the CBOE S&P 500 Buy/Write Index (BXM) and -12.43% from its secondary benchmark, the SPDR Barclays High Yield Bond ETF (JNK). For the fourth quarter, the strategy returned 14.8% versus 6.8% and 4.1%, respectively.

Compared with the S&P 500 Index, the underlying strategy of the BXM, The Enhanced Equity Income strategy was buoyed during the year by its strong allocations to the Energy, Health Care and Materials sectors, and its light allocations to Information Technology, Consumer Discretionary and Communications Services sectors. The strategy's focus on banks in its Financials allocation underperformed. Three of the top four performing equities were in the Energy sector.

Figure 1: Enhanced Equity Income Returns vs. Benchmark

December 31, 2022	QTD	YTD	1 Yr	3 Yr	5 Yr	Since Incept*
SCCM Enhanced Equity Composite (gross)	**15.2**	**2.0**	**2.0**	**8.6**	**7.9**	**9.3**
SCCM Enhanced Equity Composite (net)	**14.8**	**0.8**	**0.8**	**7.3**	**6.7**	**8.2**
S&P 500 Buy-Write Index (BXM)	6.8	-11.4	-11.4	1.3	2.7	5.7
SPDR Bloomberg High Yield Bond ETF (JNK)	4.1	-12.4	-12.4	-1.5	1.3	3.7
Russell 1000 Value Index	12.4	-7.6	-7.6	6.0	6.7	10.0

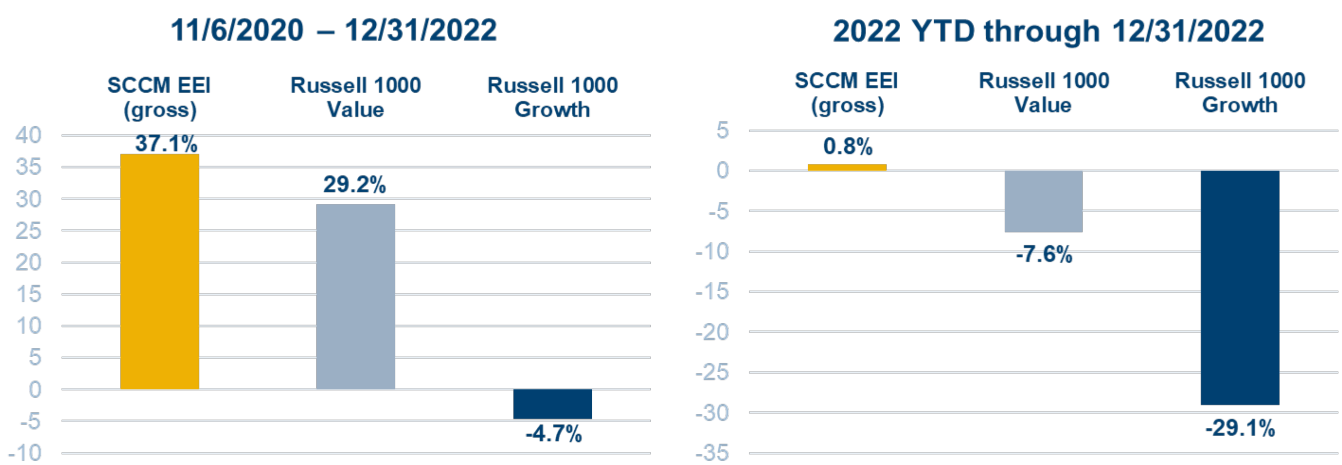
12/31/2010. Performance for periods greater than 1 year is annualized.* ***Past performance is no guarantee of future results.*

The strong fourth quarter market rally, initially driven by signs of peaking inflation, strengthened after core CPI in October declined from the prior month's decades-high reading. The subsequent release in November confirmed a downside break from the escalating inflation trends experienced over the past year. Equity markets quickly began to discount an earlier pause in the Federal Reserve's tightening cycle. However, despite the welcomed drop in inflation, equity markets drifted lower in December with the historically positive seasonal tailwinds failing to materialize. The Fed remained resolute in its primary objective to bring inflation lower and reiterated the need to observe a sustained decline before adjusting monetary policy to a less restrictive stance. Importantly, the Fed's quantitative tightening program, the reduction of its balance sheet through asset sales, remains an overhang on the market as it pressures money supply. Meanwhile, global economic growth is further decelerating and numerous leading indicators point to an imminent decline in earnings and an increasing chance of recession.

Value led the market higher in the fourth quarter and outperformed Growth for the full year. Growth stocks faced headwinds from higher interest rates, more restrictive financial conditions and a greater preference for current, sustainable earnings. The more speculative and richly valued an asset, the greater the underperformance as higher rates have highlighted the importance of cash generation, financial discipline and balance sheet strength. Pockets of blow-ups among former market darlings such as cryptocurrencies, the continued weakness of Covid beneficiaries in market rallies and the underperformance of former bulletproof FANG stocks suggests a secular change in market leadership. The Russell 1000 Value outperformed the Russell 1000 Growth by 10.2 ppt in the quarter and 21.6 ppt for the full year 2022, the largest annual spread between the two indices in 20 years.

High dividend stocks benefitted from a preference for quality, low-beta and defensive earnings and cash flow. The sharp rise in interest rates pressured long-duration growth stocks and highlighted the relative attractiveness of current income and inflation hedges. The Enhanced Equity Income strategy has outperformed the Russell 1000 Value and Russell 1000 Growth indices since the initial turn to Value in November 2020 (Figure 2). As we look ahead to market opportunities and risks, we evaluate the deteriorating economic environment but see reasons for optimism in the Market Outlook section of the commentary.

Figure 2: Performance Since Pfizer Vaccine Announcement and YTD 2022



Relative Performance	11/6/20 – 12/31/22	FY 2022
Value vs Growth	+33.9%	+21.6%

Source: CCM Research, 12/31/2022.
Past performance does not guarantee future results. You cannot invest directly in an index.

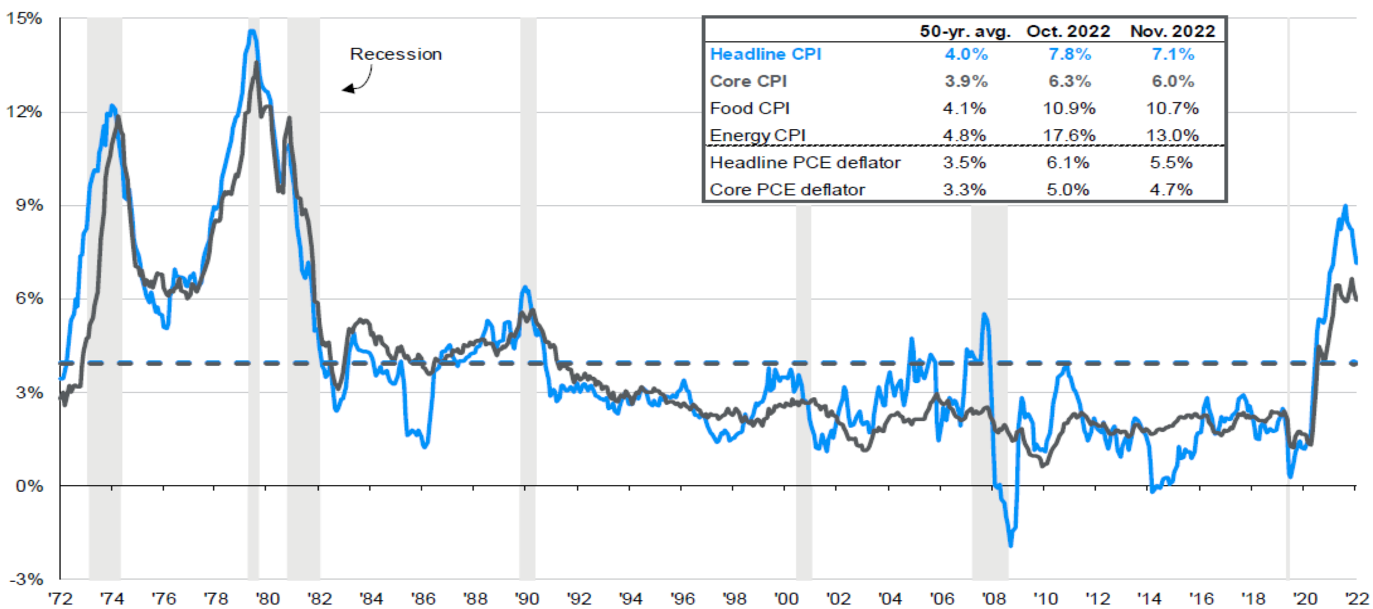
Portfolio Changes:

There were no purchases or sales in the fourth quarter.

Market Outlook:

Global inflation appears to have peaked and is decisively falling as one of the most widely watched economic releases, US monthly CPI, showed year-over-year headline inflation declining from a decades-high reading of 9.0% in June to 7.1% in November (Figure 3). The less volatile core CPI measure peaked in September at 6.6% and has since declined to 6.0% in November. The combination of decelerating economic growth, more stable commodity prices and a moderation in wage and shelter inflation point to headline and core inflation moving closer to the Fed's target. This has brought considerable relief to financial markets as Fed futures predict lower peak rates and interest rate cuts considerably earlier than the Fed's current communicated plans.

Figure 3: US CPI Y/Y Change



Source: JPMorgan, Guide to the Markets, 12/31/2022.

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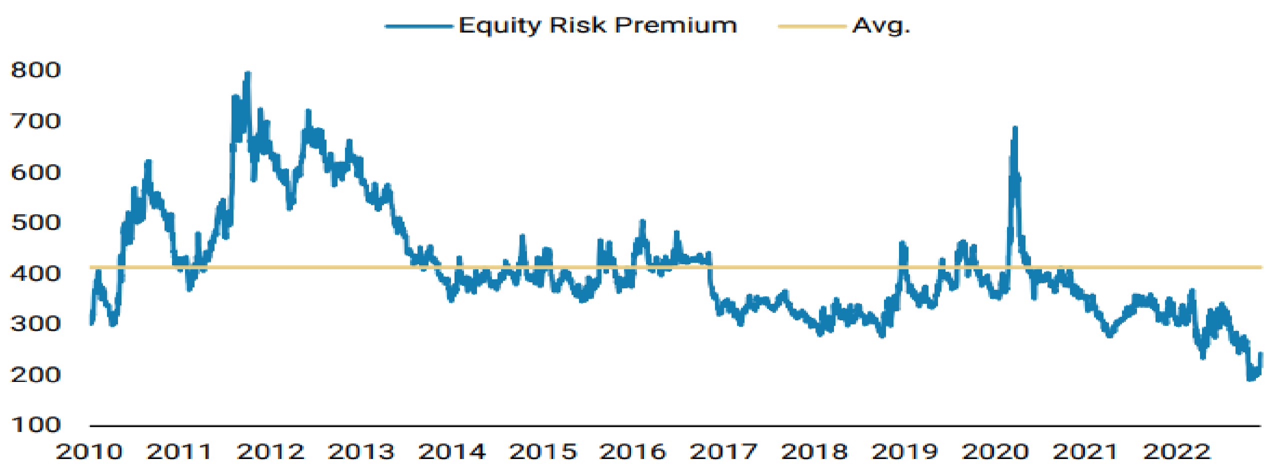
Meanwhile, the effects of the fastest and most aggressive global central bank tightening cycle in decades is impacting global growth and corporate earnings. The effects of monetary tightening typically work with a lag but are already evident in broadening economic weakness, drawing increasing concerns of an eventual recession. Economic and financial market data indicate an increasing likelihood of a recession:

- Currently, 84% of Treasury yield curves are inverted. The US 10Y-2Y Treasury Spread is the most negative in 40 years; an inverted yield curve has historically preceded recessions.
- A variety of leading economic indicators are flashing red: 75% of the world has a manufacturing PMI in contractionary territory (including the US), the USES Business Cycle Indicator (combination of hard and soft economic data) turning severely negative, and housing gauges weakening.

- Money supply (M2) year-over-year growth fell to zero in November 2022, the lowest level since 1995.
- Positively, the unemployment rate, a lagging indicator, remains near cycle lows; however, the consumer personal savings rate has reached a 15-year low, indicating a weaker spending environment ahead.

The US equity bear market, a full year in length, has been driven by a significant decline in valuation multiples as a result of higher inflation / interest rates and fears of an economic slowdown. The Price/Earnings multiple on the market fell from 21.4x (January 2022) to 16.7x (December 2022), a 22% decline. However, the spike in interest rates led to a drop in the Equity Risk Premium – the excess compensation needed to take on more risk – to below its long-term historical average (Figure 4), indicating a lower equity market return profile. The current equity risk premium is materially below levels typically observed at bear market lows suggesting the market has yet to price in a meaningful earnings downturn.

Figure 4: S&P 500 Equity Risk Premium



Source: Morgan Stanley, Weekly Warmup, 12/19/2022.
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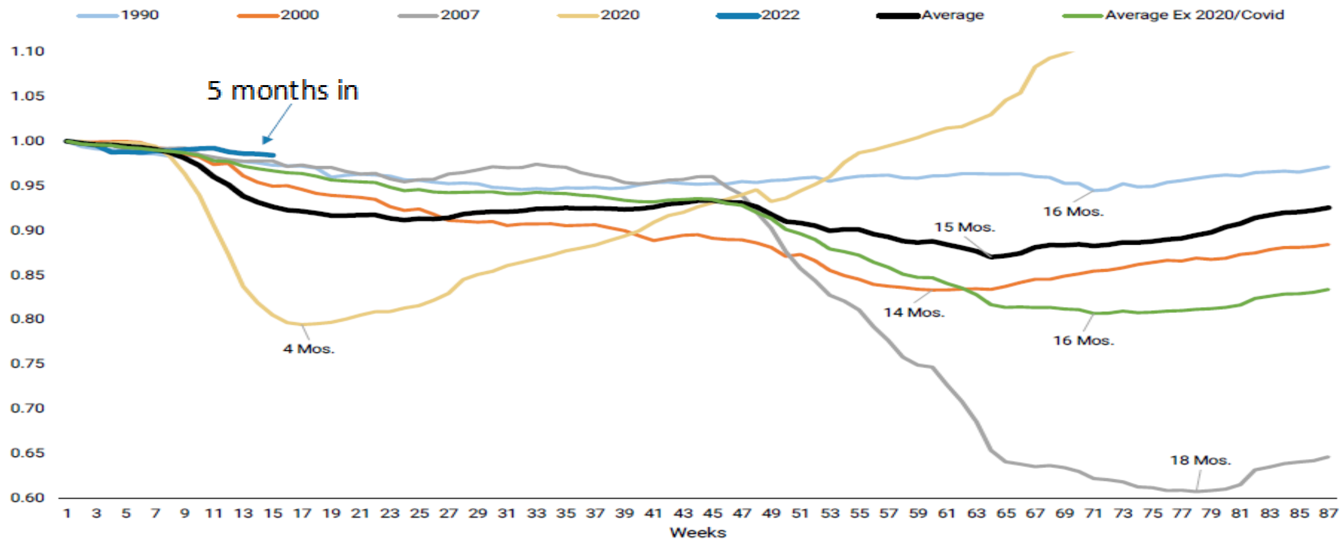
The second leg of bear markets is driven by a decline in corporate earnings. Currently, consensus earnings expectations for the S&P 500 are for a 4% increase in EPS in 2023, a level which is likely to be revised lower in the coming months. In recessions, the S&P 500 EPS declines by an average 15% (magnitude) for on average 15 months (duration) (Figure 5). In this cycle, earnings have declined for 5 months; therefore, we are likely in the early innings of an earnings downturn. Importantly, S&P 500 Dividends per Share have proven to be particularly resilient in recessions with S&P 500 DPS largely flat in most recessions. Dividends become the key contributor to total returns in down markets.

Figure 5: Forward EPS Declines Around Prior Earnings Recessions



Source: Morgan Stanley, Weekly Warmup, 10/17/2022.
Past performance does not guarantee future results. You cannot invest directly in an index.

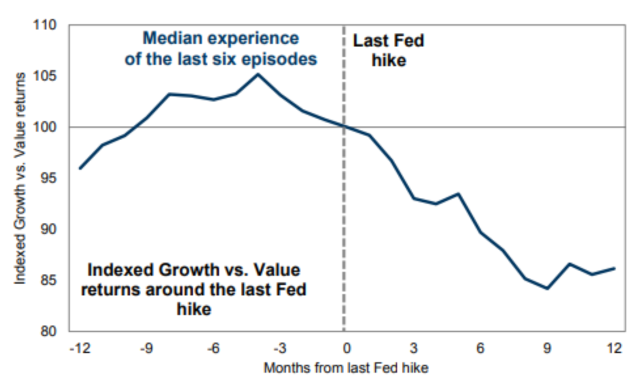
Despite all these concerns, there is reason for optimism. Equity bear markets typically bottom before fundamentals improve – past bear markets have typically troughed approximately two quarters before EPS bottoms. On the one hand, markets could be supported by weaker growth and the several rate cuts being discounted into Fed futures as a result of higher recession probabilities and a shift in focus back to growth in a pre-election year. On the other hand, a soft landing could counterintuitively be a more bearish outcome as it would serve to maintain a more restrictive monetary policy.

Looking ahead, the Fed expects to pause its rate hike cycle as inflation declines to more acceptable levels. Historically, after the peak in Consumer Price Index (CPI) (Figure 6) and after a Fed pause (Figure 7), Growth has surprisingly underperformed Value over the subsequent year.

Figure 6: Growth vs. Value Returns Following Peaks in Core CPI

CPI peak	Growth vs. Value returns in 1/3/6/12m from core CPI peak: 1m	3m	6m	12m	Core CPI peak (YoY)
Jun-80	(2)%	2 %	4 %	4 %	14 %
Sep-81	4	(0)	(7)	(7)	12
Aug-84	(4)	(7)	(9)	(9)	5
Feb-91	(2)	(2)	(3)	(3)	6
Dec-01	(5)	(11)	(15)	(15)	3
Sep-06	(0)	(2)	(3)	(3)	3
Apr-12	1	2	(3)	(3)	2
Aug-16	(1)	(7)	(7)	(7)	2
Median	**(1)%**	**(2)%**	**(5)%**	**(5)%**	**4 %**

Figure 7: Growth vs. Value Performance Around Last Fed hike



Source: Goldman Sachs Research, US Thematic Views, 9/6/2022.
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The recent market leadership of Value stocks has a number of long-term secular tailwinds for sustained outperformance. First, while near-term inflation may subside, the underpinnings of several inflationary trends will continue to build, benefitting Value stocks:

- Globalization, a driver of deflation over decades, is no longer providing downward pressure on pricing for manufactured goods as import prices from China are no longer falling at the same magnitude as in the deflationary era. In addition, reshoring and corporations' drive to increase manufacturing base diversification is inflationary in nature.
- Demographic trends, highlighted by the global support ratio (number of workers to number of consumers) declining, are turning increasingly inflationary as output will potentially decline relative to spending over the coming years.
- The unmitigated rise of global sovereign debt over the past several years coupled with rising rates may increase investor preference towards hard assets.

Next, money supply growth is a key factor in financial conditions and liquidity as well as investor risk appetite. The Fed's quantitative tightening actions are leading to a decline in money supply (M2) which is reversing the impact of quantitative easing; since 2009, the Fed's balance sheet expansion has a near perfect correlation with the rise of large cap technology stocks. In addition, investors willing to pay up for Growth stocks on the view that they provide better relative growth in downturns would be surprised to find that three of the top ten industries with the highest correlation with composite PMI levels (cyclicality) are in the Technology and Communication Services sectors (Source: Morgan Stanley Research). Furthermore, the opportunity for Value to outperform Growth given the abnormal length and magnitude of Growth's recent decade of outperformance rests on the improving valuation of Value stocks or mean reversion of Technology stock performance (Figure 8). The weight of the largest four stocks in the S&P 500 peaked at 22% of the index in 2021 and is currently 18%, still far above the long-term historical average weight (Figure 9). Despite the bearish headlines in 2022, flows into Domestic ETF and mutual funds were over $100B for the full year (Strategas, 4Q'2022 Quarterly Review in Charts, 1/3/2023).

Figure 8: 10-Year Annualized Monthly Returns from Technology Stocks

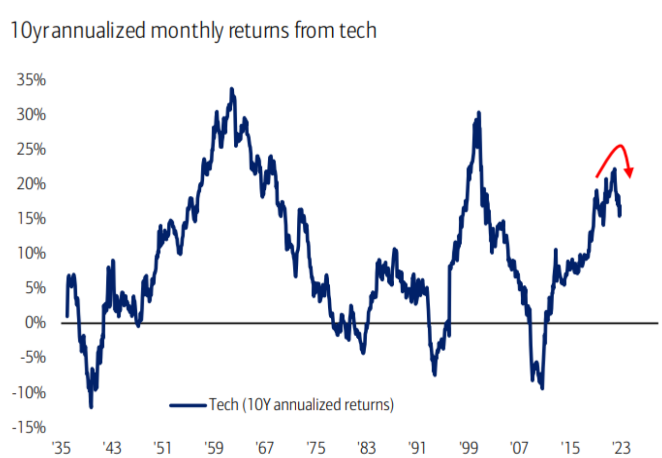
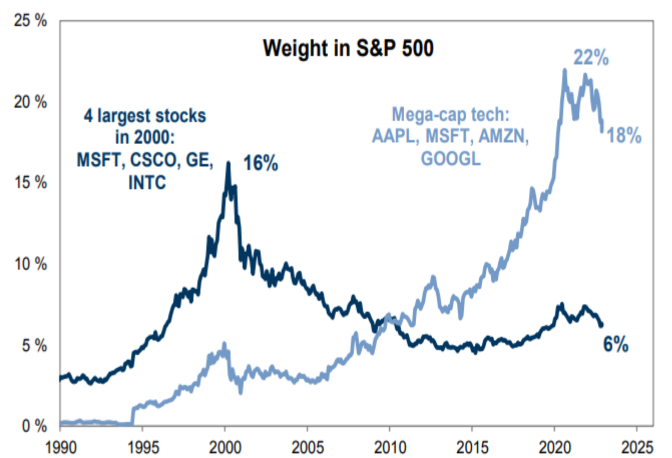


Figure 9: Weight of Largest 4 Stocks in the S&P 500



Source: BofA/ML, The Flow Show, 10/27/2022; Goldman Sachs Research, 2023 US Equity Outlook, 11/21/2022.
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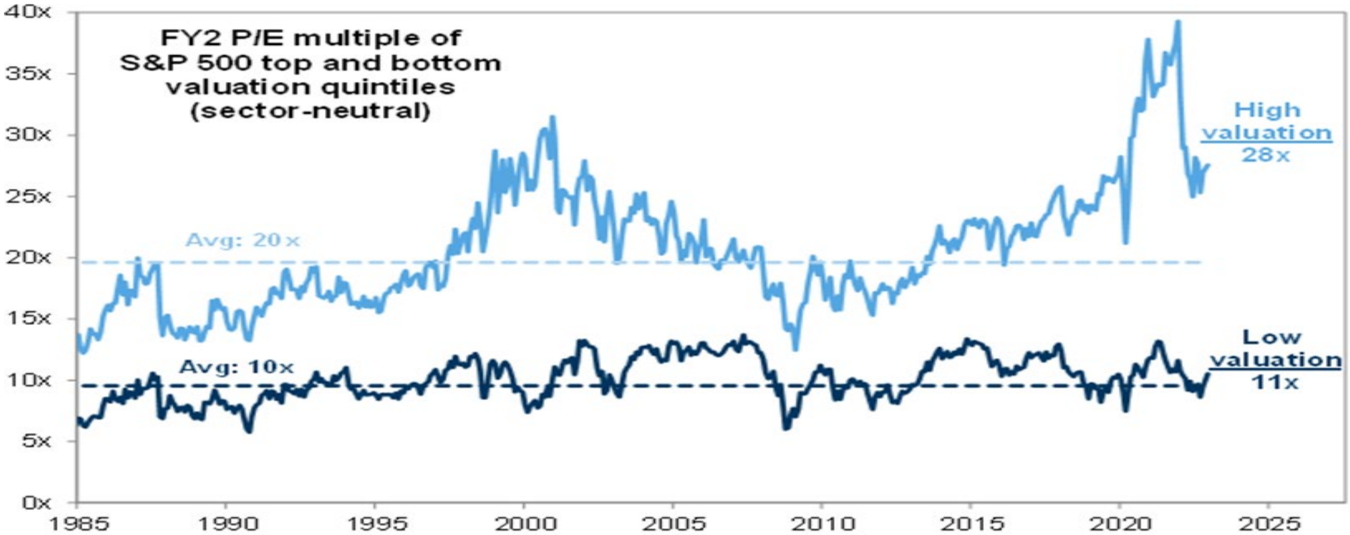
Value stocks still represent an attractive investment from a valuation perspective. Despite the recent relative outperformance of Value stocks, the valuation spread between Growth and Value stocks in the S&P 500 is still historically wide (Figure 10).

Figure 10: Valuation Between Growth and Value Stocks



Source: Goldman Sachs Research, 12/31/2022.
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Thank you for your continued support. Feel free to reach out to us if you have any questions.

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