Waterfront Opportunistic Equity

Fourth Quarter Commentary:

The Opportunistic Equity Strategy returned -12.9% in 2022, which was a little ahead of its benchmark and beat the S&P 500 by over 500 basis points. The strategy has many cyclical stocks that tend to sell off harder than broader markets in bear markets. Two things helped to keep returns better than benchmark and better than its sister strategy the OS, even though the OS is supposed to be a more risk-adverse strategy. The OE takes more of a trading approach vs the buy and hold approach of the OS. In 2022, the full sales of stocks in the OE vs. perhaps only a trim in the OS proved beneficial. Also, the OE has a heavier international weighting than the OS which proved to be beneficial as well.

As of 12/31/2022	1 Year	3 Year	Since Inception
Opportunistic Equity	-12.9%	17.5%	17.5%
Benchmark	-14.6%	3.7%	3.7%
SPX	-18.1%	7.6%	7.6%

*Inception is 1/1/2020

Some of the highest performing stocks in 2022 included Unum Group, Cigna Corp, and Impinj. Unum was bought as an investment for rising interest rates. The positive impact to Unum's business from rising rates was not fully appreciated by investors and as the year unfolded, it became clear how beneficial higher interest rates were. Cigna Corp was bought as a defensive holding but it ended up doing quite a bit better than other managed care as it executed well and its valuation discount closed to peers. Cigna is an example of the type of companies I look for. A company that has a valuation discount due to perceived inferiority to peers but through solid execution the company can close that discount as investors start to think the discount is not necessarily warranted. Impinj had a very strong return considering it is a semiconductor technology company. RFID prospects for increased adoption continue to grow and this company truly does have a massive market opportunity, so enthusiasm is rampant. Impinj's investment issue is if it can grow fast enough to justify its stock price.

Advancers/Detractors	2022 Return
Unum Group	73.6%
Cigna Corporation	46.7%
Impinj, Inc.	23.1%
Hanesbrands Inc.	<59.7%>
Interfor Corp (in USD)	<51.1%>
Ally Financial, Inc.	<46.9%>
Intel Corporation	<46.7%>

Some of the lowest performing stocks included Hanesbrands, Interfor Corp, Ally Financial and Intel. The innerwear business of Hanesbrands was viewed as more defensive than other apparel and I considered Champion to be a secular growth story that could hold up in a tough environment. Both of those beliefs were largely wrong and Hanesbrands has too much leverage to keep its stock price up in a declining business environment. Interfor largely spent its windfall of profits from the pandemic on acquisitions and did not keep the cash cushion that some of its peers kept. Therefore, as lumber markets corrected in a big way, its stock sold off more. It has tremendous upside to an improving lumber market but a meaningful uptick in housing starts and remodeling projects does not seem to be right around the corner. Ally Financial's stock sold off on fears of a surge in auto delinquencies and concerns over NIM (net interest margin) compression due to the need to pay more for deposits. Those are both valid concerns but one could argue the fear over both of those dynamics is overblown. Intel sold off with all semiconductor stocks on the global slowdown and too much semiconductor inventory built up. Intel also had another delay, this time with Sapphire Rapids, its chip to help stabilize share in the data center. Because of this, it continued to lose share in the data center. Intel and Interfor were trimmed earlier in the year so the strategy absorbed those losses at a much lower weight than it started the year.

Looking forward, the OE has a very heavy weighting to international stocks. 57% at 12/31/22 and that is at the extreme end of where the strategy will go. Europe has so far dodged an energy crisis this winter due to very warm weather. Economies in Europe are proving resilient and there is talk of avoiding a recession in many European countries. The valuation discount of European stocks is not justified by economic growth prospects. The growth prospects in Europe are believed to be similar to that of the United States. Japanese stock prices look attractive and an economic recovery in Asia can be a catalyst for stock outperformance there. Emerging Market assets have a good chance of benefiting from the upcoming peak in US interest rates and then the ensuing decline in rates. How much pent-up demand there is in China as China opens up from Covid remains to be seen. However, the OS does maintain the view that the government of China does not want to be seen as an enemy of the capital markets and fears over government control over private companies are overdone. India has the best secular growth story of any large economy.

The markets are pricing in a 1 year US inflation rate below 2% and that does seem reasonable considering almost 70% of core cpi is made up of goods and housing, two categories that very well may experience deflation in 2023. As the year unfolds, investors will focus less on inflation and more on the structural productivity problems in the US coming out of Covid that are not easily solved. These range from worker shortages to debt's impact on productivity to the impact of elevated asset prices on economic growth to a dysfunctional government. While many stock prices are reasonably priced, what can drive meaningful and sustainable real growth in our economy is a little bit of a mystery at this point. And that means a diversified allocation that includes a healthy percentage of international assets make sense for 2023.

Chris Harrington
Portfolio Manager

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