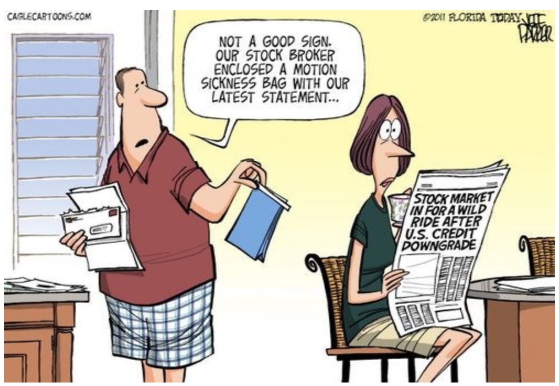
MarketView

Second Quarter 2023

Whipsawed



All things considered, we got off to a decent start in the first quarter of the year with the S&P up 7.5%, however, the path to get there was a bit of a roller coaster. We started the year with value stocks outperforming growth as banks and financials led the way. Then, in early March we had a mini banking crisis that hit the financials hard. When the dust settled, the regional bank index was down 23.5% for the quarter, but technology growth stocks were up significantly as rates dropped back down. In fact, three stocks (Apple, Microsoft, and Nvidia) were responsible for half of the entire S&P 500 gains during the quarter.

It appears that a full-blown banking crisis has been averted, but banks will face some headwinds as they are forced to pay higher interest rates on deposits and as customers convert their bank deposits to securities that pay more interest, such as CD's and treasuries. Additionally, commercial loans present some problems as the work-from-home trend continues and office buildings remain underutilized.

As we look back, the rapid rise in interest rates last year led to significant unrealized losses on bank balance sheets. Rates rose from almost nothing in 2021 to around 5% early this year. The best solution to higher rates for banks is lower rates. To a large degree, that has happened. For example, two-year treasury rates hit 5.05% on March 8th and just over two weeks later had dropped to 3.76% on March 24th. This will help lessen the unrealized losses banks are carrying and put them on a firmer footing if they need to sell loans or securities to fund deposit withdrawals.

So, what to do. We continue to position for the longer term and pay less attention to the week-to-week moves. That said, on occasion, we will take advantage of the opportunity gifts that the market sometimes presents.

Is the New ESG Rule a Big Deal?

Over the past several years there has been a greater public interest in sustainable investing. This is often referred to as making investment decisions based on environmental, social and governance (ESG) factors. On February 1st, a new Department of Labor rule went into effect that clarifies ESG within the context of "investment duties" of those with a fiduciary responsibility for plans that fall under the Employee Retirement Income Security Act (ERISA) such as 401(k)s, profit sharing, pension plans, etc. The long-standing Department of Labor position has been that fiduciaries may not sacrifice investment returns or take on greater risk to promote social policy goals. The new rule takes a neutral stance stating that a fiduciary "may consider" ESG factors that are financially relevant to an investment's risk-return analyses.

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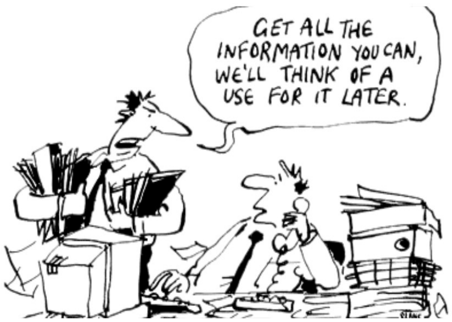
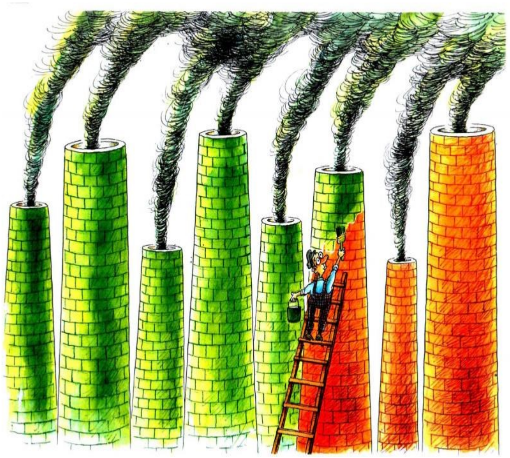
Like almost everything these days, there has been a great political debate regarding what these changes mean. On the right, they call it "woke investing" and on the left it is seen as a way to promote equity or to save the planet. Both sides make some legitimate points but given the fairly neutral stance of the rule (may versus must consider ESG factors) and the current practices of most investment advisors, each is probably way off the mark. That said, the Republican controlled House voted to cancel the rule change. Surprisingly, the Democratic controlled Senate voted to do the same. The president vetoed the bill leaving the rule in place for now, but it faces many court challenges and could be overturned in a future administration.



Whether the rule stays or goes, may not really matter. According to a recent Russel Investments survey, 82% of U.S. based asset managers already incorporate ESG information in their investment process, GS Investments included. This was without any rule being in place. On its face, this makes a lot of sense. As corporate governance expert Neil Minow wrote , "if we have learned anything from the market upheavals of the last 40 years, from the dot.com implosion to the Enron-era accounting failures to the financial meltdown caused by wildly inaccurate ratings of bundled sub-prime securities, it is that Generally Accepted Accounting Principles are inadequate to give us the information to assess risk and return". ESG offers a broader approach to evaluating risk that may not be effectively covered in the quarterly financials. Multibillion dollar environmental disasters, companies that face boycotts or strikes due to their treatment of customers and employees, or governance issues that result in bankruptcy, should be taken into account when considering an investment, and most managers do. The argument for ESG is that it can reduce costs, open new employee pools and end markets, and minimize company threatening risks.



That is not to say ESG offers a perfect solution. ESG is not well defined, has inconsistent data and measurements, has spotty regulation, and minimal requirements for documentation. For this reason, some dismiss ESG as being politicized or a push towards a social agenda. Take for example the case of Tesla. Early on Tesla, with its electric car and solar energy divisions was an ESG darling, then Musk bought Twitter, and the ESG rating of Tesla collapsed. Was the rerating political, or a function of a better understanding of the carbon footprint of mining for heavy metals in zero emission products? Who knows. Greater transparency and consistency may help resolve some of this.

"Greenwashing", where a firm paints a better than actual picture, is also a huge problem. If anyone has been on a Delta flight over the last couple years, you may have watched the pre-flight video that promotes its 2030 carbon neutral goal. While some of the underlying programs have resulted in weight reductions

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Notable Quotes

"How many millionaires do you know who have become wealthy by investing in savings accounts? I rest my case."
Robert G. Allen

"Sustainability and growth must coexist. Look at nature: things only sustain themselves when they continually grow. Growth is a prerequisite for sustainability.
Hendrith Vanlon Smith Jr

"Given a 10% chance of a 100 times payoff, you should take that bet every time."
Jeff Bezos

"Don't look for the needle in the haystack. Just buy the haystack!"
John Bogle

"I don't look to jump over seven-foot bars; I look around for one-foot bars that I can step over."
Warren Buffett

"If there is one common theme to the vast range of the world's financial crises, it is that excessive debt accumulation, whether by the government, banks, corporations, or consumers, often poses greater systemic risks than it seems during a boom."
Carmen Reinhart

and operational efficiencies, this minimal reduction in fuel usage in no way puts them on track to be carbon neutral in less than 7 years.

Astonishingly, ExxonMobil, the oil and gas giant, pledged to be carbon neutral by 2050. However, read the fine print and this only relates to their own operations. They do not include the carbon produced from oil and gas burned in your car and furnace. That's on you. In fact, a study published last year in the Washington Post indicated that no company in their study was on pace to achieve the announced carbon reduction goals when measuring all inputs and outputs of the companies in the study. These exaggerated claims are more about feel-good marketing campaigns than about saving the planet. Since there are no standards, few regulations, and short memories, they can get away with it.

While most of the focus has been on environmental issues, governance may be of more importance. Only recently, Silicon Valley Bank went bankrupt due to an old-fashioned run on the bank. They loaned money to green start-ups and had fully staffed equity and inclusion departments. Given these factors, Morningstar gave them an ESG rating of "A", but overnight they went under. Apparently, the company was without a Chief Risk Officer in place to process the bank's risk limits. The company received $100 billion in new and fluid deposits in 2022 and invested most of them in long-dated bonds that lost significant value when rates soared last year. In fact, governance factors appear to be the most significant in achieving market beating returns.

Last year, the Wall Street Journal and Reuters both came out with studies regarding market performance on ESG funds. The Wall Street Journal said ESG funds underperformed while Reuters said they outperformed. Differences in methodology, what companies were included, timeframes, etc. led to differences in outcomes, but a deeper dive showed that on the Reuters study, most of the outperformance was due to governance ratings.

Another reason there is no agreement on performance metrics is that there is no clear definition of an ESG fund. Some ESG managers buy the biggest polluters or those with governance issues to try to fix them within in order to gain stock appreciation. Others exclude whole categories (i.e. no fossil fuel companies or big pharma). Alternatively, some funds buy the best-in-class ESG firms across all S&P sectors. One of the simplest explanations regarding relative performance is that many ESG funds have had lower exposure to oil and gas. For most of the past decade, energy firms have underperformed

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the market, then after the Russian invasion of Ukraine, they wildly outperformed.

Most ESG funds performed in accordance with this simple allocation variance.

So where do we go from here? With ESG allowed to be considered as part of the investment process, the SEC is looking into standardizing definitions and reporting metrics so companies can be compared on an apples-to-apples basis. However, this will inevitably bring more political debate into the mix. Some believe this will lead to more regulations, fines, court challenges etc. ultimately leading to declining trust in the system. Others think it will lead to more informed investment decisions. Time will tell.

In the meantime, GS Investments, like most investment managers, will continue to look at ESG factors, especially governance, in limiting risks while achieving positive returns.

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20 Years & Growing

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GSI Tenets

GS Investments

GS Investments, Inc. is an investment management company specializing in individual and institutional asset management. Privately owned and operated, GS Investments, Inc. is run by its owners, Glenn H. Steinke, C.F.A., John G. Steinke, M.B.A. and Greg Cunningham.

Glenn Steinke, CFA brings over 50 years of investment management experience to the business. Previous capacities include Vice President and Senior Investment Officer with a major pension fund ($1.8 billion under management) and Senior Vice President with a major Minneapolis-based financial institution ($3 billion under management). Glenn is a graduate of the University of Minnesota.

John Steinke MBA offers a broad financial services background with 29 years of portfolio management experience and 7 years of banking experience including capacities as a Vice President of a $50 million bank and as a private banking office for a large, Minneapolis-based financial institution. John received his BA from Concordia College (Moorhead) and his MBA from the University of Minnesota.

Greg Cunningham Prior to joining GS Investments, Greg spent 18 years at Minneapolis-based Ameriprise Financial, a national leader in financial planning with over 2 million retail clients and $300 billion in assets. Here he worked with the Chief Investment Officer in support of the international and domestic hedge funds and with the President and General Manager of RiverSource mutual funds. Greg is a graduate of Gustavus Adolphus College in St. Peter, MN.

Sheri Ritchie brings over 30 years of financial services experience to the business. Previous capacities include client service and support positions with Dean Witter and Kemper brokerage firms and a Minneapolis-based investment management firm. Sheri is a graduate of the University of St. Thomas.

GSI Investment Philosophy

GS Investments, Inc. utilizes a balanced approach for the majority of its accounts although each account is tailored to the individual needs of each client. Taxable or tax-exempt bonds are used along with a common stock component. The division between bonds and stocks is determined by the personal objectives of each client. A need for income and a willingness to assume risk are also determinants of an account's bond/stock mix.

GS Investments, Inc. emphasizes the purchase of quality securities and employs a long-term investment style, as market timing, frequent shifts in asset allocation and interest rate forecasting are not consistent with the firm's philosophy. In-depth market analysis and many years of experience support this approach.

GSI Fixed Income Strategy

GS Investments, Inc. emphasizes a staggered maturity approach when purchasing bonds. Individual security investment grades and call protection are considered when making these investments. Quality grades of "A" or higher are favored with tax-exempt issues. Government bonds are dominant among taxable securities.

GSI Equity Strategy

GS Investments, Inc. favors stocks emphasizing quality and growth. Appropriate cyclical growth stocks and small capitalization growth stocks are used periodically as well. Additionally, GS Investments, Inc. believes that a growth oriented philosophy tends to result in less frequent trading and lower tax payments (for taxable accounts) on realized capital gains. This provides a lower cost approach for the client.

GSI Client Communication

GS Investments, Inc. emphasizes client communication. Written investment objectives as well as periodic oral and written reports are used to heighten the understanding between the client and investment manager. In addition, easy to read, detailed reporting is provided by state-of-the-art investment software in order to inform the client of portfolio progress.