



# Auxier REPORT

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## Fall 2022 Market Commentary

Global stock and bond markets remained under pressure in the third quarter as the world continued to deal with higher-than-expected inflation and disruptive geopolitical events. In the US, stocks as measured by the S&P 500 were down 4.9% for the quarter and 23.9% year-to-date. Energy remains the only industry that has recorded a positive return this year. The US dollar gained 7% during the quarter and 17.19% year-to-date. It is at its highest point in 20 years which hurts US multinationals and pressures emerging markets. The chart below shows how recent drops in Chinese markets have wiped out gains over the last three decades. It illustrates the dangers of communism as the government has turned extremely hostile toward free market capitalism. Harsh COVID-19 lockdowns and an imploding real estate market are contributing to slowing GDP (gross domestic product) growth which in turn negatively impacts global growth.



China's population is expected to shrink in 2022 for the first time in 70 years.

After being crippled due to the pandemic, international travel has been making a recovery throughout the year which has boosted cross-border payments for companies like Mastercard and Visa. Despite ongoing inflation pressures and recession fears, both have seen their volumes surpass pre-pandemic levels. In the first half of the year, Mastercard's cross-border volumes were 140% higher than the same period in 2019. We

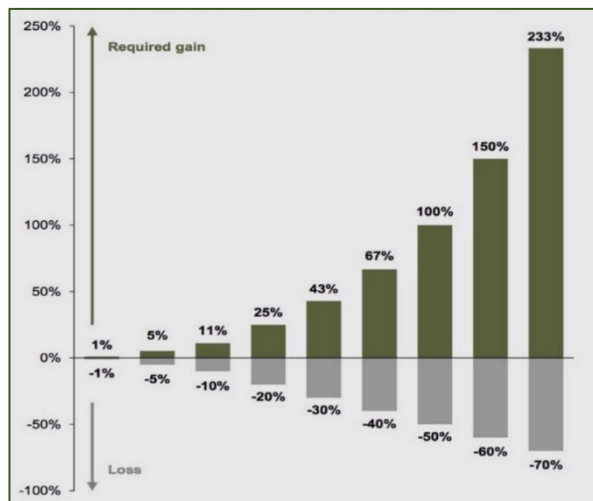
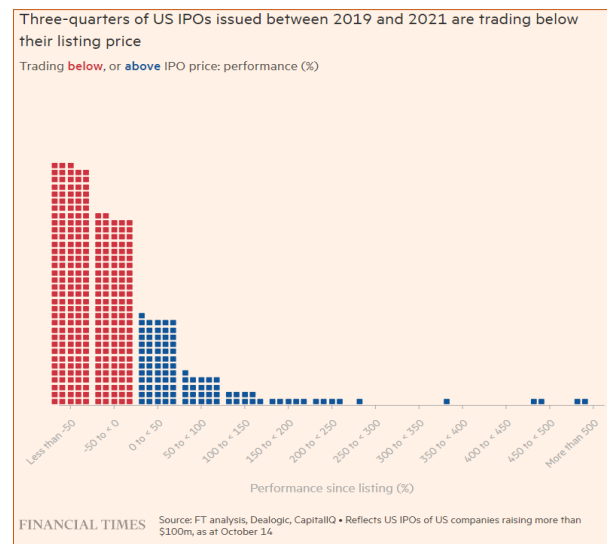
continue to see positive pricing and strong fundamental demand in the insurance industry. Higher interest rates enhance the value of insurance float while increasing cash flow on investment portfolios. Insurance companies tend to perform well during recessions as they offer something consumers need. Health insurers we own like UnitedHealth, Elevance, CVS and Cigna are seeing good demand with the growth in Medicare coverage. Conservative property casualty insurance companies like Travelers, AIG and brokers like Marsh & McLennan, Ryan and AON benefit from firm pricing and increasing coverage following disasters like Ian. Elsewhere in the healthcare industry pharmaceuticals like Merck are outperforming with strong revenue and earnings growth. Positive results from their blockbuster cancer treatment Keytruda led to a 14% overall sales gain. Keytruda was the second highest-selling drug in the world in 2021 behind AbbVie's Humira. Their cancer therapy could become the top-selling drug in 2023 as it is expected to earn \$21.6 billion according to a peer reviewed journal from Springer Nature Group. The company generated cash flow of \$13.12 billion in 2021 which they use to invest heavily into their new drug pipeline. Despite consistently good performance during the year, Merck trades at a reasonable valuation with a P/E on 2023 EPS of 13.

The energy sector outperformed nearly every other sector during the quarter and was a strong contributor for the Fund. The sector makes up about 5% of the S&P but is accounting for over 10% of the profits. OPEC+ plans to reduce oil production by 2 million barrels per day in November which adds further support to oil prices. In response to this reduced supply, the US has been releasing more of their strategic petroleum reserve (SPR) to help control prices at the pump. At the end of the quarter the US's SPR was at the lowest level since 1984 and the White House is planning to release another 10 million barrels in November. Replenishing the SPR will add further to demand. Rising oil prices should benefit energy companies that we hold down the line such as BP, ConocoPhillips, Valero Energy, Phillips 66 and Chevron. US shale producers are seeing improved fundamentals due to more disciplined spending and are expected to wipe out \$300 billion in losses just in 2021 and 2022. Deloitte forecasts that the global oil and gas industry will generate a record \$1.4 trillion in free cash flow in 2022 and could become debt-free by 2024. The US exported a record five million barrels per day for the first time in August.

The technology sector was a detractor for the Fund during the quarter. In general, the past few years we have seen a massive capital spending boom in tech, telecom and media. The market is now punishing undisciplined, sloppy capital allocation. Many companies like Alphabet and Microsoft have reduced job openings or frozen hiring completely. However, Alphabet's \$140 billion in cash represents 14% of its market capitalization. One could argue that Google Search and YouTube are necessities for most Americans. Advertising is a key revenue driver for Alphabet and ad spend is one of the first costs to get cut in a recession. In addition, personal computers have seen a massive glut after the COVID-19 supply chain bottleneck. According to the *Wall Street Journal*, demand for PCs has dropped off the fastest in 20 years. Technology stocks comprise less than 8% of the Fund vs close to 27% for the S&P 500.

### Euphoria and Easy Money a Lethal Combination

Years of zero interest rates and ebullient market sentiment created unrealistic expectations for many investors. Reckless speculation led to the cryptocurrency (20,268 currencies as of July 2022) and IPO bubbles which we are now seeing collapse. According to *Forbes*, there were 1,073 IPOs in 2021 that raised \$317 billion. Over 50% of these listings were done through the highly controversial special purpose acquisition company (SPAC) model. 2021 was a record year for IPOs. Companies that were chasing growth at any cost are now paying the price as higher inflation and interest rates crush money-losing enterprises no matter how popular the story. This chart from the *Financial Times* shows how bad IPO returns have been over the last several years.



Poor performance has led to a collapse in new IPOs. The first half of 2022 saw a dramatic decline in listings with only 92 companies raising less than \$9 billion. *Forbes* estimates just 184 total IPOs by the end of the year. The Reuters Venture Capital Index, which tracks the performance of venture-backed companies, ended the quarter down about 61% from its all-time highs. The power of compounding may be the most underappreciated investment phenomenon and to win you must first survive and not lose. This chart shows just how much a holding must recover after a significant drop in value.

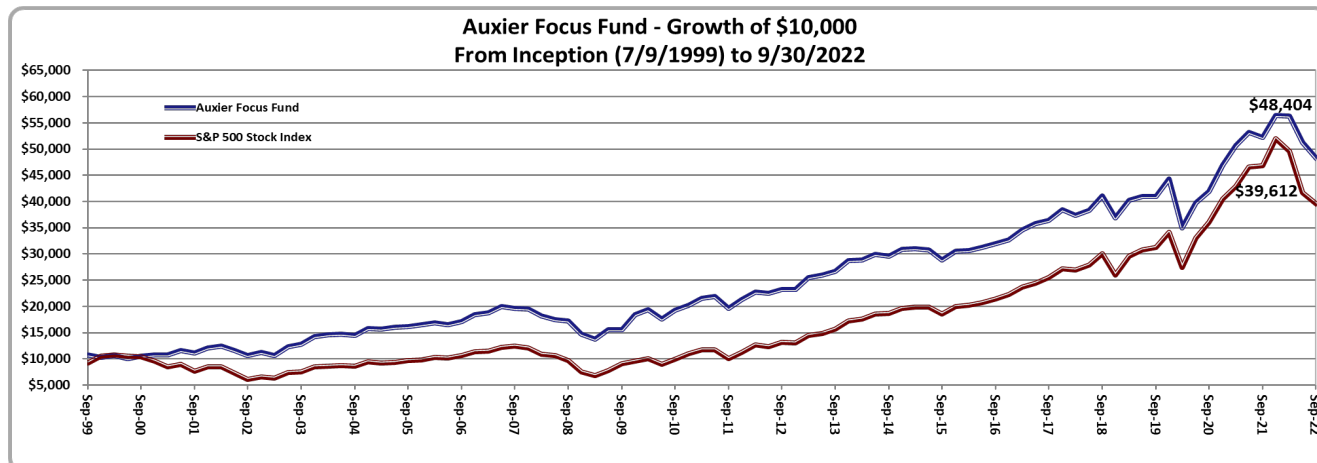
## **Inflation Remains a Concern Despite Rising Rates**

Despite record rate hikes by the Federal Reserve, consumer inflation does not seem to be slowing as overall CPI in September rose 8.2% year-over-year. Compared to August overall CPI increased by 0.4%. The European region is seeing record inflation readings over 10% as energy prices rise due to supply disruptions from Russia. Heating oil and diesel are also rising in the US. States like Maine, where a majority of homes are still using heating oil, are seeing costs increase by over 50% year-over-year. Rising costs like these leave many consumers in the position of choosing to “heat or eat.” The *Capital Press* recently reported that 97% of California is under severe drought conditions which will likely contribute to continued food inflation. California grows more than 33% of the vegetables and 75% of the fruits and nuts in the US. According to the California State Board of Food and Agriculture costs for harvesting and processing crops like tomato, garlic and onion have increased by 25% this year. COVID-19 lockdowns in China and problems in barge shipments due to low Mississippi river levels further add to price pressures. Holiday air travel is more expensive this year as travel company Hopper is forecasting a 39% increase over last Christmas. Through August airfare had seen a larger year-over-year increase than nearly any other category. Las Vegas casinos are enjoying record-high performance for this past quarter. Even with inflation on the rise, consumer spending has been more resilient than expected as spending increased by 0.4% in August and 0.1% in September. Consumer spending accounts for about 70% of total US GDP. Service spending and strong employment levels could keep the Fed on course to tighten throughout the remainder of the year. According to Deloitte, US firms are expected to reshore almost 350,000 jobs in 2022, up 25% from 260,000 in 2021. History has shown that inflation can take a long time to normalize. According to data from Bank of America covering decades of economic history for advanced countries, inflation takes an average of 10 years to return to 2% once it surpasses 5%. It is likely that while the Fed’s rate hikes could soon start to show benefits in the inflation rate, it could be some time before we return to their target level of 2%.

## **Bond Market Troubles Continue**

The US bond market has been facing another tough year for returns as high inflation and rapidly rising rates have sent bond prices tumbling. According to NYU there has not been a double-digit decline in bonds since 1931 when they fell 15%. The S&P 500 Bond Index, which has an average maturity of about ten years was down 4.5% for the quarter and 17.53% year-to-date. The US Treasury market is also feeling pain as typically consistent sources of demand like the Fed have begun pulling back purchases. Over the last two years the Fed more than doubled its balance sheet to over \$8 trillion and that number could fall as low as \$5.9 trillion by mid-2025 if they maintain their current pace of divestitures. Due to high rates and a strong dollar, many countries have had to sell treasuries to support their own currencies. For the first time since 1998 Japan had to support their currency. According to the International Monetary Fund (IMF), emerging market central banks have had to reduce their foreign exchange reserves by \$300 billion in 2022. In the UK liability-driven investment strategies or LDIs were sold as a safe way to match current and future liabilities of pension plans. They did not factor in a sharp rise in rates and with 7-to-1 leverage it led to massive collateral calls forcing the Bank of England to step in and provide emergency relief. We are seeing historic volatility in the fixed income markets which should lead to some great bargain buying opportunities in the months ahead. Edward McQuarrie, professor emeritus of business at Santa Clara University, calculated bond market returns dating all the way back to 1794 and concluded that if the market maintains its current trajectory 2022 will be the worst year for bonds in US history. Based on returns so far, 2022 could also be the first time in over 50 years that both stocks and bonds decline in a calendar year. We have been warning for years that the bond market was artificially suppressed by unprecedented Fed bond buying. We are now seeing the painful hangover from more than a decade of zero rates.

## Third Quarter 2022 Performance Update



Auxier Focus Fund’s Investor Class returned -5.47% in the third quarter and -14.14% YTD through September 30. The cap-weighted S&P 500 Index declined 4.9% for the quarter and 23.87% YTD while the DJIA lost 6.17% and 19.72% over the same periods. Small stocks as measured by the Russell 2000 returned -2.19% for the quarter and -25.10% YTD. The MSCI Emerging Markets Index shed 11.57% for the quarter and 27.16% YTD. Stocks in the Fund comprised 87.6% of the portfolio. The equity breakdown was 79.2% domestic and 8.4% foreign, with 12.4% in cash and short-term debt instruments. A hypothetical \$10,000 investment in the Fund since inception on July 9, 1999 to September 30, 2022 is now worth \$48,404 vs \$39,612 for the S&P 500. The equities in the Fund (entire portfolio, not share class specific) have had a gross cumulative return of 735.01%. The Fund had an average exposure to the market of 79% over the entire period. Our results are unleveraged.

### In Closing

This year reminds me so much of 1999-2002 when the Nasdaq dropped about 78% top to bottom and the S&P lost 49%. The Auxier Focus Fund during that difficult period gained over 9%. Indexing had reached a historic peak in 1999 with companies like AOL, GE, Lucent and MCI WorldCom dominating (both Lucent and WorldCom eventually went bankrupt). Today also reminds me of 1982-1983 when inflation was roaring and the Paul Volker Fed was aggressively raising rates. You had to make exceptional, well researched buys as there was no “Fed put” to bail out poor selections. Back then we focused on the cheapest businesses (low P/Es) selling necessities. Corrections and recessions are healthy as they purge excesses. The market is unwinding a venture capital boom (2.5 times 2000 level), a bond market bubble where rates hit lows not seen in 4,000 years and a vigorous private equity industry that gorged on easy borrowed money to buy inflated assets. We see the potential for accidents in the \$1.2 trillion floating-rate leverage loan market as yields reprice higher. Conversely, quality undervalued conservative businesses with disciplined capital allocation, solid balance sheets, proven business

Auxier Focus Fund – Investor Class  
Average Annual Total Returns (9/30/2022)  
Since Inception (07/09/1999) 7.03%  
10-year 7.65%  
5-year 5.90%  
1-year -7.32%  
3-month -5.47%

*Performance data quoted represents past performance and is no guarantee of future results. Current performance may be lower or higher than the performance data quoted. Investment return and principal value will fluctuate so that an investor's shares, when redeemed, may be worth more or less than original cost. As stated in the current prospectus, the Fund's Investor Class Share's annual operating expense (gross) is 1.08%. The Fund's adviser has contractually agreed to waive a portion of its fee and/or reimburse Fund expenses to limit total annual operating expenses at 0.92%, which is in effect until October 31, 2023. Other share classes may vary. The Fund charges a 2.0% redemption fee on shares redeemed within 180 days of purchase. For the most recent month-end performance, please call (877) 328-9437 or visit the Adviser's website at [www.auxierasset.com](http://www.auxierasset.com).*

franchises and ethical leadership should outperform in this challenging environment. Wars, reshoring, socialism, supply chain disruptions and decarbonization all contribute to higher inflation. Policies out of California, now one of the top six economies in the world, are very inflationary. Today we see good value in smaller businesses. Small cap value stocks not only outperformed 1999-2002 but also throughout the high inflation 1970s. From 1969-1979 the cheapest low P/E stocks outperformed the most expensive high P/E stocks 213.6% vs 25.8%. While investors often think bigger companies are safer, history proves that any class of investment that detaches from underlying cash flows can be highly risky. What matters is the fundamentals of constant demand, growing sales earnings and cash flow at a sensible price. The collapse in Russian and Chinese stock markets reminds us of the importance of the rule of law, checks and balances and integrity in free markets.

We appreciate your trust.

### **Jeff Auxier**

*Before investing you should carefully consider the Fund's investment objectives, risks, charges and expenses. This and other information is in the prospectus, a copy of which may be obtained by calling (877) 328-9437 or visiting the Fund's website. Please read the prospectus carefully before you invest.*

**Fund returns (i) assume the reinvestment of all dividends and capital gain distributions and (ii) would have been lower during the period if certain fees and expenses had not been waived. Performance shown is for the Fund's Investor Class shares; returns for other share classes will vary. Performance for Investor Class shares for periods prior to December 10, 2004 reflects performance of the applicable share class of Auxier Focus Fund, a series of Unified Series Trust (the "Predecessor Fund"). Prior to January 3, 2003, the Predecessor Fund was a series of Ameriprime Funds. The performance of the Fund's Investor Class shares for the period prior to December 10, 2004 reflects the expenses of the Predecessor Fund.**

The Fund may invest in value and/or growth stocks. Investments in value stocks are subject to risk that their intrinsic value may never be realized and investments in growth stocks may be susceptible to rapid price swings, especially during periods of economic uncertainty. In addition, the Fund may invest in mid-sized companies which generally carry greater risk than is customarily associated with larger companies. Moreover, if the Fund's portfolio is overweighted in a sector, any negative development affecting that sector will have a greater impact on the Fund than a fund that is not overweighted in that sector. An increase in interest rates typically causes a fall in the value of a debt security (Fixed-Income Securities Risk) with corresponding changes to the Fund's value.

Fund holdings and sector allocations are subject to change and should not be considered a recommendation to buy or sell any security.

Foreside Fund Services, LLC, distributor.

*The S&P 500 Index is a broad-based, unmanaged measurement of changes in stock market conditions based on 500 market-capitalization-weighted widely held common stocks. The Dow Jones Industrial Average is a price weighted index designed to represent the stock performance of large, well-known U.S. companies within the utilities industry. The MSCI Emerging Markets Index captures large and mid-cap representation across 24 Emerging Markets (EM) countries. S&P 500 Bond Index is market value-weighted and seeks to measure the performance of U.S. corporate debt issued by constituents in the iconic S&P 500. The Nasdaq Composite Index is the market capitalization-weighted index of over 2,500 common equities listed on the Nasdaq stock exchange. The Russell 2000 index is an index measuring the performance of approximately 2,000 smallest-cap American companies in the Russell 3000 Index, which is made up of 3,000 of the largest U.S. stocks. It is a market-cap weighted index. The MSCI China Index captures large and mid-cap representation across China A shares, H shares, B shares, Red chips, P chips and foreign listings (e.g., ADRs). Refinitiv (Formerly Thomson Reuters)*

*Venture Capital Index tracks the gross performance of the US venture capital industry through a comprehensive aggregation of venture-funded private company values. One cannot invest directly in an index or average.*

*The Consumer Price Index (CPI) is a measure that examines the weighted average of prices of a basket of consumer goods and services, such as transportation, food, and medical care.*

*The price-to-earnings ratio (P/E ratio) is the ratio for valuing a company that measures its current share price relative to its per-share earnings (EPS).*

*Earnings per share (EPS) is calculated as a company's profit divided by the outstanding shares of its common stock.*

*SPACs, A special purpose acquisition company, is formed to raise money through an initial public offering to buy another company.*

*Cash flow is the net amount of cash and cash-equivalents being transferred into and out of a business.*

*As of 9/30/2022, the Fund's top 10 equity holdings were: UnitedHealth Group Inc. (7.6%); Microsoft Corp. (4.9%); Mastercard Inc. (4.6%); Kroger Co. (3.5%); Elevance Health Inc. (3.4%); Philip Morris International (2.9%); PepsiCo Inc. (2.8%); Johnson & Johnson (2.7%); Medtronic PLC (2.7%); Merck & Co. Inc. New (2.6%).*

*The views in this shareholder letter were those of the Fund Manager as of the letter's publication date and may not reflect his views on the date this letter is first distributed or anytime thereafter. These views are intended to assist readers in understanding the Fund's investment methodology and do not constitute investment advice.*