



IN CHALLENGING MARKETS, QUALITY MATTERS EVEN MORE

Without question, 2022 has been a challenging year for equity investors. Coming into the year, the S&P 500 Index had doubled over the prior three-year period from 2019–2021. Except for a sharp 6-week decline during the onset of COVID-19 in early 2020, the market enjoyed ideal conditions: low interest rates, low inflation, and excess liquidity. These conditions helped both high- and low-quality companies deliver excellent stock price performance.

As 2022 began, inflation emerged as a threat on the horizon and supply chain bottlenecks were beginning to have a negative impact on profits for many companies. With the invasion of Ukraine by Russia in February, oil prices spiked nearly 60 percent in 9 weeks, further challenging management teams. In March, the Federal Reserve began to raise interest rates to combat the inflationary pressures that they finally realized were not “transitory.” Change and uncertainty caused some investors to begin to sell stocks. As investors often do in times of stress, many sold indiscriminately, paying no attention to the strength (or weakness) of the company or if management was growing revenue, profit margin, or net income. Investors sold shares to move their money to “safer” investments.

To see an example of this wholesale liquidation, we don’t need to look further than the average performance of the high-quality stocks in the Compass Core 25 portfolio. Over the course of 2022, the average earnings per share (EPS) growth rate of the stocks in the Compass portfolio was 12.9% for the first quarter, 8.7% for the second quarter, and 6.0% for the third quarter. Yet, the average stock value in this portfolio declined approximately 17 percent as of November 15th.

This is one of the largest disconnects between profit growth and stock price change that the market has seen in decades. The S&P 500 Index has seen a similar pattern, as EPS has grown just under 5 percent, while the Index is down 16%. Based upon this strong fundamental operating performance, we remain confident in the long-term prospects for our equity portfolio.

Another factor that is often overlooked is that numerous companies took advantage of the prolonged period of historically low interest rates to take increasingly more debt onto their balance sheets. This did not worry investors when the average junk bond yield was 4.2% in 2021, prior to the Federal Reserve increasing interest rates 4% (and counting) this year. That yield is now nearly 10 percent, which is a significant increase in the financing costs for some lower quality companies that tend to struggle in certain economic environments. While we don’t have a crystal ball, a wave of bankruptcy filings among these types of companies could emerge in 2023 and beyond, as companies are forced to repay debt or refinance at significantly higher interest rates. The current environment exemplifies why Compass has always focused our investment strategy on companies with strong balance sheets, low debt levels, and growing free cash flow. Strong companies can take advantage of the opportunities that emerge, when weak companies must sell businesses just to survive.

In summary, at Compass we are more confident than ever in our portfolio due to the companies we own. They have demonstrated the ability to navigate multiple headwinds in 2022 to grow their businesses. The strength in their balance sheets and management teams means the future is bright. We would love to talk to you more about how you can benefit from owning a high-quality portfolio.



FIRM

INVESTMENT COMMITTEE

Charles Kelley, CFA
 Leigh Niebuhr
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AUM

\$2.0 billion

INCEPTION

1988

COMPASS PHILOSOPHY

As an independently-owned firm, Compass provides customized investment services to individuals, foundations/endowments, trusts, and retirement plans. Our objective is to preserve and enhance the real purchasing power of our clients' wealth over time.

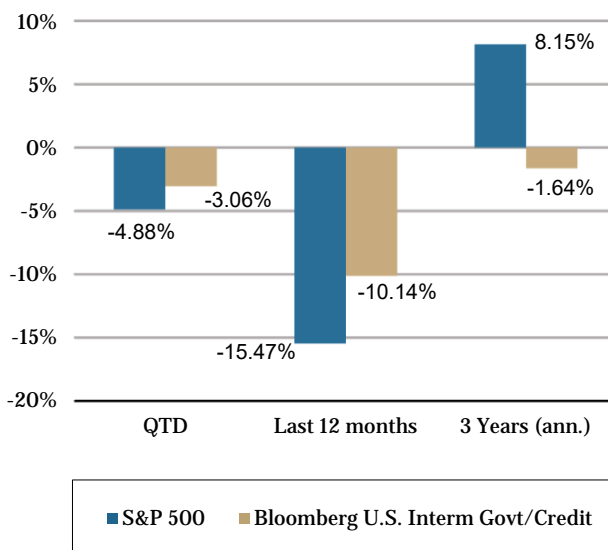
Our clients value working directly with a seasoned and experienced team of portfolio managers to help them navigate their investments relating to:

- Building a quality portfolio
- Divorce
- Retirement
- Inheritance
- Sale of a business
- Trust distribution

Our experienced team is always available to provide financial advice and review your financial assets.

MARKET INDICES

Total Return as of 9/30/2022



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For more information regarding our company or results, please contact us at investors@compasscap.com.