OCTAVIA
WEALTH ADVISORS

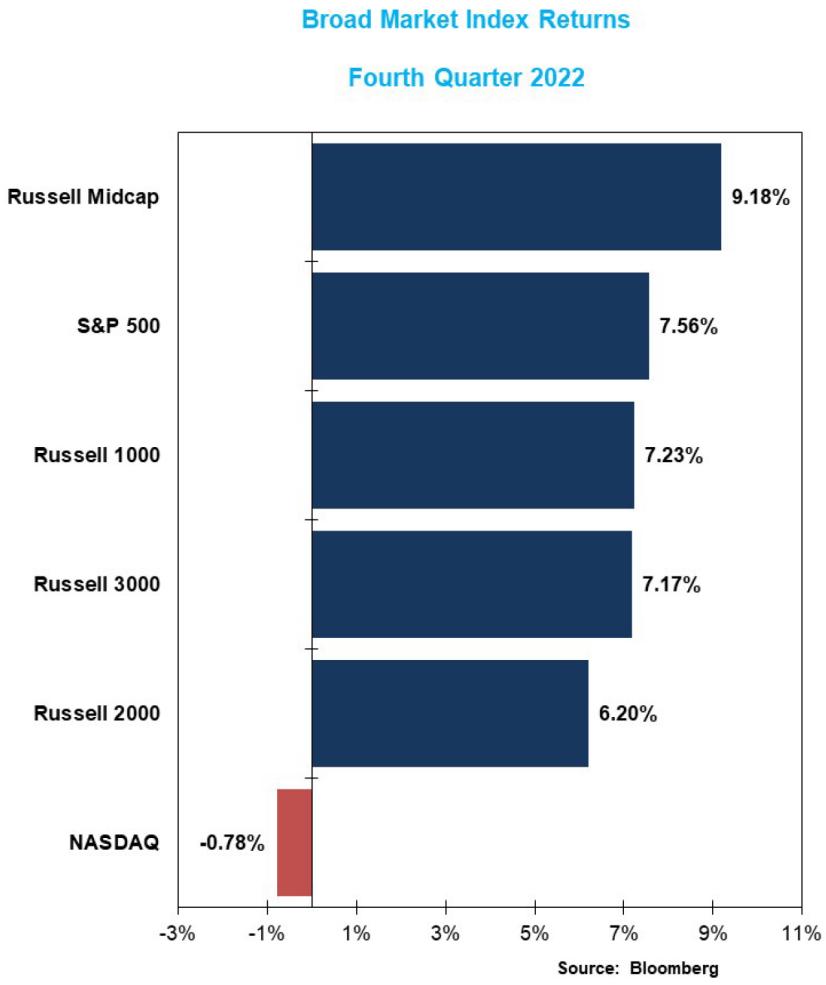
Economic and Market Overview

Fourth Quarter 2022

Building a Lifelong Partnership

The Economy

The US economy posted modest growth in the quarter, but continues to grapple with high inflation, rising interest rates, and slowing employment growth. Within this landscape, the Bureau of Economic Analysis released the third estimate of the third quarter 2022 real GDP, a seasonally adjusted annualized rise of 3.2%, slightly higher than the prior estimate, and an improvement over the 0.6% decrease in the prior quarter. The employment situation continued to be resilient in the quarter, as job gains exceeded expectations. The December report showed that employers added 223,000 jobs in the month, and that the unemployment rate fell to 3.5% from 3.7%. The Federal Open Market Committee (FOMC), in its ongoing effort to aggressively battle stubbornly high inflation, twice raised its federal funds rate target range in the quarter, to 4.25% to 4.50%, from a range of 3.00% to 3.25%. After beginning 2022 at a range of 0% to 0.25%, the increases this year have been the most aggressive undertaken by the FOMC since 1980.



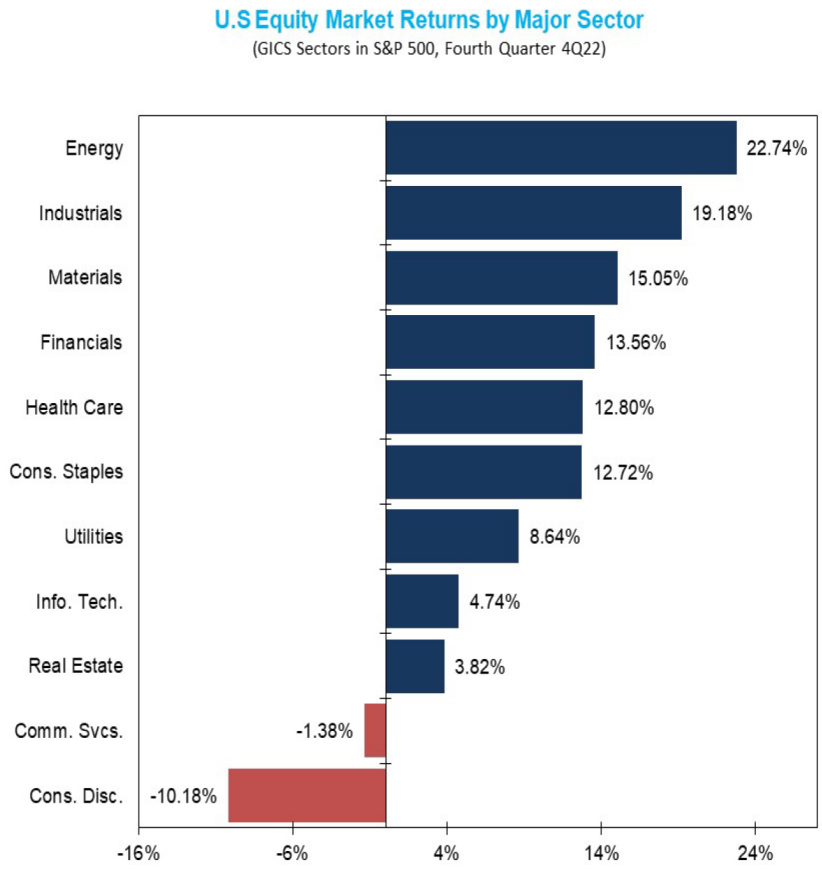
Highlights and Perspectives

GROSS DOMESTIC PRODUCT (GDP)

In the latest data available, the Bureau of Economic Analysis released the third estimate of the third quarter 2022 real GDP, a seasonally adjusted annualized rise of 3.2%, modestly higher than the prior estimate, and an improvement over the 0.6% decline in the prior quarter. The rebound from the negative real GDP growth of the prior two quarters was driven primarily by gains in trade, which economists warn could be a problem going forward as the strong dollar will increase the trade deficit, which will serve as a drag on future growth. Consumer spending was a slight positive for growth in the quarter, while inventories and fixed investment suppressed growth. Corporate profits fell by 0.04% (not annualized) during the quarter after rising by 4.6% in the prior period. Inflation expectations were in line with the prior quarter, but remain elevated.

HOUSING

The housing segment declined for the 10th consecutive month in November as a result of the rise in interest rates, which have a negative impact on the level of mortgage rates. Existing-home sales for November (the latest monthly data available) dropped 7.7% to an annualized rate of 4.1 million units, down about 35.4% from year-ago levels. The inventory of existing homes remained steady at a level of 3.3 months of supply, up slightly from levels of the prior year. Existing-home prices in November increased 3.5% from November 2021. In the new-home segment, the NAHB Housing Market Index, a measure of homebuilding activity, ended the quarter at 31, down slightly from a reading of 33 in the prior month. The index has declined every month in 2022, and stands at a level reflecting the lowest confidence reading among homebuilders since 2012. In addition, the reading of below 50 indicates that building conditions are poor in the short term.



EMPLOYMENT

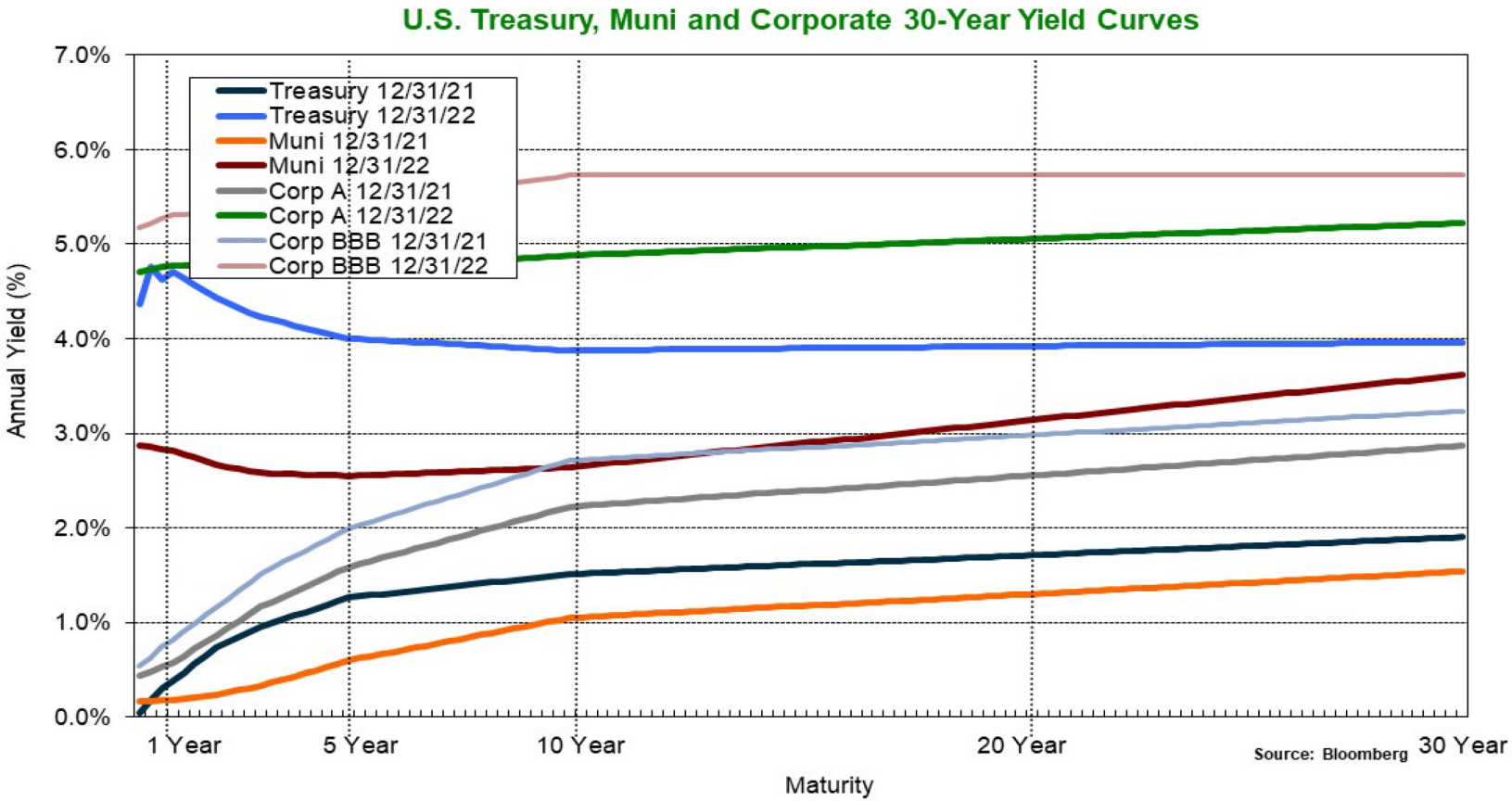
The December employment report (the latest data available) showed labor market resiliency, as gains outpaced consensus expectations. However, analysts are concerned that the trend in growth is slowing. Employers added 223,000 jobs during the month, above consensus expectations of a gain of 202,000. Analysts fear that the decline in hiring in trade, warehousing and temp help segments are negative indicators about the employment outlook. Employers are also beginning to rein in hiring due to uncertainty about the future path of consumer spending. While a pullback in hiring is not yet widespread, it is likely to become so, as the highly publicized large scale layoffs in the tech industry have not yet been reflected in the data. The consensus among analysts is that job gains will slow dramatically in the coming quarters, and particularly so if the economy does indeed fall into recession. The unemployment rate in December fell to 3.5% from 3.7%, and labor force participation increased to 62.3% from 62.1%.

FEDERAL RESERVE POLICY

The Federal Open Market Committee (FOMC) remained aggressive in removing accommodative monetary policy. Inflation remains extremely high, and in an effort to bring prices under control, the FOMC raised its federal funds rate target range twice during the quarter in 75- and 50-basis point increments, to 4.25%-4.50% from a range of 3.00% to 3.25%. The 75-basis point increase in October was the fourth consecutive increase of that magnitude. The current regime of fed funds rate increases in 2022 is the most aggressive implemented by the FOMC since 1980. The committee is erring on the side of caution, as it does not want to pause increases until it is sure inflation won't re-emerge. The FOMC's "dot plot," a forecast of future rate changes, indicates the committee now expects the fed funds rate to be at 5.1% at the end of 2023.

INTEREST RATES

Fixed income securities' prices were, on balance, higher (and yields lower) during the quarter, as investors looked to an easing in inflationary pressures. The FOMC remained aggressive in its attempts to fight inflation, and raised the fed funds rate twice during the quarter. Bond investors projected that the FOMC's aggressiveness will be enough to bring down persistently high prices. Economic growth rebounded somewhat from the negative real GDP growth of the prior two quarters, but economists warn that a recession will be difficult to avoid in 2023. As mentioned above, the FOMC raised the target range on the fed funds rate to 4.25%-4.50%, from the prior range of 3.00%-3.25%. The committee indicated that it will remain vigilant in bringing down inflation, and analysts expect additional increases as conditions warrant. The consensus among the committee is that additional hikes are likely in 2023, with the fed funds rate expected to end 2023 at 5.1%.



The shape of the Treasury yield curve remained in the same inverted shape as compared to that at the end of the third quarter. Yields on the very short-term maturities of up to one year rose up to 110 basis points, while yields in the intermediate- and long-term segments of the curve changed between -15 and +15 basis points. By the end of the quarter, the yield on the benchmark 10-year US Treasury note edged slightly higher, ending at 3.88%, compared to 3.83% on September 30.

The yield on the 10-year Treasury began the quarter trending higher, and then midway through the quarter reversed course and meandered lower before rising again in December. The yield reached a high of 4.24% in the latter part of October as the FOMC implemented another 75-basis point fed funds rate increase. Against this backdrop, the yield on the 3-month Treasury Bill settled at 4.37% at the end of the quarter, higher by 110 basis points from the previous quarter. The yield on the 5-year Treasury Note ended the quarter at 4.01%, compared to 4.09% on September 30, and as mentioned above, the yield on the 10-year Treasury Note settled at 3.88%, compared to 3.83% over the same period. The yield on the 30-year Treasury Bond was somewhat higher, ending the period at 3.97%, compared to its beginning level of 3.78%.

Total returns on fixed income securities were largely positive during the quarter, a welcome respite from the declines experienced earlier in the year. The Bloomberg Treasury 5-7 Yr. Index rose by 1.30% for the quarter. The Bloomberg US Credit Corporate 5-10 Yr. Index added 3.79% during the three months. High yield securities, which often follow the performance of equities, were also higher, posting a gain of 4.17%. Municipals posted similar results in the quarter, as the Bloomberg Municipal Bond Index tacked on 4.10%. Prices of non-US fixed income securities posted sharp gains in the quarter, as the Bloomberg Global Aggregate ex-US Index jumped 6.81%. Emerging markets bonds also surged, with the JPM EMBI Global Index advancing 7.44%. Overall, it was one of the worst years for bond performance on record, as the Bloomberg US Aggregate Bond Index fell 13.01%, the largest decline since the inception of the index in 1977.

EQUITIES

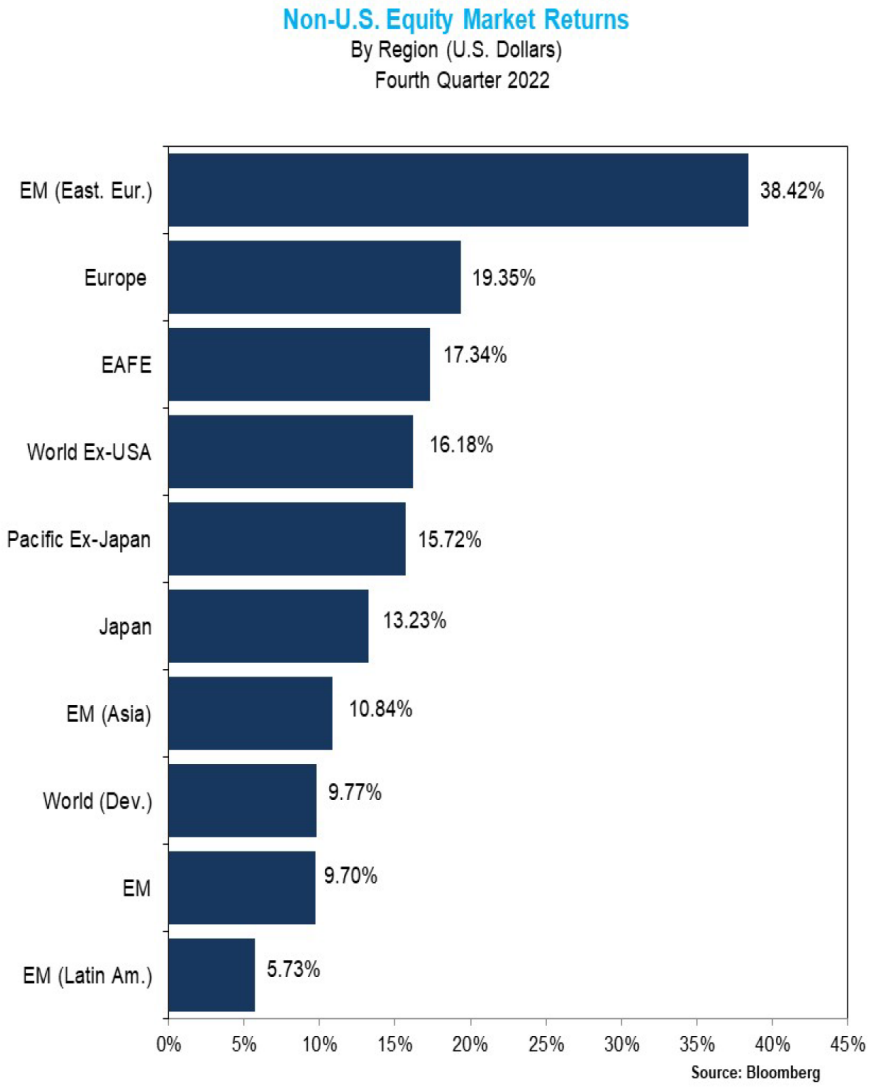
Stock prices staged a recovery in the fourth quarter following the negative returns posted in each of 2022's first three quarters. To be sure, there are many speed bumps for equities looking ahead to 2023, including stubbornly high inflation, rising interest rates, and a slowing economy that most economists expect will fall into a recession. But the rise in most broad-based indices during the quarter was a welcome respite for weary investors. In keeping with the seasonal tendencies of equity indices, the S&P 500 began the fourth quarter by rising steadily, reaching its peak at the end of November, at which point it had gained more than 14%, but then experienced a steady decline in December. When the quarter ended, the S&P 500 Index had advanced 7.56% for the quarter, but was down 18.11% for the full year. It was the steepest – and only the second – annual decline since 2008.

Performance of the 11 primary economic sectors was mostly positive during the quarter. Energy, Industrials, and Materials were the strongest performers on a relative basis, generating returns of +22.8%, +19.2%, and +15.1%, respectively. The Consumer Discretionary, Communications Services, and Real Estate sectors were the poorest relative performers, posting returns of -10.2%, -1.4%, and +3.8%, respectively.

The Russell 1000 Index of large capitalization stocks generated a 7.2% total return. Within the large cap segment, value stocks significantly outperformed growth stocks. Small cap stocks, as represented by the Russell 2000 Index, slightly underperformed large caps, and finished the quarter with a total return of 6.2%. Small cap value outperformed small cap growth. The NASDAQ Composite, dominated by information technology stocks, finished the quarter with a small decline of 0.8%. The Dow Jones Industrial Average of 30 large industrial companies jumped by 16.0%.

Real Estate Investment Trusts (REITs) were higher during the quarter, with the DJ US Select REIT Index up 4.8%. Commodities posted more muted gains in the quarter, with the Bloomberg Commodity Index advancing by 2.2%.

International stocks generated strong results during the quarter, and generally outperformed US equities. The MSCI ACWI Ex-USA Index, which measures performance of world markets outside the US, advanced by 14.3%. The MSCI EAFE Index of developed markets stocks was higher by 17.3%. Regional performance was mostly positive for the quarter. Eastern Europe was the strongest performer on a relative basis, with a return of 38.4%. Latin America was the poorest relative performer, gaining 5.7%. Emerging markets stocks were higher, as the MSCI Emerging Markets Index rose by 9.7%.



Outlook

While the latest quarter's positive economic growth was a welcome occurrence following two quarters of negative growth, the global economy remains on shaky ground. Stubborn and persistently high inflation remains near 40-year highs, and the aggressive central bank efforts to provide a release valve is moving the economy toward a recession. In the US, the FOMC is not only hawkishly raising the fed funds rate, but is also in the process of unwinding its balance sheet by letting the Treasury and mortgage-backed securities purchased during the long period of quantitative easing mature. The FOMC has stated that it will remain vigilant in fighting inflation, and has indicated that it needs to see more sustained evidence that inflation has abated before considering a rate reduction. Consequently, FOMC policymakers believe the fed funds rate will end 2023 at 5.1%, roughly 50 basis points higher than the current level. However, not all economists are of the opinion that a recession is inevitable. They cite several potential mitigators, such as employers not wanting to lay off staff due to the difficulty of hiring, training and retaining workers in the inevitable economic rebound, and the fact that inflation should naturally come down as year-over-year comparisons in areas such as oil price changes become favorable in 2023. From the perspective of equity prices, the market will be assessing the prospects for inflation and the economy, and how corporate earnings will be impacted. One of the indicators leaning in favor of stocks rebounding from the negative returns of 2022 is that since 1926 the third year of a presidential term (which is what 2023 will be) has resulted in negative returns only twice, one of which was in the midst of the Great Depression and the other a return of less than -1% in 1939. The third year of a presidential term has the highest median annual return by a significant margin: 22% vs. 11% for the next highest return-year in the term. Of course, stock prices are driven by fundamentals, and expectations thereof, so conditions on the ground will dictate how stocks perform in 2023, but it is possible that stock prices have already discounted a potential recession in 2023.

DISCLAIMER

Octavia Wealth Advisors, LLC ("Octavia") is a Registered Investment Advisor ("RIA"). Octavia provides investment advisory and related services for clients nationally. Octavia will maintain all applicable registration and licenses as required by the various states in which Octavia conducts business, as applicable.

The information provided is for educational and informational purposes only and does not constitute investment advice and it should not be relied on as such. It should not be considered a solicitation to buy or an offer to sell a security. It does not take into account any investor's particular investment objectives, strategies, tax status or investment horizon. You should consult your attorney or tax advisor.

The views expressed in this commentary are subject to change based on market and other conditions. These documents may contain certain statements that may be deemed forward-looking statements. Please note that any such statements are not guarantees of any future performance and actual results or developments may differ materially from those projected. Any projections, market outlooks, or estimates are based upon certain assumptions and should not be construed as indicative of actual events that will occur.

All information has been obtained from sources believed to be reliable, but its accuracy is not guaranteed. There is no representation or warranty as to the current accuracy, reliability or completeness of, nor liability for, decisions based on such information and it should not be relied on as such.

INDEX OVERVIEW

The **Dow or DJIA** (Dow Jones Industrial Average) is an unmanaged index of 30 common stocks comprising 30 actively traded blue chip stocks, primarily industrials, and assumes reinvestment of dividends. The **NASDAQ Composite** is a stock market index of the common stocks and similar securities listed on the NASDAQ stock market. The **S&P 500 Index** is an unmanaged index comprising 500 widely held securities considered to be representative of the stock market in general. The **DJ US Select REIT Index** is a subset of the Dow Jones Americas Select RESI and includes only REITs and REIT-like securities (The Dow Jones US Select Real Estate Securities Index (RESI) represents equity real estate investment trusts (REITs) and real estate operating companies (REOCs) traded in the US). The **Bloomberg Commodity Index** is a broadly diversified commodity price index that tracks prices of futures contracts on physical commodities on the commodity market, and is designed to minimize concentration in any one commodity or sector. The **MSCI EAFE Index** is recognized as the preeminent benchmark in the US to measure international equity performance. It comprises the MSCI country indices that represent developed markets outside of North America: Europe, Australasia, and the Far East. The **MSCI Emerging Markets Index** is a free float-adjusted market-capitalization index that is designed to measure equity market performance in the global emerging markets. The **MSCI ACWI Index** is a free float-adjusted market-capitalization-weighted index that is designed to measure the equity market performance of developed and emerging markets. The MSCI ACWI consists of 46 country indices comprising 23 developed and 23 emerging markets country indices. The **MSCI Emerging Markets (EM) Eastern Europe Index** captures large and mid cap representation across four emerging markets (the Czech Republic, Hungary, Poland, and Russia) countries in Eastern Europe. With 52 constituents, the Index covers approximately 85% of the free float-adjusted market capitalization in each country. The **MSCI EM (Emerging Markets) Latin America Index** is a free float-adjusted market-capitalization-weighted index that is designed to measure the equity market performance of emerging markets in Latin America. The **MSCI ACWI Ex-US Index** is a market-capitalization-weighted index maintained by Morgan Stanley Capital International (MSCI) and designed to provide a broad measure of stock performance throughout the world, with the exception of US-based companies. The **MSCI China Index** captures large and mid cap representation across China H shares, B shares, Red chips, and P chips covering about 85% of this China equity universe. The **Bloomberg Barclays Municipal Bond Index** is an unmanaged index comprising investment-grade, fixed-rate municipal securities representative of the tax-exempt bond market in general. The **Bloomberg Barclays Global Aggregate ex-US Index** is a market-capitalization-weighted index, meaning the securities in the index are weighted according to the market size of each bond type. Most US-traded investment-grade bonds are

represented. Municipal bonds and Treasury Inflation-Protected Securities are excluded, due to tax treatment issues. The Index includes Treasury securities, government agency bonds, mortgage-backed bonds, corporate bonds, and a small amount of foreign bonds traded in the US. The **Bloomberg Barclays US 5-10 Year Corporate Bond Index** measures the investment return of US dollar-denominated, investment-grade, fixed-rate, taxable securities issued by industrial, utility, and financial companies, with maturities between 5 and 10 years. Treasury securities, mortgage-backed securities (MBS), foreign bonds, government agency bonds, and corporate bonds are some of the categories included in the Index. The **Bloomberg Barclays Capital US 5-7 Year Treasury Bond Index** is a market-capitalization-weighted index, and includes Treasury bonds issued by the US with a time to maturity of at least 5 years, but no more than 7 years. The **Russell 1000 Index** is a market-capitalization-weighted benchmark index made up of the 1000 largest US companies in the Russell 3000 Index (which comprises the 3000 largest US companies). The **Russell 2000 Index** is an unmanaged index considered representative of small cap stocks. The **Russell 3000 Index** is an unmanaged index considered to be representative of the US stock market, and measures the performance of the largest 3,000 US companies representing approximately 98% of the investable US equity market. The **Russell Midcap Index** is a subset of the Russell 1000 Index. It includes approximately 800 of the smallest securities based on a combination of their market cap and current index membership. The **Housing Market Index** (HMI) is based on a monthly survey of **NAHB** members designed to take the pulse of the single-family housing market. The survey asks respondents to rate market conditions for the sale of new homes at the present time and in the next six months, as well as the traffic of prospective buyers of new homes. The **JPMorgan Emerging Market Bond Index** (EMBI Global) tracks total returns for traded external debt instruments in the emerging markets, and is an expanded version of the JPMorgan EMBI+. As with the EMBI+, the EMBI Global includes US dollar-denominated Brady bonds, loans, and Eurobonds with an outstanding face value of at least $500 million. The **CBOE Volatility Index** (VIX) is an up-to-the-minute market estimate of expected volatility that is calculated by using real-time S&P 500 Index option bid/ask quotes. The Index uses nearby and second nearby options with at least 8 days left to expiration and then weights them to yield a constant, 30-day measure of the expected volatility of the S&P 500 Index.

DEFINITIONS

The **Federal Open Market Committee** (FOMC) is the monetary policymaking body of the Federal Reserve System. The **federal funds rate** is the interest rate at which a depository institution lends funds maintained at the Federal Reserve to another depository institution overnight. The **European Central Bank** (ECB) is the central bank for Europe's single currency, the euro. The ECB's main task is to maintain the euro's purchasing power, and thus price stability, in the euro area. The euro area comprises the 19 European Union countries that have introduced the euro since 1999. The **Gross Domestic Product** (GDP) rate is a measurement of the output of goods and services produced by labor and property located in the United States. The **Bureau of Labor Statistics** (BLS) is a unit of the United States Department of Labor. It is the principal fact-finding agency for the US government in the broad field of labor economics and statistics, and serves as a principal agency of the US Federal Statistical System. The **Bureau of Economic Analysis** (BEA) is an agency in the US Department of Commerce that provides important economic statistics, including the gross domestic product of the US. It is a governmental statistical agency that collects, processes, analyzes, and disseminates essential statistical data to the American public, the US Congress, other Federal agencies, state and local governments, business, and labor representatives. The **PCE (Personal Consumption Expenditure) Index of Prices** is a US-wide indicator of the average increase in prices for all domestic personal consumption. Using a variety of data, including US Consumer Price Index and Producer Price Index prices, it is derived from personal consumption expenditures, and is essentially a measure of goods and services targeted towards and consumed by individuals. Sector performance is represented by the **Global Industry Classification Standard** (GICS) sectors, developed by Standard & Poor's and MSCI Barra.

Octavia Wealth Advisors
9999 Carver Road, Suite 130
Cincinnati, OH 45242
T: 513.762.7701, F: 513.762.7741