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First Quarter 2023

S&P 500 YTD 7.42%[4]

MSCI ALL WORLD ex US YTD 7.96%[4]

"I have climbed highest mountains, I have run through the fields… But I still haven't found what I'm looking for"[1]

After nearly 5% of rate increases over the last 12 months, a mini banking crisis and following the worst year for the markets since 2008, 2023's markets have shown to be resilient in the face of these seemingly endless gut punches. Let's hear it for "New Years Day"[1]!

We wrote last quarter "most investors believe the "crisis" environment of 2022 is spilling over into 2023. And most just see a litany of headwinds from Fed hikes to economy slowing to earnings contraction to "cash is king" to inflation "takes years to control." So, most investors and pundits believe stocks will be a "Lemon"[1] in 2023". However, we did not share this cynicism and there were and continue to be potential catalysts for a strong 2023.

The ingredients for a healthy year included disinflation beginning to take root along with a stronger than expected economy which would be supportive of earnings. We can now add two consecutive quarters of market gains which has never happened in a bear market.

Disinflation (the reduction of the rate of inflation) appears to be in full swing. However, the process to bring inflation down to the Fed's 2% target may turn out to be a long and choppy one. June 2022 headline CPI gave us "Vertigo"[1] coming in at 9.1%, however by March of this year CPI had fallen to 6.0%[5]. Although inflation has come down by 1/3, Jay Powell "Still Hasn't Found What He's Looking For"[1] and may likely continue down the path of additional rate increases even with a potential slowing of the economy and concerns specific to a few regional banks.

From Fundstrat "The first quarter of 2023 has come to a close and despite a wrenching but so far short-lived banking crisis, the S&P is up over 7% this year and higher by 3.5% for the month of March[5]. Many skeptics are likely dismissing these gains as mere noise until the bear market re-asserts itself. But for reasons discussed, we believe first quarter 2023 market gains solidifies that "bears are now trapped" — meaning, our analysis suggests that the lows from October 2022 are in. Let's look at three core reasons ARPG believes this to be the case.

- First, the reported "banking crisis" is looking more idiosyncratic to a few banks that mismanaged bond portfolios backing their deposits rather than a full-blown systemic credit catastrophe. Granted, regional banks equity prices are languishing, but the situation appears not to be widening into a broader loss of confidence within the banking system. This began with a "social-media" generated bank run and those hysterics have not continued. We can see the Fed's balance sheet has reduced significantly since the March 10th "Friday Bloody Friday"[1] anxieties peaked.

- Second, the Fed made a "dovish hike" in March and we expect incoming inflation data to support a further pause (softer inflation). Notably, University of Michigan consumer inflation expectations now stand far below reported CPI at 3.8% vs Feb CPI 6.0% YoY. This is the largest negative spread (-2.2%) since late-1982. This gives argument for Fed to "tolerate" CPI reports as consumers see far less inflation. It certainly will be a "Beautiful Day"[1] when the Fed communicates the long-awaited pause in rate hikes.

- Third, S&P 500 has now posted two consecutive quarters of gains:
  – Q4 2022 +7.1%
  – Q1 2023 +7.4%
  Over past 50 years, two consecutive quarters have never been seen in a bear market; in the Great Financial Crisis of 2007-09, nor "dot-com bust" of 00-03, nor during Volcker high interest era of 81-82, etc.…"[2]

Furthermore, on an economic front things are not turning out to be as dreadful as many proselytized. From Axios, "Since the Fed began raising interest rates a year ago this month, the central bank has moved more aggressively than nearly anyone expected at the time. It has raised target interest rates by 4.75%, with more likely to come, and shrunk its balance sheet by more than $600 billion. But the economy remains as robust as ever, with a five-decade low in the unemployment rate, and inflation still far above the Fed's goals. Across the broad swath of the economy consumer demand and overall hiring have remained extraordinarily healthy."[3]

Although these historic interest rate hikes have caused the economy to cool from the rocket ride of 2021 ARPG agrees the economy remains on sound footing. We can very clearly see from first quarter S&P 500 earnings coming in stronger than expected with overall earnings results exceeding estimates by a median of 6%, and 69% of companies beating their estimates. Moreover, revenue on the top line was similarly strong with overall results exceeding estimates by a median of 6%, and 65% of companies beating those estimates as well.[5]

With investor pessimism reaching an all-time high recently according to AAII data it would seem as if the equity markets are sitting on the edge of a blade waiting for an inevitable crash. But with strong labor participation, better than expected earnings & revenue along with cooling inflation, it appears this resilient economy is communicating to investors its long-term durability "With Or Without You"[1]. ARPG certainly will not be stuck on the sidelines with the rest of the bears and naysayers while the market continues to climb the never-ending wall of worry. Remember the good Mr. Buffet's everlasting wisdom… "Be fearful when others are greedy… but be greedy when others are fearful"[6]

Spring is full bloom! Time to go outside and do those things you've "Desired"[1] during those long cold months. Markets and economies both foreign and domestic will forever and always "Move in Mysterious Ways"[1] with each other. That's why the best investors focus on the long term. In any market ARPG will continue to practice our approach to value investing, "Intelligent Investment is Investment on Value". This is what sets ARPG apart from the rest. As always, we thank you for your confidence and are humbled by your trust. Please feel free to contact us at any time.

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Sincerely,.
Matthew D. Dahl
Chief Investment Officer

1. U2
2. Fundstrat
3. Axios
4. ARPG / Stockcharts.com
5. Factset
6. Warren Buffet