INTELLIGENT INVESTMENT

Second Quarter Newsletter, 2022

S&P 500 YTD (-20.58%)[4]   *MSCI ALL WORLD ex US YTD (-20.11%)*[4]

"Scar tissue that I wish you saw
Sarcastic mister know-it-all"[1]

The first six months of this year has provided many of us with plenty of "Scar Tissue". In fact, 2022 showed the S&P 500 its worst first half since 1970. Looks like "mister know-it-all"[1] Fed Chair Powell is the "Poster Child"[1] of a "Nerve Flip"[1] and went to the "Otherside"[1] by fully pivoting to hyper hawkish policy in order to tamp down the highest inflation in seen four decades.

The Fed "Kicked a Hole in Sky"[1] this spring by raising interest rates 1.25%, increasing 0.50% in May followed by an additional 0.75% increase from the Fed's June meeting bringing along with him a "Black Summer"[1] to the credit and equity markets.

"By the Way"[1] US markets aren't alone facing this inflation headwind. Many central banks "Around the World"[1] are having to raise interest rates causing international markets to experience similar turbulence to the US.
Although the S&P500 is down (-20.58%)[8] through the first half of this year, global markets are down a near equal amount of (-20.11%)[8].

Will the inflation egg crack and potentially cause the Federal Reserve to soften up its recent restrictive rhetoric and policy? How has inflation impacted consumer and markets sentiments?

We believe inflation has begun to "Give it Away"[1] in many sectors, specifically commodities. From Seeking Alpha "In response to growth fears, which were inflation fears just days ago, commodity prices are falling fast. As prices are driven by fast-moving investment flows into and out of futures contracts more so than real-world supply and demand in the short term. That means the headline rate of inflation can fall as rapidly as it rose when traders decide to take profits and run. Note the 20% plunge in the price of oil over just the past two weeks."[3]

This most recent pull back from red hot inflation is a symptom of weaker demand from the consumer. From Reuters "U.S. consumer spending rose less than expected in May as motor vehicles remained scarce while higher prices forced cutbacks on purchases of other goods, another sign that the rebound in economic growth early in the second quarter was losing steam. Though the report from the Commerce Department suggested inflation had probably peaked, price pressures remained strong enough to keep the Federal Reserve on its aggressive monetary policy tightening path. Nevertheless, Fed officials should welcome cooling demand."[7] Consumers historically are very wary of purchasing excess goods and services while prices remain elevated, it would seem inflation may be it's own worst enemy.

"Rising interest rates and tight financial conditions are stoking fears of a recession, but economic data so far point to moderate growth. New claims for unemployment benefits kept grinding lower last week, despite layoffs in technology and housing sectors, other data showed on Thursday. "The Fed hasn't won the war on inflation just yet, but there are somewhat encouraging signs that the economy is slowing down," said Christopher Rupkey, chief economist at FWDBONDS in New York. "Despite recession fears, job layoffs have not quite reached high enough levels to make the call that the economy is headed over the cliff into the depths of recession." Consumer spending, which accounts for more than two-thirds of U.S. economic activity, gained 0.2% in May, the smallest rise in five months. Data for April was revised down to show outlays increasing 0.6% instead of 0.9% as previously reported."[7]

As we continue to more fully understand the cause not just the symptom, we see weak consumer demand has stemmed from the destruction in consumer sentiment. From CNN "Consumer sentiment slumped to a record low between May and June, according to preliminary survey data released by the University of Michigan on Friday. Rising inflation continues to frustrate consumers, who are growing tired of shelling out more money -- and they are becoming increasingly despondent in the process. Record gas prices helped push down the consumer sentiment index from 58.4 in May to 50.2 in June -- the lowest recorded level since the university started collecting consumer sentiment data in November 1952. The preliminary reading is comparable to the trough reached during the 1980 recession, wrote Joanne Hsu, director of the university's Surveys of Consumers. In May 1980, the sentiment reading hit 51.7, according to historical data."[6]

We are starting to witness the slump in economic activity and poor consumer sentiment has begun to moderate the inflation narrative. This general pessimism has bled over into the financial markets as well, not just in market price but market sentiment. On June 22 the AAII market sentiment indicator reached an extremely bearish level of 59.3% a number not seen since March of 2009 which coincides with the bottom of stock market prices during the Great Recession.[4]

"Tell Me Baby"[1] are the bulls out to pasture? Are they hiding "Under the Bridge"[1] forever? Absolutely not. We are strong buyers at these bear market levels. We officially went into a bear market on June 13th, history tells us however this is a time to be greedy not fearful. According to Fundstrat from the day the bear market is confirmed there is an 80% probability the market will be higher six months later with an average return of 15.2% along with a 90% probability the market will be higher 12 months later with an average return of 22.1%.[2]

It's worth noting we have put several communications out this year anticipating a turbulent first half, however it certainly has been more than the "Storm in a Tea Cup"[1] we initially thought it would be. We continue to maintain we are in a long term secular bull market that "Can't Stop"[1] due to a temporary inflation spike and garden variety recession scare.

Summer has arrived and there's not much "Snow"[1] to be found these days. Do some "Road Trippin"[1] and get some "Wet Sand"[1] between your toes at the beach. ARPG will continue to practice our approach to value investing, "Intelligent Investment is Investment on Value"[5]. 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. Red Hot Chili Peppers
2. Fundstrat
3. Seeking Alpha
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