INTELLIGENT INVESTMENT

Second Quarter 2023

S&P 500 YTD 15.90%[3]

MSCI ALL WORLD ex US YTD 9.47%[3]

"I've been taking on a new direction, But I have to say
I've been thinking about my own protection, It scares me to feel this way"[1]

Well here we are with the S&P 500 up nearly 16% this year and the rest of the world better by almost 10%. The market is clearly "taking on a new direction" from 2022 largely witnessed from all the growling bears animosity toward this year's gains. "It doesn't scare me to feel this way"[1], we love how markets are behaving in 2023, but "What's Love Got To Do With It?[1]" Absolutely everything! Who doesn't love a hated bull market?

Although it's been a great year for the equities we unfortunately lost "The Queen of Rock and Roll", Tina Turner this last May. A once in a generation talent who combined pop, rock and soul into something truly unique. She will never be duplicated and forever be missed.

2023 has been "River Deep – Mountain High"[1] from S&P level 3808 in mid-March due in large part to the short-lived regional banking crisis, pivoting over 17% in just 3 short months to 4458 in late June. Some believe this rapid market rally was primarily fueled by the A.I. phenomenon. This simply is not the case as S&P 500 was well on its bull charge and had already expanded 11% from the March lows when A.I. entered the market lexicon in late May with Nvidia announcing their long awaited A.I. processor.

The A.I. phenomenon is just one small ingredient into this nearly nine month market advance. Last quarter we laid out three reasons why we believed the new cyclical bull market was upon us and the lows from October 2022 were in.

1. First, the reported "banking crisis" we saw in March appeared more idiosyncratic to a few banks that mismanaged bond portfolios backing their deposits rather than a full-blown systemic credit catastrophe.

   We have not seen this bleed further into a systemic banking crisis. Banks appear as healthy and strong as ever.

2. Second, the Fed made a "dovish hike" in March and we expect incoming inflation data to support a further pause (softer inflation).

   The market is expecting a mere 3.1% headline inflation print on July 12th, a far cry from the 9+% we had last summer.[4]

3. Third, S&P 500 had posted two consecutive quarters of gains:
   – Q4 2022 +7.1%
   – Q1 2023 +7.4%

   During the 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]

   We can now make it three consecutive quarters.
   - Q2 2023 + 8.5%[4]... this doesn't happen in bear markets

With inflation cooling, is the Fed done raising interest rates? Perhaps "In Your Wildest Dreams"[1]! More rate hikes? Please "We Don't Need Another Hero"[1]. Hasn't J. Powell and company done enough? The economy "Knows the Way Home"[1], why will the Fed not pause to make certain they haven't gone too far. In three words… tight labor market… The Fed believes the job market is too tight meaning there are far too many open jobs available than workers willing and able to fill them.

The May Job Openings Labor Turnover Survey "JOLTS" reported 9.8 million job openings or about 1.6 jobs per available worker[4]. Although this is a high number it's down significantly from March of 2022 at over 12 million open jobs, or more than 2 jobs for every available worker. Understanding this is very "lagging" type data, thus job market reports will take some time to adapt. We can see this normalizing through the monthly non-farm payroll report, June saw 209,000 new jobs added down from 306,000 in May[4]. However average hourly earnings (AHE) was a tad strong at +0.4%. This means wage growth was stronger and AHE for the last 3 months has annualized at 4.56% which is above the one year job growth rate of 4.35%.[2]

Cooling inflation alongside a tight but easing labor market brings ARPG to conclude the Fed is either done or may have one rate hike left to give. One rate hike will likely not have much if any affect beyond one or two days of market volatility. Ultimately, we'll need to have the bond market fever break bringing with it lower bond yields. Our thesis stems from long term disinflation taking root causing Treasury rates to contract. We think the 2-year Treasury note will come down rapidly in the near future fueled by potentially lighter than consensus inflation prints for the remainder of the year. As the 2-year Treasury comes down, we believe the commercial paper markets will rally bringing money markets that are currently yielding 4-5% down to more historical norms in the 2% range.

The mountains of data that has come in this year (both positive and negative) leaves us with a strong conviction the secular bull market is has resumed. Our analytics tell us that there is roughly $2.0 Trillion or more than typically resides in money markets funds these days.[2] If our thesis is correct as yields contract bonds will begin to look less attractive along with their money market cousins. We believe with the highest conviction these "sidelined" dollars will flow quickly into strong, durable equities. This potential high influx of money into equity markets could very well spark a strong second half to 2023 and really for the foreseeable future. In fact history tells us the S&P 500 after a strong first half which followed a negative year like we endured in 2022 that a strong second half is likely about 90% of the time with an average return of 12%[2]. I don't think it would be a big surprise to see this market run far beyond consensus expectations.

Summer is here! "Simply the Best"[1] time of the year for people who "Can't Stand the Rain"[1]. 2023 market may not turn out to be "Better Than All The Rest"[1] but we just may get to put this year in the win column. 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. Tina Turner
2. Fundstrat
3. ARPG / Stockcharts.com
4. Factset