ARPG
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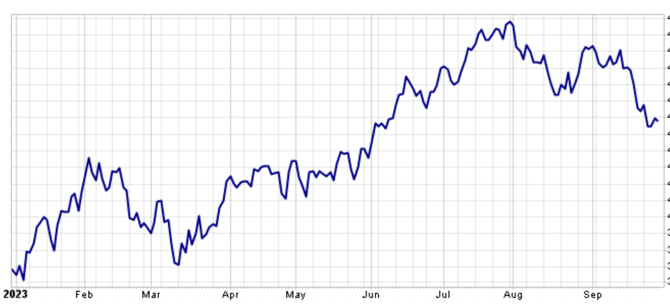
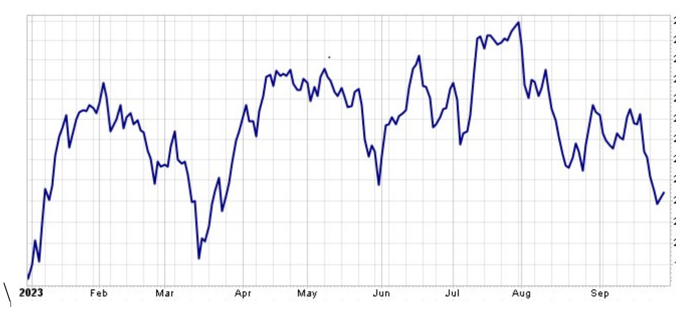
Third Quarter 2023

S&P 500 YTD 11.63%[3]



MSCI ALL WORLD ex US YTD 4.21%[3]



"I don't know the reason
Stayed here all season"[1]

What happened to 2023's juggernaut? After three positive quarters markets had a "Change in Attitudes and Change in Latitudes"[1] with the S&P 500 pulling back -3.6%. Although we know not to expect much from the third quarter beyond a "Cheeseburger in Paradise"[1]. Is the reason just the season? It doesn't appear to be so simple. And if only to make Q3 that much more dismal we lost our favorite Parrothead, Captain Relax, Bubba himself, Jimmy Buffet. His beachy laid-back vibes we all love so much, particularly while on vacation will truly be missed

What was the underlying reason for the -7% contraction from the market high witnessed on July 31st other than an overbought condition and weak seasonality? The final week of July through first week of October are historically the weakest and most volatile period of the year, 2023 did not disappoint. "And I know this is somebody's fault"[1]? Yes, feel free to point fingers in the direction of the bond markets. Volatility can exist not only in equity markets but fixed income or bond markets as well.

Equities have had to endure tremendous bond market volatility viewed through the 10-year US Treasury note yield "Volcano"[1] of nearly 20% this quarter from 3.86% to 4.57%. Bond markets are most certainly steering the equity ship and from the course they're taking they may have enjoyed a few "Boat Drinks"[1] along the way. Until the bond market sell off is complete and interest rates begin cool off, equity markets will continue to be held hostage.

What caused this spike in interest rates during the third quarter? ARPG believes there are two factors that attributed to this higher move in yields. First and foremost a significant increase in Treasury bond supply, second the Summary of Economic Projections (SEP) produced by the Federal Reserve on September 20th.

According to SIFMA, Treasury supply… or bills, notes, bonds issuance showed an increase of 24.6% in August 2023 than August 2022[2]. We know when supply increases and demand is flat prices will contract. Moreover, if demand falls in conjunction with higher supply, prices will significantly correct to the downside. As bond prices contract the interest or total yield to maturity increases as the bond is purchased at a discount. That is precisely what has happened. Bond prices are down tremendously. If we look at the TLT, the ETF that tracks the price of the 20-year US Treasury bond it has contracted approximately 14% in just the third quarter. This contraction in bond prices is due in large part to over supply but also lack of demand. The Federal Reserve, the US Treasury's largest purchaser of bonds in just "One Trip Around the Sun" has gone from a net purchaser in Treasuries known better as Quantitative Easing or "Q.E." to a net seller of Treasuries today know as Quantitative Tightening or "Q.T.". This is accomplished through allowing bonds held by the Federal Reserve to mature in greater numbers than new bonds purchased by the Fed over the same time period. This rather large reduction in demand coupled with an increased supply is a recipe for interest rates to boil over. In addition to contending with Q.T., during the September FOMC meeting the Summary of Economic Projections (SEP) was released which showed Fed members believe the Fed funds rate will be 0.50% higher at the end of 2024 than they believed it to be in June of this this year. Of course, these are merely projections which rarely if ever come to fruition. However, it added more fuel to the fire and the bond market sold off like it was black Friday causing the 10-year US Treasury note rate to spike 0.20% in seven short trading days.

It's not all doom and gloom, remember Q3 is the "Come Monday"[1] season for the markets and there are several tail winds that could propel the equities out of their summer slump. Q2 Earnings were stronger than consensus estimates even with the upward earnings revisions. 81% of companies exceeded their earnings estimates. Moreover, they exceeded by an average of 7%. This is a bit better than we normally experience. Typically, we see just 66% of companies exceeding earnings expectations by an average of only 5%.[4] Earnings were particularly strong in the mega cap tech names. "For the 'Big 7 Tech Players' as a whole, Amazon, Apple, Alphabet, Microsoft, Tesla, Meta & Nvidia, Q2 earnings are expected to be up +20.4% from the same period last year on +9% higher revenues."[4]

Initial Public Offerings (IPO) markets are opening up again. In order for CEOs to feel good about going to the equity markets to raise capital for their companies they need to be confident the equity markets will provide them with the highest valuation possible. Particularly in the tech IPO market which had been largely shut down for nearly two years with rising interest rates. This is why we don't see much IPO activity during difficult markets or economies. According to S&P Global we easily notice the difference from the hot IPO markets of 2021 to the choppy markets of 2022. There were just 149 IPOs launched in the U.S. in 2022, totaling $20.79 billion, compared to 908 IPOs launched in 2021, totaling $282.66 billion. Eight of the top 10 U.S. IPOs in 2022 were launched in the first half of the year.[5] Although we've only seen 120 or so IPO's in 2023 there has been a notable uptick lately along with three significant tech IPO's in September with Klaviyo, Instacart and ARM Holdings raising approximately $75 billion.[5] IPO markets are usually one of the first to thaw when a long-term bull market gets underway.

Fall has fallen! Time to put away "the blender to render your frozen concoctions"[1] and grab a warm pumpkin something. Let's hope 2023 looks at the third quarter they way "A Pirate Looks at Forty", something to forget. 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. Jimmey Buffet
2. SIFMA
3. ARPG / Stockcharts.com
4. Factset
5. S&P Global