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Q1 2022 STRATEGY & MARKET UPDATE: 1 + 1 + 1 = 1+

Q1 2022 registered a negative quarter across the broader indices. Still, beneath the surface turmoil, it represented nothing more than a typical correction without virulence or threat to derail the ongoing bullish market regime.

However, traditional approaches experienced it differently.

Trapped within their mid-20th-century thinking and caught up in the sensationalism of Wall Street media, conventional approaches were rattled with apocalyptic visions of a market collapse last quarter. After all, Q1 brought together what seemed to be an unprecedented cascade of threats—a combination of runaway inflation, a hawkish Fed embarking on the warpath of interest rate hikes and monetary tightening, and an *actual* military conflict in Europe that raised the specter of WW III.

It is essential to understand that legacy finance theory and conventional wealth management practice regard stresses as additive:

1 (40-yr high inflation) + **1** (rising interest rates /monetary tightening) + **1** (war) = **3**

And 3 is a much higher risk level than we had at the end of 2021 when inflation was Wall Street's only concern. Throughout Q1, analysts and strategists feared market derailment and economic stagnation, perceiving the market risk as having tripled. Amidst such sentiment, investors were tempted to realize their losses and take cover.

But did the market's risk level truly rise, and even triple, in Q1?!

In our quarterly notes, we have made it a point to find opportunities to illustrate the critical differences that separate our strategies' 4th-Generation logic from that of conventional approaches, which are powered by mid-20th-century legacy ideas. And the last two years have given us plenty of opportunities to do that (feel free to read the headlines in bold and skip the inset details for later):

1. A recap on the risk of "inflation":
   While inflation always manifests in higher prices, not all price spikes are due to inflation!

Throughout 2021 we have alerted you that our strategies disagree with Wall Street's idea of an "inflation" problem. Yes, higher prices are indisputable, generationally high, and dangerous, but they are <u>not</u> the symptoms of a classic monetary inflation disease. Right symptoms, wrong disease.

Instead, we have maintained that higher prices are overwhelmingly the collateral damage of the CoViD lockdowns that have radically upended the global supply chain. And as we have outlined before, there is plenty of evidence in support of this interpretation and against the "inflation" diagnosis:

Global consumption, net of pent-up demand, has not increased while we still face significant supply shortages and dramatic transportation delays. The difficulties of our globalized economy to produce and deliver goods and services run contrary to the character of real monetary inflation that pits reluctant producers against hoarding consumers. Also, despite prices spiking to 40-year highs, the markets have refused to move interest rates higher than in the pre-CoViD era. Moreover, inflation "break-even" measures (the difference between Treasury Inflation-Protected Securities/TIPS and regular, non-inflation-adjusted Treasuries) suggest only mild inflation on a declining trajectory that parallels the renormalization of supply chain and transportation. It is worth also pointing out that gold, inflation's perennial hedge, has failed to break out to a new high. And throughout this "inflation" episode, returns on well-positioned capital have provided investors with more-than-adequate compensation for the price spikes. And so on… The overall picture is decisively nothing like the inflation bonanza of the 1970s/1980s.

2. A recap on the risk of the Fed:
   Far from being the Fed's punching bag, the Market is actively engaged in a tug-of-war with the central bank <u>on behalf</u> of investors.

   As we communicated with you throughout Q1, **the market correction is protective for investors** instead of being destructive**.** The market has engineered this correction to control the Fed's trajectory of raising rates, very much like it did in 2018. The market detects very little monetary inflation in the current higher prices and assesses that the Fed is about to commit a significant error that could torpedo the economy. And, as we saw on March 16, aided by its correction, the market won the first round of this tug-of-war by securing an accommodating start in the Fed's crusade. Having accomplished its mission, the market put a floor in its correction and has rallied significantly since (+6.29% for the S&P 500),

savoring its victory. **This behavior vindicates our strategies' view that, from the start, has run contrary to Wall Street's orthodoxy.**

3. The new stressor:
The war on Ukraine is not an additional risk!

Wall Street has been obsessing about the potential *additional* risk the war on Ukraine represents for the market. Conventional wisdom considers risks to be additive. We disagree with this assessment, as we communicated to you throughout Q1.

Powered by their 4th-Generation logic, our strategies saw that the market found an unlikely ally in its tug-of-war with the Fed—Putin's war! The market calculated that the added geopolitical stress would defuse the Fed's hawkishness. And our strategies' interpretation was proven correct:

From the start of the war, on Feb. 24, to the end of Q1, the market (S&P 500) went **up**—not down—gaining a decisive +5.45%! This demonstrated conclusively that the risk of the war was subtractive—precisely as our strategies had signaled!

Our strategies understand that market risks are not automatically additive, although investors and classical theory perceive them as such. Actually, in many cases, risks are subtractive or mutually mitigating. **Mastering the risk-compiling calculus is a distinctive characteristic of 4th Generation strategies, like (y)our CORE, FOCAL,** and **QUAD.**

Figuratively, here is how our strategies saw the market's risk level in Q1:

1 (supply-chain price spikes) + **1** (Market-vs-Fed tug-of-war) + **1** (Ukraine war) = **1+**

So, the risk in Q1 was nothing more than the limited risk of a typical correction within an ongoing bullish market regime.

STATUS UPDATE & FORWARD POSTIONING

- **STEADY WITH A TWIST**
Our strategies navigated Q1 with minimal shifts, and their performance fell naturally between pure Growth and the Growth/Value blend.

In Q1, CORE, FOCAL, and QUAD continued to be tuned for a resumption of growth's long-standing outperformance. Still, the three strategies introduced a brand-new allocation last quarter within this carry-over positioning! Near-term, it will allow them to

negotiate better the resurgence of the defensive trade (led by energy, commodities, financials, staples, etc.). And in the future, the same allocation is expected to give them the capacity to capture the benefits and dampen the risks of market rotations without extensive portfolio repositioning.

- **HELPING YOUR INVESTOR FRIENDS**
  While the correction of Q1 was typical and relatively modest, there was a striking aspect to it—the once-in-a-generation declines in the bond market!

  Bonds declined dramatically in Q1, with the marquee Bloomberg US Agg. Index falling -6.43% in price YTD and registering a significant -8.43% drawdown. Across the board, bonds have been a more substantial drag on portfolios than stocks, sparking trouble for traditional conservative and moderately conservative portfolios. This is of particular significance:

  As we have repeatedly explained, strategic asset allocation portfolios, which constitute the staple of traditional investment offerings, are built on the assumption that asset classes have predictable and stable payouts. History has shown that this fiction is unwarranted, and quarters like Q1 have come to punish investors for catering to it.

  Unfortunately, conservative investors, who are frequently most in need of portfolio sustainability, have been placed deep in that risk zone. We encourage you to reach out to your conservative and moderately-conservative investors in your circle and alert them about the existence of a very different way to accomplish their goals—we stand by to help!

- **READY FOR WHAT IS COMING**
  The correction ended the month of March with a significant rebound that has downgraded it to a mere pullback. The market's tentative tone could continue, but savvy investors need to keep in mind that, as long as the all-all important market regime remains bullish, market equilibrations can have an overall protective effect on well-positioned portfolios. Attempting to time the market's gyrations is fraught with significant risks, as 100+ years of market timing—particularly the last 12—have amply demonstrated.

  Our strategies do <u>not</u> time the market; they track shifts in the market regime—they are genuinely "macro" disciplines. And in the contest **Market-Timing vs. Macro-Tracking**, macro-tracking has won all the critical battles in this century. In particular, by leveraging their unique macro-tracking capabilities, our strategies successfully navigated <u>both</u> bear markets of this century (2000+ and 2008) and profited from the grand head-fake of the CoViD crash! Participating fully in a bear market is a dreaded false-negative error, while getting whipsawed in a head-fake is a costly false-positive error. While adaptive and risk-controlled strategies should protect investors from both, they usually end up

"specializing" in avoiding only one. Outside of our strategies, we know of no other approach that has been successful in sidestepping both errors.

So, going forward, the strategies will adapt to and risk-control any shifts in the market regime and we believe they are currently well-positioned to extract a premium from this market.

Last Word

We invite you to spread the word about your GNH Capital Group experience within your circles of influence. The last five years have been challenging for most investors. They have been battered by the sliding bond market and whipsawed in the historic downdrafts of 2018, the crash of 2020, and the turmoil of 2022. And throughout the last thirteen years, they have been torn between the Scylla of speculation and greed and the Charybdis of worry and indecision. As our veteran clients have come to discover, our strategies' adaptability and risk controls have been an excellent antidote to haphazard performance and a booster of investor confidence. Please assist us in spreading the word.

We remain grateful for your trust, loyalty, support, and friendship!

On behalf of GNH Capital Group's entire team with Henrik, Richard, Chad, and Isabel,

Kostas

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