



2022 and BEYOND: MARKET DYNAMIC & STRATEGY POSITIONING

Executive Summary

We believe (y)our strategies negotiated 2022 with restraint, balancing out returns, risk, and taxes in the intermediate to longer-term horizon and charting a cautious path between the two investment errors—the false-positive error of getting spooked unnecessarily by transient noise vs. the false-negative error of falling heads-on into a veritable lower-for-longer bear market. In doing so, the strategies assessed that during most of 2022, there was a greater chance in the intermediate term for a robust and timely recovery and only a lesser risk of a lower-for-longer deterioration. Accordingly, in negotiating the market’s technical decline, the strategies spent a good portion of 2022 holding roughly 20% cash alongside a mix of select low-volatility and growth positions.

Still, as 2022 added some valuable fresh inputs to the strategies’ libraries, we will see some evolutionary capabilities emerge in their workings during 2023 that we believe will further enhance their adaptability, risk control, and tax awareness.

2022: THE YEAR IN REVIEW

2022 was one of the noisiest years on record. The sum of the daily returns on the S&P 500 index totaled 300%, which means that through all its gyrations, the index traveled in 2022 alone three times the percentage points it has managed to advance throughout its entire history! Against that, the index ended the year at -19.4% (SPX), which is a mere 1/15th of its 2022 travel. More importantly, the broader market index only stayed in a drawdown of more than -20% (traditionally considered bear market territory) only 21% of all the year’s trading sessions and has rebounded above that YTD.

Most importantly, the market’s gyrations have been far from random, let alone emblematic of any ‘bearish collapse.’ Last year the market carved a zone of adaptation bound by a ceiling of 4,100 and a floor of 3,600 points on the S&P 500 index. Within that range, the market has engaged in a counterplay by repeatedly falling towards that floor to push back on the Fed’s interest rate crusade and then frequently rising towards that ceiling to celebrate its wins in curtailing it.

Meanwhile, despite the gloomy headlines of the financial press, the economy has remained resilient, with its four largest wheels—employment, pay, production, and sales—persistently in healthy territory, coupled with robust bank profitability and balance sheets, surprisingly resilient corporate earnings, and the consumer remaining in good shape. This is the exact opposite of what we witnessed in 2008, the last time a real bear market and recession conspired to threaten the long-term trajectory of investor portfolios.

In this light, far from being destructive, the market’s dynamic has protected investors’ longer-term capital and bodes well for the future, as we explain in detail below.

Nevertheless, 2022’s real casualties cannot be disguised by Wall Street: First, the bond market registered its worst performance in its recorded history last year. Pristine long US treasuries lost nearly -30% or 1.6X the loss of the broader US stock index. In most cases, bonds wiped out the cumulative gains produced over the previous

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ten years in just a few months. Similarly, this was the fourth worst year since the Great Depression for Wall Street’s ubiquitous 60/40 stock/bond portfolio. The lesson for investors? As we have continuously warned investors, our research indicates that “strategic asset allocation,” “risk-graded,” (“conservative,” “moderate,” ...), and “goal-based” (“income,” ...) portfolios are inherently defective investment vehicles with high shortfall risk. Simply put, **asset classes have unpredictably variable payouts, so we believe no portfolio with a fixed asset allocation can secure a sustainable stream of payouts for investors.**

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2023: OPTIMISM vs. PESSIMISM vs. REALISM

A picture is worth a few million dollars...



The attached graph from our research can help better calibrate our current sentiment and 2023 expectations—optimism or pessimism, and when?

- By early Jan. 2022, the S&P 500 (#1 blue line) had more than doubled (+120%!) from its CoViD lows. Throughout 2021 the market rose vigorously despite the dramatic increase in inflation (#2 orange line) and the rise of market-controlled yields like the US 10-Yr. Treasury (#3 purple line). As you can clearly see, on their own, our supply-based inflation and market-based yields were not a problem for the stock market.
- The market did not peak and start falling until the Fed began its crusade (#4 green line). Previously, the market had not considered our supply-driven inflation or the natural rise of market-controlled rates to be a problem. Still, it staged a fall to condemn the Fed's rate increases as capital destructive. After all, the market knows that while it is impossible to treat supply-flation with monetary measures (as if it were a garden variety demand-flation like that of the 70s/80s), tightening is likely to hurt the consumer and the bank-borrowing small- and mid-size businesses that had already borne the brunt of the CoViD burden. Consequently, the market mounted a ferocious counter-campaign to push back on the Fed.

Push back—how?

By engineering a protective decline designed to scare corporations into contemplating or enacting hiring freezes and preemptive layoffs. Such actions undermine the Fed's first mandate of securing full employment and serve as a counterweight to its restrictive policy. The market correctly assessed that, as long as the Fed considers employment robust, it is emboldened to up its medicine.

Is the market right to condemn the Fed and antagonize it?

The Fed's denial for more than a year that there was any inflation problem (whether supply- or demand-driven) is a fresh reminder of the central banks' notorious myopia. The record is clear—historically, central bank policy has systematically been a chief cause for ushering in or exacerbating global economic crises. Their policies are infamously behind the curve and pro-cyclical.

But we digress...

- Cognizant of the Fed's inflation obsession, the market made a goodwill offer to stop falling in June (#6) as inflation peaked (#5). This timeline helps us clearly understand the market dynamic. The market expected the Fed to get the message and stop the hikes. The market hoped that the Fed would know that it was coming from behind with measures that have a huge implementation lag and would perhaps attempt not to overrun its coverage by pausing or ending its campaign.
- But the Fed did not get the message and has continued to raise rates (#4) despite the falling inflation (#7).
- So, the stock market proceeded to make a lower low in Oct. (#8), exerting even higher pressure on the Fed by rattling the C-suite corporate cages incentivizing them to start contemplating or enacting layoffs, thereby undermining the Fed's full-employment mandate.
- But while marking its Oct. low (#8), the market found another ally—the open market of interest rates beyond the Fed's reach. Having suffered the most significant decline in its recorded history, the bond market, proxied by the 10-Yr US Treasury, stopped rising (#9) a few days after the S&P 500 made its Oct. low (#8) and has since reversed course going lower (#10). Why did it stop? Because the bond market has

looked at the horizon clearly and saw that with falling inflation (#7), the Fed has no further justification for its crusade.

- As a result of that, despite the further rate-hike we saw in Dec. and the widespread confidence that the Fed will hike again some more on Feb. 1, the S&P 500 has not made a fresh low after Oct. and is sitting nicely (#11) above the 3,600 floor of this adaptation zone (3,600 – 4,100) that our research has spotlighted throughout 2022.

So, here is the critical confluence of the key factors at work that is poised to shape the market in 2023:

- Inflation is falling
- The market-based interest rates are falling
- The Fed is already behind the next curve
- The market is sitting above its correction lows, waiting for the Fed to comprehend reality, get out of the way, and allow the market to resume its rise.
- But how about our “bear market”?!
Have you seen a bear market that goes...down when the economic news comes unexpectedly...strong?! Nope. Neither has anyone else—which tells you a lot...

- And what about the impending “recession”?

Are we talking about the most well-telegraphed “recession” of all times that the market has no problem rising against on...bad economic news?! That “recession”? Then, yes, if that recession were ever to register, the Fed would be forced to reverse course radically, and you know what happens when this takes place... (the market rallies ahead of the visible end of the recession).

Plus, what “recession” is Wall Street talking about? —like the 2020 official NBER-sanctioned “recession” that lasted a few...weeks?! We cannot lose track of the most critical lesson: The market is not the economy—since 1980, there have been several GDP recessions when the market has gone... higher (2020, 2009, 1991, 1992, 1980)!

- Not to mention... Has Wall Street taken notice of the bank earnings and balance sheets that remain robust?! History teaches us that recessions without damage in the economy’s financial hub have no viral power to spread across the economy and the markets.

Again, our research and strategies remain always completely forecast-free. They do not advocate for or assume any specific future but provide a clear assessment of the current state of the market and the economy and the dynamic range of up-to-date trends. By navigating the market based on an up-to-date adaptation to the existing trends (and not forecasts) and continuously running a vigilant risk and tax calculus, we have achieved higher success than any prognostication could have given us.

This is not a good time for pessimism (or blind optimism, for that matter), and realism dictates that the odds are still better than 2:1 for a fruitful mid-term resolution of the current correction stalemate and further progress in this market. Of course, proper navigation along the way is always a must.

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 historic bond market fall and whipsawed in the steep downdraft of 2018, the crash of 2020, and the turmoil of 2022. And throughout the last fourteen years, they have been torn between the Scylla of speculation and greed and the Charybdis of worry and indecision. As our veteran clients have discovered, 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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