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FROM THE DESK OF
KEN SOUTH

Our team adheres to a set of principles designed to provide an exemplary client experience.

We believe the trust of our clients is earned over time and remains our most important asset.

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We take great pride in the professional quality of our work. Exceptional client service that is proactive, thoughtful, and customized.

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Competitive investment returns with a focus on risk management.

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Sophisticated financial planning — an essential pillar in the development of your customized investment strategy.

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We believe in continuous improvement. As our clients' needs change, we learn and adapt.

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We stress teamwork in everything we do and remain accountable for our responsibilities.

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Integrity and honesty are at the heart of our business. Integrity: we do what we say we're going to do, full disclosure and no surprises.

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Honesty means we give it to you straight, even if means having a difficult conversation

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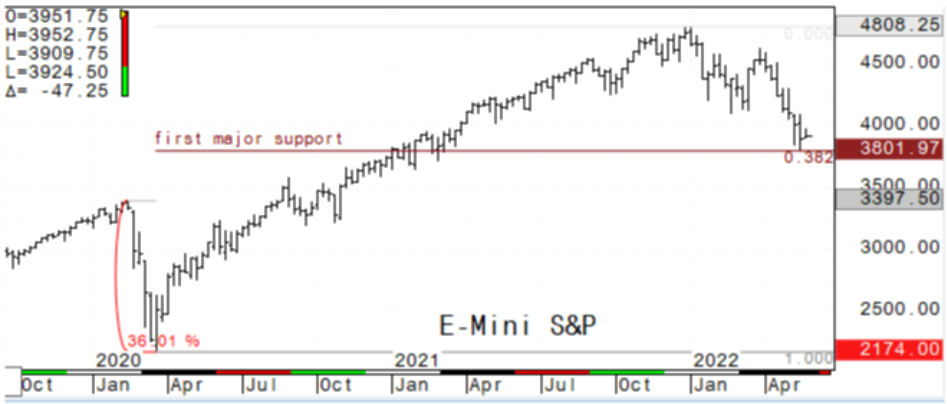
We regularly receive confidential information as part of our normal client relationship. It is our responsibility to protect against the unauthorized disclosure of this information.

May 25, 2022

Is The Bear Market Getting Tired?

Last Friday I put out a special report titled, "Market at a Crossroad." To my analysis and the various market measurements that I have been presenting the last few weeks, it was sort of looking very extended to the downside. This is why I brought up the point that it was at a crossroads.

On one extreme, the people that are pushing for more downside are targeting some very low numbers for the S&P 500. Over the weekend, in Barron's, there was mention of 3,000 for a downside in the S&P. There were also more realistic washed-out levels being mentioned in the area of 3,700. Based on the low on Friday, EXACTLY at the 38.2 Fibonacci replacement number of 3,850, this number of 3,700 does not appear too out of the question. In simple math, that is only 3.8% from the 3,850 number. Hardly a big additional drop due to the extreme volatility in individual names since November of 2021. (see chart below)



Now that we have seen the recovery on Friday afternoon, and the action in equities, bonds, and the US Dollar on Monday, we could be getting the bounce that some were hinting at. Tuesday didn't continue the bounce, but bottoms tend to be a process more than an event.

Bond yields have backed off from recent highs and the US Dollar seems to be saying that the high point in interest rates could have been seen for a bit. The US Dollar kept getting stronger and stronger as rates rose as it was a great hiding spot for foreign currency owners who wanted to get a double whammy of interest on their money and capital appreciation on the exchange rate.

Now, on Monday, the EU said that they were ready to move out above a negative interest rate environment. This means their rates finally rising and as such, pressure on an extended US Dollar trade. It has actually weakened for the last three trading days. Now, three days does not make a trend, but is how one can begin, or end as it may be in the short run. In the chart above, the US Dollar is seen clearly rolling over from its uptrend that has been in place for some time. Given that a weaker US Dollar is better for pricing our exports, this could be the reason for a jump start in our broad market as it is the first glimpse of something positive on the global trading front. This being said, a softening US Dollar tends to be a headwind for energy and commodities in general, yet they have continued their uptrend. Given that the NASDAQ is down 30% from its highs, and in effect (except for the supply chain) there is nothing wrong with the domestic economy, there is certainly enough ammo for it to make a go to the upside.

What we recognized last week was that in looking at the consumer, demand has not been the problem. Instead, the big box retailers that declared earnings said simply that they couldn't get what they wanted to be able to fill orders. Margins were being squeezed due to inflation at the commodity level and a higher cost of money in the form of higher interest rates also had an effect. The biggest consumer issue was the price of gasoline and diesel. As I've mentioned many times, fuel represents 20+% of American consumers' budgets. When you increase the cost of gasoline to $7 from $3 less than a year ago, this can really take the wind out of the discretionary spending sails.

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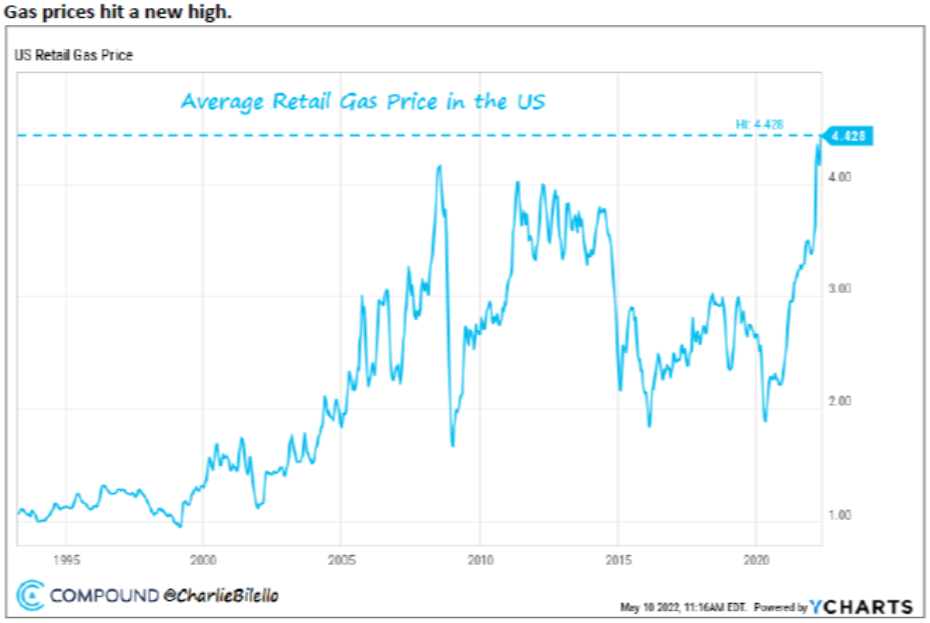
Gas prices hit a new high.



As we hold our breath about gas prices not going any higher, I read an article about gas station owners needing to replace the digital readout panels on the gas pump to reflect a double-digit first number on the price! Think about it, when they first programmed the electronics they weren't expecting the first digit to the left of the decimal point to be above one digit! Coming back to the supply chain issue, this is something fixable. Companies want to produce and consumers across the globe want to consume, so as soon as the COVID variant scares diminish, we should be able to restock inventories and get production cycles back on course.

Given the severity of the pullback we have experienced, I doubt that the recovery will be a straight-up V-bottom, but instead probably some kind of a bounce a sideways action, and then an eventual rally once we get through the normally difficult Midterm election year negativity. Midterm election years can be quite volatile with the average year down 17.1% from peak to trough, so a Bear market during this year isn't out of the ordinary. I have included an updated chart of where we are in the Midterm year so far this year.

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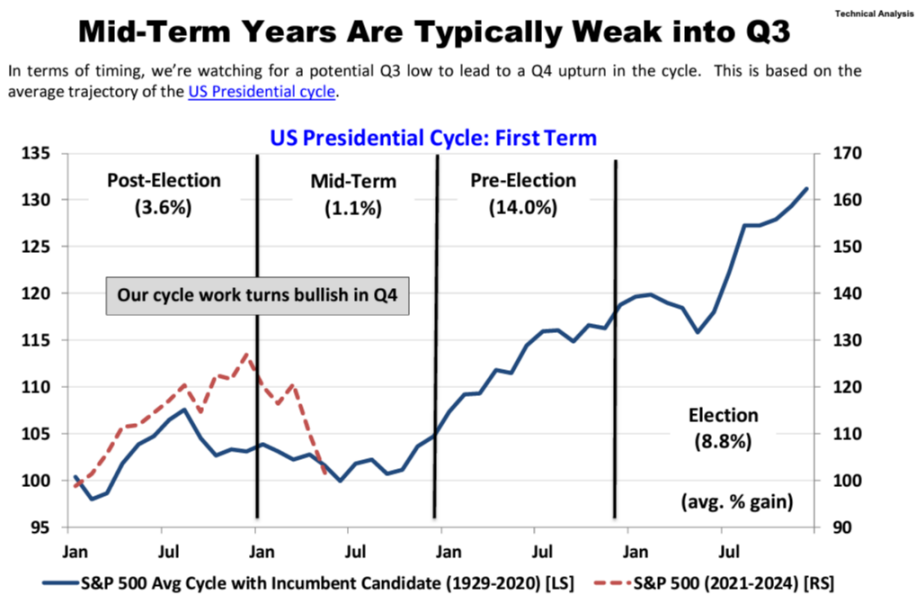
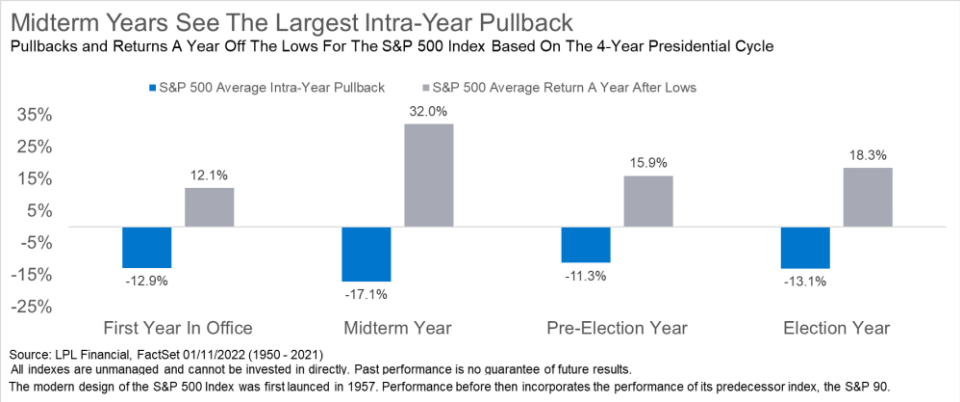


Knowing where we are and what normally occurs helps, but clearly isn't expected to do anything more than rhyme. Knowing this helps put this year's drop of 18.1% in perspective. The good news is a year off those lows, the S&P 500 has gained 32% on average, something most investors would likely take right about now!



One additional point that I would like to make is that I understand how the market pullback has been a result of the four gremlins of: 1) inflation, 2) rising interest rates, 3) supply chain issues, and 4) the Russia / Ukraine conflict, but the one thing that keeps me engaged to look for a much higher US Equity market in the future is that US earnings continue to stand out globally. US stocks are trading at more expensive valuations than their international counterparts, as they have been for quite some time. However, the chart below illustrates the continued earnings superiority of the US equity market, which suggests that US outperformance over the past year has been justified. While international stocks have outperformed the US over the past couple of months as the selloff in domestic tech stocks has accelerated, we would expect US equities to lead the rebound on the other side.

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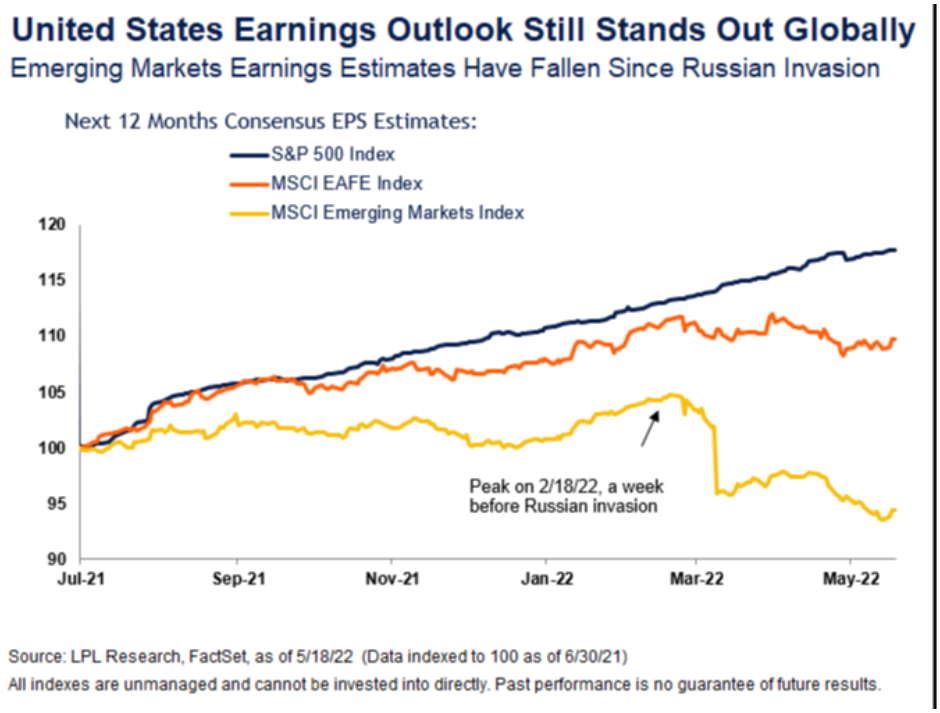

While earnings estimates for US equities have continued to rise in recent months (even though prices have declined), albeit gradually, expectations for international earnings in both developed and emerging markets have been reduced. Stronger earnings growth potential and less impact from the Russia / Ukraine conflict still support our preference for US equities over Europe, which makes up the majority of the developed international markets benchmark. We are watching for more geopolitical stability and a weaker US Dollar to potentially reinvigorate equities. So, 1) the US over international in equities, 2) bonds still in jeopardy in rising interest rates, 3) commodities still leading, and 4) cash paying nothing but providing shelter in a storm.

In closing, there was enough new information after Friday's and Monday's market action to warrant some level of expectation that possibly a short-term bottom has been put in. However, I want to stress that these are extraordinary times, and going forward I will hopefully not have to write too many more Special Reports. I also understand there is a risk of becoming "the boy who cried bottoms" if I am not careful with the way I contextualize the information I provide while in this correction. Obviously, if one keeps saying "this could be a bottom" all the way down, eventually he will be proven correct. I, therefore, have tried to objectively present a case for a possible bottom whenever I see enough evidence that one could be forming, but also stress that we need to see strong follow-through and the breaking of resistance levels to help confirm any bottom. Likewise, I have always tried to offer a but..... point that would suggest a bottom is not in and lower lows could ensue.

Please remember, I'm not trying to make bold calls, but rather, like a referee, to call ‘em as I see ‘em. Even if we are, indeed, in a prolonged bear market that will ultimately drop to deeper levels, the countertrend rallies can still be explosive and offer opportunities. If we are not at least anticipating a possible upside reversal, it could be very easy to miss when it does happen. This is why, even

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though some pain has clearly been endured, staying in this market, particularly when US Equities are still the best port in the storm, remains a prudent backdrop to the investment strategy.

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Investing involves risks including possible loss of principal.

The Standard & Poor's 500 Index is a capitalization weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

The Dow Jones Industrial Average is comprised of 30 stocks that are major factors in their industries and widely held by individuals and institutional investors.

The Nasdaq-100 is a large-cap growth index. It includes 100 of the largest domestic and international non-financial companies listed on the Nasdaq Stock Market based on market capitalization.

The Russell 2000 Index is an unmanaged index generally representative of the 2,000 smallest companies in the Russell 3000 index, which represents approximately 10% of the total market capitalization of the Russell 3000 Index.

This information is not intended to be a substitute for specific individualized tax advice. We suggest that you discuss your specific tax issues with a qualified tax advisor.

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