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WHEN GOOD NEWS IS BAD AND BAD NEWS IS GOOD

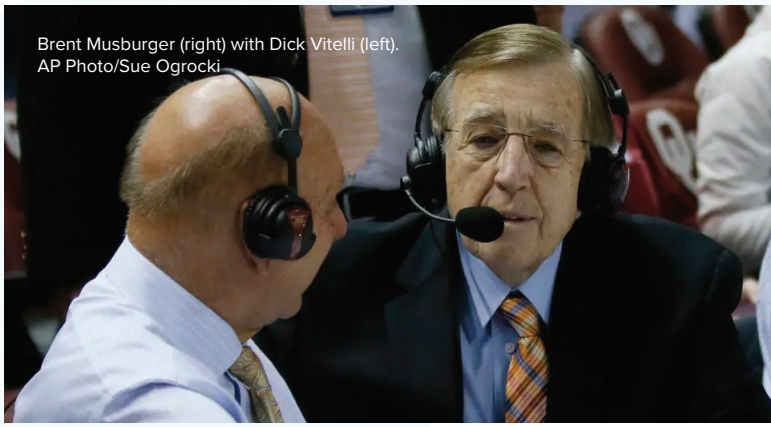
THE REAL MARCH MADNESS

Capital Defender Model 2.0 Newsletter
By Dr. Elio Chiarelli, Jr., PhD, AIF®

March Madness, as we know it today, came from humble beginnings to describe the excitement surrounding the Illinois state high school basketball tournaments. It first appeared in print almost sixty years ago and is credited to Henry Porter, who started his career as a teacher and coach at Athens High School in central Illinois. However, the term didn't become associated with the NCAA Tournament until 1982, when CBS broadcaster Brent Musburger used it during his coverage of the tournament. If you ask Brent Musburger, he will tell you he got from a car commercial he saw during his coverage of basketball games in Illinois. Either way, it is now great marketing and certainly fun to watch.

Everyone has their favorites in sports, but March Madness is certainly one of my favorites. I guess because not only are there are so many games and so much competition jammed into just a few weeks, but also filling out brackets and rooting for teams that you don't normally even watch. Even the most underrated teams have a chance. Every year it is fun to see if the "Cinderella Story" team will appear and make a good run. In basketball, even the most underrated teams and players, can have momentum at the right time and go on a shooting streak and eventually a winning streak.

Several researchers have studied this idea of momentum in sports over the years and even though it is sparse and somewhat inconclusive, sport psychologists have spent over 30 years examining both perceptions of psychological momentum and links to performance and outcomes. In basketball, you have the 'hot hand' to describe a player who just can't seem to miss. In baseball you have the 'hot streak' where batters hit one home run after another, and examples of this phenomenon can also be found in several other team sports such as football. There is just something unique about everything working together at the right time.



Brent Musburger (right) with Dick Vitelli (left).
AP Photo/Sue Ogrocki

When it comes to the current investment landscape and the economic environment we are living, the real Madness in March is when good news becomes bad new for investment portfolios and bad news becomes

good news! What do I mean? Well, we are in a unique situation where the Federal Open Market Committee (FOMC) or "The Fed" has aggressively raised rated throughout 2022 and still planning to raise rates (although at a much slower pace) in 2023. The plan for these increased interest rates will continue until the economic data beings to turn negative enough for them to start backing off the interest rate gas.

Due to this rising rate environment and a looming slowing economy we are seeing shorter duration rates higher than longer term rates which is not common and a fairly good predictor of a recession. This "inversion" of yield curve does not create recessions, rather it is a representation of how investors view the future of the U.S. economy and usually begin to flock to the safest financial asset, the U.S. bond. Although just a theory, this idea has held true for the past 6 decades and 7 recessions, with only one false positive.

I know that can get confusing at times if not familiar with all the language, but this unique situation creates an even more confusing madness as news comes out. You have to think of it like this, if "Good" or positive economic news comes out such as low unemployment, increased retails sales, solid manufacturing data, and strong corporate earnings, then the FOMC will very likely continue to raise rates to fight inflation. However, if we start to get "Bad" or negative economic news such as the opposite of all those listed above then the FOMC will likely begin to stop raising rates and even decrease them in the future. Hence...the madness of good news being bad and bad news being good. As you can imagine, this makes investment management and choices more difficult. Fortunately, (and I mean good news here is actually good!), the Capital Defender Model Series has been tested through periods such as this and historically has the opportunity to succeed through these environments. It just takes some patience and time while waiting on a rally to begin and stick and finding opportunities to gain positive returns during the short term.

The Capital Defender Series was positive in the month of January and flat to slightly negative in the month of February. For the month of March, we will be taking a more defensive position since there are now only 5 out of 12 asset classes, we follow in the model indicating negative momentum. This historically is a bearish sign forward looking over the next 3-6 months. We are still positioned to participate in some of the upside in the markets if they occur with our alternate signals and positions as well as some exposure to the positive asset classes.

For our Risk Off position for March 2023 we are still holding that position as very short-term treasuries to continue to harvest a yield while waiting. This position traditionally has very little sensitivity to interest rates.

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