January 25, 2022

Dear client,

Re: **February Conference Call on Tuesday, February 1, 2022 at 6:30 PM**

The correction that is occurring at this moment is a confluence of different emotions that are driving investors to capitulate. For one, a proposed rise in interest rates by the Federal Reserve is driving most of the sentiment. Second, a possible conflict with Russia over Ukraine doesn't help matters either. **Does this mean we should sell out and go to cash? That is a realistic and viable question and is on everyone's mind.** Let the facts clearly speak for themselves.

THEME 1: Rising markets don't go up forever without corrections.

Markets don't go up forever without corrections along the way. Although there is a set of investors who think stocks can only go up and that they can't reverse themselves, history has shown this is not true. Since 2009, the U.S. stock market has had 76 different "panic attacks". However, even with these corrections, the market is up considerably since that time. **Chart 1** illustrates the Dow Jones Industrial Averages (DJIA) for the past decade. If you look closely, you can see that there were several corrections during this time, some minor and some of major proportions. However, the general direction has been up.

Chart 1: Dow Jones Industrial Averages 2012-2021

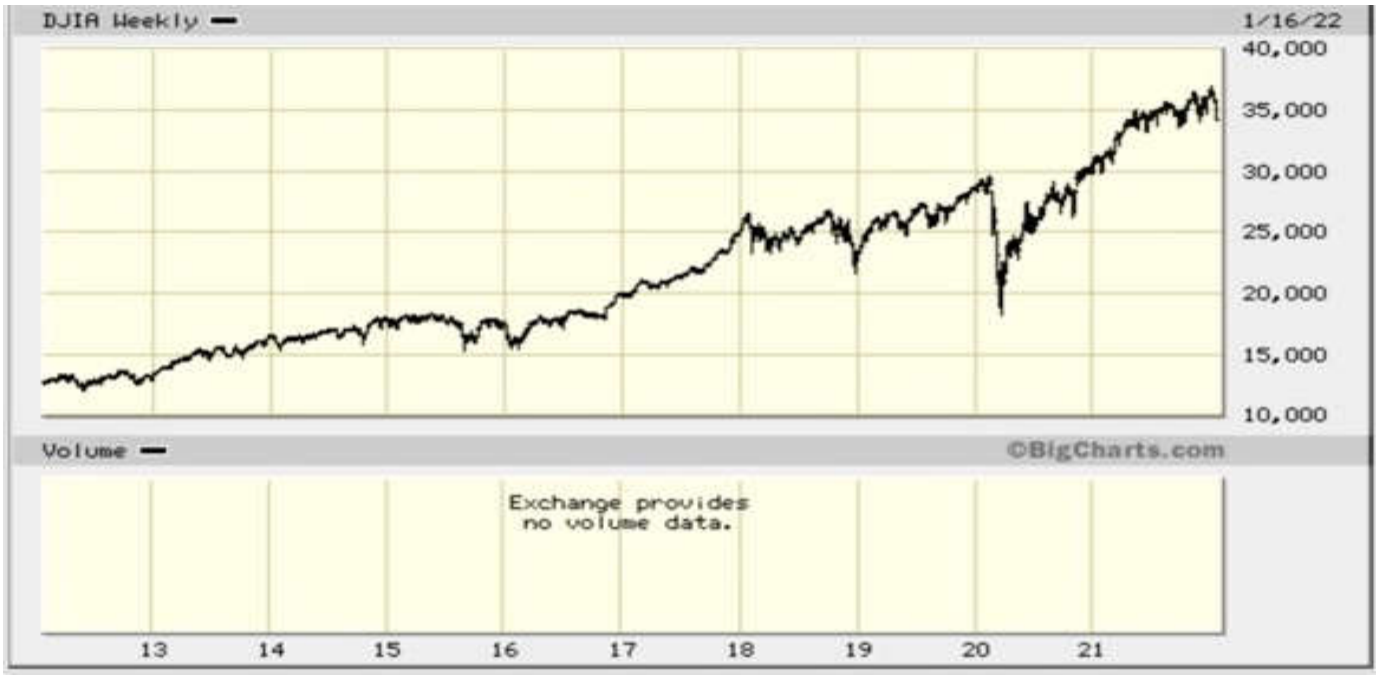


Chart 2 tells the long story and history of the DJIA. Yes, you would be correct if you assumed that stocks plunged in 1929. However, stocks did recover, although it did take a long time until 1941. This lengthy period between 1932 and 1941 of flat returns was due to the Federal Reserve applying a somewhat restrictive monetary policy. In that period, the Federal Reserve managed the economy based on what is called classical economics. Since 1944, for the most part, thanks to John Maynard Keynes and Paul Samuelson, the world has been using Keynesian theories to manage the economy. If this is good or bad is open to debate. As Chart 2 points out, the stock market has responded to the Keynesian economic philosophy even though there have been corrections along the way. The general market trend has been up, even with the turmoil of the 1970's and inflationary early 1980's. There are periods of time when the market is flat like in the 1970's. Why? Monetary and fiscal policy were flawed, and the government mismanaged their responsibilities. Today, the U.S. Government is in a similar position. That doesn't necessarily mean the markets cannot go up. In addition, in times of flat markets, investors such as us, have collected dividends in their dividend paying stocks; bond holders in the 1970's got decimated because of the loss of purchasing power.

Chart 2: Dow Jones Industrial Averages (1927-2021)

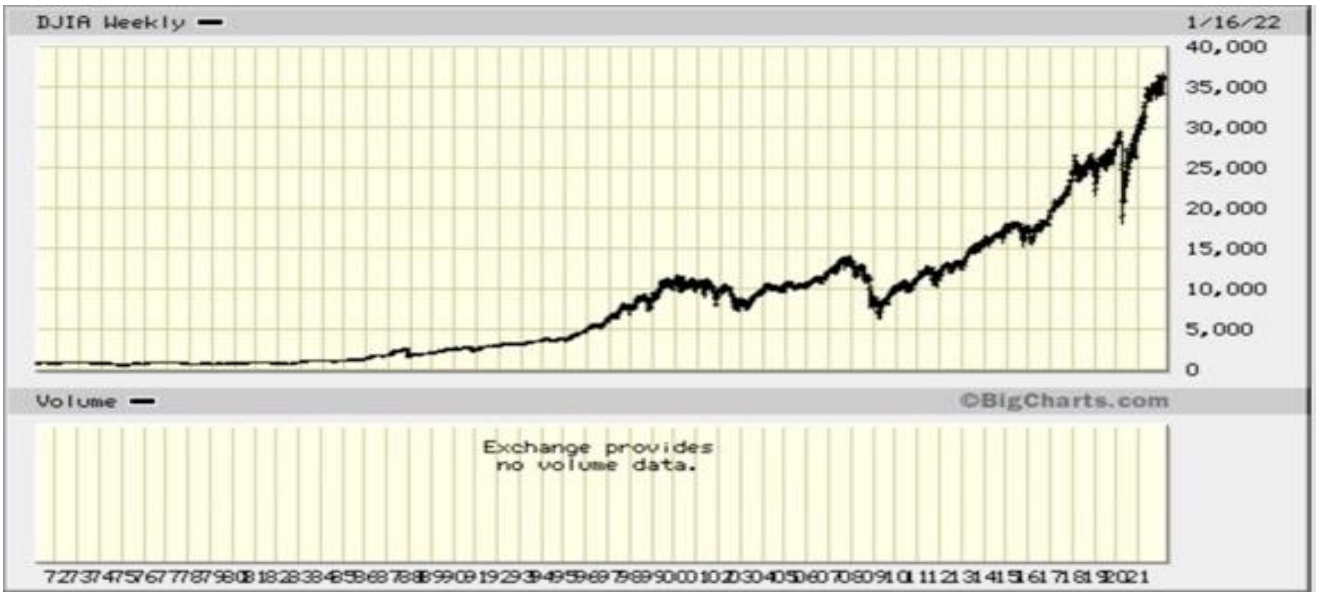
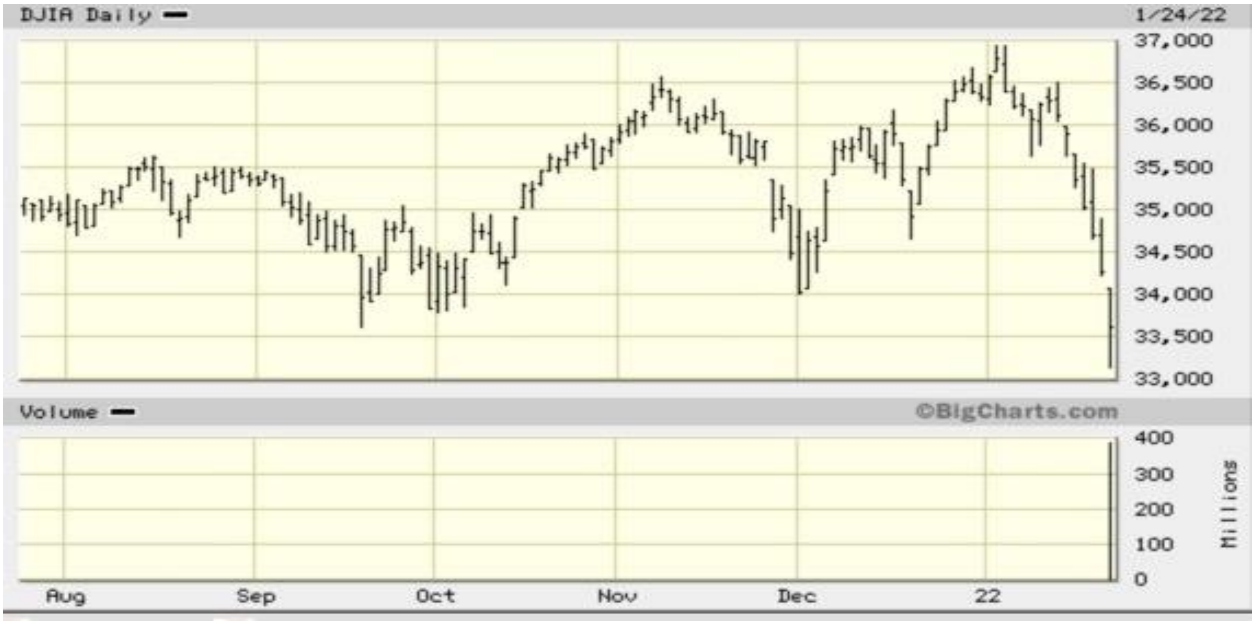


Chart 3 is very instructive because it illustrates the gyrations within a short period of time, in this case, six months. Please notice that there are corrections even within a six-month period. However, when one takes a longer view, the picture is different with up markets and corrections along the way.

Chart 3: Dow Jones Industrial Averages (Past 6 months)



THEME 2: Why we follow fundamental investing and why Ben Graham is my intellectual guru.

Our investing approach is based on fundamentals. The things that we look for are good and honest management, a decent competitive advantage, and the price of the stock trading below what it is worth. We are not traders who dart in and out of the market, nor do we look at voodoo charts. We look at the competitive position of the company and we spend an extraordinary amount of time crunching the numbers. Benjamin Graham once said, "To invest skillfully one must invest intelligently." We do this every day and if a stock doesn't meet our criteria for sound investment, then we don't buy it regardless of what market commentator says.

PayPal is one of our holdings that we first started to buy in 2016. We have held PayPal through thick and thin. We did our fundamental analysis and concluded that PayPal has a unique competitive advantage and a long runway to grow. There have been corrections along the way and PayPal is undergoing one of those right now. However, the company is the number one payment processor, moving into new areas of commerce and we believe the company still has further room to grow. It would be silly to sell PayPal, unless the fundamentals change, just because it is going through a correction. The story for PayPal is intact.

Chart 4: PayPal (2016-2022)

Some people believe that we should sell a stock when it reaches a certain technical threshold and buy it back later. However, trying to get out at tops and in at bottoms is almost impossible to do. As long as the fundamentals of the company don't change, there should be no reason to sell. This is how you build wealth and minimize taxes.

THEME 3: In an inflationary environment, stocks may not do so well, but bonds and cash do worse.

The 1970's was a period of high inflation. During this time, the stock market did poorly, beginning in 1974 and running through to 1984. This dismal period was due to the ineptness of the Federal Reserve and the Federal Government. Hopefully, they have learned their lessons from the past. In case the government does the same thing, the majority of our stocks pay dividends. These dividends are part of the total return for your portfolio. When a market is trending sideways or even moving lower, we still collect the dividends and this makes a big difference in such an environment.

On the other hand, if investors become scared and move to cash in an inflationary environment then they will get a negative return. Let's say inflation is **6%** and cash pays less than **0.1%**, then the return is **-5.9%**. The same principle holds true for bonds. If for example, a bond is paying **4%** and inflation is **6%**, then the return would be **-2%**. Inflation erodes purchasing power over time and that is what counts, the ability of your money to purchase goods and services. Over time, having only a cash and bond portfolio will decimate your returns, and retirement plans. We believe some risk to the stock market is warranted.

THEME 4: Why We Believe in a Diversified Portfolio?

Modern Portfolio Theory has clearly demonstrated that diversification has benefits which include lowering the volatility of a portfolio. Can you imagine what would happen to a portfolio if it was solely concentrated in high tech stocks? This could prove to be disastrous.

Table 1 shows that a stealth bear (down) market in technology that has already occurred in 2021 in which 62% of the S&P 500 stocks underwent at least a 10% correction and 83% of the NASDAQ stocks experiencing the same. This is despite headline index gains. Indexes can be deceiving as to what is really happening in markets. As you can imagine, we are not big fans of index strategies which purport to a "one size fits all" strategy.

Table 1 Not An Easy 2021 For Equities, Despite Headline Index Gains

% Change From 52-Week High	S&P 500	NASDAQ 100	NASDAQ Composite	Russell 2000
% Of Members With At Least 25% Correction	15%	36%	66%	60%
% Of Members With At Least 20% Correction	25%	47%	71%	68%
% Of Members With At Least 10% Correction	62%	82%	83%	89%
Average % Price Decline	-15%	-23%	-44%	-38%
Overall Index % Change From 52-Week High To Current Price	**-8%**	**-9%**	**-11%**	**-16%**
Max Drawdown From Past 100 Days	**S&P 500**	**NASDAQ 100**	**NASDAQ Composite**	**Russell 2000**
% Of Members With At Least 25% Correction	12%	31%	58%	52%
% Of Members With At Least 20% Correction	22%	44%	65%	63%
% Of Members With At Least 10% Correction	79%	89%	82%	92%
Average % Price Decline	-16%	-22%	-33%	-31%
Overall Index Maximum Drawdown % Decline	**-9%**	**-14%**	**-15%**	**-19%**
	S&P 500	**NASDAQ 100**	**NASDAQ Composite**	**Russell 2000**
% Of Members Below Their 13-Week Moving Average	62%	80%	80%	83%
% Of Members Below Their 26-Week Moving Average	54%	65%	75%	74%
% Of Members Below Their 52-Week Moving Average	41%	55%	73%	68%

Source: Alpine Macro. January 23, 2022.

In our portfolio, we have some technology stocks such as Marvell, PayPal, Cisco, and Matterport. However, we have utilities such as PPL, OGE, and NextEra as well. In addition, we have industrials and defense contractors such as Altra Motion, Archer Daniels, and SAIC and Moog. To round it out, we have bonds, gold, silver, and Japanese Yen as portfolio protectors, which I have discussed in the past. We believe we are well diversified. However, in the majority of cases, asset classes have become more correlated which means that they move up and down together, but not in the same percentages.

THEME 5: US Government's Macro and Fiscal Policies is what got us into this mess.

Simply put, the Federal Reserve kept easy monetary policy for too long and the Federal Government let wild spending get out of control. Why should anyone be surprised that inflation is rearing its ugly head. However, as I demonstrated, this is no reason to totally abandon stocks at this juncture. **Chart 5** says it all. The nation's money supply has zoomed upward at an incredible speed the last two years. The M2 Money Supply is a good indicator of possible inflation. Too much money chasing too few goods which is the spot we are in now. Yet economic fundamentals still apply.

Chart 5: M2 Money Supply Growth Since 2020

I hope that this newsletter gives you a little comfort and that I pointed out to you that it makes sense to stay the course. Please join us for our first conference call of 2022 on **Tuesday, February 1, 2022, at 6:30 pm**.

When: Tuesday, February 1, 2022, at 6:30 p.m.
Topic: BFSG Conference Call Hosted By Steven Yamshon

Please click the link below to join the Conference Call:

https://bfsg.zoom.us/j/95587997509?pwd=aHkwMkVyL2dPSVdUQzRzT2NrSmVkZz09

Or Telephone: 1 (720) 707- 2699
Webinar ID: 955 8799 750Passcode: 388235

International numbers available: https://bfsg.zoom.us/u/kAU6l2wFV

Thank you for your continued confidence in us. We look forward to you joining us on the upcoming conference call.

All the best,

Steven Yamshon
Managing Principal

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