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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.

February 15, 2023

Too Early To Call A Bull, But Markets Have Played Ball In 2023

Investors should be feeling pretty good at this point. In California, the rain storms seem to have passed (for now at least), Super Bowl LVII was filled with drama and decided by a last-second field goal, and bonds, US Stocks, and Foreign Stocks seem to be rebounding from the lows of the last quarter (4Q2022).

You might find yourself feeling anxious, wondering "what next?". You wouldn't be alone. It seems that we are faced with a dilemma: did the market correct too far and therefore we are getting a recovery bounce that should take it to a level of normalcy? Or is the Fed going to orchestrate a soft landing that should provide a backdrop for a continuation of the market advance?

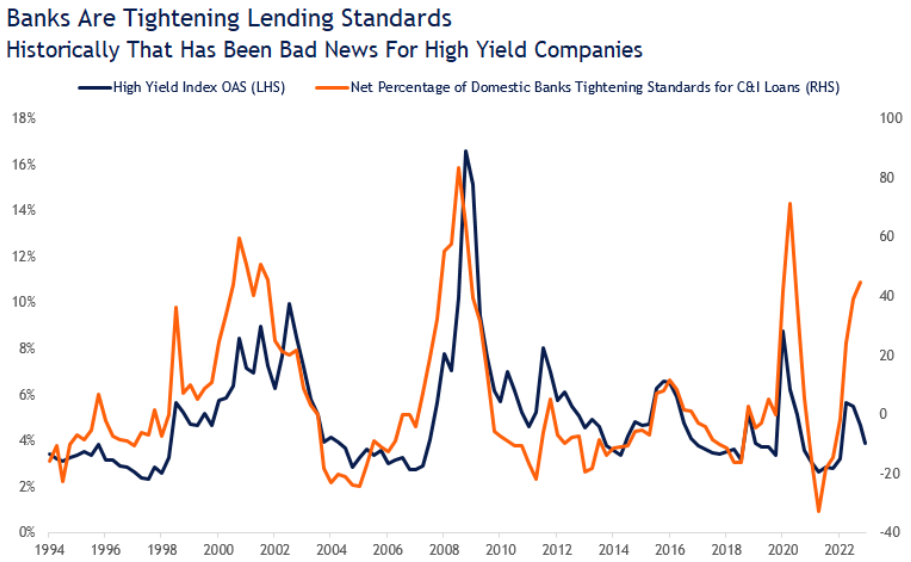
Let's try and develop a roadmap to this question by looking at where we are currently. Looking back to 2021, taking into account the drop of 2022, and the recovery that we have been experiencing in the first six weeks of this year, this is how things look currently:

Here's what I see:

1. We had a Santa Claus Rally - not large, but positive nonetheless.
2. The first five days of January were strong, up 1.4%
3. We have seen a trifecta of market breadth measured on January 12th.
4. The market crossed above the downtrend 200-day moving average, for the first time since the rollover began. The past couple of attempts encountered more selling to lower-lows.
5. We have experienced the fabled "Golden Cross" where the 50-day moving average crosses above the 200-day moving average.
6. The S&P 500 from the high point to the low point has now come back up and crossed above 50% of the decline.

So All Is Good In River City, Right? Well, Not So Fast...

Although not widely publicized, the major money center banks have quietly tightened their lending standards. This is the clearest admission that they see a possible problem looming in real estate, specifically in commercial and industrial. This tightening can be seen as a means to protect themselves.



Source: LPL Research, Bloomberg, 2/07/23
All indexes are unmanaged and cannot be invested into directly.
Past performance is no guarantee of future results.

This is not a positive sign from the perspective of banks' opinion on the future of economic growth and prosperity. This has not always been a good indicator of future business growth expectations, yet it is not a big surprise given that the banks' most recent memory is the Great Financial Crisis of 07-09 where there were financial failures and enough economic pain that there have even been movies written about this period.

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The next issue is inflation. This seems to be a "quiet cancer" to the economy that negatively affects almost everything. Yet, measures are showing that it is on the decline from late 2022 highs. Beginning with wage growth- not labor numbers directly:

To get a good handle on this, I implore you to watch the YouTube below. This is the link that explains the GDP, Inflation/wage data, and construction spending/hiring. It is an LPL webcast for Friday, February 10, 2023:

The next two inflation pictures to give you show the two biggest measures of inflation; the course of CPI inflation and PCE inflation. Both of these

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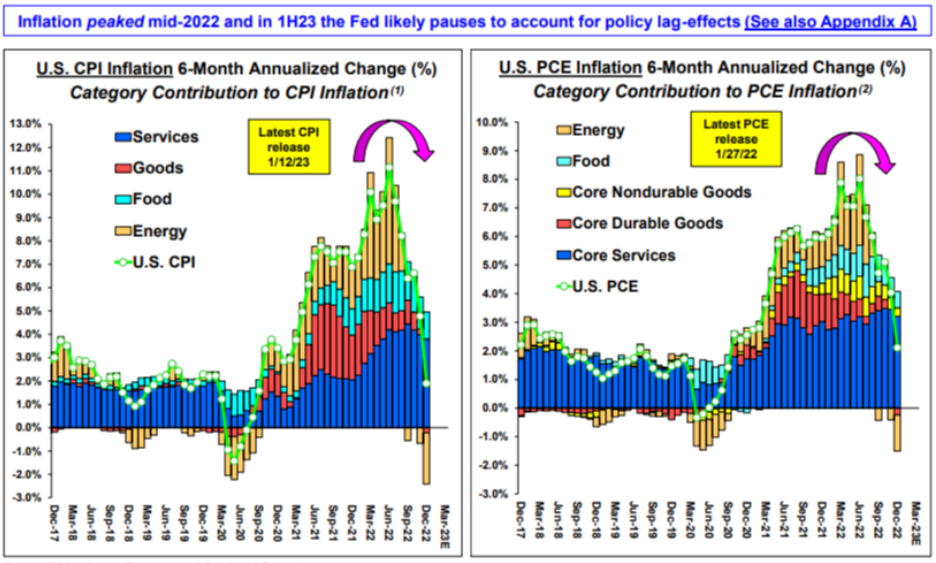
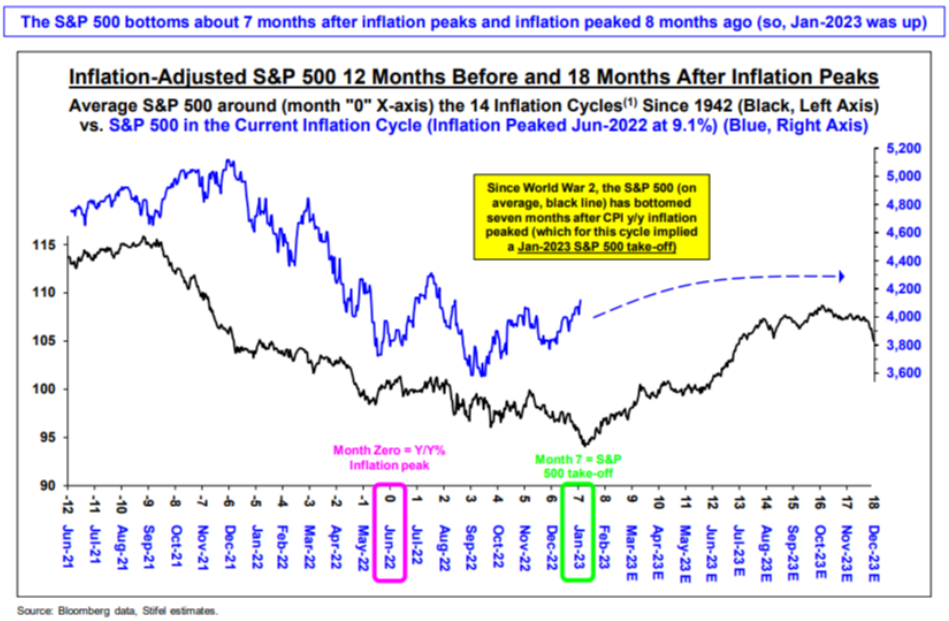
show that they seem to have topped out and are rolling over. This week gives us the next data point for the CPI. As of this writing, I don't yet have the data needed to update further:



The logical question then becomes, "OK, so the CPI and PCE seem to be rolling over, but what do the markets do when these inflation measures have seemingly topped out?" Historically, since World War II, the S&P 500 bottoms about 7 months after inflation peaks and inflation seems to have peaked about 8 months ago. Therefore, January of 2023 would be about the right time for the markets to begin their recovery. Note below the pink box at the bottom in June of 2022 when inflation seems to have peaked, and the green box in January of 2023 when the markets have started a recovery:



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This then leaves us with the last issue: recession. Because if the inflation and the market decline of 2022 were severe enough to cause a recession, are all bets off? Last week stock markets of the world (both US and Foreign) fell for the first week this year, in part because investors are starting to believe that inflation is going to re-assert itself (after the super strong shocking labor number). There is a cadence of reports that swayed many this way. But we think investors are just overlooking the far greater story. Here are the five data points that "scared" investors:

- January jobs report curiously strong at +577K.
- Manheim Used Car Index rose in January.
- University of Michigan Survey of Inflation rose to 4.2%. This is solely blamed on the bounce in gasoline prices.
- CPI this week could show a recovery in housing.
- January CPI could come in hotter than the rest of the deflationary components have shown.

So we wait to see what housing, gasoline prices, and other labor components show. If the economy is slowing, the buzz should move from the fear of unbridled inflation to that of recession vs. a soft landing on the economy. This is coupled with February historically being a tough month. Only about half the time is February a normally positive return month. So I will leave you with the latest statistical measure by Thomas Lee's Fundstrat team in their comment of Monday morning of this week.

Again, going back to 1950, the years with returns of over 5% for the year after the first week of February (last week was this first week of February) the returns have been quite impressive every year except the market crash year of 1987:

YE 2023: S&P 500 should exceed 4,800...unless this is '87

Years with >5% Returns After Feb Week 1
Sorted by Returns from Feb Week 1 to YE. Since 1950

	Year	YTD to end of Feb W1	Feb W1 to YE	Implied S&P 500 YE 2023
1	1954	6.0%	36.8%	5,697
2	1997	6.6%	22.9%	5,118
3	2013	5.8%	22.5%	5,099
4	2019	7.9%	19.4%	4,971
5	1989	7.9%	17.9%	4,911
6	1991	8.0%	17.0%	4,871
7	1980	7.7%	16.8%	4,862
8	1985	8.7%	16.2%	4,839
9	1961	6.1%	16.1%	4,833
10	1975	14.7%	14.7%	4,776
11	1996	5.5%	14.0%	4,746
12	1967	8.2%	10.9%	4,620
13	1951	7.6%	8.1%	4,501
14	1976	10.3%	8.0%	4,499
15	2012	7.1%	5.9%	4,409
16	1971	5.2%	5.3%	4,386
17	1987	15.6%	(11.8%)	3,674
	Average		14.2%	4,754
	Median		16.1%	4,833
	Win Ratio		94%	-
18	2023	8.5%	-	-

Source: Fundstrat, Bloomberg

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I'm not saying that everything is rosy and that 4,800 is the proper target for 2023, but the year is surely starting quite strong and a positive recovery following 2022 would not be completely unexpected- particularly given the statistical data we have from history. Looking at a picture of what we are currently experiencing, this is how we are looking. Let's hope that things truly are on the mend and the markets do become a much better place for 2023:

Source: Fundstrat, Bloomberg

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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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