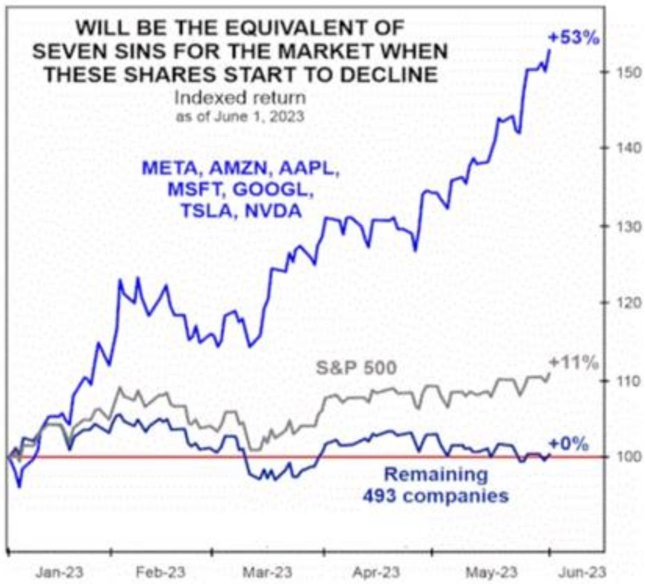
July 17, 2023

Dear Investor,

LEVERS.

Q2 delivered us the same exact backdrop as Q1, which replicated Q4 2021. Here it is:



Despite the fact that Q2 2023, saw the Dow Jones Industrials finish +3.8%, commodities down **-10%** utilities **-6.0%**, and 7-10 year bonds +0.9%, the S&P 500 finished up a solid +15.9%, above where it was on June 1st illustrated in the chart above. In the S&P, it is almost all AI (Artificial Intelligence) stocks lifting the index, which most people deem to be 'the market' since it is the headline. **But** for the 493 other companies, they finished up only 2.8%***,*** some up, some down. To put that in perspective, that is roughly the same as six months in a low-risk money market fund. The Nasdaq, on those same stocks, soared.

This is classic Bear Market (BMR) rally stuff. If it proves to be one in Q3, deception rules the day once again in 'markets'. A few of those darling big stocks are in absurd valuation levels such as **40** times ***revenue***. The S&P 500's price to **earnings** ratio is ***20***. To have any company valued at 40 times ***revenue*** is utterly insane. Yet … here we are (again).

7% rates for the 30 year mortgage have not yet taken hold, nor have car loans, nor the cessation of the student loan freeze. On the flip side, 5% money market rates provide real income for anybody holding 'cash' equivalents (note banks pay nowhere near that rate). Banks are trapped in the Fed's manipulation system, and only the bank bailout, delivered on March 16th, has given Wall Street reprieve to pump the indices again via the few, very large, growth stocks. If you are not concentrated in large cap growth, you're likely just a bit above net-zero level. Understand why, as Q3 reveals whether or not we are BMR or 'All Clear'!

Best Regards,

Mike Sullivan
President, Certified Financial Planning Professional®

Detail

2023 Q2 results followed through on the Wall Street 'Lever stocks' game. Note the other major indices barely moved. What comes next depends on recession, Here are YTD results:

INDEX	TYPE	YTD
Standard & Poor's 500	US Based Large Stocks (500)	**15.9%**
Dow Jones Industrials	US Based Large Stocks (30)	**3.8%**
Nasdaq Composite	US Based Large Stocks	**31.6%**
Standard & Poor's 400	US Based Mid-Cap Stocks (400)	**7.9%**
Russell 2000	US Based Small-Cap Stocks (2000	**7.1%**
Dow Jones Transports	US Based Transportation Stocks	**16.0%**
Dow Jones Utilities	US Based Utility Stocks	**-6.3%**
EAFE International Index	International Large Cap	**10.4%**
MSCI Emerging Markets	Diversified Emerging Markets	**4.4%**
Commodities	Bloomberg Commodity Index	**-10.0%**
7-10Y US Treasury Bonds	10 Y Us Treasury Bonds	**0.9%**

Sources: *Bloomberg, vanguard.com, yahoo.com*

Here are your bullet point highlights for Q1:

- The biggest rebound was found in the Nasdaq, the big loser from 2022 when it lost ---- **-33.1%**. Nasdaq rose 31.6%, also lifting the S&P 500, as you saw on the prior chart.
  - Note the lag in the Dow, and the Mid and Small cap indices. Very thin.
- Continuation of the rally year to date will be fully dependent on the small companies and the remaining 490+ stocks in the S&P 500 rallying from here, in the face of those interest rate hikes, job losses, and cessation of student loan relief. That is a tall order, but it could happen. That will be the driving factor for this one-sided rally having a shot at not turning out to be a Bear Market Rally (BMR).
- BMRs are famous for taking out all the bulls (2022), then taking out all the Bears before resuming the primary market trend: downward.
- Fundamentally (which is what used to matter), the pressure on earnings is still not favorable. The Fed manipulating rates 'higher for longer' is not likely priced into earnings expectations at all. Should those pressures resume as corporate reports start coming out in mid-July, we likely are near completion of a classic BMR. Note the trend, which is still lower … week by week: As of July 10th, still trending lower.

S&P 500 EPS growth expectations

Date	2Q23E EPS Growth	3Q23E EPS Growth	4Q23E EPS Growth	1Q24E EPS Growth
1/1/2023	-6.71%	0.70%	-	-
2/1/2023	-7.63%	-0.36%	6.20%	
3/1/2023	-9.09%	-1.27%	2.80%	
4/1/2023	-8.89%	-0.76%	2.99%	10.32%
5/1/2023	-9.47%	-1.45%	2.50%	7.18%
6/1/2023	-10.96%	-1.46%	1.69%	3.01%
7/1/2023	-11.40%	-2.02%	1.32%	2.27%
7/10/2023	-11.46%	-2.17%	1.17%	2.03%

Source: The Earnings Scout

- The Fed says it will keep hiking. The bond market says they're wrong. A standoff.

- The 10 Year Treasury yield (drives home & car loans, etc.) was **1.51%** at 12/31/2021
  - Rates over 3.00% dramatically impact borrowing costs and asset prices.
  - The 10 year stands at 3.84% as we go to print (down from 4.29% in Oct '22, but notably higher than last quarter's end of 3.38%).
  - In 2022, US Treasury Bond prices saw the worst YTD decline since 1788.
- Housing is holding up in several regions, other regions are rolling over rapidly, and prices are coming down as sellers are now 'dealing'. We expect that to continue.
- We provided a housing example in 2022's third quarter:
  - The $400k house, financed at 4% for 30 years cost $1,909 over 360 payments
  - The $400k house, financed at 7% for 30 years cost **$2,661** over 360 payments.
  - The added cost is nearly **$270,521** in interest over that 30 year term
- To keep the payment at $1,909, the house price would have to drop to **$287,000**
  - The price drop would be $113,000, a decline of **-28.3%**
- The 30 year mortgage rate stands at 7% as of June 30th.
- Canadian banks have added 60 year mortgages to their offerings to help manage payments. A 25 year old worker financing that $400k house will 'own' it only if they reach 85 years of age, paying $2,369/mo, and **$1,305,880** in interest to the bank: debt-slave for life … if you make it that far, but … hey, low payment! ***Seem wrong?!***
- Last, CPI is being celebrated. It was up only 3.0% in June (according to the shifty calculation). Last June was up 9.0% over the prior June. 3% + 9% = 12%. Does that sound like is a strong tail-wind for consumers??

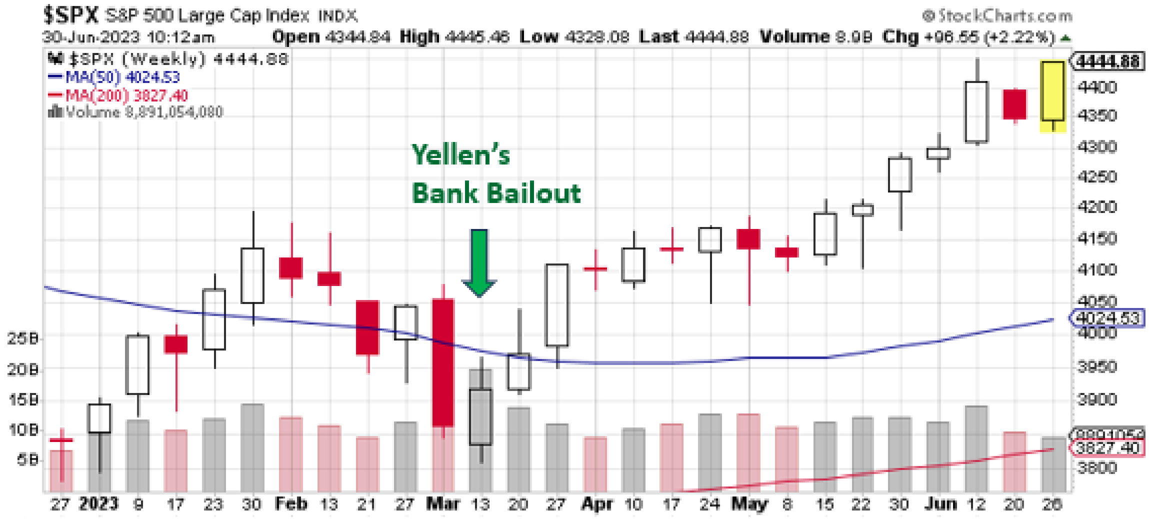
Let's take a look at the March 16th Bank Bailout, named the BTFP (Bank Term Facility Program) which Janet Yellen embarked upon after stating at 10am on March 16th that there would be no bail outs, only to effectively roll out Infinite FDIC for the banks at 6pm that same day … eight short hours later. The blow up of three of the biggest banks to fail in US history in Q1 caused her to actually think … but not until after 10am somehow.

The BTFP allowed all the banks to borrow insta-money that the Fed created, effectively making the banks suffer no losses to their bond portfolios … bond portfolios they were forced to build as they invested the money the Fed/Treasury duo cranked out of thin air back in the early days of COVID. The Fed caused the bank blow ups. The Fed/Treasury duo for the umpteenth time resorted to the only tool they have: currency/dollar destruction. The irony is that doing so directly offsets the inflation-reduction effort they embarked upon in 2022.

Here is the correlation of Yellen's latest pillaging of the Treasury for Wall Street:

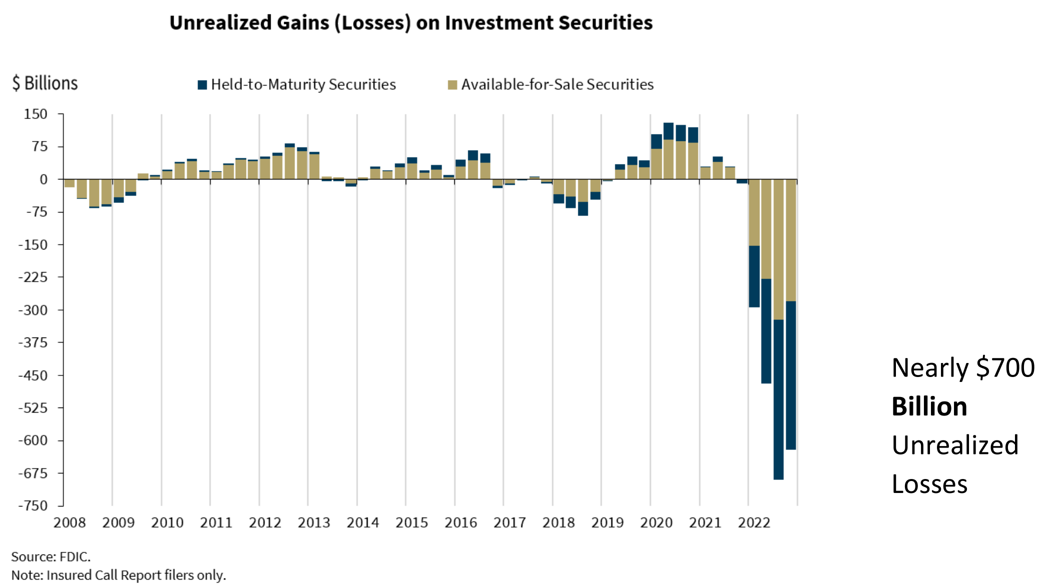
Blue line bails out banks. Red line is S&P rising via the Lever Stocks

So, March 16th was the 'All Clear' whistle for Wall Street and the biggest tech stocks **instantly** were pumped as levers under the new mania, AI. There is Yellen, clueless at 10am on 3/16, infinite bail-out by 6pm … using her one trick: print money.



Another bank bailout, another opportunity for a Wall Street pump. You get a 60 year mortgage and a 7 year car loan.

In case this sounds like sour grapes, for preferring caution, let's take a look at some of the correlations that have been distorted far beyond logic, starting first with the losses that ***still remain*** on the banks' books per FDIC data:

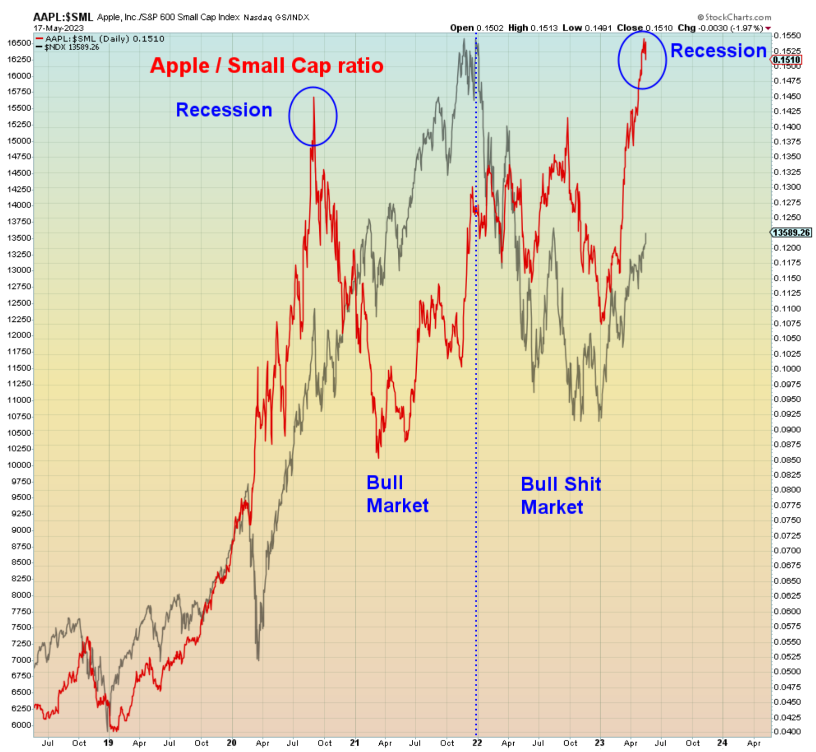


If the banks had to be responsible like you, a real investor, for what they invested in (largely treasury bonds), they would have to sell their 'assets' to pay all of the bank customers who are leaving to put money in money market funds that now pay upwards of 5% while so many of the banks offer so much less. (The banks cannot offer much more, because their long term bonds on their books are largely only earning in the 1% neighborhood.) The BTFP enables banks to not have to realize their true losses.

The bank bail-out has led to the AI pump, let's look at correlations:

Source:
Mac10

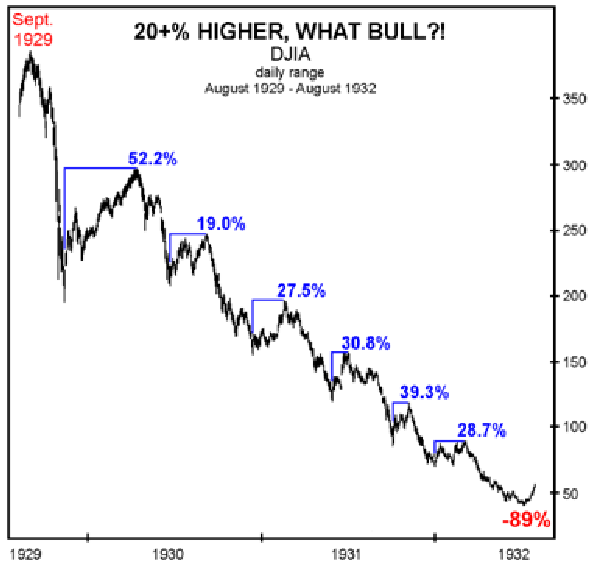
Apple has eclipsed the entire value of Russell 2000's universe of small company stocks:



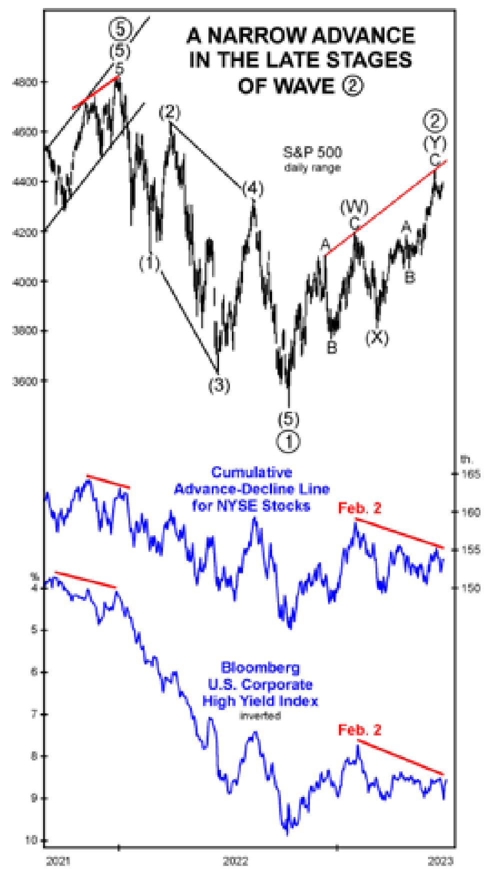
Source:
Mac10

By themselves, the two preceding charts convey the distortion. There are many.

While the Wall Street main stream media circus celebrates a new Bull market since we've risen an arbitrary 20% from the October lows, we keep in mind that many times throughout history that has occurred. From 1929-1932, there were ***five*** 20%+ rallies … the first was the strongest. Every single time, investors in that moment thought they had the 'All Clear' sign.



While just one of many technical services, Elliott Wave suggests we are lined up quite well for a 'Leg 3' down, following a ***seemingly*** strong rally. Note the circled '1' and '2' legs we have experienced since the top at the end of 2021 … when only a few stocks lifted us into year end:



Few stocks
Lift index

Junk Bonds
Not playing

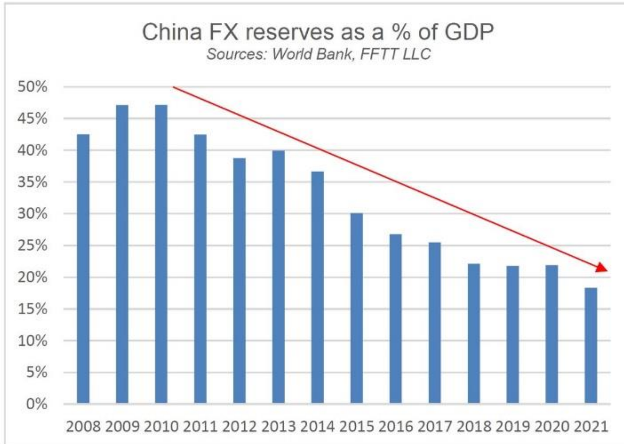
Importantly, and more fundamentally, 'inflation' coming down is being celebrated almost as much as the AI mania. Lost somewhere is the fact the latest CPI reading of 4.0% means inflation is still increasing, but only at a 4.0% rate … ignoring that is ***on top*** of the inflation spike level of one year ago!

The Haves are catching the Bank Bail-out / AI pump, but the majority of the country is in 'boiling frog' mode, struggling to make ends meet. 64% of the country lives paycheck-to-paycheck. They are somehow missing out on the party.

We can see that here as credit card balances surge, at the same time the interest rate charged by the friendly bankers surges along with it … average rate now 20.68%:

Sprinkle in the job layoffs that companies have embarked upon, mortgage rates, cessation of student loan relief, the Fed's 'higher for longer' interest rate stance, massive corruption visible in the US government, two-standards of justice in America, Russia/Ukraine, China/Taiwan, the BRICS countries dumping their trade in the US Dollar, and we stand by the stance that most investors will likely want less than normal equity exposure.

Speaking of those foreign countries, the country of focus is of course China. China has subsidized the US profligate borrow, print and spend culture that the Fed and Treasury have exploited for the past few decades. That luxury has been on a steady downtrend, and it was accelerated after the Biden administration weaponized the dollar against Russia. Look:



The downward slope of this chart directly correlates to the necessity of the US to borrow more and more, and the Fed to print more and more to finance everything. There are limits to every fiat currency, regardless of what the USD custodians (the Fed & Treasury) pretend.

The chart on page one illustrates the very narrow breadth of this 2023 advance … a few handfuls of stocks. Not only have retail investors been lured to chase these, one at that 40 time revenue multiple (insane), but investment desks use these stocks as 'levers'. They are highly liquid, in high demand, and very large in size. So investment desks, think big Wall Street firms, pension investment committees, etc. will jump into those stocks and push them higher to try to bank a few percentage points while the momentum exists. Meanwhile, in the broader market … the other 493 stocks in that chart … they are not increasing position size. They are rather down-sized, waiting for all the headwinds mentioned to take hold.

Post holiday break, where we are traditionally sent to our grills in a market-induced state of low anxiety, we will begin to find out how well corporate earnings are faring and what their outlooks suggest. Those begin in mid-July.

The markets are priced for perfection in our view. Let's see what they bring us.