P3 Parks Capital

MARKET OUTLOOK Q1 2023

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Written by: Rajiv Dixit, CPFA®
Portfolio Manager

Welcome to the Market Outlook for the first quarter of 2023. Happy New Year to you from your team at Parks Capital. Aren't we glad that 2022 is over? In our last Market Outlook in October, I left you with some key points about the markets; let's recap them first.

RECAP

1. While the S&P 500 was down 24% at the time, by breaking down that loss on a quarter-over-quarter basis, we reinforced our belief that **the worst-case scenario of inflation had already played out in the 2nd quarter of last year**, and thus so have the majority of the losses in this correction.
2. We also believed we were **closer to the market bottom than before** and expected the bottom formation phase of the correction life cycle to be volatile and choppy.

Last Quarter

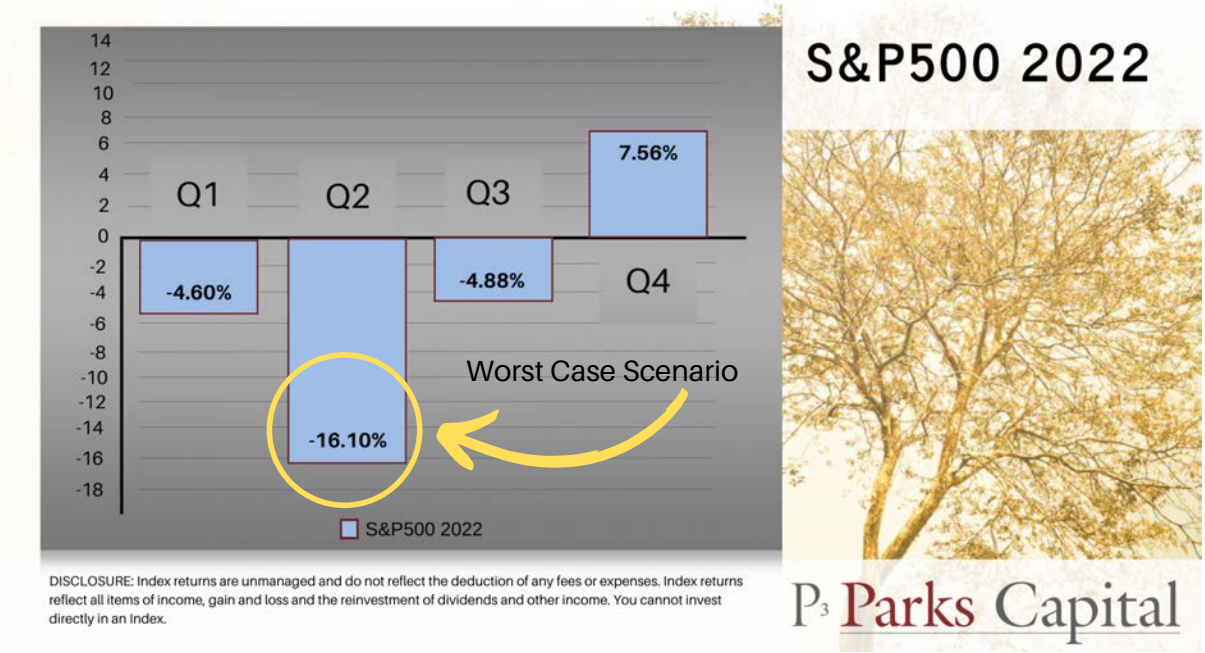
So here we are three months later; let's go back and see how things are looking now as we close out *the worst market year since the Great Recession*. Simply listening to the day-to-day news regarding markets throughout the 4th quarter makes it very easy to believe that things are starting to get worse out there. It feels a lot worse, doesn't it? Markets are up and down, there is a lot more talk about the impending recession and whether it is going to be a soft landing or a hard landing, whether the Federal Reserve is going to continue raising rates or change course on a dime; it's a forest fire out there when it comes to volatility and negativity.

But we talked about this last time. We warned you that, by nature, bottoms are choppy. Volatility drastically increases when bottoms are being formed because bulls and bears conflict with each other with their different viewpoints of the future.

Is the Worst Behind Us?

What might come as a surprise to you is that, actually, we had a great quarter from a market performance point of view. Yes, markets were up in the fourth quarter of 2022. Remember the chart I showed you last time when we broke down the losses on a quarter-over-quarter basis?

This illustrated the notion that most of the losses came in the second quarter, and the worst was already behind us. Let's look at this chart again with the 4th quarter included.



As you can see, things are getting better: the **S&P 500 grew 7.56% throughout the last three months of 2022**. Who would have thought that was possible amid all this volatility? But let's not get too excited yet. By no means am I saying that all is clear in terms of the market correction, that the chop is over. What it simply means is that the case for the worst-case scenario being behind us is only becoming stronger and that the probability of being closer to the bottom is increasing.

What is certain, though, is the fact that *we have just completed the worst calendar year in terms of market performance since the Great Recession of 2008*. No one can change that fact.

INVESTMENT STRATEGY EVALUATION

Let's talk about that a bit more. You just saw the quarter-over-quarter performance of the S&P 500 for 2022; I am about to share for the first time with you another set of numbers, but before I do that, I want to explain what this data is and what it isn't.

As a client of this firm, you are used to seeing your Portfolio Performance number on our wealth reporting platform, *Black Diamond*. You know that you can log into *Black Diamond* and see your portfolio's performance at any time and compare it to that of the S&P 500 and other indices for different periods.

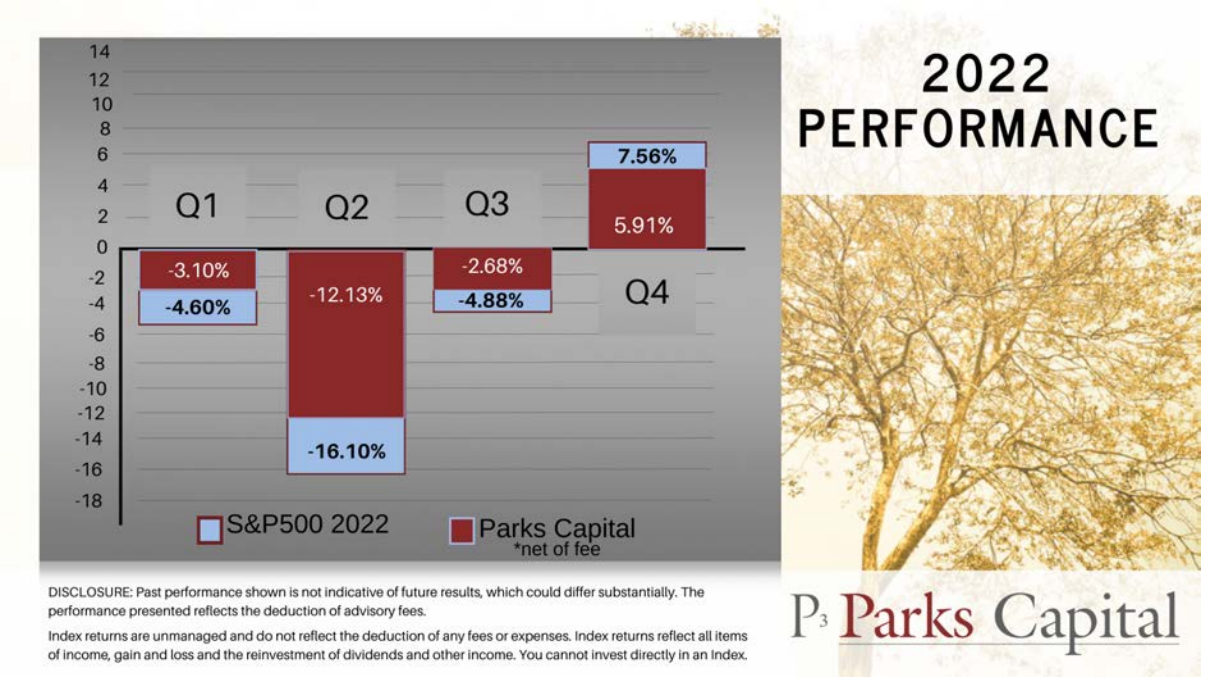
Firm Performance

What you don't see is another set of performance numbers we call the Firm Performance. What is firm performance? Each client has different goals, risk tolerances, and withdrawal rates, among other things that make their portfolio unique. Firm Performance takes all client performances and combines them together to derive the performance of all assets managed collectively by Parks Capital. It includes every single dollar managed, every withdrawal taken, every deposit made, and every fee collected—everything together as one portfolio.

Why is Firm Performance important? Because it is the real test of the investment strategy that we use to manage your money across the board.

I am telling you this before I share the Firm Performance with you because there is a strong chance that your individual performance is going to be different from the Firm Performance numbers you see below, but that is because your portfolio is custom designed for you. I hope that makes sense. If at any time you want to discuss the reasons why your performance is different from the Firm Performance, please don't hesitate to call us.

Below is the same chart you saw earlier, but now with the Parks Capital's Firm Performance numbers.



At the end of the year 2022, **the S&P 500 was down a total of 18.11%, while the firm was down 12.17% net of fee.**

What does this mean? It means that **for the year 2022, our overall strategy was able to avoid 33% of the downside of the S&P 500 total return index**, or in other words, one-third of the downside.

You all know this well; *the primary goal of our investment strategy is to lose less than the market when markets go down*. As you just saw, we did achieve this goal in the past year, a year that has been one of the hardest years to manage money since the Great Recession of 2008. We lost one-third less than the market, and that is great. Of course, there is no guarantee that this will happen again and again in the future, but it does give us some assurance that the strategy has the ability to achieve what we intend for it to achieve.

I would submit to you, though, that the *goal of losing less than the market is only a means to an end*. The end goal is that we have a portfolio that provides long-term returns similar to the market but is much less volatile than the market, or in other words, less risk with more return.

That sounds like a tall order: less risk with more return. Well, that is what you pay us for. Today, I want to outline to you how with a disciplined active management strategy, we can achieve that goal on a long-term basis.

Less Risk, How Much Reward?

Now that we know that our investment strategy allows us to avoid 33% of the downside, we can then calculate how much of the upside we need to capture in up markets to achieve the same or more return than the overall market. That number is 88%. What does that mean? **Because we did not participate in all the downside of the market, we get the luxury of only capturing 88% of the upside and still making the same amount of money over the long term.** That is what we get for losing less than the market.

What else do we get? We also now know that, over a long period of time, if we consistently keep achieving this goal of avoiding 33% of the losses and gaining 88% of the upside, our **portfolio will have 20% less volatility** than a "buy & hold" strategy. Less volatility means less risk! Less risk with similar returns – isn't that our end goal?

Again, there is no guarantee that any of this will happen in the future but what we have is a clear roadmap of how to achieve that end goal.

INVESTMENT OPPORTUNITIES

Now that we have a better understanding of what we need to achieve when markets start to move higher again let's talk a little about how to achieve that outcome of participating in 88% or more of the upside.

You have heard me say this before, *"as long-term investors, we must view market corrections as an opportunity that needs to be exploited for our long-term gains"*.; this recent correction is no different. It has created value in parts of the market that are primed for growth in the long term and has removed excess from areas of the markets that were attractive but overvalued earlier.

We at Parks Capital are actively evaluating such opportunities. I want to discuss some of these opportunities with you today, but please know that this list keeps changing and evolving as more data comes in and markets move out of this bottoming phase.

Equity: International Markets

In the equity space, we believe that the recent meteoric rise in the US Dollar, the supply chain issues of the recent pandemic, the zero COVID policy of China, and the correction have created enormous value in the **emerging market** space. Coming into this correction, we had very little exposure to this part of the market; thus, there is room to grow here. We are specifically looking to invest in Southeast Asian markets like China, India, Indonesia, and others. As always, such investments would either be in the form of Exchange Traded Funds (ETFs) with a focus on these markets or through investments in large-cap robust companies that are primed for more growth and have a significant presence in these areas.

Equity: Electric Vehicle (EV)

Another sector in the equity space that we are actively looking to diversify our exposure to is the **electric vehicle** space. There is no doubt that the world is rapidly moving towards a transition to electric vehicles both in the consumer and commercial spaces. Before the correction, this sector was both saturated and heavily overvalued, in our opinion. Now with those valuations coming back down due to the correction and the much larger number of players entering this market, we believe that it provides an enormous opportunity for future growth for a long-term investor. We are looking to expand our exposure to more technology and resource-based companies.

Equity: Health Care & Biotechnology

The other equity space that we are actively looking into is **pharmaceuticals and biotechnology**. We believe that we are currently underinvested in this space and that there is potential for enormous growth in the future due to technological developments and the potential for mergers and acquisitions in the coming years.

Fixed Income:

In the fixed-income space of the market, we believe the Federal Reserve's aggressive actions to raise rates have created an excessive strain on bond prices across the board. It is unusual to see such a drastic fall in bond prices and a rise in bond yields in such a short period of time.

In our opinion, this has created enormous opportunities in the fixed-income space, where our exposure was relatively light before the correction, so there is room to invest here. This kind of opportunity does not present itself often in the **fixed-income** space, and we are definitely excited about it.

ECONOMIC FORECAST

This is a good time to transition into our discussion about the **economy. inflation and, of course, a possible recession**. I would tell you that in most normal economic scenarios if the Federal Reserve was to attempt to raise interest rates as aggressively as they have in the past year, you would see unemployment rise, consumer spending decrease, inflationary pressures reduce, and an overall decrease of economic growth – if not, a complete halt of the economy.

Savings vs. Interest Rates

But these times are anything but normal in nature. The Federal Reserve has raised rates at an unprecedented rate in its zest to control the inflation problem, and yet, there hasn't been any meaningful effect on unemployment, consumer spending, or economic growth till now. It is our view that the reason this time the rate hikes had much less of a negative impact on the economy is due to the **$5 trillion that was pumped into the economy in 2020** to combat the effects of the pandemic. This federal stimulus resulted in historic levels of consumer and business savings.

Think about it, if you already have a lot of money saved in your bank, the rise in interest rates to borrow money has much less of an impact on your ability to buy goods and services because you are more likely to use your savings than credit to buy them.

The same is true for businesses; if businesses are flush with cash, they are less likely to make significant reductions in workforce and capital spending because they don't have to worry about the borrowing cost as much. So, interest rates matter less to them than before. **Inflationary pressures, on the other hand, have started to come down a bit in the past months**. This could be the outcome of the decline in oil prices and the relief of global supply chain issues.

The big question from an economic point of view is that of **"which will last longer?"** The consumer and business savings, or the Federal Reserve's resolve to keep raising rates at this pace? That is where the answer lies in whether we are going to have a meaningful recession or not. We currently believe that if inflation continues to slowly come down, the Federal Reserve will slow down its rate hikes and maintain the federal funds rates near the current level.

Deep Dive into Recession

As you all know, we have a new employee, Meg Prokop. She is an extremely bright young individual who comes to us with a degree in economics and a strong passion for research and education. Meg and I have been researching the **similarities and differences between the economic condition of the 1980-81 period and now** so we can better understand the possibility of a recession that is deep, shallow, or doesn't happen at all. Soon we will publish a white paper with our findings for you to enjoy.

If you viewed our last outlook video, you know that we believe that whether there is going to be a recession or not, it should have no impact on the investment strategy of a long-term investor. This is because we believe that *a recession is only an economic outcome of the problem and is thus priced into the market correction* much before the determination is made whether we are in a recession or not.

You also know that it is the charts and not the economic forecast that helps us manage our investment strategy. So, let's look at the charts to see what the game plan is for the future.

OUTLOOK

Shown below is a monthly chart of the Small Cap index. The last time we talked in October, this chart was testing this support line we drew back in January. In the past few quarters, equity markets have successfully tested this support and continued to hold it. This, in our opinion, is a very positive technical sign.

Our strategy remains the same: as this line gets successfully tested and markets gain strength, we plan to slowly put the cash we raised last year back to work in the area we discussed above or wherever we find the best opportunities for the future.

Of course, if this line were to break meaningfully, we would be readjusting the portfolios again and raising more cash to wait for the next support line.

Closing

I want to remind you again: the purpose of this update is not to predict the future. No one can do that. The purpose of this update is to inform you of what we are seeing and how we are preparing for it. Of course, if things were to change between now and the next update in 3 months, we would be reporting about those changes and how we adapted to them in the next update or during our next conversation.

We cannot close this piece without highlighting one obvious fact: the above view of the markets and the narration of the events is a general view. You know that every portfolio in Parks Capital is managed based on who you are; thus, they all look a bit different based on your risk tolerance and your individual goals. Please keep that in mind. We are looking forward to talking with each of you in your quarterly meetings. Remember, Education + Investing = success!

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