Dear xxxx;

While financial markets have recently been rattled by banking insecurities, the first quarter of 2023 was not all doom and gloom. In fact, the first 33 days of the year delivered tremendous returns in US (+9.9%) and international equities (+10.2%). Even US fixed income was up 3.9%. The first inflection point of the quarter was the February 3 Non-Farm Payroll release. This report came in almost three times higher than expected, causing markets to decline on fears of continued rate hikes.

The second major inflection point was caused by two consecutive announcements. The first occurred on March 7 when Jerome Powell gave a hawkish testimony to Congress. The next day, March 8, the global banking fallout commenced with a poorly worded announcement by Silicon Valley Bank.

On March 13, US Stocks reached their quarterly intra-day low before reversing course to move steadily higher throughout the remainder of the quarter. US equities (Q: +6.92%) performed best, followed by international equities (Q: +6.17%), and US fixed income (Q: +2.96%). Commodities (Q: -4.94%) continued to disappoint. This letter will provide an analysis of the major geopolitical, financial, and thematic events that shaped the quarter as well as our predictions for how these events will shape economic performance and returns in the remainder of 2023.

Inflation & The Federal Reserve Bank

Chairman Powell has made it abundantly clear that while the board of Governors are taking into consideration the ongoing global banking struggles, inflation and the fight against inflation are the most pressing concerns facing our economy. In January, the year-over-year readings (December 2021-2022) show the CPI rose by 6.5% and the core CPI rose by 5.7%. The core PCE, however, came in above expectations at 4.4%. While both numbers were high, they were lower than the preceding month's readings. In response to these readings the Fed raised interest rates by 0.25% on February 1.

Later in February, the core CPI ticked lower to 5.6% and then 5.5% in mid-March. The core PCE unexpectedly rose to 4.7% in February, before falling to 4.6% in March. Both the core CPI and the core PCE are below their all-time highs; however, only the core CPI is materially lower than its post-pandemic high reading of 6.6% in June 2022. Unfortunately, both economic market indicators remain substantially elevated when compared to the Federal Reserve's mandate of keeping inflation at 2%.

On March 22, The Federal Reserve increased rates by 0.25% to 4.75-5.00%. During his testimony, Chairman Powell explained that he expects the credit markets will tighten due to the banking sector turmoil coupled with the relatively high interest rate. Further, he believes this tighter credit market will help slow the economy and lower the rate of inflation. In his published statement, the words "ongoing increases" were removed, signifying to the market that rates may have reached their apex. Upon hearing this, the stock market jumped higher by almost 1%.

However, during Chairman Powell's press conference, the Secretary of The Treasury, Janet Yellen, was giving a testimony of her own. As the market was cheering the ending of rate hikes, Secretary Yellen announced that there has been "no consideration or discussion about blanket insurance to US banking deposits". The possible rate hike cessation euphoria was halted in its tracks and by the end of the day the S&P 500 had dropped 100 points or almost 2.5% from its intraday peak.

The Global Banking Crisis Simplified

The financial stimuli provided during the Covid-19 pandemic was the fuel that lit the fire on the Global Banking Crisis of 2023. A combination of cheap and free money poured into the US banking system. With short-term rates at zero, banks purchased long-term US Treasuries and high-quality Mortgage-Backed Securities with those deposits. Banks earn the spread between the rates on the bonds they purchase and the rate they pay customers for their deposits. Banks also use interest rate hedging strategies to prevent losses from an increase or decrease in the federal funds rate.

In 2022, as inflation spiked, the Federal Reserve announced they would be raising rates to quell inflation. On March 22, 2022, GA Pincus Funds saw the writing on the wall and took the logical step of selling our clients' long-term bonds and replacing them with ultra-short duration bonds. Silicon Valley Bank not only failed to see the rate increase coming, they also didn't have hedges in place.

Typically, when companies need emergency funding, they secure the funding privately prior to informing Wall Street via a press release. Informing the market about the need for funding after the funds are in place, calms fears. Silicon Valley Bank not only failed to secure funding, but they also asked for the funding after revealing a substantial realized loss on their bond portfolio. These press releases spooked clients and shareholders alike causing a run on the bank and a 60% drop in the price of the stock. Silicon Valley Bank was taken over by the Federal Deposit Insurance Commission on March 10. On March 12 the FDIC announced a special assessment on US banks to make all depositors at Silicon Valley Bank whole. During the same announcement, the FDIC also put Signature Bank into receivership.

In the days since March 12, the FDIC and other large banks have worked together to try to reestablish confidence in the US banking system. The Fed has created a new Bank Term Funding Program to offer one-year loans up to $25 billion to financial depository institutions who pledge US Treasuries, Mortgage-Backed Securities, and other qualified debt. In addition, a group of the largest US banks have stepped up to provide deposits to First Republic Bank, the 14th largest US bank by assets under management, which has been getting shellacked by the market turmoil.

The collapse of Silicon Valley Bank and the US bank stock rout did not cause or lead in any way to the failure of Credit Suisse. Credit Suisse has been in the news for all the wrong reasons since 2014. Their misdeeds led to various large fines which exacerbated the company's need for funding. When Saudi Arabia failed to come to the rescue, the Swiss Government was forced to step in to offer a liquidity backstop. On March 19, it was announced that UBS, another Swiss Bank, would be purchasing Credit Suisse for $3.2 billion.

Days later, on March 24, Deutsche Bank fell by as much as 15% after the cost of insuring the bank against a default rose to four-year highs. At it's low, Deutsche Bank had dropped almost 30% in two weeks. While this sounds bleak, Citibank released a note on March 24 explaining the decline on irrational fear of contagion. They explained that Deutsche Bank had been profitable for the last ten consecutive quarters and has strong liquidity and capital flows. Deutsche Bank closed the quarter up 15.4% from its low point on March 24.

Tech Stocks Rule Once Again

From November 22, 2021, until October 14, 2022, the technology-centric Nasdaq 100 lost just shy of 6000 points or 35.13%. However, since October 14, 2022, the index has recovered 2500 of those points. At the end of the first quarter, the Nasdaq 100 was up 21.35%. Shockingly, 92.5% of these gains came from just seven companies: Apple, Microsoft, Nvidia, Tesla, Meta, Amazon, and Google. Five of these companies are consistently profitable growth names, however Amazon and Tesla are not. We find it surprising that both Amazon and Tesla have performed so well in 2023 given the high federal funds rate. We do not expect continued bullishness in Amazon and Tesla unless future earnings reports both reveal and project larger and more stable profits.

Debt Ceiling

On January 19, 2023, the Department of the Treasury officially reached the debt limit – the amount of debt that it can issue to public or other federal agencies. The Treasury has announced a "debt issuance suspension period during which, under current law, it can take extraordinary measures to borrow additional funds without breaching the debt ceiling." The Congressional Budget Office projects that if the debt limit remains unchanged, the US will default on its debt sometime between July and September of 2023.

While the thought of default sounds frightening, this process is a battle that plays out between Democrats and Republicans every few years with the same result. Politicians wait until the very last minute to ultimately come to an agreement where the debt ceiling is raised, and the fight is pushed out a few more years. There is no reason to believe this year will be any different. There will be some market volatility as the US gets to the brink of default, but any losses will be recouped once an agreement is in place.

Biden Budget

On March 9, President Biden released his budget proposal for 2024. As with most Democratic budgets, the proposal aims to increase taxes on the wealthy to fund social programs and transform the economy. Neither the taxes nor the expanded social programs will pass as they are currently written. Instead, this is a starting point from which negotiations can begin. It is very likely that these negotiations will be intertwined with the ultimate passage of a bill that increases the debt ceiling.

Conclusion

While there is still increased volatility in the banking sector, it is a promising sign that most of the assets owned by Signature Bank and Silicon Valley Bank have been acquired by New York Community Bancorp and First Citizens Bank respectfully. This volatility caused substantial declines in the high dividend asset class, which has led to buying opportunities for our algorithm. As the volatility decreases, the hardest hit sectors will recover, and the market will move on to the next perceived calamity.

Looking forward to the remainder of 2023, we remain bullish not only on the banking sector but also the US stock market. We no longer foresee a drawdown that brings the US stock market below the levels witnessed in October 2022. While an economic recession is possible, it is our belief that this has already been priced into stocks. As we begin to see more significant CPI and PCE decreases, the Fed will likely pause or even lower rates, which will improve not only US equities but US fixed income as well.

Client Referral Network

One of the oldest and most successful methods to grow a business is through word of mouth. GA Pincus Funds has been fortunate and has grown substantially due to referrals made by you and your fellow clients. We would like to use our future quarterly newsletters to return the favor to our clients. We plan to dedicate a section of our newsletters to our client's businesses. Rather than list your name or company name, we will instead indicate the category of business and location where you operate. For example, Real Estate Professional in Chicago, or Employment Lawyer in Georgia, or Public Relations Professional in New York, etc. If you would like to participate in this program, please let us know. This referral program is **free marketing** for your business. **We will not accept payments for these referrals.**

Performance Calculations

The performance of your accounts is calculated daily, taking into consideration daily deposits and withdrawals, and those daily returns are combined to form your quarterly, YTD, and since inception returns. When we round off this enhanced precision it may shift your performance by 0.01-0.02% when compared to the calculation ((end date value – start date value)/start date value). Please note, the performance figures on your statement are accurate and are GIPS (Global Investment Performance Standards) compliant.

Exchange Traded Funds (ETFs) are required to distribute all excess cash, net income, and dividends received from their constituent companies to their shareholders annually. These distributions take the form of dividends. Many ETFs issue special dividends at the end of the year to ensure compliance with this rule. The amount of the dividend is removed from the ETF on x-date, and the shareholder receives the funds on the pay date. The x-date and the pay date can at times straddle New Year's Day. Please be aware, your full year returns may be slightly lower than expected due to this nuance.

It is impossible to predict whether and by how much the market will increase or decrease. Our algorithm rebalances your accounts according to changes in the relative weightings of the securities you hold. As one security becomes too heavily weighted the algorithm sells shares in that security. Conversely, as one security becomes too lightly weighted, the algorithm purchases shares of that security. Instead of rebalancing based on time (as most managers do), this algorithm rebalances based on a securities' relative weighting in the portfolio. This gives GA Pincus Funds a long-term advantage. No matter what the market does in the future or has done in the past, if your time horizon is long enough (>1 year), this algorithm has proven itself to be successful.

Please stay safe and healthy. I am always available to answer any questions you may have.

Best regards,

Gabriel

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