Dear xxxx;

Most financial pundits and market participants spent late 2022 and early 2023 discussing the magnitude of the recession that would likely hit the US in the second half of 2023. Instead, after reaching a low of 3,577.03 on October 12, 2022, the S&P 500 crossed into bull market territory on June 8, 2023. The tremendous performance of US equities (Q: +10.26%; YTD: +17.89%) this quarter has once again been driven by the seven largest mega-cap technology firms. The performance of international equities (Q: +1.41%; YTD: +7.67%) and US fixed income (Q: -0.84%; YTD: +2.09%) were muted, while commodities (Q: -2.73%; YTD: -7.54%) continued to lag.

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. We will also provide information regarding the migration of your accounts from TD Ameritrade to Schwab which will take place over Labor Day weekend.

Debt Ceiling Resolution

As mentioned in our last quarterly newsletter, 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 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." On May 1, 2023, Janet Yellen projected the US would default on June 1, 2023 before later revising that date to June 5, 2023.

After a lot of hemming and hawing and posturing, President Biden and House speaker Kevin McCarthy struck a deal to increase the debt-ceiling by $2.5 trillion and reduce federal spending. President Biden signed the Fiscal Responsibility Act of 2023 into law on June 3, 2023. Most surprising was the incredibly muted market response to the debt ceiling crisis. This debt ceiling process was the most talked about news story in May, yet the stock market was completely unaffected. During the month of May, the S&P 500 gained just 0.287%. This performance is better than -0.10%, the average market performance in May over the last 95 years.

Inflation & The Federal Reserve Bank

Chairman Powell has taken steps to be as clear and predictable as possible when it comes to current and future interest rate decisions made by the Federal Reserve. In April, the year-over-year readings (March 2021-2022) for CPI and PCE both came in below expectations. The CPI rose by 5% and the core CPI rose by 5.6%. The core PCE increased by 4.4%. While all three remain elevated when compared to the 2% target of the Federal Reserve, they also clearly indicate an inflation rate that is declining. In response to these readings the Fed raised interest rates by 0.25% on May 3, 2023.

Later in May, the core CPI ticked lower to 5.5% and then 5.3% in mid-June. The core PCE unexpectedly rose to 4.7% in May before falling to 4.6% in June. 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. In response to the May readings, the Federal Reserve held rates steady during their meeting on June 14, 2023.

Since the rate hiking cycle began, people generally assumed that the apex of the cycle would begin as soon as the Federal Reserve stopped increasing for a single month. On June 14, 2023, rates stopped increasing and everyone breathed a collective sigh of relief. However, during the press conference following the June meeting, Chairman Powell that "future rate hikes would continue to be determined on a meeting-by-meeting basis and if inflation does not slow down further, rates could increase to 5.6% by the end of 2023." Powell also indicated that any future rate cuts were a few years away.

In general, the indication of continued rate hikes by Chairman Powell was brushed off by the market. Using the CME 30 Day Fed Fund futures prices, the Fed Rate Monitor Tool indicates where financial professionals believe interest rates will be after each Fed meeting. Currently, the consensus is that rates will increase by 0.25% in July, remain unchanged through December 2023, and begin slowly declining starting in January 2024. By the end of 2024, rates are expected to have decreased to 3.75%-4.00%.

Tech Stocks Reign Supreme

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 4500 of those points. Through the midway point of 2023, the Nasdaq 100 is up 38.75%. Shockingly, 107% of these gains came from just seven companies: Apple, Microsoft, Nvidia, Tesla, Meta, Amazon, and Google. This means that in aggregate, the other 93 companies in the Nasdaq 100 have combined to lose 2.9% of their value in 2023. Looking at the S&P 500, these same seven companies have delivered 124% of the full year's S&P 500 gains while the remaining 493 companies have combined to lose 3.8% this year.

As we mentioned last quarter, 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.

Artificial intelligence

Artificial intelligence (AI) is a machine's ability to perform the cognitive functions we usually associate with human minds, such as perceiving, reasoning, learning, interacting with an environment, problem solving, and exercising creativity. Machine learning is a form of AI where the machine can teach itself to become smarter through repetition. Deep learning is a type of machine learning that can process a wider range of data and produce even more accurate results. ChatGPT is a form of deep learning which uses a deep neural network with hundreds of millions of parameters to analyze and generate text.

Like past stock market crazes (cryptocurrency, meme stocks, electric vehicles, SPACs, and unprofitable tech companies), every stock even loosely associated to AI has skyrocketed in 2023. This is not to say that AI is the same as GameStop; however, companies are still in the early phases of learning how to use AI to benefit their employees, customers, and shareholders. There will be huge winners from AI, but there will be many companies that increase in value due to hype rather than fundamentals. Currently, we do not use AI at GA Pincus Funds and our algorithm does not incorporate machine learning.

What Recession?

Economists and financial professionals use the yield curve as a recession indicator. The yield of the 10-year Treasury Bond minus the yield of the 3-month Treasury Bill is seen as the most accurate predictor of a recession. A yield curve inversion is when the yield curve goes from a positive number to a negative number. Or in other terms, a yield curve inversion occurs when long term debt starts paying lower rates than short term debt. This occurred on October 25, 2022. This inversion has preceded every US recession during the last 50 years by anywhere from 6-24 months.

Based on history, the yield curve inversion should precede the US recession. However, seemingly every bit of economic data this year has beaten expectations. Five examples are below:

- 9.8 million people passed through TSA checkpoints over Memorial Day weekend this year, about 300,000 more than over the same holiday period in 2019. June 30, 2023 was the busiest day in US aviation history with 2.883 million people passing through TSA checkpoints.
- Housing starts rose to 1.63 million, higher than the 1.4 million expected by Wall Street. New home sales increased by 12.2% with gains seen in markets across the country.
- First quarter GDP was revised up from 1.3% to 2.0%, substantially above the 1.4% consensus projection.
- Currently sitting at an 18-month high, the US consumer confidence index increased to 109.7 in June, significantly above the 104 forecasted by economists.
- New orders for US manufactured durable goods rose by 1.1% in May, easily beating market expectations of a 1.0% decline.

Jonathan Golub, Head of US Equity Strategy and Quantitative Research, believes that the recession will take place once the yield curve un-inverts. Golub explains that "This makes intuitive sense as the yield curve steepens when the Fed cuts rates in anticipation of a downturn." Using the futures market as a guide, Golub believes the yield curve will first un-invert in June 2026.

Transition From TD Ameritrade To Schwab

On November 25, 2019, Schwab announced its planned acquisition of rival discount brokerage, TD Ameritrade. The merger was approved and completed on October 6, 2020. Since the acquisition date, Schwab and TD have been working to merge their platforms, ensuring the best features of both companies survive. Your accounts at TD Ameritrade will be automatically transferred to Schwab over Labor Day weekend. In the coming weeks you will receive additional correspondence from TD Ameritrade, Schwab, and GA Pincus Funds. If you currently have online access at Schwab, starting on September 5th, you will see your TD Ameritrade holdings when you log into Schwab. If you do not currently have online access to Schwab, in August, you will be asked to create a login and password. While your account number will change, nothing else will. GA Pincus Funds proprietary algorithmic software has been redesigned to function using Schwab's APIs. Business will proceed as normal. We believe the new Schwab platform and offerings will be better than those at TD Ameritrade. If you have any comments, questions, or concerns, please do not hesitate to contact us.

Conclusion

Looking forward to the second half of 2023, we remain bullish on equities and fixed income and remain bearish on most of the commodity sector. As we remain in a high-rate environment, we believe the performance of the mega cap and AI-related stocks will slow making room for some of the more unloved sectors (financials, health care, and utilities) to see gains. We predict that inflation as measured by the CPI and PCE will continue to decrease, leading to a cessation of rate hikes. As rates stabilize, we will enjoy the fixed income yields. Once rates begin decreasing in 2024, we will see price improvement in fixed income securities and equities.

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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