Dear xxxx;

“Be fearful when others are greedy, and greedy when others are fearful.” We will echo Warren Buffet’s words throughout this quarterly report. During the last 90 days every financial market has experienced both positive and negative sentiment; however, it is abundantly clear that negativity won out. By the midway point of the quarter, the S&P 500 was up 13.86% and investors seemed less concerned about the rising rate environment. However, as the quarter progressed, bearish signals re-emerged in abundance. The CPI did not decrease as expected, Chairman Powell increased rates, and his speeches echoed his hawkish sentiment.

Unlike the first half of 2022, commodities (Q: +2.01%) fell significantly in the third quarter. In fact, commodities are now down xx.xx% since their June 9, 2022, peak. US equities (Q: -17.63%) and US fixed income (Q: -4.69%) declined almost in unison. The seemingly nonstop increases in the strength of the US dollar had a negative impact on emerging markets and international equities (Q: -x.xx%).

Typically, we use these letters to explore the major geopolitical, financial, and thematic events that shaped the quarter. Like last quarter’s newsletter, we will once again address those themes by answering the most common questions clients and prospective clients have asked of us during the last three months. Within our answers we will strive to provide our short and long-term predictions for the market and broader economy.

What Are the Most Common Measures of Inflation?

The Consumer Price Index (CPI) is a measure of the average change over time in the prices paid by urban consumers for a basket of consumer goods and services. The categories with the largest weightings are housing (42%), food and beverages (15%), and transportation (15%). Many people believed the CPI would be lower in August due to falling gas prices; however, gasoline only accounts for 2.81% of the CPI. Sectors weighted similarly to gasoline include full-service meals and snacks, limited-service meals and snacks, electricity, new vehicles, used vehicles, tuition, and telephone services.

The Personal Consumption Expenditures Index (PCE) measures the changes in the cost of living for households by following the prices of a basket of goods and services. Data for the CPI comes from surveys of consumers, while the data for the PCE is derived from reports from businesses on what they sell. The CPI tends to show higher rates of inflation than the PCE.

Core CPI and core PCE are inflation indices that remove food and energy, as they are the most volatile sectors. Core PCE is the preferred inflation measure used by the Federal Reserve. The most recent year-over-year readings (August 2021-2022) show the CPI rose by 8.3% and core CPI rose by 6.3%. The PCE is released almost three weeks after the CPI. As of September 30th, the year-over-year PCE readings (August 2021-2022) show the PCE rose by 6.2% and the core PCE rose by 4.9%.

What is The Federal Reserve Bank Doing?

The Federal Reserve aims to maintain stable prices and support conditions for long-term economic growth and maximum employment by implementing effective monetary policy. The three tools of monetary policy are: open market operations, the discount rate, and reserve requirements. With the US inflation rate at 40-year highs, the Federal Reserve has raised the federal funds rate by 3% thus far in 2022 to the range of 3.00-3.25%. During their most recent meeting on September 21st, Jerome Powell projected future hikes will be necessary to take the federal funds rate to a terminal rate of 4.6% in 2023. This is more than 1% higher than the rate he has mentioned in previous remarks.

During the press conference that followed, Chairman Powell explained that a housing correction was necessary as home prices have increased too quickly during the last three years. Chairman Powell also expects a 1% increase in the unemployment rate during this rate hike cycle, which, based on employment metrics, signifies a US recession. Chairman Powell further explained that the number one priority is a decrease in inflation, and that he will do whatever is necessary to achieve that goal.

Is The US In a Recession?

Yes.

In every macroeconomics textbook, a recession is defined as two consecutive quarters of negative GDP. However, in the United States, a recession has only occurred if the National Bureau of Economic Research says so. This body tends to wait almost a year to determine and disclose when a given recession started. In the opinion of GA Pincus Funds, the US is currently in a recession. And, in our opinion, the duration of this recession is based entirely on US inflation.

Normally, inflation is controlled by technological improvements which help lower prices. However, during the last 12-24 months inflation has been caused both by post-Covid domestic government market intervention and the actions of foreign governments. The zero-Covid policy in China has routinely paused or delayed exports and Russia's aggression toward Ukraine has disrupted global wheat and energy markets. These geopolitical shocks have increased US lead times for a multitude of items contributing to inflation.

It is our opinion that the US government and Federal Reserve are also responsible for a considerable portion of the sky-high inflation. During Covid, the Federal Reserve not only kept rates at zero for too long, but they also purchased far too many financial securities and kept purchasing those securities long after it was necessary. The US government is at fault for providing too much stimulus and many state governments are now directly at fault for providing the absurdly named "inflation-relief check."

Is This Capitulation?

Yes.

As mentioned last quarter, capitulation is "the dramatic surge of selling pressure in a declining market that marks a mass surrender by investors." Capitulation is substantial broad market declines day after day. Capitulation is seeing every single asset class drop multiple days in a row. Capitulation is when good stocks with strong balance sheets decline on good news. Capitulation is scary and we believe the entire world economy experienced capitulation in the days following the Chairman Powell's speech at the FOMC meeting on September 21.

The duration of capitulation may be one week or one month; however, we believe by entering the phase of capitulation, we are closer to a bottoming of the market. Jerome Powell made it explicitly clear that he believed the federal funds rate would need to increase to 4.6% to stifle inflation. The bond market responded quickly. Since we believe inflation will decrease sooner than the Fed does, we do not expect the federal funds rate to hit their 4.6% target. In fact, we believe US deflation will prevent the Fed from achieving their final target federal funds rate.

It is the belief of GA Pincus Funds that the US Federal Reserve is obligated to sound hawkish because they have for years been too dovish. The reality is the actions of the US Federal Reserve are 100% based on the monthly PCE and to a lesser extent CPI readings. We believe a substantial decrease in any future PCE or CPI reading indicating inflation is subsiding will cause the Fed to pause rate hikes regardless of any previous comments that have been made.

Is there a silver lining?

Yes.

It is widely understood that the stock market hates uncertainty. During the press conference following the most recent rate hike, Chairman Powell laid out his market predictions and expectations more directly than any statement we've heard in our lifetime in the markets. Chairman Powell's comments quickly and uniformly trounced the world investment markets (stocks, bonds, and commodities).

The silver lining is that once the global markets retreat to the levels disclosed by Chairman Powell on September 21st (i.e., the 2-Year US Treasury bond reaches ~4.6%) the global stock and bond markets will have nowhere to go but up.

Is It Time to Buy?

Yes.

Warren Buffet is often heard saying, "Be fearful when others are greedy, and greedy when others are fearful." It is unlikely that today is the bottom of this cycle; however, we believe the market is in the final stage of its drawdown. Almost every asset class has been destroyed in 2022. We do not believe it is possible to predict the ultimate bottom of any drawdown; however, we believe in our ability to pick relative bottoms.

If you turned on CNBC last month, you would have heard bullish and bearish opinions from banks and pundits. If you turn on CNBC today, it's all bearish. That's the signal. That's how traders know the bottom is imminent. On March 18, 2020, Bill Ackman tweeted to President Trump to "close the country." At approximately the same time, he covered a short trade which earned his fund billions. GA Pincus Funds believes we are close enough to the bottom that buying makes sense.

Conclusion

After peaking midway through the third quarter, global stock, bond, and even commodity markets declined dramatically during the last six weeks. The economy and the stock market are not one in the same. While we are currently in a global recession, the stock market is a leading indicator, and like always it will lead the world out of its' recession. We believe large bearish moves will continue in the near-term and elevated volatility will abound throughout mid-2023; however, we believe in the strength of America, and we are bullish on the long-term potential of the equity and bond markets.

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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