Dear xxxx;

The final two weeks of the first quarter gave us hope that the market was recovering from what we believed was a healthy bull market decline. Unfortunately, it now seems that this was a dead cat bounce. Investopedia defines a dead cat bounce as "a temporary, short-lived recovery of asset prices from a prolonged decline or a bear market that is followed by the continuation of the downtrend." At the close of business on Monday June 13th, the S&P 500 was down more than 21% from its January 3rd all-time high, causing the US to enter its 15th bear market since 1929.

Commodities (Q: +2.01%) remained the best performing sector in the second quarter; however, they had been up as much as 16.26% on June 9th, before falling to end the quarter. US equities (Q: -17.63%) suffered a significant beating, more so than international equities (Q: -14.45%). While it is rare for equities and bonds to perform in unison, unfortunately, fixed income (Q: -4.69%) declined as well. Typically, we use these letters to explore the major geopolitical, financial, and thematic events that shaped the quarter. During this quarter's letter we will address those topics 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 is a Series I Savings Bond?

Series I Savings Bonds, also known as I Bonds, are issued by the US Treasury via Treasury Direct and currently yield 9.62% for 6 months. The interest on an I Bond is comprised of a fixed rate of interest (0.00%) and an inflation rate of interest (9.62%). Semi-annually, on May 1 and October 1, the inflation rate of interest is recalculated, and the new interest rate takes effect based on the issue month of your bond.

Investors are required to hold their bonds for a minimum of one year, and if the funds are removed within five years, the investor forfeits the most recent three months of interest as a penalty for early withdrawal. The bonds are taxable at the federal level but not at the state or local level. The maximum annual purchase is $10,000 per person and the bonds must be purchased through the Treasury Direct website.

Since the inception of the I Bond on September 1, 1998, the six-month yield has ranged from -2.68% to 5.51%, with an average yield of 2.09%. Given the current tumultuous market conditions, the guaranteed fixed rate on the I Bond sounds attractive, but in our opinion, the lockup period, tax ramifications, complexity of the Treasury Direct system, and the low maximum annual investment make holding US fixed income a more attractive option over the long-term.

How will increasing the Federal Funds rate affect inflation?

The Federal Reserve aims to maintain stable prices and support conditions for long-term economic growth and maximum employment by implementing effective monetary policy through the reserve requirement, open market operations, the discount rate, and interest on reserves. With the US inflation rate at 40-year highs, the Federal Reserve has raised the federal funds rate by 1.5% thus far in 2022 to the range of 1.50-1.75%. During their most recent meeting on June 15th, Jerome Powell projected future hikes will be necessary to take the federal funds rate to 3.4% by the end of the year. This is only slightly below yearend market projections of 3.5%.

Increasing the federal funds rate makes it more expensive for banks to borrow money, thus making it more expensive for businesses and individuals to borrow money. As the cost of borrowing increases, purchasing power, or what one can afford to buy, decreases. Both individuals and corporations are encouraged to postpone or slow the purchase of large assets which typically require loans. As the purchasing power and frequency of purchases decrease so too will inflation.

Simultaneously, bank yields will increase, motivating individuals to sell risky assets in favor of holding cash or fixed income securities. The trifecta of reducing purchasing power, decreasing overall risk asset exposure, and increasing the cost to service the United States' deficit is why a growing number of market participants are expressing concern about a possible US recession.

What does this mean for real estate?

During Q2 2020, the height of the COVID-19 lockdowns, the average sales price for a house in the US was $374,500. By Q1 2022, the average price had increased to $507,800, an increase of 35.6% or an annual increase of 20.33%. Over the 20 years preceding Covid-19, the average annual increase in US home prices was 4.25%. The dramatic surge in real estate prices was at least in part caused by the Fed. Not only did the Fed keep interest rates at or near zero for too long, but also, the Fed pumped money into the economy through quantitative easing and to individuals through multiple stimulus packages.

The abundance of cheap capital and stimuli encouraged individuals and companies to spend. Outsized demand led to an increase in prices also known as inflation. As previously mentioned, in an attempt to stifle inflation, the Fed has begun to undo the pandemic-driven policies that caused it. Mortgage rates for a 30-year loan reached an all-time low of 2.65% on Jan 1, 2021, before ending the year at 3.11%. On June 30, 2022, the current average mortgage rate is 5.70%. This represents an increase of 83.28% in six months. While the current rate is high compared to recent years, it's low when compared to every year before 2008. In fact, in the early 1980's mortgage rates peaked at 18.51%.

With the 10-Year Treasury yielding more than 3%, the US market has already priced in most if not all 2022 increases. Since mortgage rates are highly correlated to those of the US 10-Year Treasury, we foresee both remaining relatively stable in the back half of 2022. The increased cost of a mortgage and the broader decrease in purchasing power will likely push real estate's annual performance back toward the long-term 4% growth rate rather than the post-Covid 20% growth. While the rate on adjustable-rate mortgages (ARMs) have increased as well, the 4.5% yield on a 5/1 ARM represents a 26.67% discount to that of the 30-year fixed. To put this in perspective, when I purchased my house in August 2019, I used a 5/1 ARM at a rate of 3.625%. It is our belief that even though rates are up, homes will continue to be purchased, and there will not be a real estate crash like there was in 2008.

When will the bleeding stop?

A bear market is a 20% drop from a recent high point in the market. The Nasdaq entered a bear market on March 7th when it closed 20% below its November 19, 2021, high. The S&P 500 entered a bear market on June 13th, 2022. While in a bear market people always ask, "what level will the S&P 500 drop to?" or "what percentage do we need to lose before we bottom?" First, nobody knows the answer to those questions. Second, the answers won't be known until months after the bottom is hit.

We do not believe the US markets have reached the bottom of their decline. We believe the bottom requires capitulation, "the dramatic surge of selling pressure in a declining market that marks a mass surrender by investors." The declines experienced in 2022 have been far too orderly to represent capitulation. As long as retail investors remain unphased by the market declines and continue to buy the dip, the market will keep going lower. For the market to find its bottom there must be not only indiscriminate selling but also the fear about what horrible news tomorrow will bring.

This summer, on the way to the bottom, we foresee an increase in layoffs aimed at giving the upper hand back to corporations. Wage growth will diminish, and employers will force their employees back to the office. As purchasing power decreases so will spending and corporate earnings. By the time market capitulation is reached, inflation will have peaked, and there will be a substantial number of profitable stocks to buy at significantly reduced prices.

What should I do now?

Stay the course, maintain your investments, stop watching the financial news and do your best to ignore your portfolio. Check back at the end of the year.

Forward looking conclusion

Global stock and bond markets are in a rut. We believe this summer will see additional downward pressure on equities and commodities, while fixed income markets will begin to stabilize. As layoffs accelerate over the summer, personal and business spending will contract, ultimately causing capitulation in the stock market. As prices decline, inflation may briefly turn to deflation. However, we believe that as long as the deflationary period is short (a few months or less), this could actually serve as an economic boon.

While the US market will be unpleasant this summer, we believe it will close out 2022 15-20% higher than where it is today, which will be a full-year decline of 5-10%. While the Fed will continue to raise rates through 2022, we believe most of these hikes have already been priced in. We believe the 10-Year Treasury will end 2022 at approximately 3.5%. While fixed income investors have lost money through price depreciation during the first half of the year, we believe they will begin to recoup those losses through interest payments in 2022 and 2023. As inflation normalizes towards the Fed's 2% goal, future rate decreases will be needed and will provide price appreciation to fixed income investors.

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

GA Pincus Funds
Gabriel Pincus, President
1574 Woodberry Court
Brentwood, TN 37027

www.gapincusfunds.com
m: 917-597-1450

e: gabriel@gapincusfunds.com