Aurimax Investment Club

Member Newsletter

Q4, 2022

A Tough 2022, Not So Bad an Outcome for us

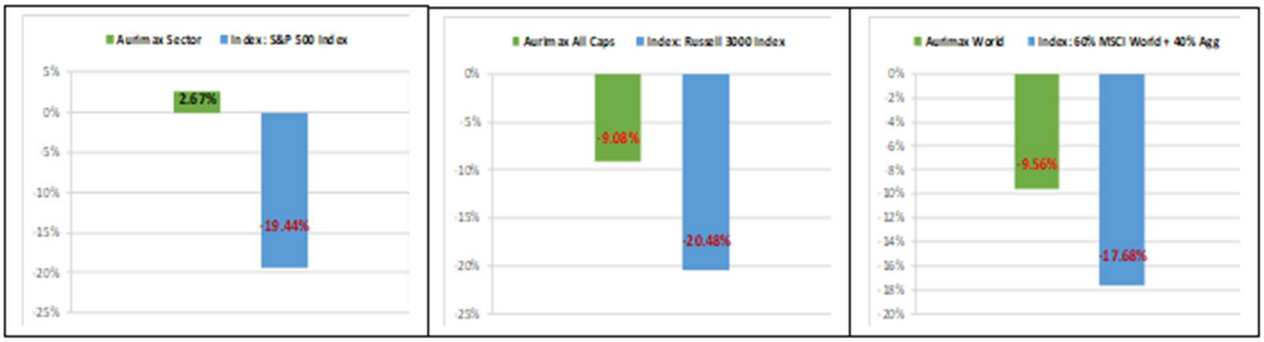
2022 was the worst year for equities since the Great Recession with the benchmark index down 19.44%. The rollercoaster year saw a war between Russia and Ukraine, surging inflation, the Fed hiking rates, and subsequent worries that the central bank's aggressive tightening would push the economy into recession. The resilient labor market made the Fed's stance more and more hawkish. Bond yields surged, high-growth tech stocks sold off, and cryptocurrency collapsed.

Outside the US border, Europe suffered high inflation caused by high energy prices because of the Russian invasion of Ukraine. The Japanese yen collapsed because of the strong US dollar. Besides Sri Lanka, a couple of weak emerging market countries are on the brink of bankruptcy. China's economy ended the year in a major slump, with its Zero Covid policy draining off the wealth of local governments and residents, and with business and consumer activities plunging in December as Covid surged across the country due to the sudden abandonment of the Zero Covid policy.

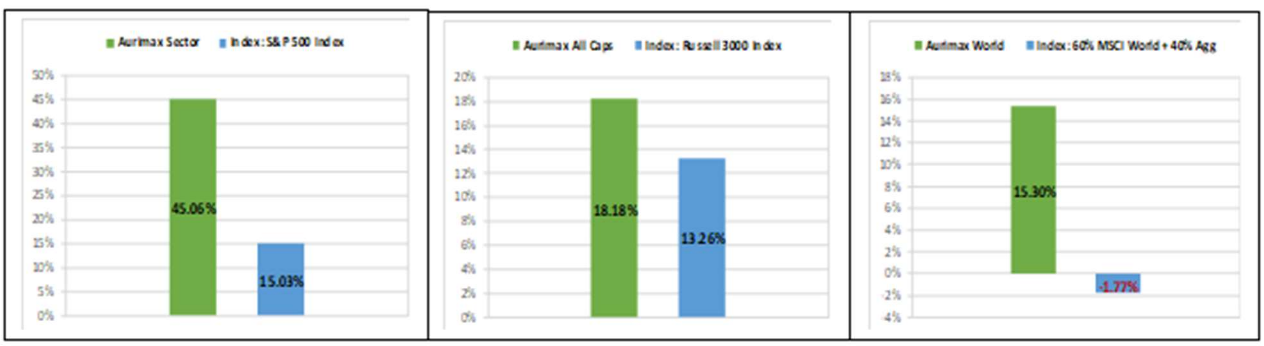
Our investments performed reasonably well thanks to our robust investment models, our diverse investments, and our portfolio hedging approach. All three of our portfolios beat their respective benchmarks by a wide margin. Our S&P Sector Rotation Portfolio, in particular, was up nearly 3%, thanks in part to the overweight in the energy sector.

Aurimax Net Returns:

The year 2022



Since Inception (02/24/20 ~ 12/31/22)



Note: AGG - US Aggregate Bond Index

Disclaimers:

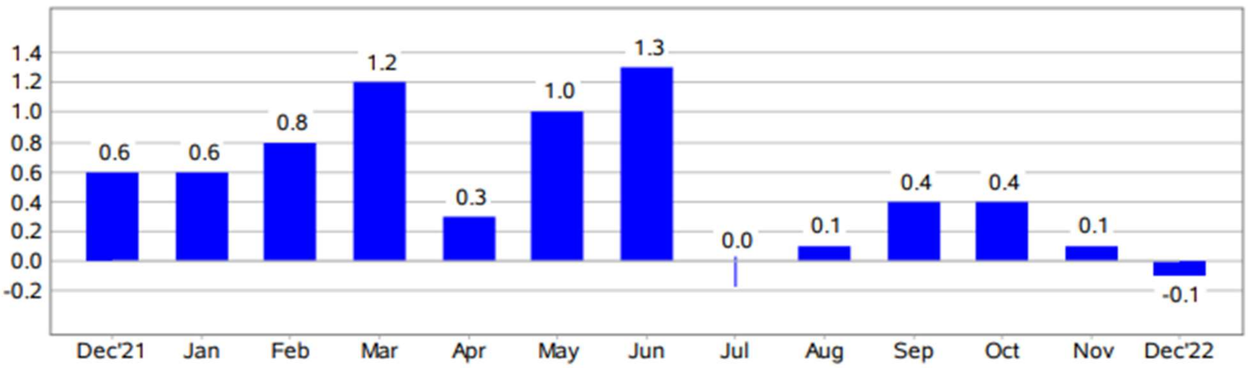
- *Aurimax Investment Club and its team have, to the best of their ability, taken into account various factors – both quantitative measures and qualitative assessments, in an unbiased manner while conducting our strategies. However, these strategies carry risks and uncertainties linked to broad markets and model underperformance due to some potential extreme future events. They should not, therefore, be the sole basis of investment decisions.*
- *Our back-testing model returns and incubation portfolios' actual returns do not guarantee our funds or portfolios' performance. Nor should they be taken as indicative of a fund, or the fund's underlying securities' creditworthiness.*
- *Mutual fund or customized wealth management portfolio investments are subject to market risks and management costs. Please read the portfolio information and other related documents before investing. Past performance is not indicative of future returns. Please consider your specific investment requirements before choosing a fund, or designing a portfolio that suits your financial goals.*

- *For more portfolio information, please visit: Aurimax Investment Club (aurimaxclub.com)*

2023 May Turn Better

Inflation

Since peaking in June, inflation has cooled off quite a bit. Although the December headline CPI was still at 6.5% on a year-over-year basis, the seasonally adjusted monthly inflation is actually running at an annualized 1.9% since July.



The Fed

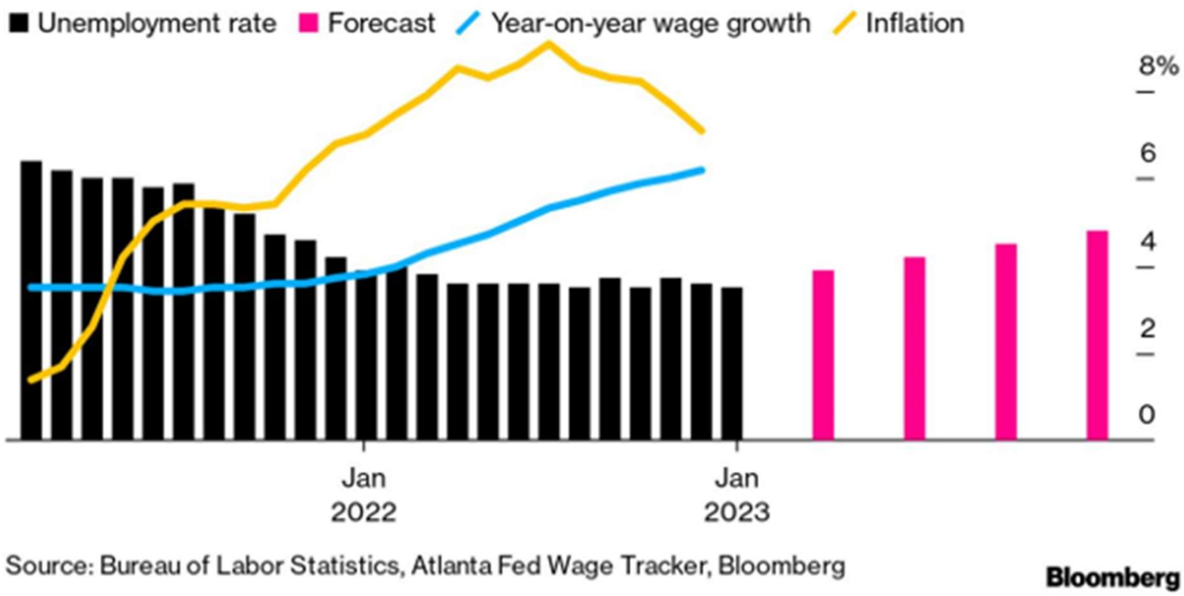
Federal Reserve officials continuously affirmed their resolve to bring down inflation. Nonetheless, if inflation persists on its downward trajectory, the "data-dependent" Fed may at least temper its rate hikes. To borrow a word of Double Line Capital chief investment officer Jeffrey Gundlach, "There is no way the Fed is going to 5%. The Fed is not in control. The Bond Market is in control."

The Economy

There is a great chance that we will have a recession in 2023. A recent survey shows that of 4,410 business leaders surveyed by PricewaterhouseCoopers, 73% predicted global growth to decline over the coming 12 months, while two out of five even expressed concern their companies may not last a decade. A separate survey of chief economists, released by the Davos Forum, found two-thirds expect a worldwide recession in 2023. It is a rare case that after the yield curve has inverted for such a long time, a recession will not follow. Nevertheless, we believe the recession in the US will be shallow for two reasons: the robust job market and consumer resiliency.

While tech giants and Wall Street firms have cut jobs since Q4 2022, the US economy has still been creating jobs. 223,000 jobs were created last month. The unemployment rate was down to 3.5%, matching a five-decade low. Job gains were led by health care, leisure and hospitality, and construction.

A hiring boom has supported US wages, which in turn has propped up US consumers.



Earnings

US corporate earnings won't look good in this reporting season and the next. We have repeated this message in our previous updates. In our Q2 2022 Newsletter we wrote "As the rate hike effects take hold in the real economy (e.g., the rising business funding costs), corporate profit will start to deteriorate." In our Q3 Newsletter, we used a whole paragraph to warn our club members that Wall Street's earning's estimates were "overly optimistic."

The prognostications were accurate. The quarter-end reports from the world's largest banks are receiving cold responses from Wall Street. Beats on revenue and profit from some banks didn't do much to impress investors because forecasts for some key metrics came in worse than expected.

Looking over the valley, we believe the earnings will gradually recover toward the end of 2023 due to lower inflation, Fed's possible pause in rate hikes, and China's post-post-pandemic economic reboot.

China

China's economy grew only 3% in 2022, the lowest in nearly 50 years. China's stringent zero-Covid policy greatly slowed economic activity across the country. In 2022, for example, the metropolis of Shanghai was locked down for about two months in an attempt to control a Covid outbreak. The abrupt relaxation of most controls in early December leads to a surge in Covid cases across the country with business and consumer spending plunging. While the outbreak has already peaked in several big cities like Beijing, Shanghai, and Guangzhou, the infection will likely surge in smaller cities and the countryside in February as China New Year brings huge population flows inside the country.

However, we are not particularly worried about this Omicron outbreak. Based on the experience of other countries, the infection will likely recede by March. Then China will set to offer a boost to a flagging world economy. The first good news will be heard through services sectors such as aviation, tourism, and education as Chinese people pack their bags for international travel. Commodity producers like Chile and Brazil will also benefit. China's pivot from covid Zero can be the single most important factor for global growth in 2023 according to Kristalina Georgieva, the head of IMF.

Based on the above analysis, after an unpleasant earning sting in the first half, the equity market can be expected to turn the corner by the end of 2023.

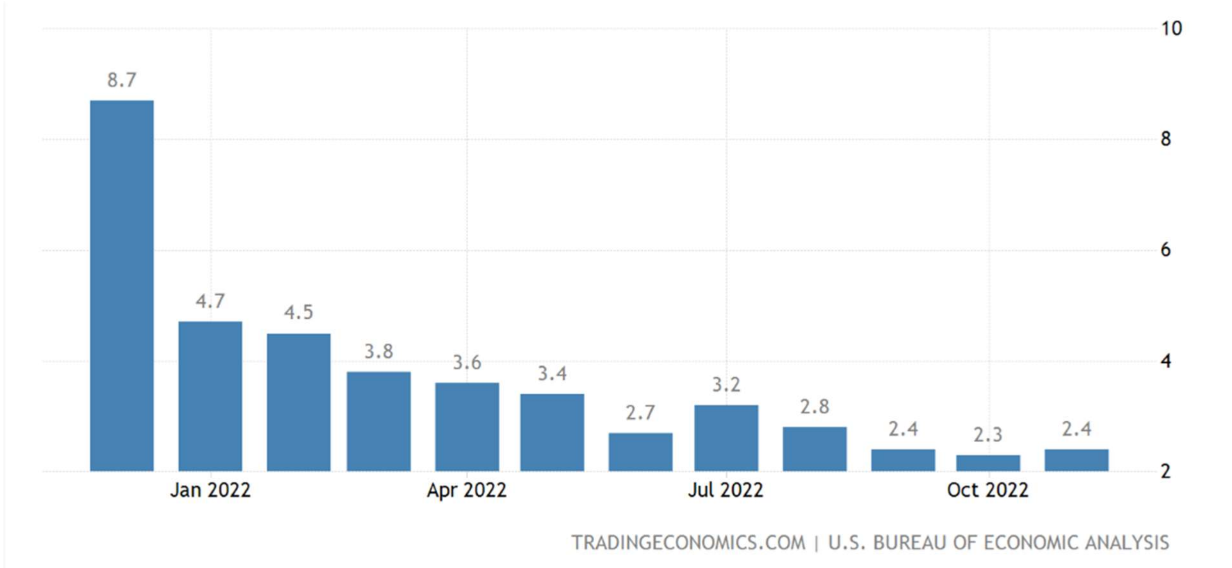
Uncertainty Remains

There are a lot of things to look forward to in the new year:

The Extent of Economic Recession

We expect a mild recession. But a lot of factors may shock us. One of which is US savings. The consumer savings rate spiked in 2020 due to the pandemic but is now as low as it was just before the global financial crisis.

US Personal Saving are depleting



What is the effect of this erosion of savings on the economy in this high inflationary era? We cannot ascertain. It is a top concern for some Wall Street gurus.

Russia-Ukraine War

In the second half of 2022, the Russia-Ukraine war entered into a stalemate. Both sides expressed willingness to negotiate. However, the terms of negotiation presented are sky and earth apart. Recently, there are signs of escalation of the war. Nobody knows how far both sides can go. Will Russia use weapons of mass destruction? If so, how will the West respond? Only God knows.

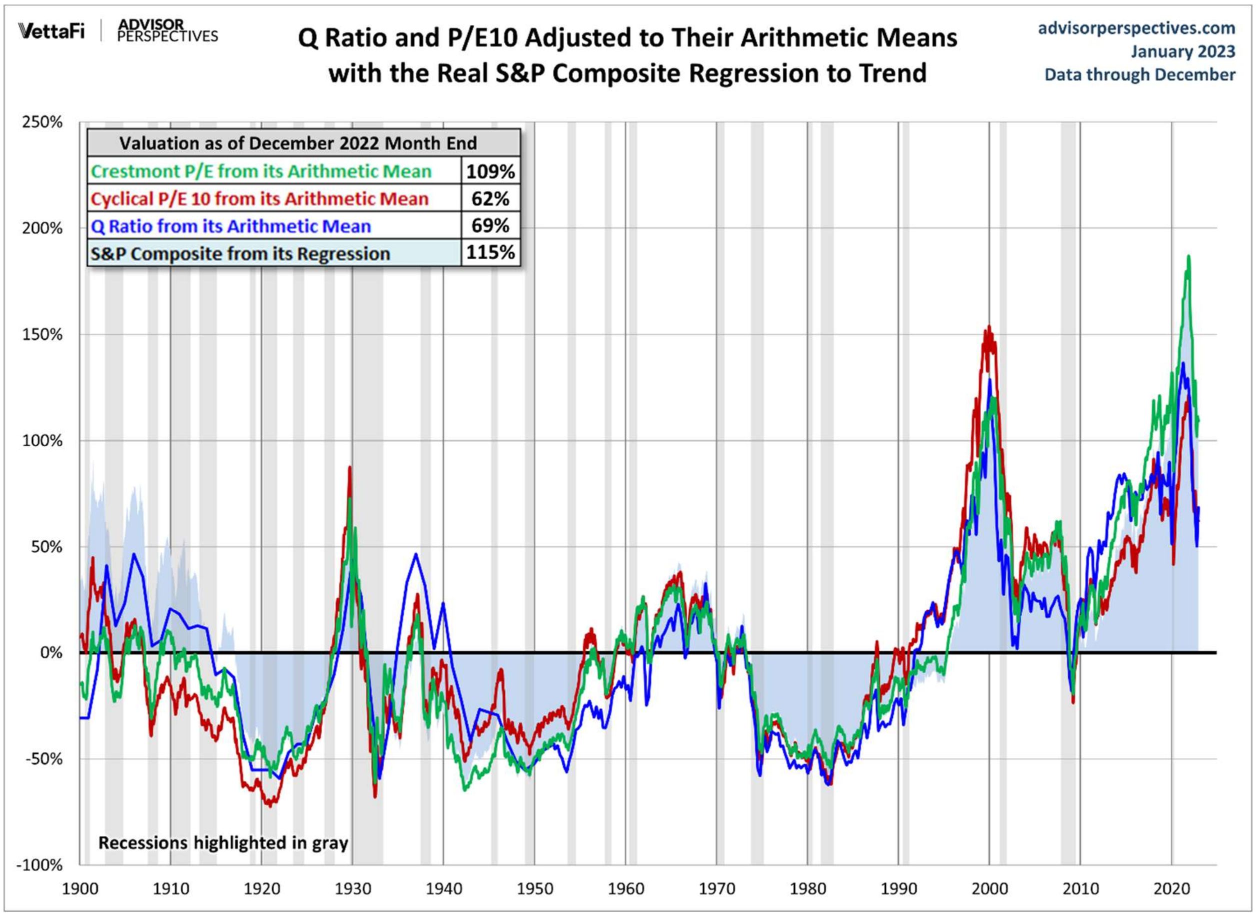
Taiwan

As the US-China political relationship remains intense, the atmosphere across the Taiwan Strait also becomes more and more dangerous. The climax was last year's visit of Nancy Pelosi to Taiwan. Chinese military launched an unprecedented military exercise surrounding the island soon after Pelosi left. How will China respond if Kevin McCarthy, the new House Speaker visits Taiwan sometime this year? We believe the response will be much stronger.

Valuation

Yes, the market is still expensive.

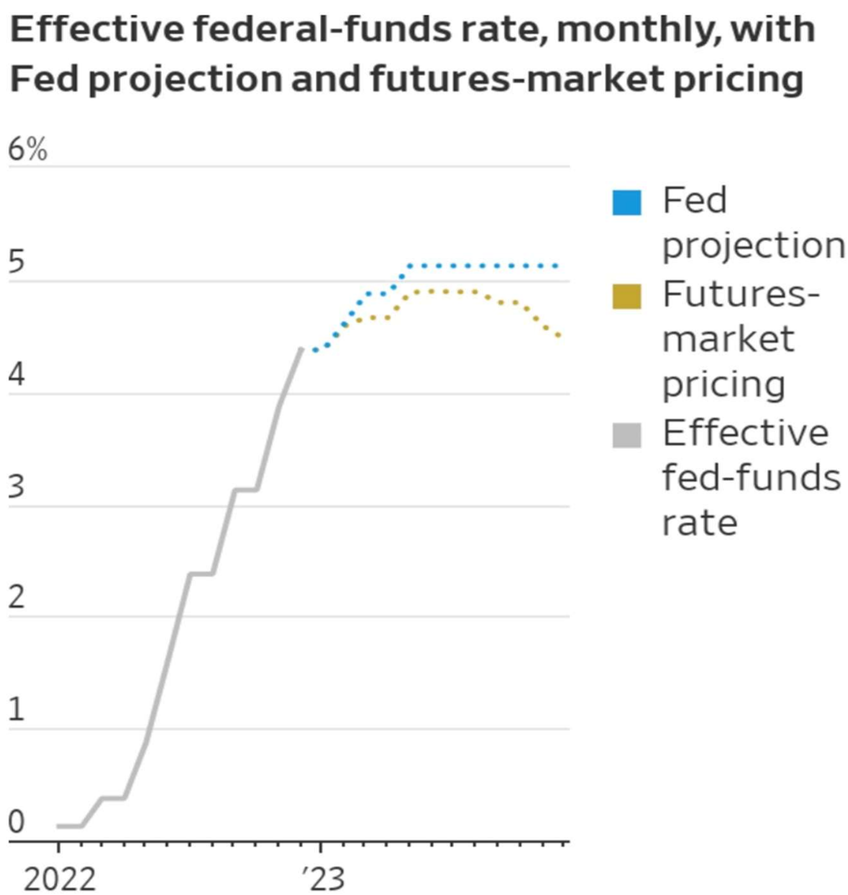
Market valuation has come down a lot from the peak after last year's market correction. However, the major valuation metrics are still high from their "fair value" line. Below is the Advisor Perspectives' valuation chart that was updated in December 2022:



Jill Mislinski suggests the market is overvalued by some percentage in the range of 62% to 115%, depending on which measure you are looking at. That assessment may look worse by the first half of 2023 as corporate earnings continue to be sullied by weaker economic growth and still high inflation.

Fed-Markets Game of Chicken

Market watchers, including us, expect that the easing inflation may lead to the Fed to shift its tune anytime this year. Yet, the Fed is in a different mind. Their message is apparently different from that of Wall Street: This time will be different because inflation is much higher. Minneapolis Fed president Neel Kashkari told the media: "it seemed almost as if the market was playing chicken with the Fed." The chart below clearly shows the different projections on the rates between Wall Street and the Fed.



If it is a game of chicken, who blinks first? This is the biggest question mark for the markets in 2023. But one thing is for sure: investors who are counting too much on a Fed pivot will be burnt if things don't go as they had expected.

Our Q1 2023 Investment Strategy

To avoid getting burned, our strategy will continue to be cautiously optimistic. We will move more and more cash back to equity and fixed income, but fully hedge our equity exposure until the risk and return tradeoff improves.