Aurimax Investment Club

Member Newsletter

Q3, 2022

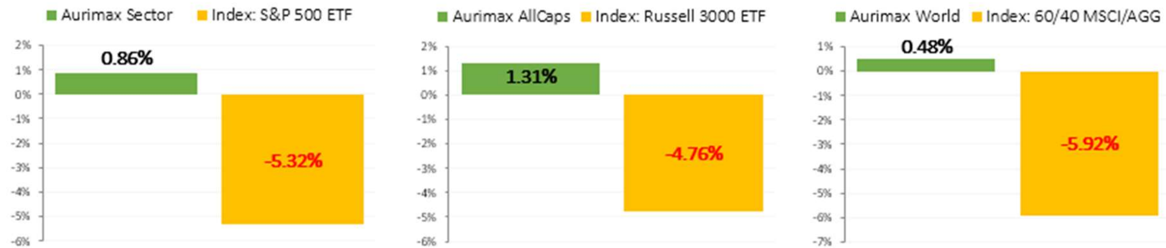
Another Good Quarter

Q3 2022 witnessed a roller coaster ride of the stock market. The market seemed to be punished by Zeus to roll the stone like Sisyphus. Starting from June low, S&P started to roll up hill in mid-July encouraged by lower than expected, and lower than previous month's inflation numbers. The media touted "peak inflation" and then further put a high hope of a "FED pivot." From mid-July to mid-August, S&P shot up 13%. The hope was dashed by Fed Chairman Jerome H. Powell's hawkish speech at Jackson Hole and the subsequent 75 bps rate hike by FOMC in September. The stock market rolled down from the top hill faster than Zeus stone. By the end of Q3, S&P dropped slightly below the June low.

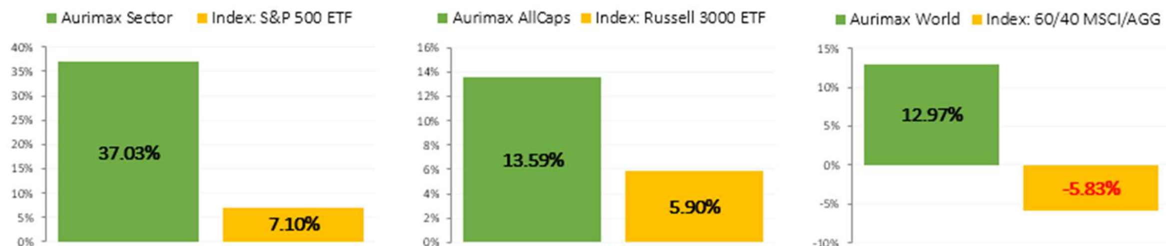
The roller coaster run of the equity market in Q3 was exactly the "bear market rally" phenomenon that we mentioned in our Q2 Newsletter. And yes, we took advantage of that. That is why the performances of our portfolios in Q3 were all positive. By September 30, the performance difference between our portfolios and their relevant indexes further widened!

Auriamx Net Returns:

This Quarter (Q3/2022)



Since Inception (02/24/2020 ~ 9/30/2022)



Note: AGG - US Aggregate Bond Index

Disclaimers:

- *Aurimax Investment Club and its team has, to the best of its 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, as well as model underperformance due to some potential extreme future events. They should not, therefore, be the sole basis of investment decisions.*
- *Neither our model back-testing simulation returns nor our actual incubation returns guarantee Aurimax funds or portfolios' performance, nor should they be viewed as an assessment of a fund's, 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.*
- *The indexes we use are all ETFs for fair comparison purposes. ETF returns may differ slightly from the indexes themselves. For more portfolio information, please visit: Aurimax Investment Club (aurimaxclub.com)*

More Rate Hikes to Come

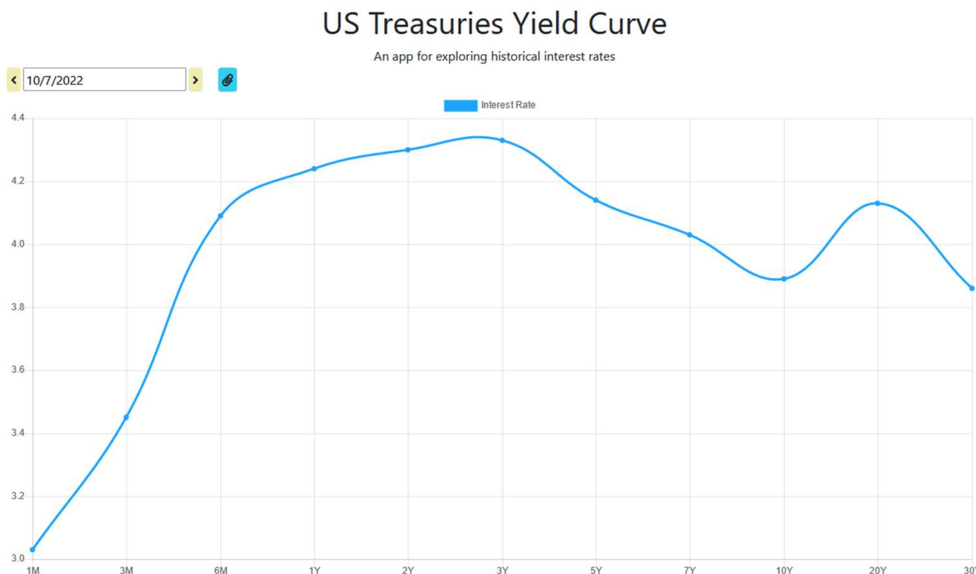
As we all know the Fed has dual mandate: "maximum employment and stable prices." During different periods, the Fed seems to lean toward one mandate more than the other. This time around, the balance is tilted to lowering inflation. It seems that the Fed is willing to sacrifice the U.S. economy in the near term for long-term price stability. Powell in recent public

remarks, including the Jackson Hole speech last month, suggested that he doesn't mind some economic pain ahead. "These are the unfortunate costs of reducing inflation," Mr. Powell said. "But a failure to restore price stability would mean far greater pain." Powell seems to follow the track of former Fed chairman Paul Volcker. In the early 1980s, Volcker raised interest rates to the highest on record to finally curtail the inflation surge from the late 1970s.

Therefore, unless inflation shows solid signs of cooling down, the Fed will continue to jack up rates. But inflation, once up, tends to be sticky, especially in the service sector. The white-hot job market, the energy crisis caused by the Russian invasion of Ukraine, and the slow-recovering supply chain add to the complication. We expect this interest rate hiking cycle will be longer than normal.

Market Risk Persists

Despite a drop of more than 20% this year for the S&P, we believe the market risk still persists. The coming global recession seems to be a very likely scenario given the main central banks continuing their rate hikes and the depening of the yield curve inversion. Ned Davis Research now sees a 98% chance of a looming global recession.

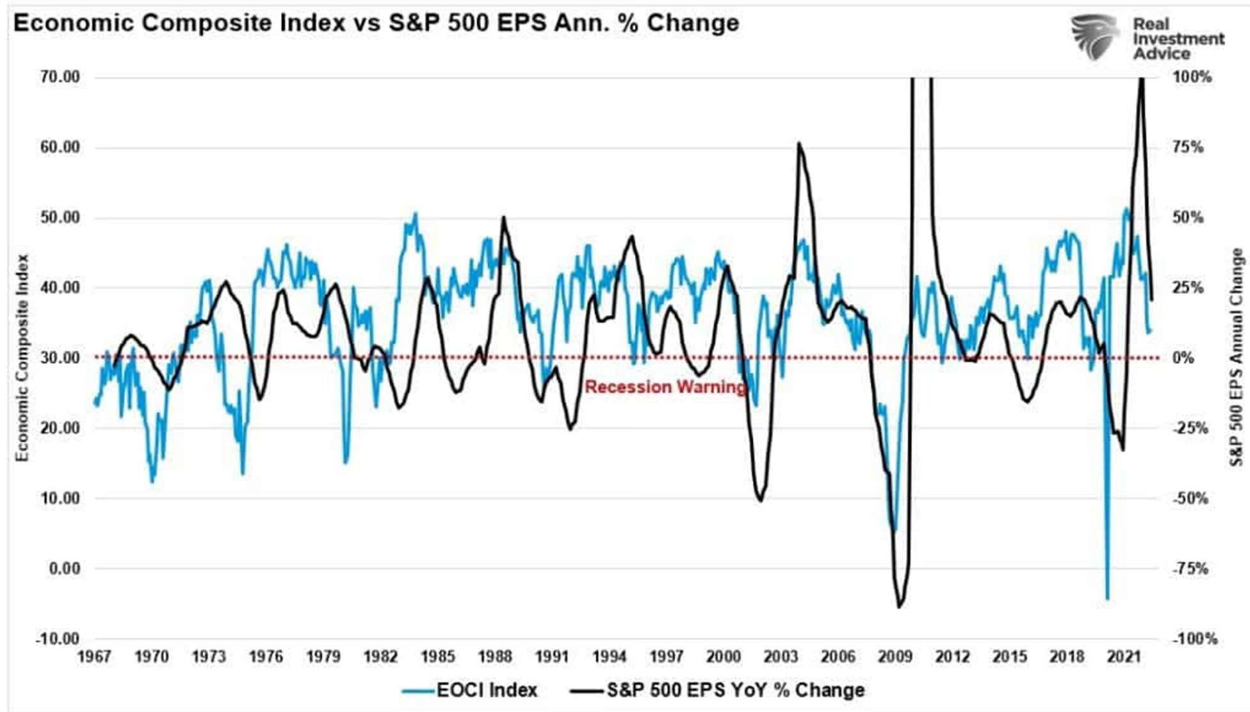


Source: www.ustreasuryyieldcurve.com

Nevertheless, while acknowledging the coming recession, major investment bankers and institutional analysts only expect a "mild recession." JP Morgan said recently that there could be a roughly 50% chance of a "mild recession" ahead. Fitch said "the eurozone and UK are now

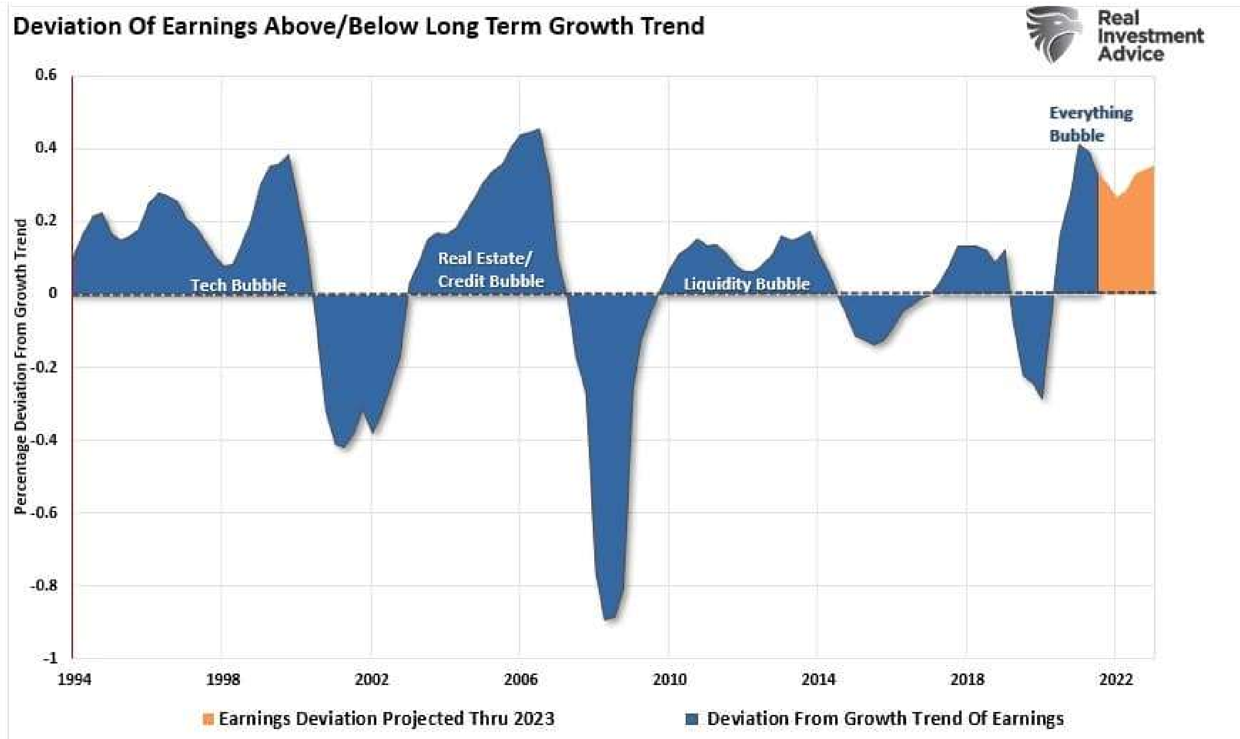
expected to enter recession later this year and the US will suffer a mild recession in mid-2023." Deutsche Bank forecasted "that the U.S. economy will enter a mild recession in H1 2023."

Our view is that analysts are almost always overly optimistic. The actual recession may come much more severe than they are now forecasting. This may pose a significant risk to the future equity market since corporate earnings are highly correlated to economic growth. Below is the chart of the Composite Economic Index (EOCI) versus S&P EPS change. The chart shows that the deeper the recession, the deeper the earnings decline will be.



Source: Real Investment Advice

The underestimation of the severity of the coming recession leads an overestimation of the earnings growth. As Lance Roberts of Real Investment Advice put it, "the estimated earnings for the S&P 500 companies remain highly elevated. Such gives a false sense of security to investors looking at 'forward valuations,' assuming stocks are fairly priced. In reality, most companies in the index remain overvalued despite the price decline in 2022." The chart below suggests that despite the recent downward revisions, the current EPS estimate is still above the long-term historical exponential growth trend.



Source: Real Investment Advice

As a recession arrives and deepens, the current EPS estimate will have to be further revised down, thus giving the market shocks. That is why Goldman Sachs and BlackRock are warning that markets are yet to price in the risk of a global recession.

Our Q4 Investment Strategy

Our general strategy continues to be a cautious one. We believe time is not yet to be bold. Therefore, risk management is still our main theme in the Q4.

Ken Fisher, an investment legend and founder and CEO of Fisher Investments, in his New York Times bestselling book *Beat the Crowd* wrote, "the market is The Great Humiliator. TGH for short. Its goal is to humiliate as many people as possible as often as possible for as long as possible." No one has the crystal ball to see through when and where the bear market ends and the bull market begins. Neither do we. The Bible likens the coming of the Kingdom of Heaven to the coming of a thief in the night. Our experience tells us that the bull markets act in a similar manner. They come without us knowing them.

Looking back, the last several bear markets caused by inflation and Fed interest rate hikes lasted about two years (11/29/1968–5/26/1970; 1/11/1973–10/3/1974; 11/28/1980–8/12/1982). If history rhymes itself, we may be halfway into this bear market (just maybe). In light of this, in the next few quarters, we will gradually put our cash back into the solid sectors identified by our investment models. At the same time, we will hedge our equity exposure fully until the Fed has completed its rate hiking cycle, the market multiple comes down to a reasonable level, and above all, corporate earning prospective starts to brighten.