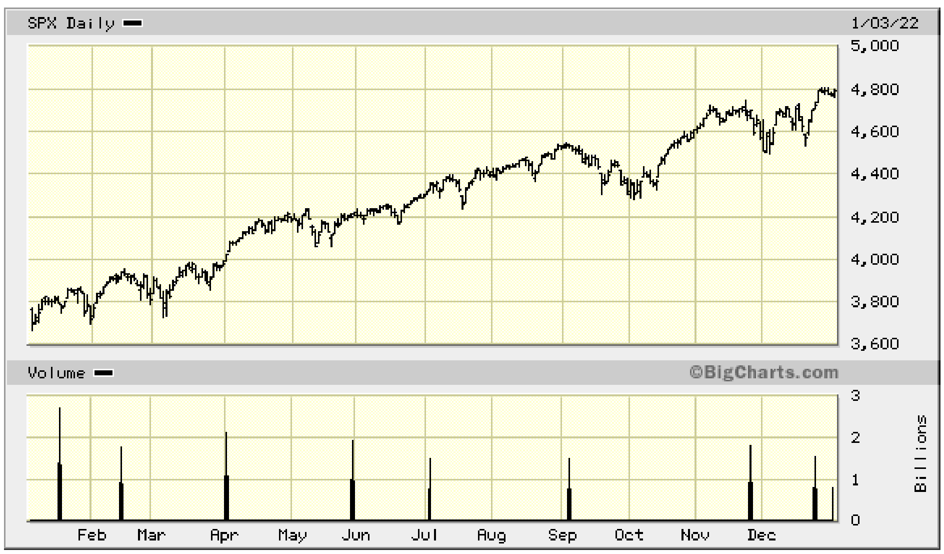
MRP CAPITAL INVESTMENTS, LLC

4th Quarter 2021 Client Newsletter

Capital Market Update

Inside this report:

2021 turned out to be a very consistent and steady year for the market. Of course, the television shows and news outlets did their best to ramp up emotion, anxiety, and worry. But in the end, the S&P 500 finished the year with a 10.65% gain in the 4th quarter to put the entire year's price change for the index at 26.89% for the year.



S&P 500 2021 Chart Supplied by BigCharts.com

In this year's 1st quarter newsletter, we mentioned that we had a good feeling about 2021 as we saw the Fed continuing to support asset price appreciation. Moving into 2022, we still think the Fed is the most powerful force in the markets. However, their power might be more focused this year.

We believe their desire to increase the speed of the "taper" while slowly raising short-term rates is designed to steepen the yield curve. A steeper yield curve should increase the profitability of bank loan portfolios. This should incent them to lend, which should increase the velocity of money. And the low velocity of money readings have been holding back GDP growth.

All in all, we are excited for 2022!

Year in Review

The beginning of a new year is a good time to look back at what happened in the prior year and to start making plans for the upcoming year. With that in mind, let's take a look at 2021. In the Capital Market Update section of the Q4 2020 newsletter, we said:

"Heading into 2021, there are still some uncertainties regarding how all of the moving pieces of the global economy will fit together and we certainly do have a lot to worry about. But Bull Markets are said to "climb a wall of worry."

The fact that the Fed and the Treasury appear to be working seamlessly together to stabilize and inflate asset prices, gives us <u>a lot of confidence that the direction of the markets should be upward biased for the new year</u>."

In the newsletter which came out after the closing of the 1st quarter of 2021, we, essentially, reiterate those comments:

"Throughout 2021, we think you can expect more of the same. The Fed and the Treasury have made it clear that they will do whatever it takes to ensure that asset prices are stable, if not appreciating. Surely, we've all heard the saying "Don't fight the Fed." Market participants have been saying those words for multiple generations. Make no mistake about it, there is a reason for that. When the Fed is on your side, they can make the game a lot easier to win.

Of course, twist and turns will occur as the days tick by in 2021. There will be scares and reasons to worry. This is why we asset allocate when managing money. However, <u>we feel pretty good about the market for 2021."</u>

Fortunately, the global central banks did keep liquidity flowing and this did inflate asset prices. Anyone who was with us for the full year will see that their portfolio grew in value very nicely. Furthermore, I'd bet your home also increased in value. The Fed's move to oversupply the market with cash pushed up the value of, seemingly, every asset.

In the summer of 2021 we mentioned that once others realized they were wrong to be pessimistic on stock prices, we could see a big move in the market. This is because not only did those investors need to unwind their bearish trades but they needed to place bullish bets as well.

Here is a snippet from the newsletter that come out after the 2nd quarter ended, which captures the above sentiment:

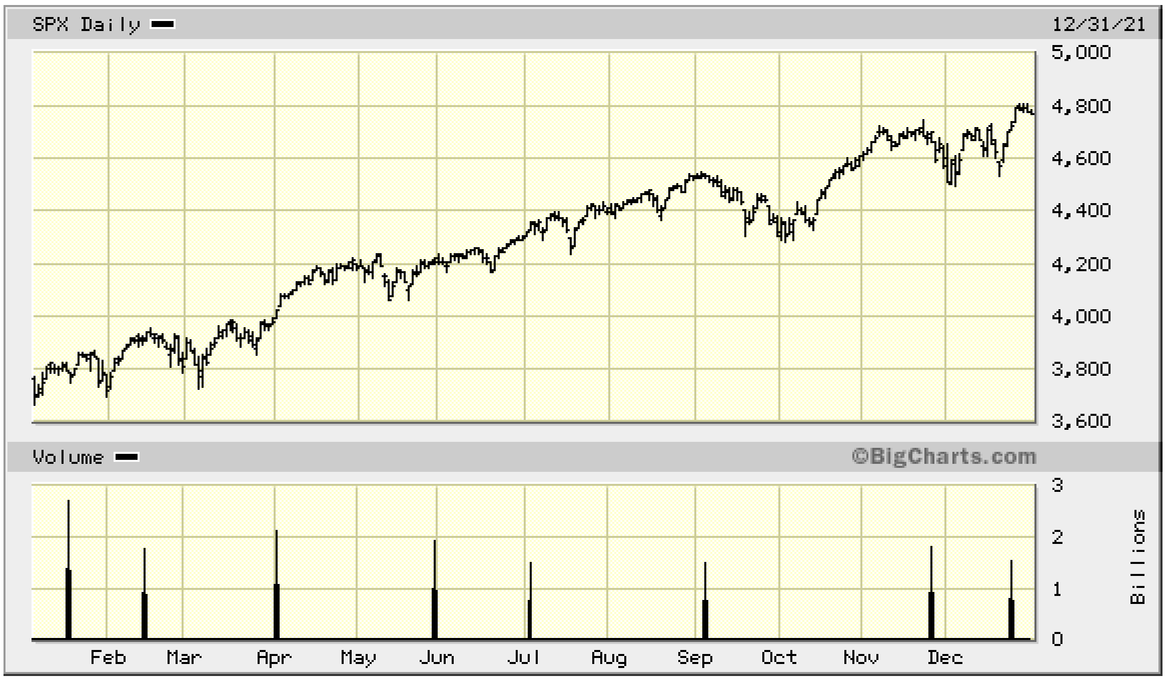
"When we first mentioned that we thought the market would continue its Bull Market run after the 2020 election, regardless of who won, many people scoffed at that idea. Now, it seems that, <u>many people are jumping on the bandwagon. This piling on effect can push asset prices past the point of where rational investors feel comfortable</u>."

With the S&P's year to date price change at the end of the 3rd quarter being +14.76%, I do believe that almost every investor was feeling this "piling on" effect in the market.

S&P 500 chart from 01/01/2021 — 09/30/2021provided by Bigcharts.com

Our first "not 100% bullish" comments came as we entered the 4th quarter:

"we see two new issues developing. The first is <u>inflationary pressures</u>, which are well known and discussed in the markets. The other is <u>supply chain issues</u>. Those issues are as visible as semiconductor production shortages. And as opaque as shortages of willing labor to unload cargo ships. But these issues are not garnering too many headlines at this point. We expect that to change."



S&P 500 chart from 01/01/2021 — 12/31/2021provided by Bigcharts.com

The S&P 500 ended 2021 with a price change for the year of +26.89% and that brings us to this newsletter. To re-iterate, we believe the Fed, and other Central Banks, are the most powerful force in the markets. However, we think they will be more focused in comparison to the last few years. Their focus seems to be on steepening the yield curve, which should make lending by banks more profitable. This should increase the amount of lending done by banks and, hopefully, boost GDP growth by increasing the velocity of money.

In our minds, this is the most important thing to watch in regard to judging how effective the Feds policies are playing out in the real world. Should this be successful we expect big upside moves in the market, particularly in the 2nd half of the year.

Bull Market Peak Behaviors

As we've mentioned in previous newsletters and research reports, we believe that we are approaching the end of a Bull Market run. We do not mean that this Bull Market will be over next week. Rather we take a longer term view of the markets and we think in the next few years, this market could transition into a Bear Market. Historically before a market completes the transition from a Bull to a Bear, there is a euphoric phase which sends the prices of stocks into the stratosphere.

In last quarter's newsletter, we reviewed in great detail the indicators we use to see how close we are to that transition. We don't want to do another deep dive into those metrics right now. Rather, we want to do a quick review to see what signals those indicators are flashing now. At the end of the 4th quarter:

Earnings Relative to Potential were above potential, which indicates earnings don't have a lot of room for further gains.

Stock Market Valuations were high on a historical basis but low relative to fixed income alternatives.

Consumer Sentiment was low, which is a bullish sign regarding future market gains.

and **investors were more fearful** than complacent regarding the risks to the market.

This tells us that moves higher in the market need to be driven by improving Consumer Sentiment and higher valuations on stocks as compared to other investment alternatives in the market.

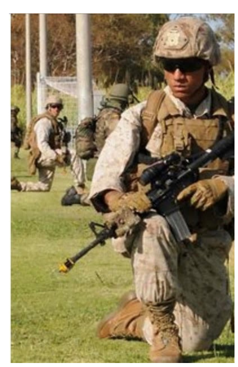
Those quantitative metrics are good for modeling into spreadsheets and analyzing market data. But very few people run financial and economic models when they think about investing. Instead they simply behave like human beings instinctively behave. This can lead investors down the wrong path from time to time. I'd like to highlight some things I've seen over the years that I think can help us avoid some of those missteps.

The first thing centers on the performance of their portfolios. During bad markets, most people have no interest in their returns relative to market indices. They don't want to hear, "The S&P was down 25%, but you were only down 20%." They don't necessarily view this as a good thing. Interestingly enough, they DO care about relative performance the longer a Bull Market runs. If the market is up 35%, they want to be up 38%. This leads to aggressive risk taking at Bull Market tops, which leaves them over-exposed to stocks (and other risky investments) at exactly the wrong time.

This dovetails into another signal that a Bull run might be getting close to the euphoric top. That "indicator" flashes a warning sign when performance of an investor's portfolio far exceeds the return required to achieve their financial goals but it still isn't good enough for them. For example, an investor who needs to earn 8.5% to make their life's financial goals a reality is unhappy they only made 20% in the market because their friend made 23%.

Another one concerns how investors view risk. As stocks move higher and higher, their returns will dwarf the returns put up by defensive assets, like bonds. As we near Bull Market tops, questions like, “why do we even have bonds?” get asked. The booming returns posted by equities can cause investors to disregard the diversification benefits provided by other asset classes because over the short/medium term the returns of “risk assets”, like stocks, have outperformed. Once again, this will leave investors over exposed to risk assets as the market peaks and begins to fall.

These types of thoughts can cause investors to disregard long term financial planning and prudent asset allocation strategies in their pursuit of quick gains. Rest assured, we are aware of these psychological phenomena and we will always strive to stay appropriately allocated given your goals and risk tolerance. When we see these risk-taking behaviors pop-up with clients, we will discuss them and attempt to put things in context of obtaining long term success. And we never forget that it is a mathematical fact that risk control is the key ingredient to compounding capital and obtaining financial success over the long haul.



Theme Avoided

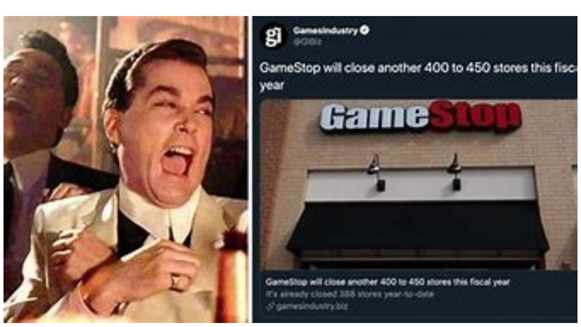
Managing money is what I do professionally and it is also an interest and a passion. Given this, a lot of my time is spent outside of the office meeting with other like minded investment geeks.

At one of these recent get-togethers, it was brought up how wild investments were in 2021. In fact, a comment was made that the average stock was down close to 50% from its high. I didn't do any research to refute or verify that comment, but, regardless, I was stunned by the comment. I had almost the exact opposite feeling about the year. The performance of the portfolios I manage certainly didn't experience anything close to the wild up and down swings that were being attributed to the "average" stock.

I had to ask for clarification of the comment and some examples of the stocks he was referring to. To which the response was: Gamestop, Robinhood, and other meme stocks. Ah!!! The lightbulb went off in my head. Yeah, of course those types of stocks were wild and crazy in their price movements because their price had nothing to do with the fundamentals of those companies. To be frank, I only did surface level analysis of them throughout the year because after one quick peak at them, it was clear to me that they were not the kind of stocks I buy. Therefore, they were irrelevant to me and I never thought a serious investor would buy them either.

Evidently, I was wrong. Lots of people did buy them and I am sure those investors did have a wild ride in 2021. Gamestop (GME) had a high of $483 in early 2021 and ended the year at $152, which is a 68.5% decline from that peak. Robinhood (HOOD) had a 2021 high of $85 and ended the year at $18.20, which is a 78.5% drop.

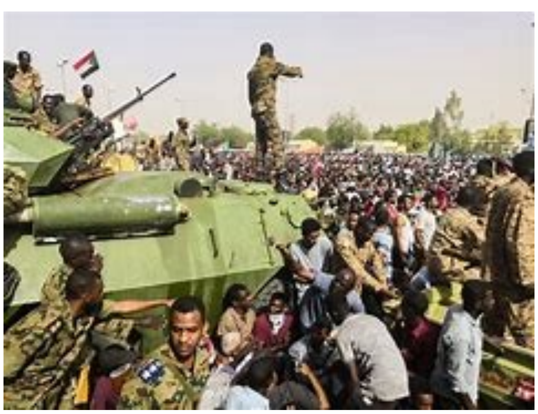
Again, these are not the types of stocks that I typically invest in and, therefore, we didn't have a volatile year in the markets. For our portfolios, 2021 was good and consistent. I guess I am happy we avoided the Meme Stock non-sense, but, like the CDO's that took the market down in 2008, after taking a look at them I never gave a second thought to investing in them. Perhaps the best investment decisions we make are the ones we decide not to put any money into.



Non-Financial Events occurring this quarter

U.S. announced a "diplomatic boycott" of the 2022 Winter Olympic games to be held in China due to China's "egregious human rights violations."

Colin Powell passed away. During his service to the Nation, he served as: a Wartime General, Chairman of the Joint Chiefs, Secretary of State, and National Security Advisor.



The Sudanese military launched a coup against their government and Prime Minister Hamdock was arrested.

NASA launched DART (Double Asteroid Redirection Test), the first attempt to deflect and asteroid to protect Earth.

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MRP CAPITAL INVESTMENTS, LLC

8440 Holcomb Bridge Road, Suite 520

Alpharetta, GA 30022

404-274-7851

www.mrpci.com