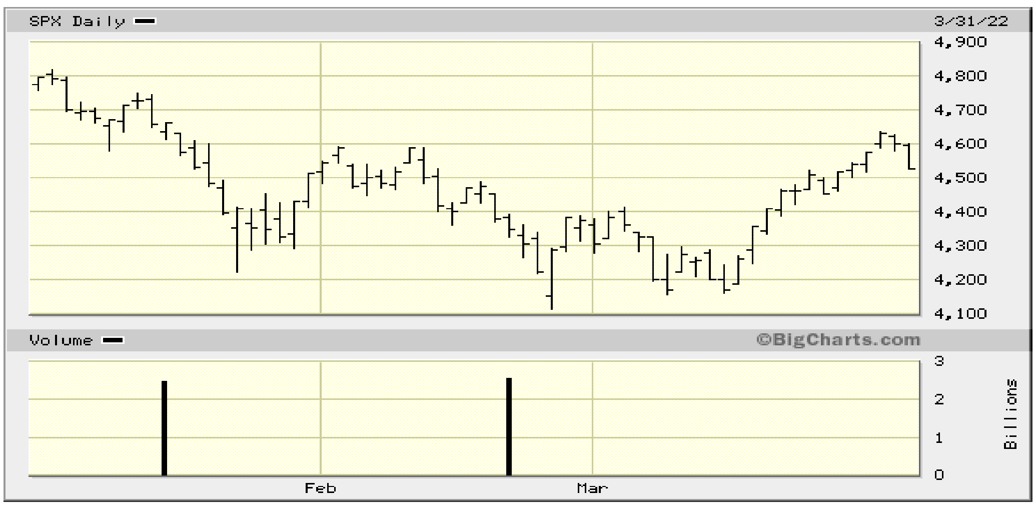
MRP CAPITAL INVESTMENTS, LLC

1st Quarter 2022 Client Newsletter

Capital Market Update

Inside this report:

The 1st quarter of 2022 has been a roller coaster ride. From peak to trough, the S&P 500 declined about 13%. We also saw multiple rallies during the quarter, including a rally of about 10% from the quarter's low point on March 14th. Adding it all up, the market posted a quarterly price change of –4.95%.



S&P 500 2021 Chart Supplied by BigCharts.com

This quarter threw us a big curveball in the form of the Ukraine/Russia conflict. Investors were focused on the Fed and the interest rate tightening cycle they embarked upon. However, the addition of a geo-political issue complicated the situation and made market predictions and forecasts more difficult to confidently layout.

Nevertheless, we keep moving forward and making adjustments to plans and portfolios as needed. The good news is that our call on inflation is being proven more and more correct as each day passes. This has led to solid performance from the investments we have put in place to handle those pressures.

As always, the key is to remain focused and diligent. Our process is designed to handle highly stressful times like this and, thus far, we are pleased with the progress and we hope you are too.

Inflation

We've been saying for quite sometime that inflation was an issue that we needed to be prepped and ready to handle within portfolios. The last few CPI reports have shown inflation over 7%, which are the highest readings in 40 years. As you can see, my friends, inflation is upon us and we are very thankful we took steps to help insulate the portfolios we've been entrusted to manage from inflation.

Frankly, those initial thoughts of inflation began to creep into our brains, way back, when the Fed bailed out the world in 2008. Our inflationary thesis reared its head again with the Fed's steps taken to bail out everything, again, in 2020 over the COVID pandemic. It was soon after that we began making investments in a variety of assets that we felt had a good chance of surviving and, maybe, thriving in an inflationary environment.

The most basic and easy to track investment we've made to combat inflation is the iPath Bloomberg Commodity ETF (DJP).

DJP chart for 2-1-202 through 3-31-2022 provided by BigCharts.com

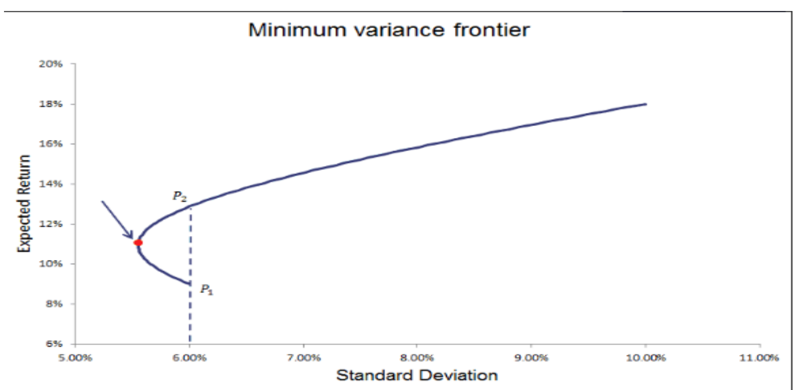
Since the COVID sell off, DJP has appreciated about 120%. There are plenty of other "inflation plays" in our portfolios and some of those are up more than DJP. But, even with just illustrating the returns for DJP, we trust you see that inflationary assets have been very important to own during this cycle.

And that begs the question, what assets are good to hold during inflationary times? To answer that question, let's examine the concept of the Minimum Risk Portfolio.

In the CFA curriculum*, the Minimum Risk Portfolio is the portfolio that minimizes the risk being taken in an investment portfolio while obtaining the most efficient return profile. Many non-professional investors think minimum risk is keeping all of their assets in cash or cash equivalents because their absolute dollar amount will never go down. That is, if they put $1,000,000 cash in their safe, then they will always have $1,000,000 of cash in their safe.

With the "cash in the safe" approach you will have no variance in the dollar amount of your portfolio, so the volatility is minimized but the return on that capital will be zero. However, due to our current environment, that 0% nominal rate of return is actually a lot closer to –7% because inflation is around 7%. This means that you can buy 7% less stuff with that money than you could have just 12 months ago. Obviously, this is nowhere near efficient.

To account for this, the Minimum Risk Portfolio not only uses a lot of cash and cash equivalents but also includes assets that can inflate in price over time. This helps offset the impact that inflation has on your portfolio's purchasing power.



The above chart, provided by Investopia, illustrates where the Minimum Risk Portfolio falls on the Efficient Frontier of the Risk/Reward matrix. That far left portion of the frontier line is the Minimum Risk Portfolio which historically has included about 25-30% of equities. And this is how it generates returns over time and offsets the purchasing power erosion being caused by inflation. To be clear, I am not advocating that people should change their allocation and jump into the Minimum Risk Portfolio. I am simply using it as an example to illustrate the concept that being defensive doesn't mean putting all your money under your mattress.

*As a sidenote, the Chartered Financial Analyst program is the most highly regarded organization in terms of thought leadership relative to investments and finance in the world.

While reading this, it should make sense to everyone that inflation erodes purchasing power and this isn't a good thing for anyone. It should also make sense that in order to counteract that erosion, you need some growth. A diverse portfolio of equities has generated long-term average returns of 10-12% per year. This growth is why a portion of most people's assets should be in **equities**.

However, being broadly diversified allows for overweighting different sectors and/or types of stocks within your portfolio. **Commodities** are another play investors use to offset inflation. Therefore, it makes logical sense that overweighting commodity stocks would provide an extra benefit to someone's portfolio during times of inflation. In fact, the Basic Materials/Commodities stocks in the S&P 500 are positive for the year while the overall index is negative. And the Energy sector, another commodity based sector, is the leading sector in the S&P 500 YTD. Fortunately, we are overweight these sectors in, essentially, every portfolio we manage.

Another sector and/or asset class that has historically held its own during times of inflation is **Real Estate/**REITs. So far this year, the sector is negative but it is outperforming the S&P 500 YTD. Drilling down into the specific REIT sectors, Lodging REITs are the best performers so far this year while Data Center REITs are not doing well at all.

One final sector that I'd like to touch base on regarding portfolio protection during inflationary times is the **cryptocurrency and decentralized finance** space. Obviously, this is a new asset class and many people aren't that familiar with it. Nevertheless, there are two main points I'd like to mention. To begin, the most well-known asset in crypto is Bitcoin. The simple fact that Bitcoin has a fixed amount of it that will ever be issued makes it a potential hedge for inflationary pressures. As long as it remains valued in the market place, the more dollars, yen, euro, or any other fiat currency that gets printed, puts upward pressure on the price of Bitcoin.

Additionally, there are numerous DeFi protocols that offer investors really attractive rates of return on their cash assets. The way these protocols work, combined with the industry's need for cash to fund their expansion, has allowed them to offer annual percentage returns that are greater than our current CPI readings. Yes, the space is new. Yes, not many people feel comfortable with it. If this is the case for an investor, that is totally fine. But if someone has an interest in learning more about DeFi and how they do what they do, give us a call and we can discuss whether it makes sense or not for you to put a portion of your assets in these types of protocols.

Invasion

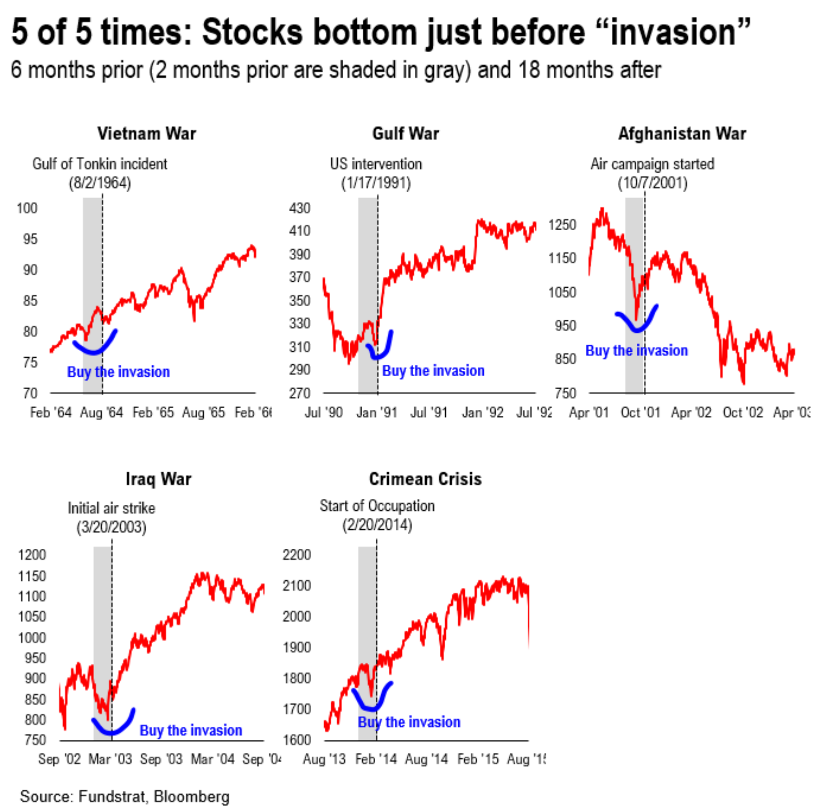
As we mentioned previously in this newsletter, the market was thrown a curve ball when Russia invaded Ukraine. All of the focus was on interest rates, but then war broke out. We hear so many different takes on what is actually happening that we don't really know exactly what is going on, but it does seem like Ukraine is putting up strong resistance against the Russian invaders. They appear to be warriors who will defend their homeland at all costs. Godspeed!

Nevertheless, we believe there are two things that we must discuss about this invasion.

-How is this invasion affecting the stock market and how does that compare to historical precedent.

-How does this impact our investment decisions?

For starters, let's take a look at past geo-political conflicts and how the market reacted. The graphs below were provided by Tom Lee of FS Insights and they illustrate how past markets have reacted to similar situations.



Of course, history doesn't necessarily repeat itself exactly like it did the time before. However, people often react similarly in times of similar occurrences. And as you can see from the previous charts, the markets bounced off their pre-invasion lows every time. And, with the exception of the 2001 Afghanistan conflict, all the conflicts saw significantly higher stock market prices within 18 months after the actual war began.

In fact, I will never forget the 2003 Iraq War. We had just endured the 2000 Tech bubble bursting, the 9-11-21 Terrorist attacks, and then the 2002 botched election. The market had fallen significantly over that time, the mood of the market was awful, and here we were about to start another war. People were nervous. They were scared. It was a tense time. Then the first bomb was dropped and the market went, seemingly, straight up for 5 years. Go figure!

But, seriously, the above paragraph is a great example of the market pricing in all the bad news before the conflict actually started. And this is the kind of thing it does all the time. Remember the 40% drawdown during COVID? The market priced in a global depression that never occurred. And ever since that pullback ended, the market has shot up over 100%. All the bad news was priced in. It's what the market does. Knowing this can help ease nerves and allow your logical mind to properly analyze risk and return metrics rather than react with pure human emotion.

The latest emotional strain on investor's minds is this Russia/Ukraine conflict. In the latest research report we published on 2/20/2022, titled the "Tracking the Bear", we broke down the market's historical reaction to interest rate hiking cycles and geo-political conflicts. Our conclusion from the data we had at that time was that **"we see that history suggests that we are very close to a neutral risk/reward situation...the data doesn't compel us to make an outsized bet one way or another."**

Interestingly enough on the day of the report being published the S&P 500 closed at 4,348. It declined to a low of 4,157 and closed the quarter out at 4,530. So, its been down about 200 points and up about 200 points since then. And at its current price, the market has appreciated about 4% from the time that report was distributed. Given this, I would say there was a darn good chance that almost all the bad news was priced into the market before the invasion actually began. But only time will tell us for sure on that issue.

There is one thing that I see as part of this attack that no one else is talking about. It is actually a concept I've been discussing for quite some time now. It looks to me like this invasion by Putin is a part of a continuing global test and attack on the U.S. dollar. And I know that most people can't imagine the U.S. dollar being dethroned as the world's undisputed global reserve currency.

Quite frankly, this disbelief reminds me of something I wrote about in the "Central Bank Hubris" report that came out back in 2017. I quoted a line from C.S. Lewis where he said, **"It is not the assumptions that are discussed in society that are dangerous, but the one's that are implied."** The point I was making then was that the world assumed the Central Bankers saved us from the economic collapse of 2008. However, I was making the case that they may not have "saved" us. In fact, they may have doomed us with all the manipulation they did in the markets to prop up prices and bail out "too big to fail" institutions. But the point that I am making now is that the world seems to take for granted that the dollar is the king of all currencies and always will be. I am not so sure about that, but I'll spare all of you a continued diatribe on my U.S. dollar thoughts right now.

Rather, let's just take a quick peak at what has happened in this conflict regarding currencies and international money movement.

First off, it appears Putin knew economic sanctions would be levied as soon as his invasion began. Why do I say that? The information available shows that Russia began to make moves to recognize cryptocurrencies as legal tender before the invasion. Subsequently, with the big moves in Bitcoin after the invasion, it appears as though Russians continued to conduct their business using crypto.

Furthermore, when the ruble was cut off from most global financial institution access the price tanked. But then when Putin said that anyone who wanted to buy Russian oil or gas would need to pay in rubles (not USD as has been the protocol for all oil and commodity pricing since the Bretton Woods agreement post World War II). As such, the price has rebounded significantly.

Adding further upside pressure to the ruble, Putin backed the ruble with gold. The big knock on the dollar and, seemingly, every currency in the world is that they aren't backed by anything, making them fiat currencies. In the early 70s and before, the dollar was backed by a specific amount of gold. This gave the currency a real and tangible value. But during President Nixon's time in office, he took the dollar off the gold standard. This opened the door for rampant money printing. And, of course, that has gone on in a big way ever since and ultimately, has become a big contributor to currency debasement and inflation. Putin using gold to support the ruble gives it stability and having his oil sold in rubles gives it demand.

To me, it appears China is part of this dollar attack as well. The SWIFT system is the dominant international payment system and the USD is the most used currency on that network. The Chinese currency is not a big player on that stage at all. Ergo, they have set up their own international payment system (CIPS). They are actively trying to recruit countries and large corporate entities to use it in place of SWIFT. And, with Russia being blocked from SWIFT, this gives a potential big international energy dealer the opportunity to jump to CIPS.

Furthermore, oil has been priced and sold in dollars since Bretton Woods as well. But now it appears that Saudi Arabia is close to finalizing a deal with China to price their oil in Chinese yuan. This would be just another blow to the U.S. dollar's international dominance.

When you wrap all of this up and look at it in its totality, you can then begin to process what the **investment implications** are.

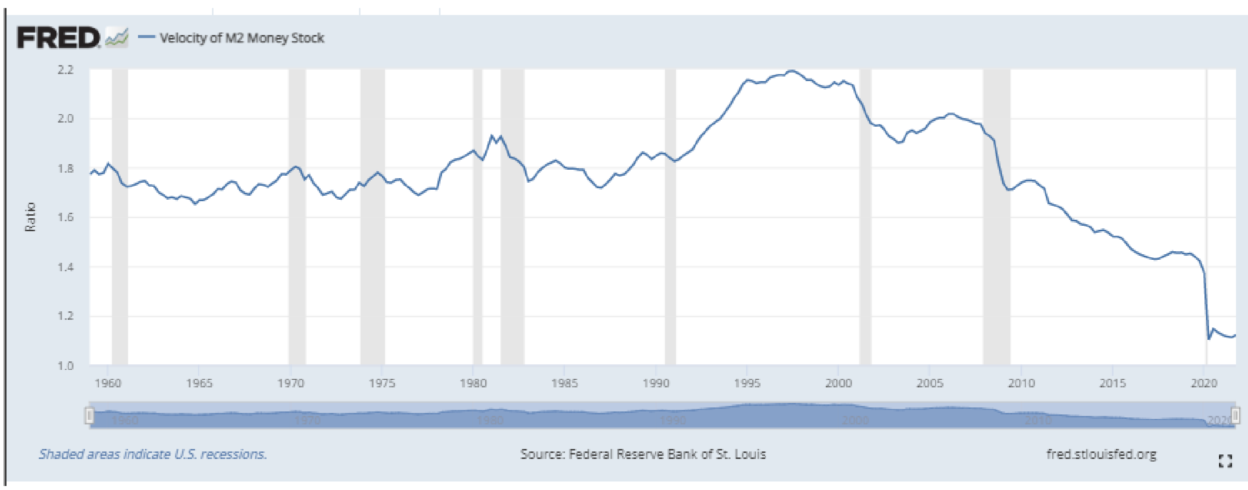
For starters, the **inflation** pressures should not subside anytime soon. Fiat currencies are not backed by anything, so they can be printed at will. This unchecked money printing has led to inflation. We've seen asset price inflation for years and now we are seeing inflation impact goods, services, commodities, and a little bit in wages as well. This is certainly something that needs to be factored into our investment plans.

Furthermore, inflation brings with it interest rate hikes. We've had over a decade of insanely low interest rates. Now that inflation is on the rise, rates are racing to catch up. **Higher interest rates** is another factor to consider when investing in today's markets.

And finally, **change** is occurring on so many levels. Global leadership seems to be shifting and changing. Currency markets are in a time of change. Technology is changing our lives. I could go on and on and on. I think research, education, and non-stop diligence is vital to understanding what changes are going to last and what that means for the our current ways of doing things, our ways of life, and, therefore, the investments we make.

Interest Rates

As we've been discussing throughout this newsletter, inflation is running rampant and with that interest rates are moving higher. In the last quarterly newsletter, we mentioned that the key was for the yield curve to steepen. The idea behind this was that if this happens banks can earn more money from the loans they make, as they play the "spread" by borrowing at short end and loaning out at the long end. This will increase the velocity of money if banks lend more, which as you can see from the chart below, provided by the St. Louis Fed, is at an all-time low.

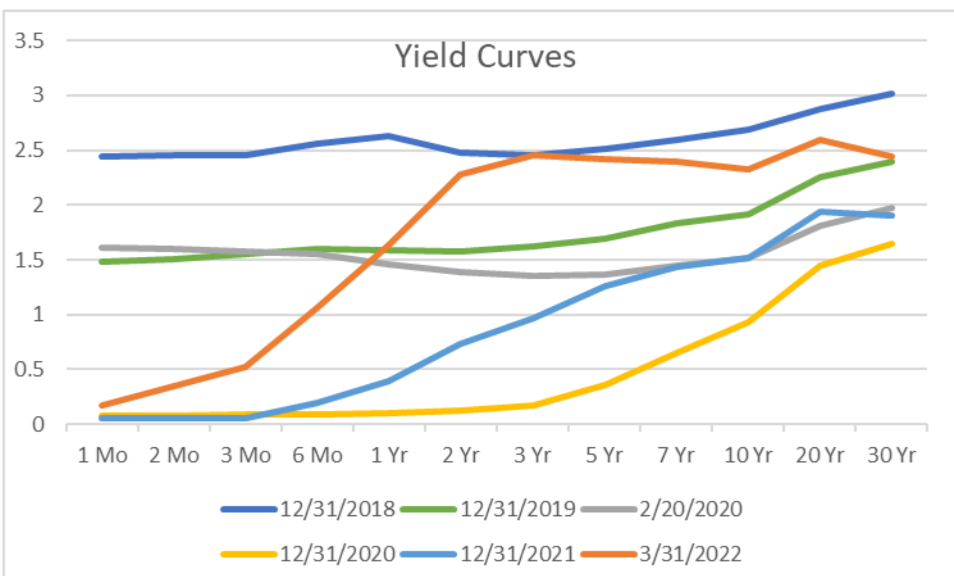


The calculation of the velocity of money is the ratio of the gross national product (GNP) to a country's money supply. If the velocity of money is increasing, then transactions are occurring between individuals more frequently. The reason we want to see an increase in the velocity of money is that it plays a key part in the process of increasing economic growth, which, of course, plays a big part in increasing corporate earnings, which plays a big part in making our investment appreciate in value.

Given this backdrop, you can see why we feel it is so important to see a steepening yield curve, or at least a steep enough yield curve, to reward banks for making more loans. These facts naturally compel us to take a look at the yield curve and to see if it is steepening.

Below you will see historical information regarding the yield curve. I simply took year end data relative to all the different maturities of U.S. Treasuries from 2018 through end of 1st quarter 2022 and put them in a table and graph to help us see the data in a few different ways. For some additional context, I also included where rates were right before COVID hit.

Date	1 Mo	2 Mo	3 Mo	6 Mo	1 Yr	2 Yr	3 Yr	5 Yr	7 Yr	10 Yr	20 Yr	30 Yr
12/31/2018	2.44	2.45	2.45	2.56	2.63	2.48	2.46	2.51	2.59	2.69	2.87	3.02
12/31/2019	1.48	1.51	1.55	1.6	1.59	1.58	1.62	1.69	1.83	1.92	2.25	2.39
2/20/2020	1.61	1.6	1.58	1.55	1.46	1.39	1.35	1.37	1.45	1.52	1.81	1.97
12/31/2020	0.08	0.08	0.09	0.09	0.1	0.13	0.17	0.36	0.65	0.93	1.45	1.65
12/31/2021	0.06	0.05	0.06	0.19	0.39	0.73	0.97	1.26	1.44	1.52	1.94	1.9
3/31/2022	0.17	0.35	0.52	1.06	1.63	2.28	2.45	2.42	2.4	2.32	2.59	2.44



As we simply look at the table and graph, it is clear that 2018 had the highest rates across the board and the curve was FLAT! Also, we notice that at the end of 2020 rates were the lowest among this selection of yield curves and there was a pretty decent amount of steepness between the short end and long end of the curve.

To make further analysis of the yield curve easier, I took the data from the last table and made a new one which notes the differences in the yields of a few key points on the curve. Those key points are: 1 month versus 10 year, 3 months versus 10 year, 2 year versus 10 year, and 5 year versus 10 year.

Date	1 mo/10 year	3 mo/10 year	2 year to 10 year	5 year to 10 year
12/31/2018	0.25	0.24	0.21	0.18
12/31/2019	0.44	0.37	0.34	0.23
2/20/2020	-0.09	-0.06	0.13	0.15
12/31/2020	0.85	0.84	0.8	0.57
12/31/2021	1.46	1.46	0.79	0.26
3/31/2022	2.15	1.8	0.04	-0.1

What we see from this table is that the steepest from 1 month versus 10 year Treasury is our current environment, as this shows a 2.15% interest rate differential between those two treasuries. The steepest in regards to 3 month/10 year is, also, our current environment. The 2 year/10 year shows the biggest spread at the end of 2020, while the 5 year to 10 year spread was widest in 2020 as well.

The market seems to always focus on the 2 year and 10 year spread as those are two of the most highly traded Treasuries. However, its accuracy of predicting a recession is a mixed bag. But ever since the National Bureau of Economic Analysis began formally declaring recessions, the 3 month and 10 year yield curve has inverted 8 times and there has been 8 recessions.

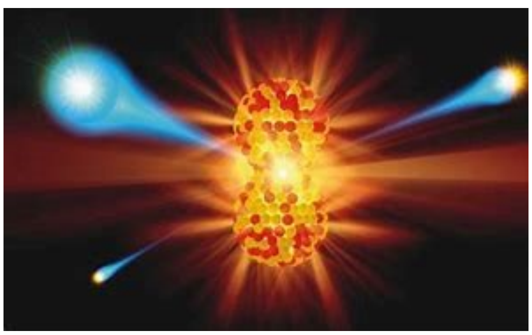
We must understand that higher rates can hurt the economy. But a steeper yield curve should boost bank lending, which should provide a boost to the economy and corporate earnings. Since the end of 2021, the yield curve with the most accurate recession predictions (the 3 month/10 year) has steepened by 34 basis points. This is taking it further away from inversion, which has historically been a good thing for asset prices appreciation.

Obviously, we will be watching this closely. But as of right now, it appears things are moving in the right direction.

Non-Financial Events occurring this quarter

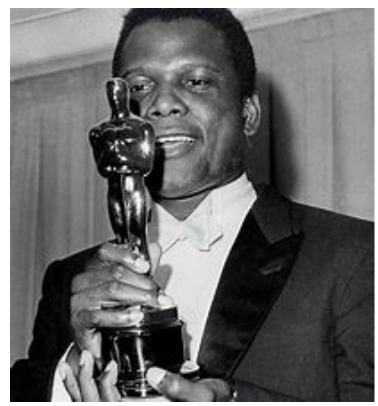
March 9th The Endurance, the greatest undiscovered shipwreck, was discovered in Antarctica.

February 4th the Winter Olympics in Beijing began, making Beijing the only to city to host a summer and winter Olympic games.



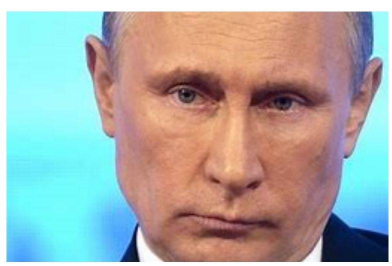
February 9th saw the biggest fusion energy breakthrough since 1997 take place at the Joint European Torus in Oxford,

January 22nd, Buddhist Monk Thích Nhất Hạnh passed away.



January 6th the amazing Sidney Portier passed away.

January 4th, the United Nations Security Council issued a rare joint statement condemning nuclear war.



February 24, Russia launches a full scale invasion of Ukraine.

March 1, U.N. member states pass a resolution calling for immediate withdrawal of Russian troops from Ukraine.

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