MRP CAPITAL INVESTMENTS, LLC

2nd Quarter 2022 Client Newsletter

Capital Market Update

Inside this report:

The 2nd quarter of 2022 turned out to be one of the worst quarters we've ever seen in the market. In fact, it was the worst quarter in over 40 years. In the quarter, the S&P 500 declined 16.45%. When you combine that with the drawdown in the first quarter, you get a market that is down 20.58% year to date. UGH!!!

S&P 500 2022 Chart Supplied by BigCharts.com

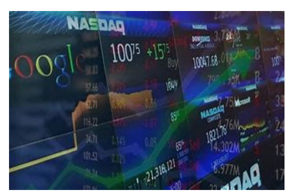
Heading into this quarter, we mentioned that we wanted to see the yield curve steepen. Technically that did happen, as the spread between the 2-year and the 10-year Treasury went from 0.04% to 0.06%. So, yeah, that is steeper but that is not what we wanted to see. At times in the quarter that spread got up to 40 bps or so, but it narrowed considerably in the closing weeks of the quarter as economic fears mounted.

With 1st quarter real GDP coming in at –1.6% and 2nd quarter GDP expected to be negative as well, it appears that we are in a recession. This change in the economic environment calls for portfolio adjustments and we have made them and we are looking to potentially make more portfolio modifications as new information and trends are revealed.

Tactics and Strategy

As we mentioned in the opening article, we wanted to see the yield curve steepen as the Fed raised rates and embarked upon Quantitative Tightening. We wanted this because the steeper the curve the more banks would be incented to make loans because their profits would be higher on those loans. We felt this would provide a much needed boost to the economy that would foster more economic growth. For awhile, we did see the yield curve steepen and we were encouraged. However, near the end of the quarter that widening spread between the short end and the long end of the curve narrowed considerably.

Given this set of circumstances, our cautiously bullish stance entering the quarter turned bearish. As a result of that switch, we adjusted portfolios accordingly. The main tactic employed regarding these adjustments was reducing exposure to equities. No one was over-exposed to equities to begin with, but given the economic backdrop we adjusted portfolio allocations and we are now under-weight equities. Reducing holdings in stocks should reduce portfolio volatility and leave us some dry powder to repurchase stocks at a lower price, should the market continue to sell off.

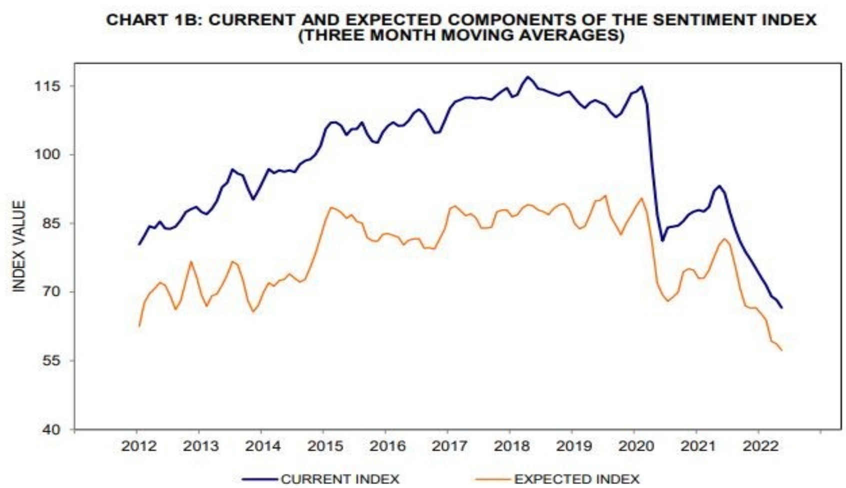


Additionally, we have been reallocating within the equity asset class. This reallocation has the aim of selling off assets that are more sensitive to economic conditions and buying assets that we feel should be more stable in the face of uncertainty.

Across the board, with very few exceptions, we are beating the market. This fact demonstrates that these maneuvers are working, but the market has sold off so much that even beating the market means negative returns. And, of course, we aren't pounding our chest in victory over outperforming a down market. Nevertheless, protecting on the downside is the best way to compound capital over the long term.

Bear markets are a necessary part of a healthy market. They help control speculation and they separate the good companies from the bad. Remaining mentally strong and focused during Bear markets is the key to long-term success. We might be stressed. We might be putting in long hours of research and portfolio analysis. But we've done this before and we won't tire until the market stabilizes and our client's portfolios are positioned exactly as we need them to be.

In regards to our place and time in the market, there are a number of positive things that will eventually occur. However, many investors may not believe that right now. There is a tendency for human beings to extrapolate the current environment into the future, some people call this phenomena "anchoring." Whatever the academic gurus call it, we all know the feeling. The problem is that when we are in the midst of "anchoring", we don't realize it and we think we are making accurate assessments of potential future outcomes. Perhaps this chart can shed some light on this phenomena for everyone, as it did for us.



It is a chart of University of Michigan Consumer Sentiment Index. The blue line is the portion of the index that encompasses people's current sentiment regarding their finances. The orange line represents their expectations regarding their future financial situation. Every time their expectations are more pessimistic than their current situation. This clearly shows that people are always **overly** pessimistic regarding the outlook for their future financial situation.

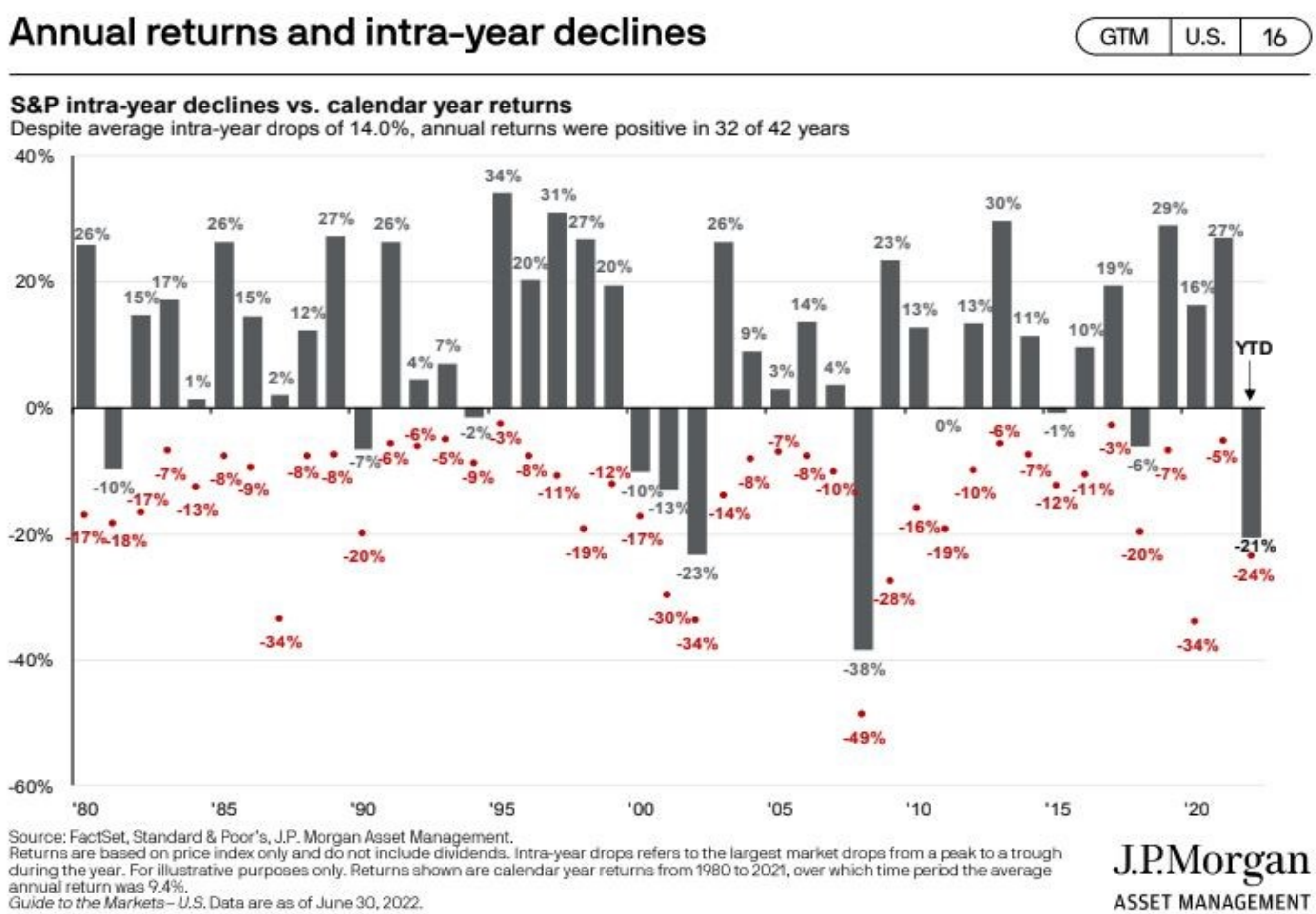
There appears to be 3 things that have rattled the market and turned it Bearish. Once these issues begin to dissipate, we suspect the market could turn around.

The first is the inflation spike and the corresponding hawkish stance of the Fed. The Fed raising rates is not something many market participants are used to. We've grown accustomed to falling rates and a dovish Fed in the face of, seemingly, non-existent inflation. However, it really does appear the Fed is getting results in regards to their rate hikes. The PCE deflator (supposedly the Fed's favorite gauge of inflation) has seen 3 months of declining inflationary readings. If we see inflation readings begin to peak on the more widely followed measures (CPI, PPI for example), we would expect the market to react favorably.

Regarding the other two items that seem to be rattling the markets, any hint of Russia backing off their assault on Ukraine should also be well received by investors. And once we get through the mid-term elections a great deal of uncertainty will be removed from the market.

As things begin to unfold regarding these three issues, new pieces of information will be released and investors will need to digest that data as well. But I want to remind everyone that just because a market is negative at some point during the year, doesn't mean that year is a total dud. Remember 2020? COVID took us down 34%, but the S&P finished with an annual return of approximately 16%! For more information regarding that, check out the chart below provided by JP Morgan. It shows the market's annual returns coupled with the lowest the market was in that given year.

For a quick example of how to read this confusing chart, in 1980 (first year on chart) the S&P 500 at one point was down 17% but finished the year up 26%.



Another One, again.

After the Fed's actions in late 2018 caused the market to fall substantially, we wrote an article in the 4th quarter 2018 newsletter called "Ugh; Another One!" In that article, we detailed all the market pullbacks that we've managed money through. Since we are smack dab in the middle of another market sell-off, we are re-writing and updating that prior article.

1998—Russian Rubble Crisis

This one happened when I was a newbie at Merrill Lynch. Seemingly out of nowhere, beginning in the late summer, the market fell 19.3%. The Russian default in August kicked off a cascade of events that led to Long-Term Capital Management bringing the financial system to the brink of collapse. What was especially neat for me was that the Merrill Lynch CEO was in Atlanta during this time and a host of other big wigs came in and out of our office as they met to save the world. It was really cool to see the larger than life Dave Komansky's leadership in action. After the issue was fixed, the market went on to rally over 60% until finally peaking in late 1999.

1999—The Forgotten Pullback

In late summer of 1999 through early fall, the S&P 500 fell 12.1%. And, frankly, no one seems to remember this one because there wasn't any major catastrophe that kicked it off and because after this correction the market roared upwards another 26.5% before peaking in early 2000.

2000-2002—Tech bubble bursts

As much as people forgot the 1999 pullback, everyone remembers the 2000-2002 Bear Market. Tech stocks were over-valued and when they began to collapse, everything started to give way. It certainly didn't help that the election of 2000 was botched with the "hanging chads" in Florida. And then we all had to endure the terrorist attacks of September 11th, 2001. Nevertheless, from its 2000 peak through its 2002 trough the S&P fell 40%.

2008—The Financial Crisis

After the market bottomed out in late 2002, it ran up over 80% until late 2007. What happened then, no one will ever forget. The ensuing Global Financial Crisis, that forever changed the way our global economy functions, knocked the S&P 500 down 37% in 2008. The crisis saw many major and powerful banks go out of business or get gobbled up by stronger banks at fire sale prices. This was the worst recession since The Great Depression and without coordinated global efforts, this calamity may have brought our entire way of life to an end.

2010—Greek Debt Crisis

The Financial Crisis did get "resolved" and the S&P rallied 78% from its lows until 2010. It was then that the market began to focus on the aftermath of The Great Recession and the fact that it left many countries around the world in bad shape in terms of debt relative to GDP growth. Perhaps Greece was in the worst shape. Fears grew that they couldn't service their debt, they might default, and/or leave the EU. These worries caused the S&P 500 to fall 16%.

2011—Euro debt crisis

The market did bounce after a "solution" was found for the Greek crisis in 2010, but it soon became evident that many other countries in Europe had severe financial issues. This caused the S&P to fall nearly 20% peak to trough in 2011 and the fallout actually hit the United States when its debt was downgraded.

2015—China slowdown

After the Euro debt crisis issue, the market did rally by about 86%. However, in late 2015 the market sold off on fears of a China slowdown. After a brief rebound, in early 2016 it sold off again. The peak to trough drawdown was –14.2%.

2018—January Correction

In early 2018, the market sold off after a tremendous run. From the lows of the China driven sell off and including the post-2016 election rally, the market gained nearly 50%. It was in late January of 2018 when it looked like the market realized it had come a little too far, too fast. It had a plain and simple price correction that took the market down about 10% in just 12 days. It may have been a simple price correction from slightly over-valued levels, but the speed of the sell off rattled quite a few investors. Nevertheless, the market did appreciate after that by about 15%.

2018—Worst Christmas Eve market EVER!

To cap off 2018, Fed Chair Powell began raising interest rates to "normalize" the market. He further bolstered his hawkish persona by making comments to the media about his intentions to raise rates and begin quantitative tightening regardless of market conditions. Obviously, the market hated these comments and fell from 2,939.36 in October to 2,346 on Christmas Eve. This 20% decline was finally reversed when that same Fed Chair switched from a hawk to a dove, just a few months later, in February. Frankly, this was one of the quickest and strangest pivots in policy I have ever seen. From that Christmas Eve low, the S&P 500 rallied 45% to approximately 3,400 before another situation arose.

2020-COVID

I am sure no one needs a recap of what happened in 2020. Nevertheless, for context we need to briefly touch on the scenario. In 2020, a global pandemic was unleashed. Countries, economies, people, and businesses were locked down. The global economy was, basically, frozen. No one was really sure what the heck was going on and the market, sensing uncertainty, went to a "risk-off" mode. In February, it began falling when it was approximately 3,400. In late March it bottomed out at around 2,200. This 37% decline began reversing course when the Fed, the Treasury, and other global financial institutions bailed everything out by printing extraordinary amounts of money. This COVID bailout rally pushed the market up to a little bit above 4,800, which represents about a 120% gain, by late 2021.

2022-Inflation/Invasion

And this brings us to our latest crisis. We currently have inflation caused by excessive money printing and a geo-political conflict on top of that. The conflict between Russia and Ukraine is adding extra pressure to the economy in terms of inflation, supply chain disruptions, and further uncertainty. These factors have caused our market to (as of the end of the 2nd quarter 2022) bottom out at 3,636, which represents a fall of about 25%.

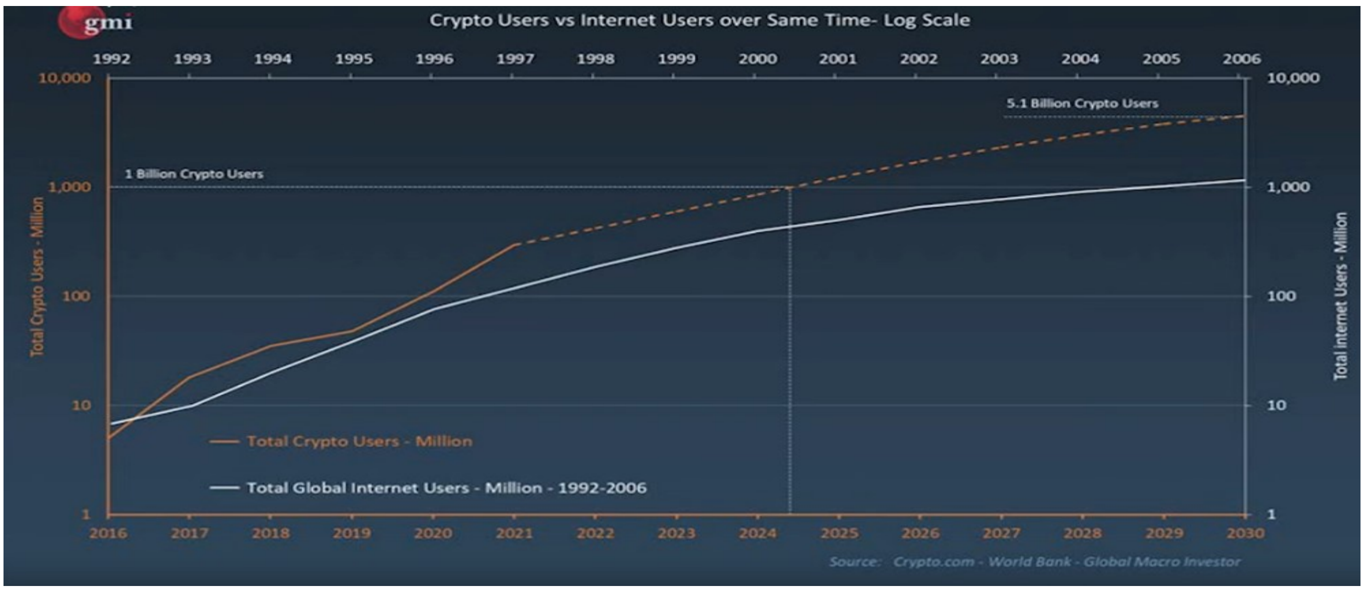
As you can see, these sell offs happen frequently. Additionally, they usually contain hints of something very sinister and damaging to the global economy, which makes them very scary. We just talked about Long Term Capital Management bringing the economy to the brink of collapse, a European debt crisis that threatened the survival of the European Union, the Tech Bubble Bursting, 9/11 attacks, The Global Financial Crisis, and a global pandemic. **But through all of that, the S&P 500 is up about 300% on a total return basis over the time frame we discussed.**

In the end, I am in the fortunate/unfortunate situation of having done this drill many times over. Fortunate because I have experience handling it and I hope this gives me the wisdom to take a prudent and proper path while navigating this market for clients. Unfortunate because managing money through sell offs is, just plain and simply, miserable. With this in mind, we all need to focus on our own individual sets of needs and goals and keep our wits about us while remaining patient.

It appears we have two key components to deal with before this Bear Market eases up. Most importantly, we need to see signs that inflation has peaked and, then we need to see it start coming down. Furthermore, we need to have a resolution to the Russia/Ukraine conflict. Once we see that, then the next leg of the market's path can begin to be forged.

Cryptocurrency Update

What is happening in the world of cryptocurrency is nothing short of historical. First off, the fact that it even exists is mind-boggling. When this is combined with its rapid appreciation in price, the massive increase in the number of users, and the pace of institutional adoption, its place in history has been cemented. In fact, bitcoin's speed of adoption surpasses the Internet's adoption pace.



"*Crypto adoption is now massively outperforming the internet. It's been growing at about 165% a year versus 85% for the internet for the same period of time now. This is the fastest adoption of any technology in all human history."*

-Source: Real Vision Finance

Recently, however, the most obvious thing that people notice about cryptocurrency is that bitcoin fell about 58% in price this quarter. Nevertheless, that is nowhere near the most interesting (or important) thing that happened to crypto in the 2nd quarter. The reasons bitcoin fell, juxtaposed with the fundamental changes in the crypto markets, are, in our opinion, the most fascinating things we've ever seen in the world of high finance.

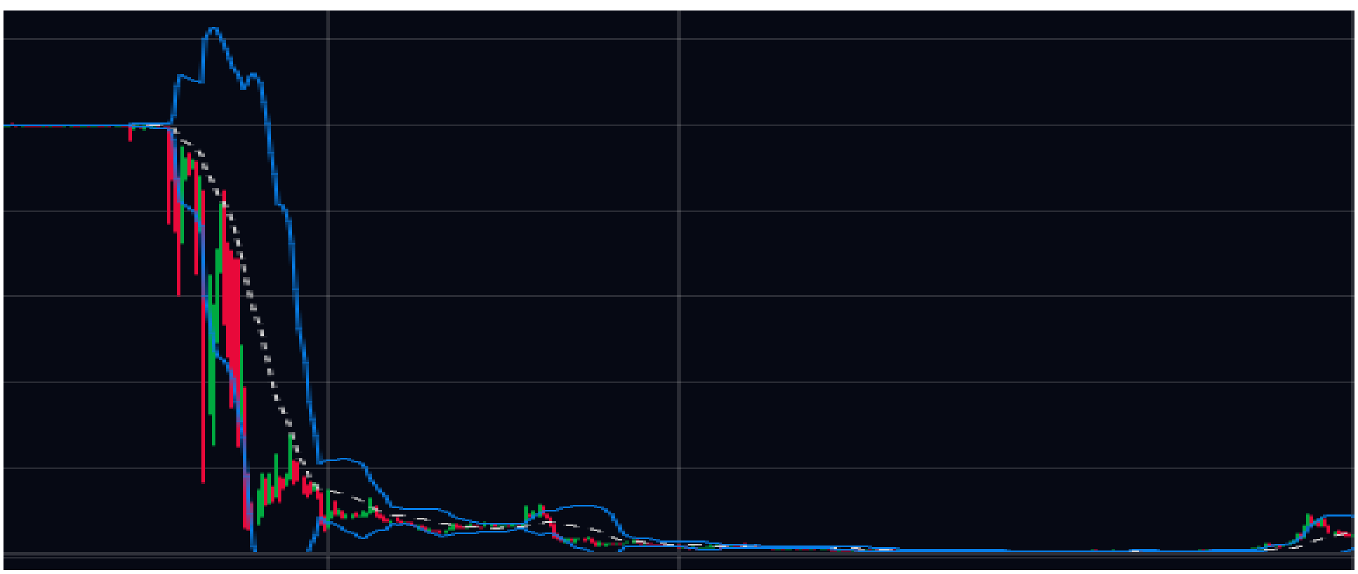
For starters, we would like to say that we welcome this sell-off in the cryptocurrency markets. We think it should shake out the weaker players and make the market a lot more healthy, which should set the stage for its next move higher. There are over 19,000 different cryptocurrencies in the market place right now. This is a ridiculous amount of coins and there is no question that this shake out will reduce that number drastically.

Even with all these coins, there is no doubt that bitcoin is the king crypto and it is the foundation that the entire industry is built upon. Without Bitcoin, crypto doesn't exist.

During the quarter, the soundness of this foundation was tested to the extreme.

The first test came when Terra/Luna fell apart. To summarize this debacle, Terra (UST) was an algorithmic stablecoin designed to always be worth $1. If it deviated from $1, the Luna coin (LUNA) could be added /subtracted to/from the collateral pool to get it back to $1. Additionally, massive amounts of bitcoin (BTC) and U.S. dollar-backed stable coins were held as further collateral to backstop any issues with the algorithms' stability process.

The Terra/Luna protocol had grown to about $40 billion in size when, it appears, they were attacked and their stability process was tested. May 7th was the beginning of the assault on the cryptocurrency as massive amounts of UST and LUNA were sold. The selling continued and by May 12th UST had fallen from $1.00 to $0.057. This fall also decimated the "stability" coin LUNA. LUNA opened on May 7th at approximately $68 and by May 12th it was priced at $0.0001.



Terra (UST) price from April 1, 2022 through June 30, 2022

Needless to say, their algorithmic process of keeping UST at $1.00 failed as the incredible amount of selling caused more and more LUNA to be printed and deposited in an attempt to stabilize UST. When that failed the US dollar reserves and bitcoin collateral had to be liquidated in an effort to hold off the barrage of selling. Not only did this not stop the bleeding in UST or LUNA, it also led to a serious decline in the price BTC as those collateral reserves were dumped into the market in an effort to save UST.

[To get more detail regarding the Terra/Luna disaster, I suggest checking out articles like this one (https://decrypt.co/100402/how-terra-ust-luna-imploded-crypto-crash).]

As bitcoin's price was driven lower by this forced selling, other entities that utilized bitcoin as collateral for loans also began to feel the pressure. Crypto lending firm Celsius was rumored to be insolvent due to this exact issue. Once again, BTC was forced to be sold to cover the loan losses and the price decline continued.

The last major catastrophe (that is currently known in the marketplace) is the bankruptcy filing of 3 Arrows Capital, a highly levered $10 billion crypto hedge fund. The same story unfolded at 3 Arrows as the others we just discussed, a fall in the value of the asset base prompted their collateral (BTC) to be liquidated to cover their loans. And this, once again, pushed the price of BTC even lower.

Bitcoin (BTC) price from March 20, 2022 through June 30, 2022

Hearing what happened during this quarter makes it pretty easy to understand why Bitcoin fell 58%. But what is really weird is how the fundamental landscape for crypto and Bitcoin progressed while the market price took such as dive.

Two of the biggest moments regarding mass adoption for crypto occurred right before and right after this quarter. On March 9th, President Joe Biden issued an executive order instructing all financial regulatory bodies to draft and adopt crypto legislation as soon as possible. The Treasury's report on cryptocurrency framework, which was given to the President on July 7th, shows that regulations are on the way for crypto.

In our opinion, the creation of legislation and regulation is the most important step in regards to cryptocurrency's continued growth in terms of adoption and price appreciation. We know that Goldman Sachs, JP Morgan, and Fidelity (as well as many others) are ready to unveil their client-based crypto platforms, but they are unable to do so until legislation and regulations are put in place.

We believe this will be **<u>THE</u>** watershed moment for cryptocurrency and the reason why we feel this way is simple; scale. You see, at the end of the quarter, the value of the entire crypto marketplace was about $1.5 trillion. Onyx, JP Morgan's crypto division, is on record saying that, once they are legally allowed to help their client's invest in crypto, they plan on "tokenizing" U.S. Treasuries and using them on the crypto ecosystems. This means they will create electronic tokens which will be digital versions of U.S. Treasuries and they will use them on the crypto networks. Maybe this seems ho-hum to some people, but the fact that this represents $23 trillion shows how much bigger the world of cryptocurrency will get once regulations are in place. In one instant, the marketplace could grow from $1.5 trillion to $25 trillion. We are of the mindset that this type of capital injection should have a very positive impact on the pricing and value of cryptocurrencies.

Fidelity DIGITAL ASSETS

ONYX by J.P.Morgan

With any start-up industry like crypto, there will be volatility. This is a given. There will be companies that go bankrupt and others that skyrocket in value. There will be moments of utter despair and unfettered joy as investments boom and bust. But if a start-up industry can add value to an economy by creating something better than what currently exists and/or by solving an existing problem, then the marketplace should eventually reflect this value in terms of appreciating prices of the companies within that industry.

Regardless of how things shake out, buckle up! Even if the crypto industry's full potential is realized, the ride is sure to be bumpy.

Non-Financial Events occurring this quarter

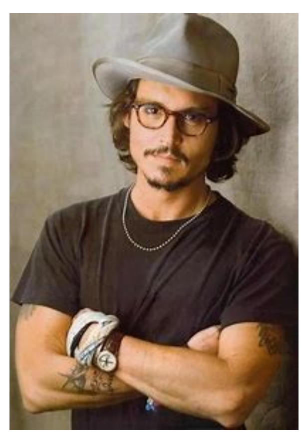
Real Madrid defeated Liverpool 1-0 to win the UEFA Champions League Finals

Matt Fitzpatrick won the U.S. Open

Scottie Scheffler won the Masters

Emmanuel Macron was re-elected President of France

Amber Heard and Johnny Depp's trial was must see tv



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