MRP CAPITAL INVESTMENTS, LLC

1st Quarter 2023 Client Newsletter

Capital Market Update

Inside this report:

As we've grown accustom to in this post-Pandemic world, the markets kept us on our toes this quarter. We opened the year with a gangbuster January, as the market sky-rocketed 6.2%. February gave a little back, but the market remained positive. March saw a banking crisis emerge which took the market negative for a bit, but then the Fed stepped into "save the day". When it all settled out, the S&P 500's price appreciated 7.03% in the first quarter.

S&P 500 2023 Chart Supplied by BigCharts.com

In our last newsletter, we noted that we needed inflation to get under control and the Fed to stop raising rates in order for the market to begin to make gains again. It does appear that rates will stop being raised soon but the catalyst was the banking system starting to fracture because rates were brought up too quickly.

This brings a potential double whammy of stimulus to the economy. First off, rate hikes could stop. Secondarily, rate cuts could start before the year ends. We've already heard Fed Chair Powell say the banking crisis could lead to tight credit, which usurps the need for rate hikes. Additionally, rate cuts might be in order if banks need further assistance.

In the meantime, China has opened its economy and Russia's war on Ukraine continues.

Behavioral Finance Update

In the "Behavioral Finance" article in our last newsletter, we put forth a forecast of potential market outcomes in 2023. Using interest rates, earnings levels, and valuation concepts, we put forth the following, concerning year end S&P 500 price levels:

Bear Scenario 3,460

This would represent a YTD return of –10% and –18.7% from here until year end.

Base Scenario 4,073.35

This would represent a YTD return of 6.09% and –0.9% from here until year end.

Bull Scenario 4,599

This would represent a YTD return of 19.78% and 12.1% from here until year end.

We discussed our opinion that inflation would continue falling and this will give the Fed the opportunity to stop raising rates sooner than the market expects. Recall, lower rates mathematically equate to higher valuation multiples for stocks and higher prices for bonds. These were the main reasons why we considered the Bullish Scenario, listed above, as being the most likely scenario to unfold.

As we look back at the 1st quarter, it is difficult to say that any one of the scenarios grabbed the market and clearly demonstrated that their path was the path that the market would follow. Therefore, it is still anyone's game concerning how the market will behave this year and what the end of year 2023 returns will look like.

However, it does appear that the consensus view of most market participants that rates are going higher than expected and that they will remain higher for longer than anticipated is being seriously challenged. The rapid increases in the Fed Funds Rate, and its influence on the short end of the yield curve, seems to have broken a portion of the banking system. *

The usual antidote to a problem caused by rates that are too high is to reverse course and cut rates. In fact, this is what we expect to see in the market before year's end.

*This will be discussed in detail in the next article.

Feelings very similar to the ones we are expressing now are what prompted us to post the chart provided below of the Fed Funds rate in last quarter's newsletter. The chart highlights the interest rate hikes, and subsequent cuts, by the Fed in 2018 and 2019.

It's like déjà vu all over again—2018-2019

2018-2019 Chart of Fed Funds Yield provided by Trading View

During that time, a Jerome Powell led Fed wanted to "normalize" both monetary policy and the structure of the yield curve. They felt that the extremely low interest rate levels, which helped get our economy kick-started after the 2008 Financial Crisis, were no longer needed. As Fed Chair Powell continued hiking rates into the 4th quarter of 2018, the market began to deteriorate rapidly. From peak to trough in the 4th quarter of 2018, the S&P 500 had fallen 20% and a crescendo of pain followed as the market posted its worst Christmas Eve trading day ever!

Of course, this time inflation has crept into the system after the incredibly large bail out programs associated with the government's response to the COVID pandemic. Nevertheless, the rapid rise in interest rates in 2022 has continued into 2023 and, even after a nearly 20% decline in the equity markets, the market is showing fresh signs of new cracks. These cracks can be found within the banking system.

The Fed's response, when these cracks first became apparent, reassured the market that the "Fed Put*" was still alive and well. The Fed/Treasury printed $300 billion in one weekend to backstop all account holders at the cracking banks. After letting a few banks go under, they bailed out the remaining struggling banks as well.

The market's reaction to these moves by the Fed was straight from the textbook that was developed from similar situations in the past. Historically, the Central Bankers flood the market with liquidity and drop rates dramatically. Below is a chart of the 10 year Treasury Yield for 2023 provided by Trading View.

The first red circle is the date Silicon Valley Bank, the 16th largest bank in the country and a highly respected technology-centric bank, dropped over 100 points. The 10 year was yielding 4.012% at that time.

The second red circle highlights the day after a consortium of banks deposited $30 billion into First Republic Bank to stabilize their balance sheet. Interestingly enough, just two days before this bailout , the Fed Chair raised interest rates 25 basis points. During this timeframe, the 10 year Treasury had dropped in yield to 3.287%.

Seeing interest rates drop so significantly bolsters our view that the **Bull Case is the most likely scenario for 2023**. And considering China has opened its economy back up and ended its Zero COVID policy, we get an even bigger level of comfort that the **4,599 level for the S&P 500 is very much in play for 2023.**

*The "**Fed Put**" is the concept that if the investment markets get in too much trouble, the Fed will jump into save everyone with some sort of a bailout.

Financial System

In the last article, we discussed that the Fed just led us through a journey in which they raised interest rates at a historically rapid pace. Of course, this means that bond prices fell just as rapidly. In fact, they fell even faster the farther out on the yield curve an investor went.

Interestingly enough, the bulk of bank assets/investments are fixed income related investment vehicles. This means, most, if not all, of the banks are sitting on big losses in their investment portfolios. Any catalyst that makes the banks recognize those losses also hurts their capital ratios, As such, they most likely, will need to raise capital to get those ratios back in line with the regulations.

If this occurs simultaneously with client funds being withdrawn from the bank(s) en masse, the banks are susceptible to being decimated by an old-fashioned bank run.

This is exactly what happened to a number of banks during the month of January, until the Fed stepped in and unveiled their Term Lending Facility. This bailout program gave the remaining banks all the capital needed for them to escape the threat of overnight bankruptcy.

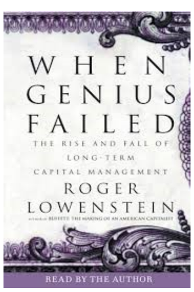
The Rescue Plan

However, this doesn't actually fix the problem as I see it. The problem isn't bond rates going up and prices going down. That unmasked the real problem. The problem is we have an antiquated banking system, a centralized fractional reserve system, combined with a burgeoning digital banking network on which people operate. People no longer need to physically go down to their local banking branch to withdraw their money. They don't even need to go to an ATM. Rather they can electronically move all of their money in and out of a bank with the click of a button.

I took note that, when interest rates went back to zero after the pandemic, the banks took that opportunity to pay their depositors, essentially, nothing on deposits. Maybe, they paid 0.01% on customer accounts. Other emerging business/banks began to offer more interest, and in many cases substantially more interest than that for customer deposits.

When the Fed began to hike rates, these same banks were extremely slow to increase the rates they offered their depositors. Their customers, rightfully so, sought out other places to park their cash and earn a more attractive rate of interest. Banks that were not honoring their clients with decent rates of interest income began to see outflows of customer cash. Inside a fractional reserve banking system, these outflows destroy the banks ability to make and/or maintain their loan base. This, of course, puts traumatic stress on the bank's going concern/solvency. And to no surprise, this is exactly how our current Regional Banking Crisis started.

What is even more interesting than that is the fact that just in my time as a professional money manager, the world's financial system has needed to be bailed out AT LEAST four times. The first one, which I saw front row center seat, was the Long Term Capital Management debacle. Then we all saw The Great Financial Crisis unfold in 2008. After that, came the bailouts use to fend off the COVID pandemic. And now, we have this "little" Regional Banking Crisis.

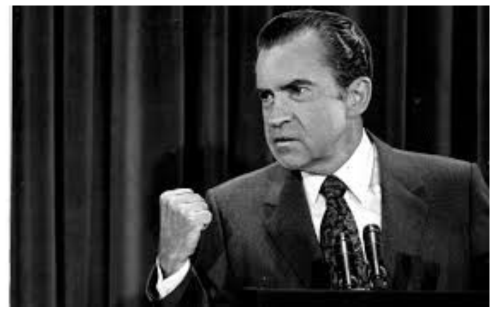


Fascinatingly, the Long Term Capital Management crisis of 1998 literally saw the world's global financial network teeter on the brink of collapse until a consortium of Wall Street investment banks cobbled together $3.6 billion to save the world from the destruction caused by the $126 billion hedge funds bad trades.

Then in 2008 the bailout size for The Great Financial Crisis was $700 billion. The bailout dollars ballooned to $5 trillion for the COVID pandemic!!! And in, what is being called a "little regional bank crisis" the Fed and Treasury spit out over $300 billion in just a few days and authorized, seemingly without breaking a sweat, another $300 billion just in case. We've, literally, gone from $3.6 billion about bringing the world, as we know it, to an end, to $600 billion being raised effortlessly, essentially, overnight.

Does this sound like a sustainable system to anyone? It doesn't to me.

Our global financial system has been deteriorating for quite a long time. I think it is fair to say that when Nixon took the dollar off the gold standard in 1971, that marked the beginning of the end of our financial system's soundness.



Prior to that, there was something tangible backing the U.S. dollar: gold! After World War II, the dollar was backed by 1 ounce of gold (which was trading at $35/oz. at the time). Most other major currencies in the world were pegged to the dollar after the famous Bretton Woods meeting of 44 major international countries. Since then the U.S. has been the World's #1 Super Power and a major reason for that global status was the dominance of the U.S. dollar.

But as I have been writing about for the last 3 years, the dollars dominance as the King of Reserve Currencies and the undisputed "go-to" global transactions currency is under assault.

<u>Here are a few recent international happenings that appear hostile to the U.S. dollar</u>:

-Russia has used cryptocurrencies to help run its economy after the global sanctions were put in place after their attack on Ukraine.

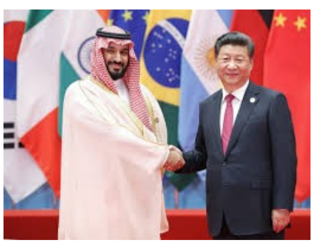
-Furthermore, Putin backed the Russian ruble by gold and demanded anyone who wanted to buy their oil had to pay in Rubles.

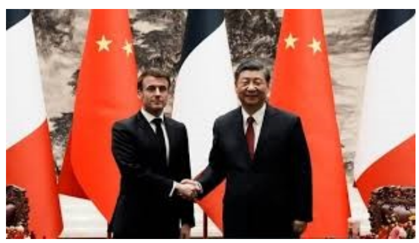
-China has developed their own international payments system, which is a direct attack on the dollar dominated SWIFT system.

-Saudi Arabia just inked a deal to sell oil in Chinese yuan, rather than U.S. dollars which it has done exclusively for the last 48 years.

-France's Total signed a deal with Chinese oil company, CNOOC, to purchase LNG (Liquified Natural Gas) in Chinese Yuan, not dollars.

-Brazil and China are working on a deal to conduct non-dollar international transactions. And the BRICS (Brazil, Russia, India, China, South Africa) are working on a new global currency as we speak.





The questions that I always ask myself when I see more evidence that the dollar has the potential to be dethroned as the world's reserve currency are:

-**<u>What does that mean for the global economy?</u>** The main thing that happens is that the world would be less dollar beholden. A U.S. dollar that has less demand makes the global financial system more decentralized, as the U.S. has less control over global finance. With that, countries will become more autonomous and in greater control of their own economic prosperity. This can make it easier for non-U.S. countries to flourish, if they make good economic decisions.

<u>-What does that mean for my investment portfolio?</u> With less demand for the U.S. dollar, the greenback will have downward price pressure on it. This would be a catalyst for inflation to take hold in the U.S. The markets, in general, will be more volatile. Furthermore, there will be a need for currency diversification and greater geographic diversification within everyone's portfolio.

Cryptocurrency Update

As we've previously discussed, Bitcoin must have something that is appealing to people. Since its birth in 2009, it has seen 3 sells offs of more than 80%, one in the 70%+ range, and one over 60%. But every single time, it comes roaring back! In fact, excluding our current recovery, it has seen rebounds of 6,230%, 2,388%, 12,336%, and 1,692%. In regards to our current recovery: <u>year to date, bitcoin is up 73.09% and from the bottom of the 2022 pullback it is up 83.78%.</u>

Bitcoin YTD 2023 chart provided by Trading View

We've been talking for a long time about the need for standardized regulation of the crypto markets. In fact, we feel that the finalization of these regulations will be the catalyst that kicks off the next epic bull market run for bitcoin and, potentially, other cryptocurrencies.

Interestingly enough, the Securities and Exchange Commission has just started a new division called the Crypto Assets and Cyber Unit Division. Hiring is fast, furious, and voluminous within this new division. In addition to the SEC's rampant regulation by enforcement approach to crypto throughout 2022 and into 2023, SEC Chairman Gary Gensler, has publicly stated that every crypto, except bitcoin, is a security.

Not to be left out of this developing regulatory free for all, the Commodities Futures Trading Commission (CFTC) has stuck their regulatory flag in crypto-land by suing the world's largest crypto exchange, Binance, for numerous violations of the Commodities and Exchange Act.

And, quite frankly, in those last two paragraphs, the regulatory conundrum within the crypto space is laid out for all of us to see and consider. Are cryptocurrencies securities or commodities? Who should regulate the space? What should those regulations be? And how should they be enforced?

This is significant because an institutional investor cannot make significant investments into bitcoin and, especially, other cryptocurrencies until the regulations are in place. However, upon those regulations being formalized, you could see an avalanche of institutional money being invested into cryptocurrencies.

But before an investor can begin to invest into the space, they must understand the investment options and their fundamentals. Bitcoin is the premier cryptocurrency asset and represents over 46% of the entire market. Therefore, a quick discussion of bitcoin makes some sense to us.

Famed investor Bill Miller is a big owner of bitcoin and is on record saying he believes **“Bitcoin can provide investors with an insurance policy against financial disaster.”** I find this fascinating because I was first drawn to bitcoin because of the incredible amount of debt our global economy generated during the 2008 Financial Crisis and the 2020 COVID pandemic response. When I combined this with the fundamentals of bitcoin and the Bitcoin network*, it became clear to me that an investor with any concern about inflation and/or currency debasement needs an allocation to bitcoin.

To break it down quickly, bitcoin has historically prospered when our current centralized financial system is doing things that go against sound money principals. For example, let’s look at the chart of M2 (a gauge of the supply of money in the system) below. When the Fed printed money to pay for the 2020 COVID payments, the Fed’s balance sheet nearly doubled (highlighted in the graph below). Those maneuvers are nowhere near sound and that year bitcoin was up 304%. However last year, the Fed shrunk their balance sheet and bitcoin fell significantly. This year the “Regional Banking Crisis” caused the Fed’s balance sheet to balloon by over $300 billion, essentially, overnight and bitcoin is up over 70% year to date.

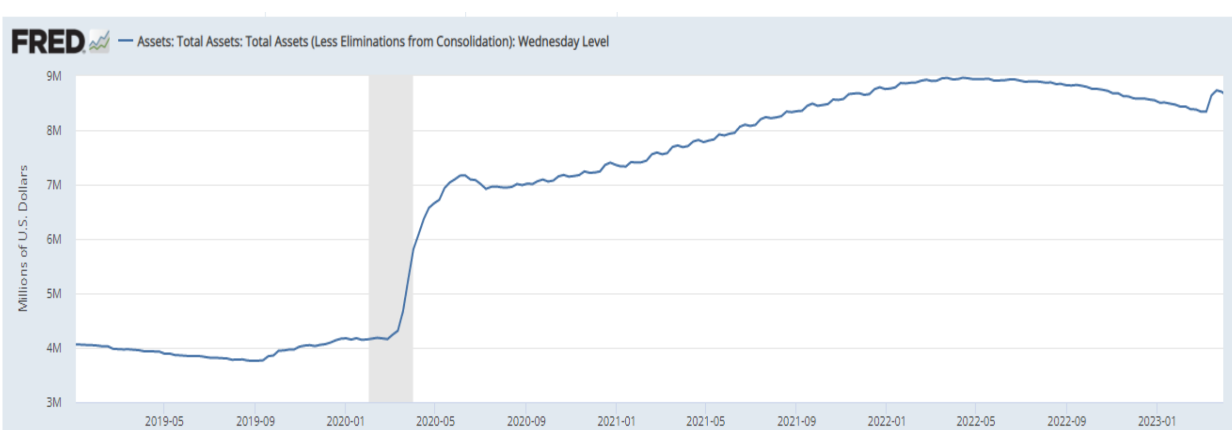


Chart of Total Assets held by the Fed 2019-2023 provided by the St. Louis Fed

It appears to me that once an investor notices this correlation, they simply need to ask themselves two questions: 1) Are the world's central banks more likely to print money or shrink the money supply in the future and 2) How much more upside room is left in bitcoin's price?

Both questions are unknowable with 100% certainty right now. However, I certainly have my mind made up on whether central bankers are likely to print more money in the future or not. And the table below (provided by Triple A) shows the countries with the highest adoption/ownership rate of crypto in the world. With the biggest adopter of crypto being less than 10% of its population, it seems likely that there is more upside room regarding the pricing of crypto assets. But, of course, only time will tell.

Country	Population	Ownership	Ownership Percentage
Thailand	71,801,279	6,692,796	9.32%
India	1,428,627,663	103,317,638	7.23%
Brazil	216,422,446	15,113,232	6.98%
Pakistan	240,485,658	15,400,547	6.40%
France	64,756,584	3,820,638	5.90%
Russia	144,444,359	8,485,749	5.87%
Nigeria	223,804,632	12,862,740	5.75%
Argentina	45,773,884	2,544,102	5.56%
United Kingdom	67,736,802	3,740,280	5.52%
Turkey	85,816,199	4,684,727	5.46%
Kenya	55,100,586	2,713,117	4.92%
Morocco	37,840,044	1,854,162	4.90%
Colombia	52,085,168	2,505,605	4.81%
Nepal	30,896,590	1,369,467	4.43%
Indonesia	277,534,122	11,851,926	4.27%
Germany	83,294,633	3,490,926	4.19%
Canada	38,781,291	1,608,595	4.15%
China	1,425,671,352	58,187,265	4.08%
Ethiopia	126,527,060	5,079,631	4.01%
South Korea	51,784,059	2,059,015	3.98%

*<u>**Bitcoin fundamentals**</u>...the most powerful computing network in the world (in terms of computational energy), over 40,000 decentralized nodes securing the network, over 1,000,000 active BTC wallets, hash rate and mining difficulty at all time highs, and only 21,000,000 btc will ever be produced!

Non-Financial Events occurring this quarter

In the quarter, the Chiefs won the Super Bowl...

Chinese spy balloons were shot down in the U.S...

Putin was named a War Criminal by the International Criminal Court...

Scotty Scheffler won The Players...

Georgia Bulldogs won the National Championship...

And Saudi Arabia and Iran restored diplomatic relations.

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