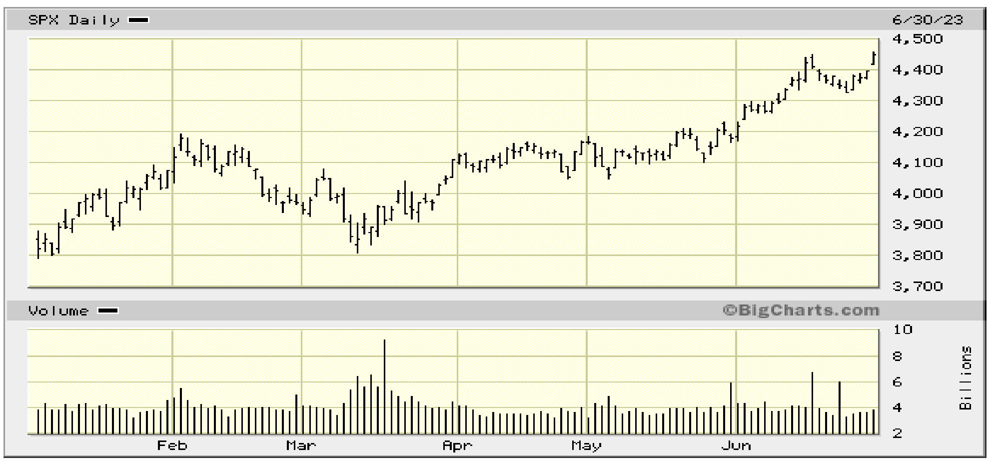
MRP CAPITAL INVESTMENTS, LLC

2nd Quarter 2023 Client Newsletter

Capital Market Update

Inside this report:

We mentioned in the last newsletter that we believed our Bull scenario was likely to be the path the market would begin to embrace. With the S&P 500's price up 8.3% for the quarter and 15.91% year to date, it is evident the Bulls are in control of the market.



S&P 500 2023 Chart Supplied by BigCharts.com

If the Bullish trend continues, history suggests that more and more investors will begin to shift their mindset away from being overly conservative. This generally means cash balances will decline and equity allocations will increase. As a result, this should push up stock prices. However many sophisticated investors are not simply holding cash, they are also short the market. If stock prices continue to rise, these shorts will need to be covered. This, in addition to cash moving off the sidelines, has historically had a very large impact on market pricing.

Of course, time will tell us what will happen next quarter. For now, there seems to be a recognition by many investors that they were too fearful and, therefore, too defensive with their investment allocations. This has proven beneficial for us as we've been increasingly optimistic since the beginning of the 4th quarter of 2022. Hopefully, we can keep our arms around the mood of the market and keep everyone allocated appropriately. Regardless of what happens, you can rest assured that is what we will be striving for day in and day out.

Psychology of Investors

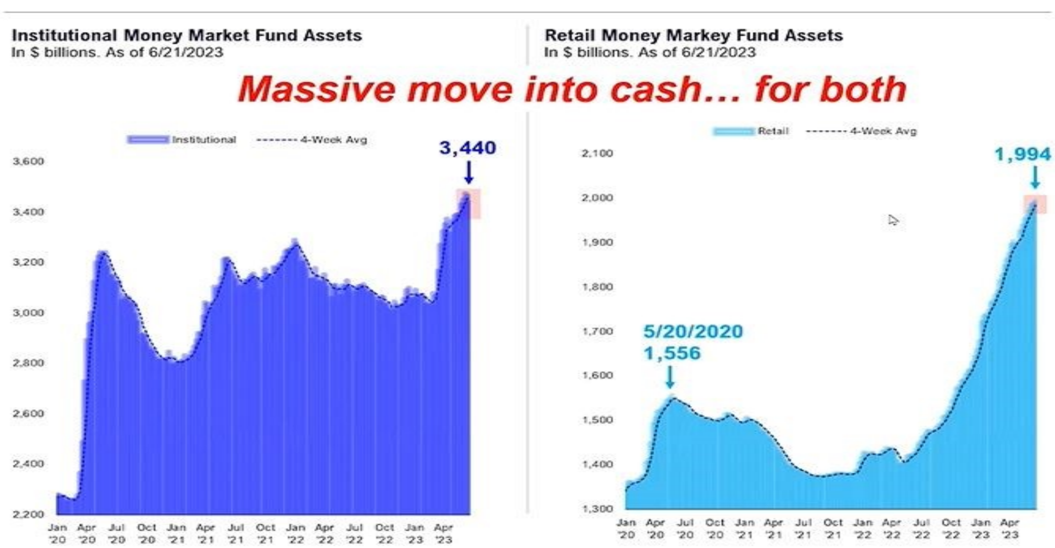
At MRP Capital Investments, we are big believers that the market is not purely mathematical, logical, and rational. Rather, we believe it is simply a bunch of human beings interacting. To understand why human beings do what they do, you must have a fairly robust understanding of human behaviors and what drives those behaviors. Within the market, the two most important behaviors/emotions to understand are: fear and greed.

At the beginning of this year, we put out a breakdown of potential market outcomes for 2023. Those outcomes ranged from Bearish (pessimistic) to Bullish (optimistic). Last quarter, we said that we thought the Bullish scenario was beginning to unfold. This outlook projected an S&P 500 price level of 4,599 by the end of 2023. If this outlook were to become reality, it would represent a gain of approximately 20% for the year.

Due to the very low sentiment readings and high levels of fear in the market, we expected most everyone would think that we were idiots to suggest market gains were just around the corner. But there were some pretty important signals, that we saw through the noise of the marketplace, which led us to have strong enough convictions in our outlook to put it out there for all to see (and scoff at initially).

One of the first signals we saw was that it is rare for the market to rack up consecutive negative years. Since 1950, there have only been two periods of time where the market was negative after a negative year. Those times 1973-1974 and 2000-2002. Running these numbers suggested a 95.8% chance of having a positive year in 2023.

The second signal we saw a massive amount of cash sitting on the sidelines. Of course, cash on the sidelines is stored up firepower to buy stocks with, once investors gain confidence in the market. At the beginning of the year, this cash stockpile was about $4.6 trillion and, interestingly enough, it has GROWN to $5.4 trillion due to investors being net sellers into this market rally. This gives our current market even more pent up firepower, that has yet to be unleashed on the market..



Charts provided by FS Insights

The most striking signal for me was when I saw one of the world's largest investment banks, which is world renowned for their investment research, ignore their own market indicators and instead willingly use their personal emotion to make, and advise their clients on, investment decisions.

It is Merrill Lynch/Bank of America which I am referring to. They have a time and battle tested indicator that they use to help guide their investment decisions; the Bull Bear Indicator. It is a contrarian indicator. When the data it collects registers overly pessimistic readings, it recommends buying (and vice-versa). In October of 2022 (the bottom of our latest sell off), it registered the most pessimistic reading it is capable of, which is 0.00. This, as we discussed, is the strongest buy signal it can give, but the Chief Investment and Market Strategists at Merrill advised clients to ignore the reading and remain Bearish in their asset allocations.

Interestingly enough, a few weeks ago I saw them on tv (after a nearly 25% upside move in the market) saying that the Bull Market has started and people should begin buying stocks.

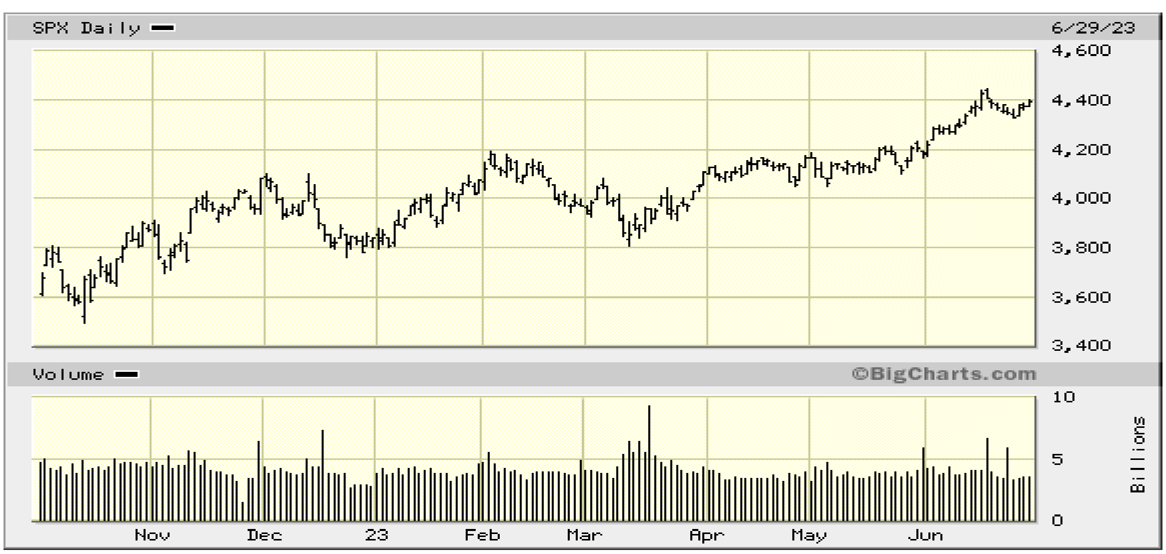


Chart of S&P 500 from 10-2022 through 6-2023 provided by BigCharts.com

Quite frankly, this opens the door to a potentially large market risk. The risk is that investors/consumers, who are currently very pessimistic, could become optimistic and bring all of that cash off of the sidelines and into investments.

Naturally, the question of “Why is that a negative for the markets?” should follow my last statement. And, yes, if this shift from pessimism to optimism were to occur, this flood of capital into the market should push up investment prices dramatically and we could see our portfolios rise to astounding levels.

But long term secular Bull Markets begin when earnings are low, valuations are low, the mood of the consumer is very low, and fear in the market place is high. All it takes, to turn a market like that around, is a catalyst; like a revolutionary breakthrough in the way business is done. Currently, we have that with A.I. (Artificial Intelligence) and people could get very excited about the potential A.I. has in terms of business efficiency.

Nevertheless, we don’t have low earnings. We have earnings that are above, what my works deems, a sustainable level of healthy earnings. Furthermore, valuations are not low and the market is not demonstrating a tremendous amount of fear. In fact, the only thing we have going for us, that could start a major Bull Market run, is that our current level of Consumer Sentiment is historically low. If something could push Consumer Sentiment higher, we could see a surge of euphoria overtake the market and kick off the final, typically very strong, run in our long term secular Bull Market.

And that is the negative, I was referring to. If this shift to optimism were to take place in our current environment, then we are set for the “blow off top” that historically spells the end to Bull Markets.

If this does happen, I think almost every client will be super happy for a fairly long period of time. These euphoric market phases are, generally, not short-lived. Remember Alan Greenspan coined the term “irrational exuberance” in 1994, yet the market went on to deliver 5 straight years of 20%+ returns until that bubble finally burst in 2000.

1994-2002 S&P 500 chart provided by Bigcharts.com

Historically, Bull Market runs end with a euphoric rally. As I've just mentioned, we are set up for this kind of situation if we could get that catalyst to kick off the final Bull Run. I've already touched on the idea that this unveiling of A.I.'s potential could spark another rally. It makes one wonder what other potential catalysts are there to continue to fuel the fire if the excitement behind Artificial Intelligence can ignite it?

I think it is as simple as looking at what we've been fearing for about a year now: inflation. Does everyone realize inflation peaked in June of 2022? Yes, it has been steadily falling for a year. Nevertheless, the media seems to want to stoke the fear of inflation every single time we get a CPI update and/or Fed meeting looming on the horizon. In fact, by the time everyone gets this newsletter the Fed should be in the middle of an F.O.M.C. meeting discussing what they are going to regarding rates. Currently, the market has priced in a 92.4% change the Fed will hike in July.

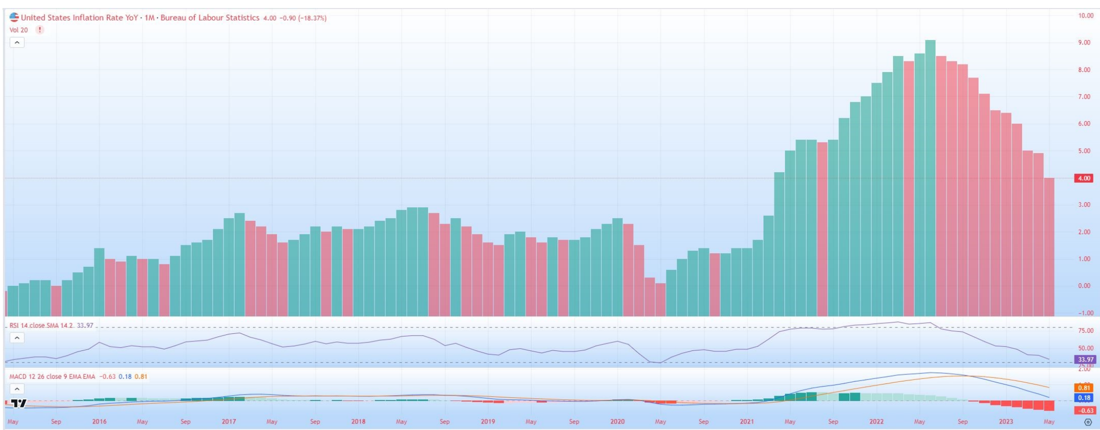


Chart of U.S. Inflation data from 2016-2023 provided by Tradingview

That means the market has priced in a 92.4% chance of a hike in July. But the stock market has been rallying with that baked in the cake. Why? Perhaps the market knows that the risk of inflation is being over-hyped by the media, and it is looking beyond this month's Fed's actions.

In fact, the yield curve is heavily inverted. And this could be suggesting that the market thinks rates are too high and will be coming down in the not too distant future. If inflation has peaked, we don't need sky-high interest rates. As we've discussed many times, lower rates mean higher pricing levels in almost every valuation model.

Furthermore, the simple fact that the market is up over 15% in the first half of the year suggests things are already looking better than the current mood of the average investor would suggest.

Given these signals, we have been getting increasingly Bullish. However, we don't see the market going straight up. Healthy markets need to consolidate gains, digest incoming news, and pullback to price in new risks. These types of things drive the day to day market gyrations, but underlying macro-trends are what drive long-term market moves.

It should be noted, that since late December and through the first quarter, almost all of the gains in the market were derived from 7 stocks.

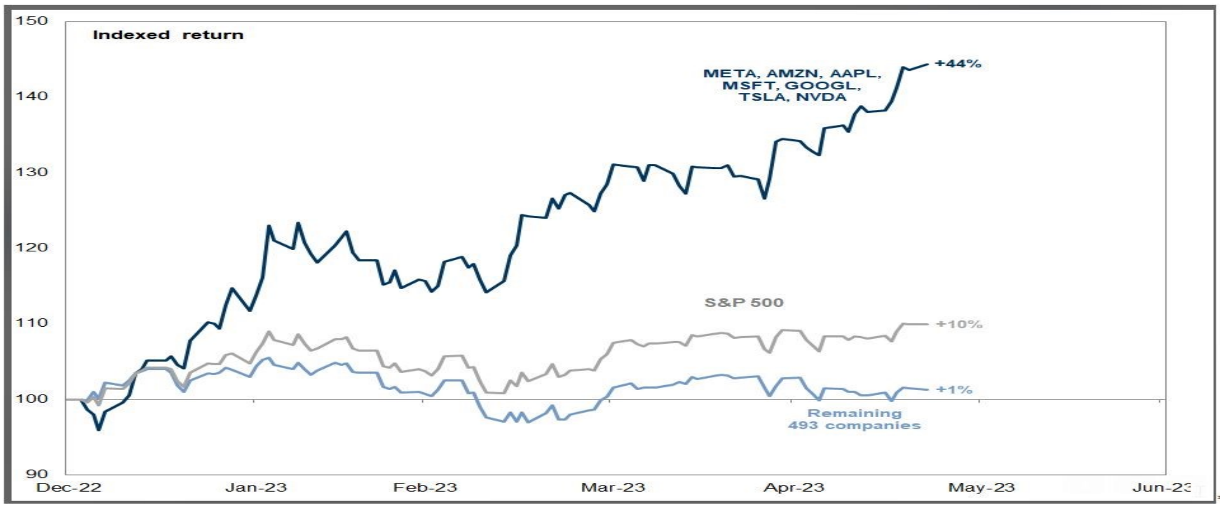


Chart provided by Goldman Sachs

However, the extremely narrow market of the first quarter began to broaden substantially in the second quarter. This broadening of the market needs to continue for the market to remain healthy and avoid too much risk being placed on too few stocks.

The key to this broadening will be an improvement in the sentiment of the consumer/investor. Given that we have been stuck at an historically low level of confidence in our economy and financial system, it shouldn't take too much to get Consumer Sentiment moving higher. The better people feel, the more likely they are to pull from their huge war chest of cash they have on the sidelines and begin putting it to work.

This could be the key to igniting the markets once again.

2016-2023 University of Michigan Consumer Sentiment chart provided by Tradingview

Cryptocurrency Update

Last newsletter, we discussed how the Securities and Exchange Commission (SEC), led by Gary Gensler, was beefing up its regulatory staff within the newly created Crypto Assets and Cyber Division. This quarter, this new division went on the offensive.

In previous snippets, interviews, and testimonies, Gary Gensler has stated the he believes bitcoin is a commodity and not a security. Therefore, it is not subject to the SEC rulebook for securities. However, he did state that most other cryptocurrencies are securities, which means they must register with the SEC. And since, essentially, none of them have, they are in violations and U.S. Securities Laws.

Thus far, the SEC has officially labeled 68 cryptos as securities. More will follow, for sure, as there are now over 20,000 different cryptocurrencies. With this official labeling as a security, comes litigation and lawsuits from the SEC. We have stated before that there are WAY too many cryptos out there, so a reduction in the number is welcomed by us because it is needed to reduce the noise and it helps bitcoin to distinguish itself as unique and special.

In fact, bitcoin remains a strong performer this year. Year to date through the end of the 2nd quarter, its price appreciation was 84.33%.

Bitcoin year to date 2023 chart provided by Tradingview

A major string of related events took place this quarter as well. On top of a few smaller regional banks going belly up (including the largest crypto-centric banks), many of the world's largest investment firms filed to offer their own Bitcoin Exchange Traded Funds. The names that have officially filed and entered this arena include:

Blackrock...world's largest money manager with over $10 trillion of asset under management

Fidelity...money manager with over $4 trillion of assets under management

Invesco...money manager with over $1.5 trillion of assets under management

This means that a marketplace (the cryptocurrency market) with a total market capitalization of about $1 trillion (of which bitcoin is $500 million) should soon be opening on-ramps to pools of new capital totaling over 16 times the marketplace's entire size. Now, not all of that new money will go into bitcoin, but Blackrock and Fidelity have formally recommended asset allocations for cryptocurrency ranging between 1% and 5% of assets. This suggests that flows between $200 billion and $1 trillion could find its way into bitcoin.

These funds will also flow from firms that have long track records of successful compliance with the SEC, which could help explain some of the SEC's maneuvers when handling the regional banking crisis and regulation via enforcement in regards to crypto firms.

Along those lines, another major event this quarter was the string of lawsuits against crypto exchanges. These lawsuits were levied against the biggest crypto exchanges in the world, with Coinbase and Binance being the two with the biggest targets on their back.

Low and behold, this quarter also witnessed some of the biggest Wall Street firms united to readily form their own crypto exchange, EDX. Included in this conglomerate of firms founding the EDX crypto exchange are: Fidelity, Schwab, Citadel, Sequoia, and Virtu. Not surprisingly, firms with long track records of working well with the SEC.

And one final closing note, Jamie Dimon, CEO of JP Morgan, a long term critic and skeptic of cryptocurrency, oversaw his firm, JP Morgan, launch their own crypto token this quarter. It is the "JP Morgan coin", which is primarily being used right now to facilitate international transactions.

This one put a grin on my face as I shook my head when reading the news.

Crypto is dead! Long live Crypto!

-Jamie Dimon

Non-Financial Events occurring this quarter

May 6th, Prince Charles became King.

June 18th the Oceangate sub began its journey to visit the Titanic.

April 4th, Finland became an official NATO member.

April 9th, Jon Rahm won the Masters.

June 20th, Hunter Biden agrees to plead guilty to tax crimes.

June 8th, President Trump is indicted on federal charges.

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