MRP CAPITAL INVESTMENTS, LLC

3rd Quarter 2023 Client Newsletter

Capital Market Update

Inside this report:

Entering the 3rd quarter, the market had been running hot. In July that hot streak continued, as the S&P went up another 3%. August brought a pullback, that was much needed, and then in September that, much needed, pullback continued .

The September FOMC meeting gave us the Fed's thoughts on inflation and interest rates; it was clear that higher for longer was the message!

Nevertheless, the S&P 500 saw its price fall 3.65% for the quarter and this made the YTD change +11.69% through the end of the 3rd quarter.

S&P 500 2023 Chart Supplied by BigCharts.com

Let's cross our fingers that our thoughts on the market continue to be correct so performance-wise, we can repeat the outperformance we put up, essentially, across the board this quarter.

Regardless, the key to the 4th quarter should be understanding what higher for longer means for the broader market and the underlying sectors of the market. It looks like stock picking, sector and asset allocation will be the factors that separate good performance from poor performance.

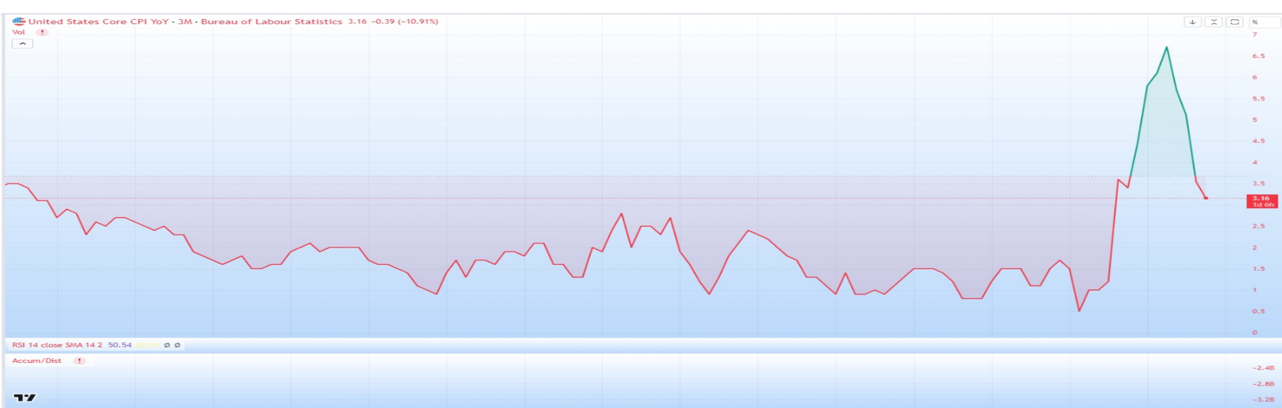
Higher for Longer!

As mentioned in the opening article, the FOMC meeting clearly highlighted rates should be higher for longer than most market participants expected. One of the main things to keep an eye on when dealing with investor expectations is Consumer Sentiment.

Consumer Sentiment has been steadily increasing since the summer of last year. In fact, there was a brief period of time when sentiment drastically improved and enthusiasm entered the market once again.

Consumer Sentiment Chart provided by Trading View

However, that short lived period of time was brought to an end when fears of inflation, once again, overwhelmed market participants. To be quite frank, this inflation fear seems to be a bit overdone. Below you see a chart regarding inflation. Yes, it is higher than a number of years ago, but the reading is SUBSTANTIALLY lower then when inflation-mania shocked the markets.



US Inflation Chart provided by Trading View

Nevertheless, Fed Chair Powell made it quite clear that the Federal Reserve will be keeping rates elevated for quite some time. As such, we need to address, and understand, two key points before we can make intelligent investment decisions.

The first is: **<u>why are rates going to be higher for longer than most market participants thought?</u>**

That question was answered by Powell during his comments during the FOMC meeting. He said**.** *"Recent indicators suggest that economic activity has been expanding at a solid pace, and so far this year...growth in real GDP has come in above expectations."*

To summarize what Powell is saying, is that despite the record pace of interest rate hikes by the Fed, the economy is still strong and growing.

So, we have interest rates going up because our economy is strong. I would certainly prefer a strong economy rather than a weak one. And I'll take higher rates with that strong economy rather than rate cuts due to an economy that is falling apart.

The second one is; **<u>when will rates be coming down?</u>**

Again, to answer this question, we will look at what Powell said during the FOMC meeting. He said, *"Reducing inflation is likely to require a period of below-trend growth and some softening of labor market conditions"*

He also mentioned that in order to accomplish their goals, the committee *"projects that the appropriate level of the federal funds rate will be 5.6 percent at the end of this year, 5.1 percent at the end of 2024, and 3.9 percent at the end of 2025."*

Again to summarize, with the Fed Funds rate currently at a range of 5.25% to 5.5%, he is saying that, maybe, they will raise one more time to get the rate to 5.6%. Then they will cut once or twice in 2024 and they will cut between 4 and 6 times in 2025.

Hmmm….seems as though this game of rising rates will end pretty darn soon. That is, unless it is already over.

As I type this, the Futures Markets currently have priced in a 23.1% chance of the Fed hiking in November, a 35.5% chance of higher rates by the December 13th meeting, and a 32.5% of rates being higher by January. However for the January meeting, the Futures also have a 5.3% chance of a rate cut. And by June 2024, the markets have priced in a 57.9% of rates being lower, and, by July, the market sees only a 5.7% chance of rates being higher.

Looking at this data, it seems to me that there could be fireworks after the November 1st Fed meeting. I say this because we literally have trillions of dollars sitting on the sidelines in cash right now ($5.6 TRILLION to be precise) just waiting to be deployed into investments. Furthermore, the data in the preceding paragraph shows that once we get into the New Year, the chance of higher rates begins to drop significantly. And the Fed is historically a little reticent to make a big move on rates in December. This hesitation is especially high in an election year, but it is still on display in non-election years. Finally, it looks like interest rates are hitting nose-bleed levels and are peaking.

Given those points, November looks to be the prime candidate for a hike. However, if that doesn't come and/or Powell has dovish comments about the outlook for future rate hikes; hold on to your hat! We could see a 1982 type of pop in the markets.

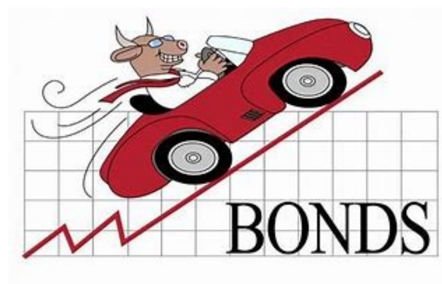
1982-1983 S&P 500 Chart provided by Trading View

S&P goes rallies 44% in 3 months and 70% in 9 months

Lining this all up, the market had that brief period of Bullishness in July and ever since then the Bears have been selling everything, including bonds, and piling up cash, buying puts, and getting in highly defensive positions. If something happens that is negative in the November FOMC meeting, it looks to me like the market is already positioned for bad news. Therefore, downside risks are a bit buffered due to the markets weakness over the last two months.

However if we get positive news, investors are not positioned to take advantage of it.   If this were to occur, not only do investors need to move that cash into the markets, they need to cover shorts, take off hedges, and swap defensive stock positions for aggressive ones. It'll be just like this past July's booming market, but this time we should see it for November AND December.

What actually happens is anyone's guess. All I can say is get your popcorn ready! It should be a very interesting show.



Another interesting thing that we should see are bonds being purchased big time. Why? First off, rates are finally to a point that investors are happy to hold them to maturity and to lock in those yields.

Furthermore, capital gains can be made on bonds if rates drop. And, per the Fed's own words and the Futures Market's pricing, rates should begin to drop in 2024 and drastically drop in 2025. This action regarding interest rates should almost guarantee that those investments in the fixed income markets will be profitable.

In summary, it looks like after the November FOMC meeting markets will blaze a trail that will define 2023. It looks, to us, like that trail will lead markets even higher. Then heading into 2024, over time, the market should get very choppy for one big reason: Presidential election year. During this potentially choppy time frame, bonds should provide a tremendous amount of benefit. We should see bonds not only act as a diversifier that can cushion an account from equity declines but also, if done right, they should actually generate substantial profits. Once we are done with the elections, then the equity markets should kick in and help the bond markets buildup our portfolio's value.

Cryptocurrency Update

The theme for the Crypto Markets in 2023 seems to be focused on regulations. In the last two newsletters, we discussed how the Securities Exchange Commission bolstered their Crypto Division and had begun an aggressive campaign of legal action against any cryptocurrency they believed to be actually an unregistered security.

Per their own words, bitcoin is not a security and is not subject to the SEC's regulatory guidelines, but, in their opinion, most of the other 20,000 cryptocurrencies do fall under the SEC's jurisdiction. To date, a total of 68 cryptocurrencies, including bitcoin, have been labeled by the SEC as not being securities.

The most interesting turn of events occurring this quarter is the fact that the **SEC was defeated in the court of law** regarding their unilateral labeling of a cryptocurrency as an unregistered security. Ripple, the parent company and creator of the XRP token, has been battling the SEC since 2020 concerning allegations that their XRP token is actually an unregistered security. On July 12th, Judge Torres, of the U.S. District Court of the Southern District of New York, ruled that, although their direct institutional sales of XRP were deemed to be securities, the sale of Ripple's XRP tokens on exchanges and through algorithms did not constitute investment contracts and are, therefore, not securities falling under the SEC's jurisdiction.

This court decision is being labeled as a landmark ruling concerning the regulation of the crypto markets. Although the SEC can appeal this decision, XRP rallied 73% on the day of the announcement and pushed the entire crypto market higher. U.S. based crypto exchanges relisted XRP on their platforms and, once again, it was available for U.S. investors to buy and sell on the open market.

There was **another court decision that went against the SEC** this quarter. This case related to Grayscale's attempts to convert its bitcoin trust into an exchange traded fund and, thereby, eliminate the discrepancy between the value of the assets the fund owns and the market price of the fund. Since this trust is the world's largest pooled bitcoin investment vehicle holding approximately $17 billion of bitcoin, the elimination of the NAV discount would provide billions of dollars in benefit to its investors.

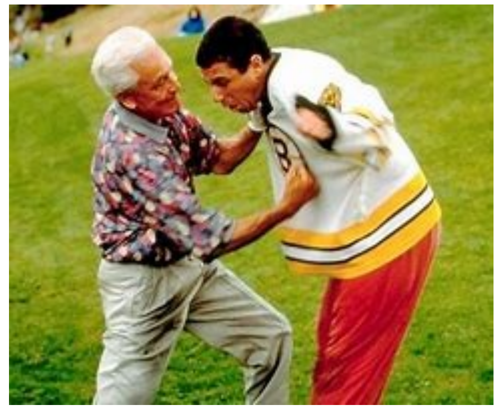
On August 29th, The D.C. Circuit Court of Appeals ruled that some of the SEC's arguments in rejecting spot bitcoin ETF applications seemed "arbitrary and capricious." Judge Neomi Rao, writing for the unanimous court, said the SEC's denial of the application was inconsistent with the approval of a pair of bitcoin futures ETFs, and did not explain why it viewed these types of products differently given the underlying bitcoin market had a "99.9% correlation" between spot and futures market prices. And with that, Grayscale's argument that its proposed ETF was "materially similar" to the futures ETFs defeated the SEC in court.

This ruling moved the crypto-markets higher and led more financial firms to formally file to begin operating their own bitcoin fund/etf. In regards to applying for a new bitcoin fund, the SEC stated that October 17th is the deadline for applications of such pooled investment vehicles. After that, the SEC has 240 days to review the applications and either approve or deny them on a case by case basis. In addition to Grayscale, the firms applying for approval of their proprietary bitcoin fund/etf include: Blackrock, Wisdomtree, Fidelity, Invesco, Ark Invest, VanEck, and Bitwise.

I'm sure it will be awhile before the regulations are totally in place, but with every passing day the framework is being built out for institutional adoption to begin in full force.

Non-Financial Events occurring this quarter

Spain won the Women's World Cup



Bob Barker died at 99

Hawaiian Wildfires killed 97 people

Hurricane Idalia hit the Southeast

Two coup d'états occurred in Africa (Nigeria and Gabon)

UAW went on strike

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