2022

GKV CAPITAL

SECOND QUARTER

MARKET REVIEW AND OUTLOOK

Uncertain Expectations

2Q22 DATA POINTS

DJIA	-15.3%
S&P 500	-20.6%
NASDAQ	-29.5%
US BOND	-10.4%
10-YEAR TREASURY YIELD	2.98%
S&P 500 LTM DIVIDEND YIELD	1.69%
S&P 500 EPS	$239.42
S&P P/E	15.8x

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Opening Thoughts

The probability of a recession in the U.S. has increased since the first quarter. Wall Street analysts have been slow to revise corporate earnings estimates for 2022 and 2023 lower, but we expect downward revisions as companies report second quarter results in the coming weeks. To debate whether the U.S. economy slides into a recession or not this year or even next is to miss the point. Fact of the matter is that the euphoria exiting the pandemic is over. Economic stimulus has been spent and growth has slowed. The party didn't last very long but the hangover is acute.

Stock prices are predicated on future earnings and cash flows. Lower growth yields lower future earnings projections resulting in lower stock prices. The question that needs to be asked now is whether the reduced stock prices accurately reflect reasonable growth in the coming years. Unfortunately, there is tremendous uncertainty in the outlook. This uncertainty is played out in the stock market in the form of volatility. Economic data from one day to the next can make the market look expensive on Monday and a good value on Tuesday. Inflation data, retail sales, household income, unemployment, interest rate expectations all affect investor earnings assumptions. These data points are closely watched; however, nothing is more important than actual quarterly earnings results and management estimates for the coming quarters. The level of earnings growth for the last half of 2022 and into 2023 will determine if the present bear market in stocks continues or ends soon.

In the short-term there are no successful stock market timers. Picking the market top or bottom requires a clairvoyance into future earnings that no one we know of, possesses. If we did, we would be writing this from our yacht. Equity valuations, stock prices, have been reduced substantially this year as we are all painfully aware. We suspect most of the damage is done, although depending on the economic outlook, prices can fall further. Uncertainty and fear is reflected in some of the present declines in prices, meaning there may now be attractive values for intrepid investors but we do not yet see cause to rush back into the market with the cash we raised earlier this year.

We believe a mild recession will occur in 2022 and 2023, but with a reduction in inflationary pricing power to reflect more accurately supply and demand, a favorable investment environment is likely to emerge by 2023. A recommitment of cash reserves to the present bear market in the succeeding months should allow a swift recovery of losses experienced thus far in 2022. As unnerving as this year's losses are, equities will continue its long-term positive performance trajectory. Bear markets and recessions occurred about 11 times since the 1960's, but the stock market remains the most rewarding and attractive long term asset class for investment.

2022 Review

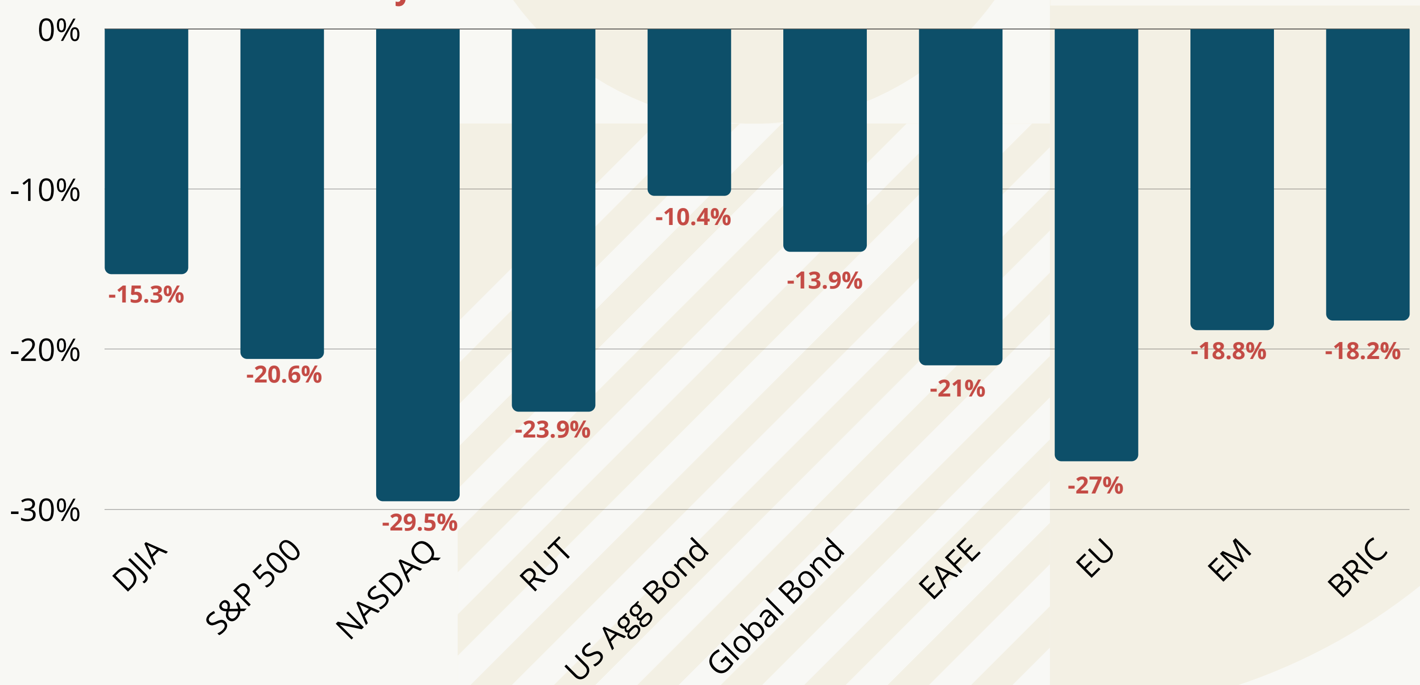
The declines in the global stock and bond markets accelerated in the second quarter. Economic optimism exiting the pandemic has been replaced with expectations of slower growth driven by a dramatic resurgence in inflation resulting in sharply higher interest rates. Rising uncertainty around future earnings and growth, even in the near-term, have prompted investors to reduce risk resulting in significant losses in both the stock and bond markets through the first six months of this year.

For first two quarters of 2022 the S&P 500 lost 20.6%, the Dow Jones Industrials 15.3% and the NASDAQ, which is disproportionally weighted towards technology companies, fell 29.5%. Small cap companies, as measured by the Russell 2000 index, declined 23.9%.

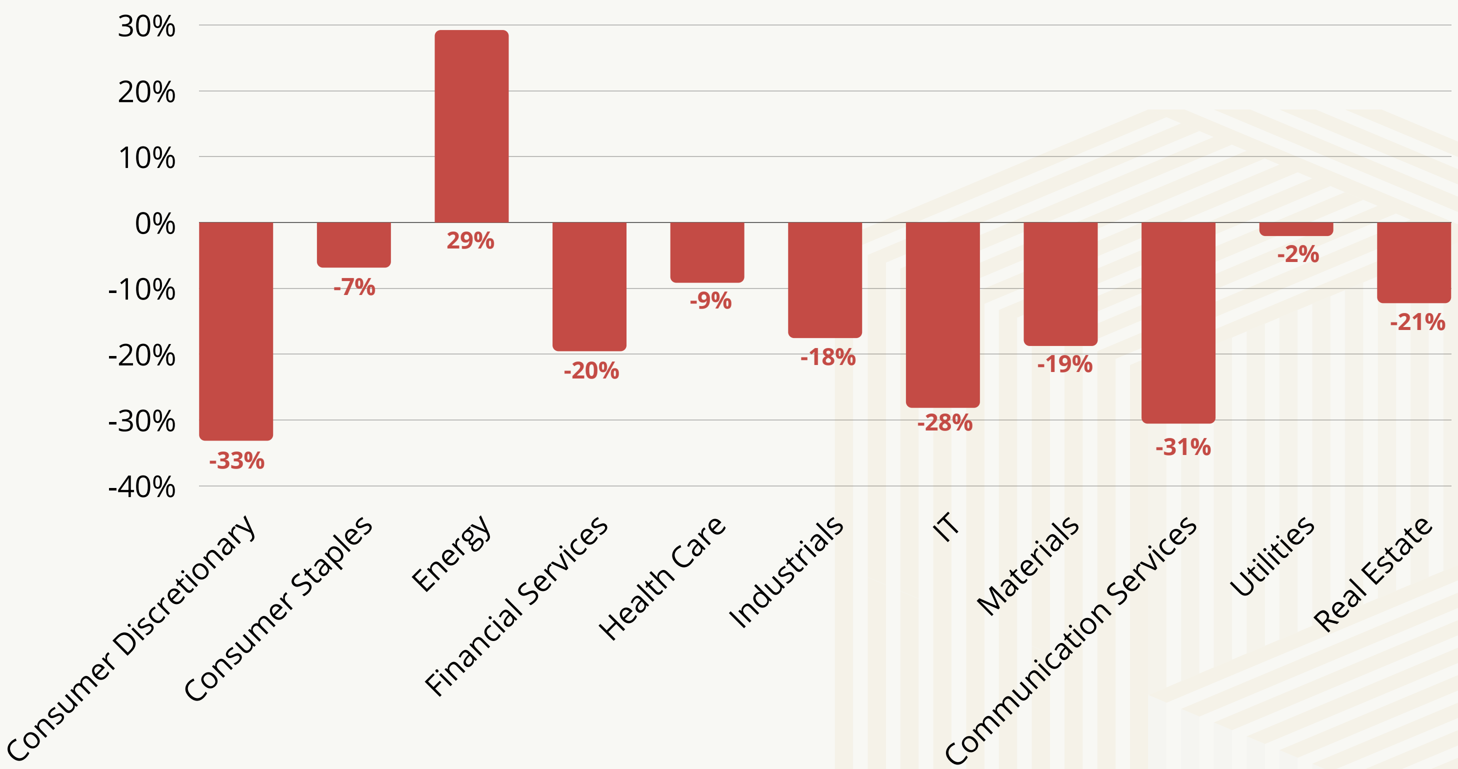
Only the energy sector recorded positive a performance in the first half of the year. Demand for all types of energy has bounced back to pre-pandemic levels while supplies have been constrained as energy producers struggle to get back to full output capacity. Add the disruption of the Ukrainian war and sanctions on Russian commodities and energy prices remain near historic highs. Apart from energy, the best performing sectors are the traditionally defensive sectors of utilities and consumer staples. While they are down for the first half of the year, declining 2.0% and 6.8% through June 30th, they are well ahead of the rest of the S&P 500. Hardest hit are the high growth technology and consumer discretionary sectors which are most affected by higher interest rates and recession fears. Communication services, which includes Facebook parent Meta, ended June down 30%. The consumer discretionary sector, which includes Amazon fell 33% and the information technology sector closed the second quarter off 28%.

It is apparent that economic growth is slowing globally as well as in the U.S. Higher interest rates are certainly beginning to affect the housing market and borrowing costs. Meanwhile higher inflation, particularly for energy and food prices, is curtailing consumer purchasing power. Rising interest rates are also driving the value of the U.S. Dollar relative to the rest of the world higher which further dilutes corporate earnings for large companies with significant international sales. Despite the consensus view that growth is slowing, company guidance has not yet been revised downward and research analysts have been reluctant to reduce estimates on their own. As a result, the earnings forecast for the combined companies in the S&P 500 totals $224.06 in 2022 and $249.01 in 2023. These estimates represent annual growth of 9% and 11% respectively.

YEAR-TO-DATE MAJOR INDEX PERFORMANCE



YEAR-TO-DATE SECTOR PERFORMANCE



If the 2023 estimate were realized, the S&P 500 on June 30th closed at a price-to-earnings ration of 15.2, which is a significant discount to the average 18 times since 1988. It is apparent that the market is highly skeptical of the current 2022 and 2023 earnings forecast and we expect significant reductions to these forecasts. If companies can realize the estimates, then the market has overcorrected. The recent volatility in the market is due to the extreme uncertainty that currently exists for future earnings. While it is apparent that the forecasts are too high, no one is certain just how much they will have to be revised lower. A lot lower and one can argue the market is still expensive even after a 20% decline this year already. A minor adjustment lower and stocks look inexpensive and should move higher from current valuations.

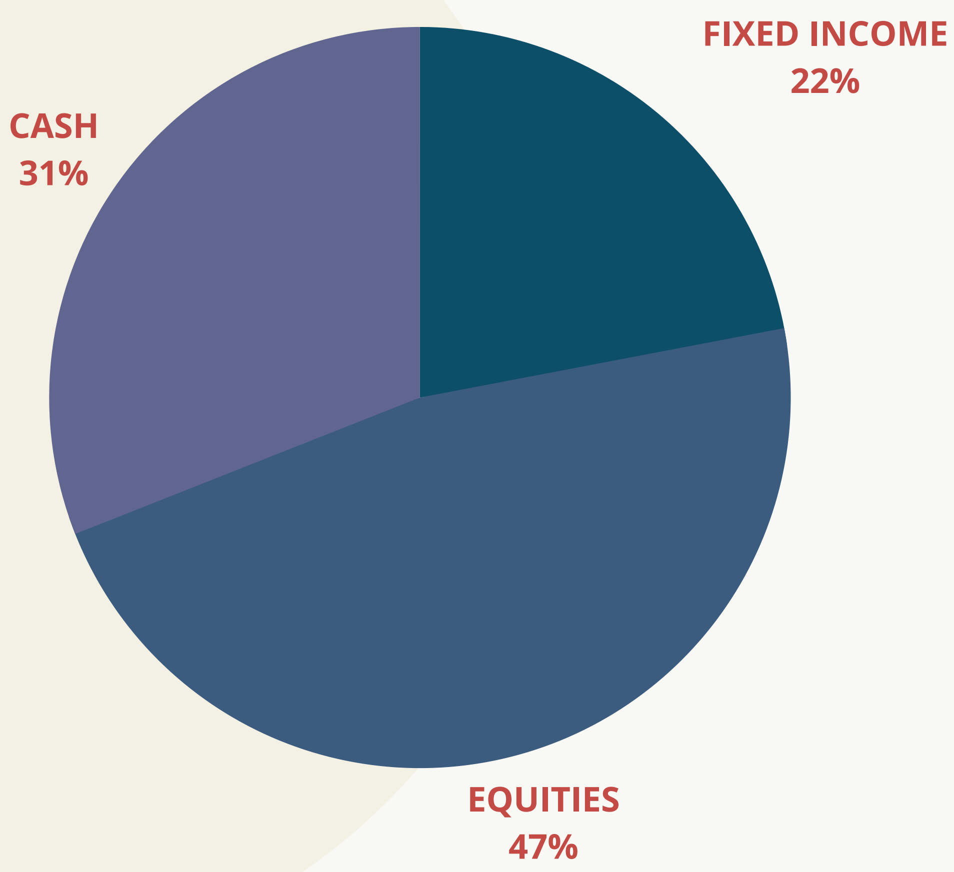
Despite the sharp decline for the first half of the year, the U.S. equity markets outperformed much of the global equity markets. The MSCI EAFE (Europe, Australia, Far East) ended the second quarter down 21.0%, Europe finished down 27.0%, and emerging markets ended the first half down 18.8%. Rising prices globally and the economic fallout from the war in Ukraine and Russian sanctions are likely to continue to have a negative impact in Europe. Many emerging markets were hit particularly hard in the pandemic and may continue to slightly outperform developed markets in their relative recovery. Global GDP growth is slowing. The 4.4% growth forecast for 2022 has been reduced to 2.9% by the World Bank and we expect the estimate may be reduced further due to the impact of higher prices, higher interest rates, and Ukraine war consequences. From our vantage we continue to favor U.S. based equities over foreign markets.

Macroeconomic data particularly related to the health of the consumer continues to be positive. The unemployment rate has returned to pre-pandemic levels hitting 3.6% in June. Retail sales for May 2022 were up more than 6.8% from a year ago. U.S. disposable income also increased in May, up 2.5% from last year. While these metrics are all positive, they reflect the recent past. If growth slows enough, we should expect slower hiring and slower wage growth which will add to the impact of higher prices due to inflation.

To combat inflation, interest rates are rapidly moving higher. The 10-year treasury ended the second quarter at 2.98%, up dramatically from 1.5% at the beginning of the year. In May the Federal Reserve increased the Federal Funds Rate by 0.5% and then hiked rates again by 0.75% in June resulting in a rate of 1.58%. With inflation showing little sign of slowing, we anticipate additional steep rate increases as the year progresses. Rising interest rates have had a negative impact on bond prices resulting in a 10.4% negative performance for the U.S. aggregate bond index in the first half of the year. Rising interest rates are likely to continue to put negative pressure on bond prices until inflation shows real signs of moderating. The global aggregate bond index finished even lower than the U.S. bond index, declining 13.9% for the year through June 30th.

Every client has their own risk appetite and tax consequences to consider. Despite this disclaimer, it is worthwhile to look at the summary of our asset allocation broadly across the firm. On June 30th equities totaled 47% of assets across all our client portfolios, fixed income positions were 22% of assets and cash doubled to 31% from 15% at the end of March. By comparison, on September 30th, 2021, equities exposure totaled 72%, fixed income 26% and cash 2%. We have been steadily reducing exposure to equities since last fall. Obviously sitting in cash is not a long-term investment solution. As we gain some clarity into a feasible earnings picture for 2022 and 2023 we can begin to recommit cash opportunistically.

WE MANAGE SEPARATE ACCOUNTS FOR EACH OF OUR CLIENTS. NONE OF OUR CLIENT PORTFOLIOS LOOK THE SAME.



GVK FIRMWIDE

Asset Allocation

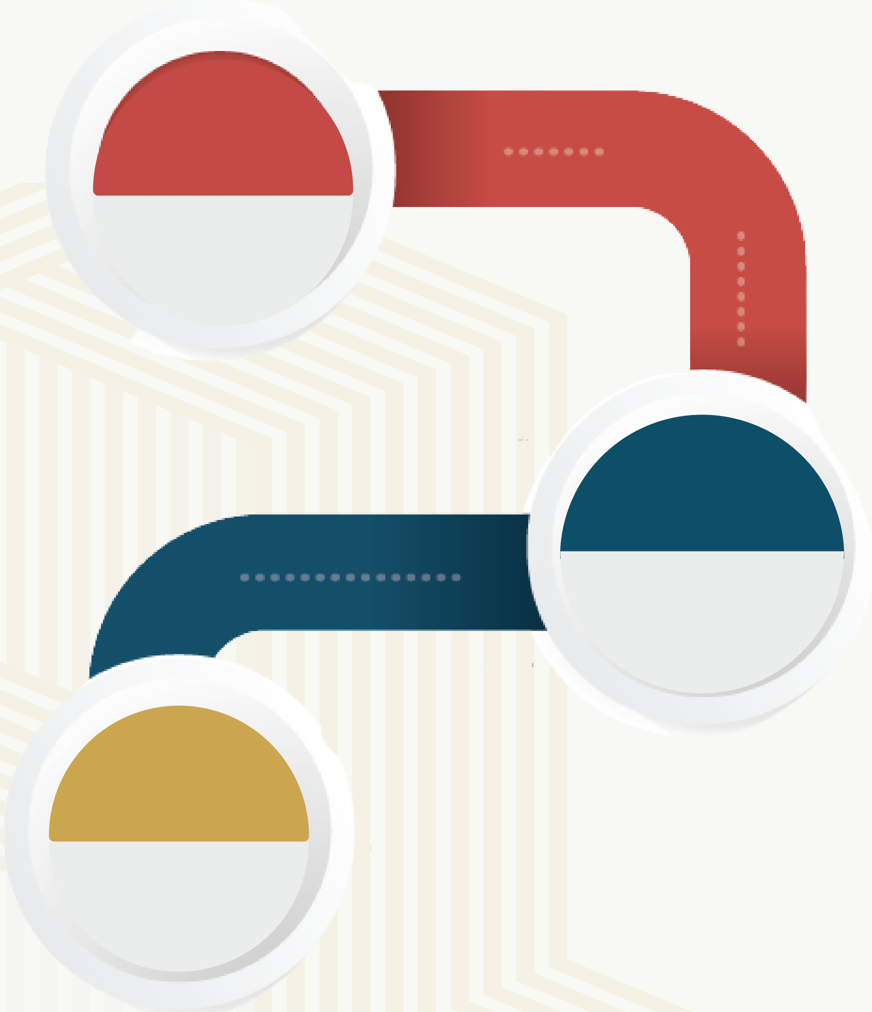
Uncertain Expectations

As we begin the second half of 2022, investors are possessed with increasing recessionary fears juxtaposed against the fear of missing the opportunity to reinvest funds at market lows. Each new stock market decline prompts countervailing predictions that the markets are attractively priced for reinvestment or poised for further declines. Wall Street loves its idioms. You want to “buy the dip” but “don’t try to catch a falling knife”. Obviously both positions can’t be right. The difficulty is, the correct answer is dependent on an accurate assessment of the future. If enough of the coming bad news is reflected in current prices, then expectations have been appropriately reset and stocks can move higher. Although times may be deteriorating now, investors are already looking for that turning point where the worst to come is already priced in. In anticipation of this, prices will begin to turn positive even before the economic news begins to offer hope, so the strategy is to accurately determine when the investment equation turns from bad news with minimal good news to a balance of good and bad news with good news in clear ascension. We didn’t say it was easy.

Going into the Iraq war, the Secretary of Defense, Donald Rumsfeld issued his famous, circular quote on uncertainty. There are “known knowns, known unknowns, and unknown unknowns.” When the likelihood of unknown unknowns is decreasing and known unknowns are increasingly morphing into known knowns, it is probably time to turn positive about stock market prices and aggressively recommit accumulated reserves.

We know the U.S. economy’s growth rate is slowing in comparison to 2021. A generally accepted definition of a recession is two consecutive quarters of negative growth in GDP. In the first quarter our economy shrank by an annualized rate of 1.6%. Although the second quarter’s results for 2022 will probably again post very modest negative growth, the final figures for the second quarter will not be known for several weeks. The possible small decline in GDP for the first half of 2022 would signal a very mild recession. The known unknown is whether the economy in the third and fourth quarters will continue to demonstrate a further contraction in growth and will the decline accelerate. It is very unusual for unemployment to remain at record lows while the economy approaches the precipice of a recession. Recessions are almost always accompanied by rising unemployment. But in 2022 employment remains very strong. Monthly additions to the roles of the employed are sizeable and wage growth is strong although less than the rate of inflation. The unemployment numbers now indicate a mild recession and not a severe one.

“THE IDEA THAT THE FUTURE IS UNPREDICTABLE IS UNDERMINED EVERY DAY BY THE EASE WITH WHICH THE PAST IS EXPLAINED.”
-DANIEL KAHNEMAN, THINKING FAST AND SLOW



Where do we go from here?

It is a known that consumer demand is softening. How much and for how long is unknown. It is a given that inflation will abate. The best cure for high prices is high prices. But when will a discernable down trend be evident is unknown. Higher interest rates and the contraction in money supply has been ongoing for several months. How long must it continue is a known unknown. For the past 50 years the Federal Reserve's methodology to fight inflation has always led to an economic contraction and a recession. Only fortuitous luck will prevent a recession somewhere in the last half of 2022 or 2023.

We read and hear daily about the war in Ukraine. Here was an unknown, an unpredictable event, which has dramatically altered the world economic scene. It has caused massive disruptions in food supply, commodity prices, and supply chain dislocations. It has caused a massive migration of people and a major realignment of geopolitical blocks. There is no way to predict the outcome of this war or the price it will extract on the world. It is an existential unknown, which Wall Street is basically ignoring now in assessing security price valuations and the depth of any market decline, but it may foster greater unforeseen consequences over the long-term.

Consumers entered 2022 with healthy balance sheets as a result of government largess during the Pandemic. However, with the current very high price inflation, Americans are beginning to draw down their Pandemic era savings. If inflation persists at high levels for the rest of 2022 and into 2023 household budgets will be severely constrained and consumer demand, which supports our economy, will be impaired.

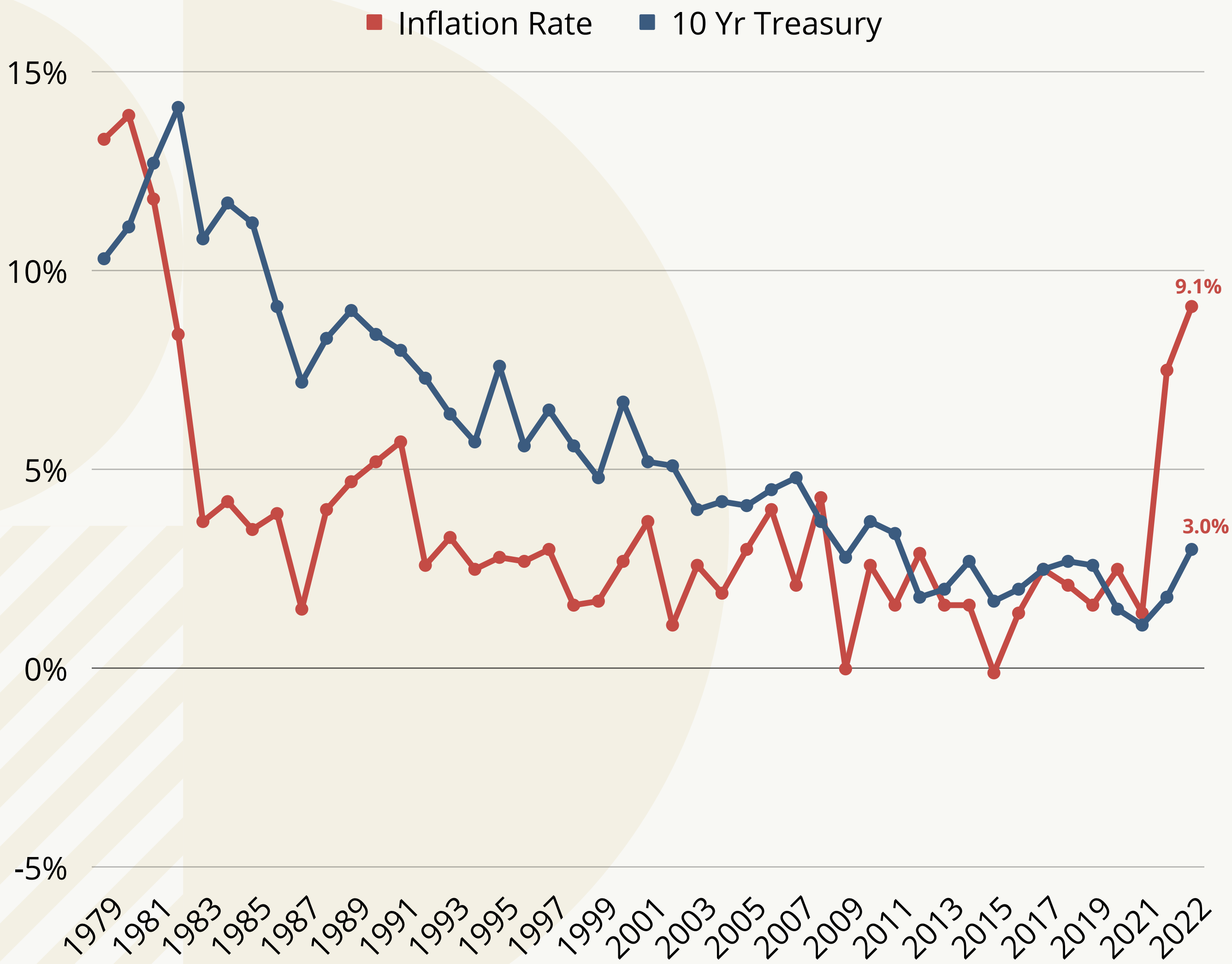
THE FED SAYS FIGHTING INFLATION IS ITS NUMBER ONE PRIORITY

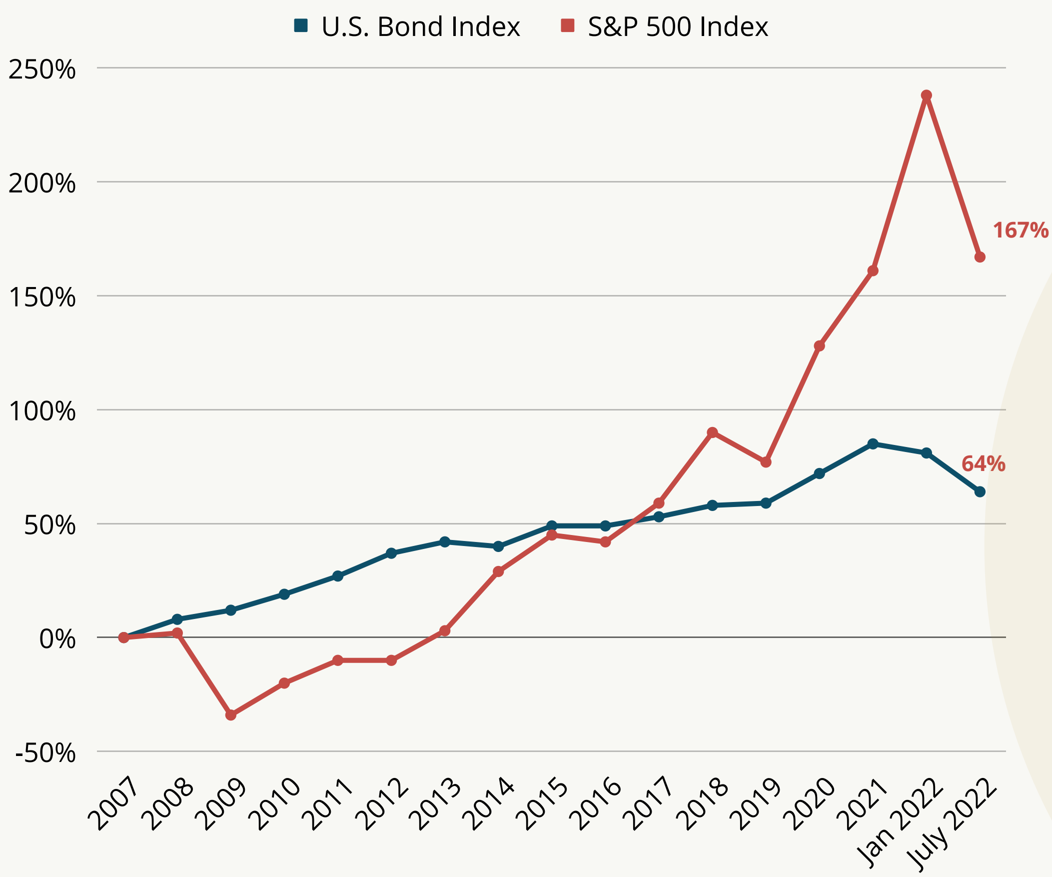
Continuing inflation will curtail consumer demand, but the Federal Reserve's avowed intent to crush inflation may also destroy retail demand. Higher rates in conjunction with a tightening of monetary policy may succeed in reducing demand pressures on pricing but these policies may in turn cause a recession. The Fed says fighting inflation is its number one priority but as the economy weakens and unemployment grows, its conviction could falter before achieving its goal. To reduce inflation to its 2% goal is achievable but the price may be too high and cause a deep recession.

As we began the year, the enthusiasm of exiting the worst global pandemic in a century began to fade. Fantastic economic growth driven by pent-up consumer demand and unprecedented government stimulus gave way to supply chain disruptions, rising prices and renewed geopolitical conflict. The optimism that supported historically high price-to-earnings ratios evaporated in the face of interest rate hikes. The higher the P/E, the more speculative the business model, the harder the fall. In the second half of 2022 much of the stock market movement in prices will be determined by corporate earnings rather than optimistic long-term visions. The known is that corporate earnings will be under pressure. The unknown is the magnitude of any reduction in profit growth.

With inflation and higher costs throughout the corporate product chain, profit margins will be declining. It is doubtful that companies will be able to raise prices as fast as their rising costs. And as mentioned, with the efforts to temper consumer demand to curb inflation, corporate revenues and earnings growth will slow. Comparisons with the dynamic growth in earnings in the second half of 2021 will be weak.During the first half of 2022 Wall Street analysts steadfastly held to their high, beginning of the year earnings estimates for 2022 of about 10% growth. The decline in market prices in the first two quarters of this year was primarily a function of a compression in price-to-earnings ratios in recognition of greater risk as opposed to a response to declining earnings estimate revisions. Now reality is setting in.

10 YEAR TREASURY YIELD & INFLATION RATE





The country is on the verge of a recession and clearly corporate earnings estimates written early this year are wrong. They are too high. This is the known. The unknown is the extent of the downward revision to match reality.

A temporary short term modest decline in earnings is likely already reflected in current stock market prices. Significant downward revisions will result in continued stock market declines.
Corporate guidance for the last half of 2022 will be important. It will give us an uncertain but clearer picture of what managements think will happen during the remainder of 2022. A more cautious tone about the near future will be evident. Investor sentiment right now is fragile, so guidance below expectations will be met unfavorably.

Total sales for all the combined companies in the S&P 500 are expected to have increased in first half of the year 10.4% from the same period last year, while earnings are anticipated to increase 5.6%. These numbers aren't bad until you take out the performance of the energy sector. Excluding energy, sales are expected to decline by 2.4% over last year.

If investors can have confidence in future earnings estimates, then appropriate equity valuation metrics can be utilized resulting in less volatility and reasonable expectations for future stock performance. But first inflation must be brought under control. U.S. manufacturing weakened in June along with new orders. Commodity prices have fallen sharply from their highs of only two months ago.

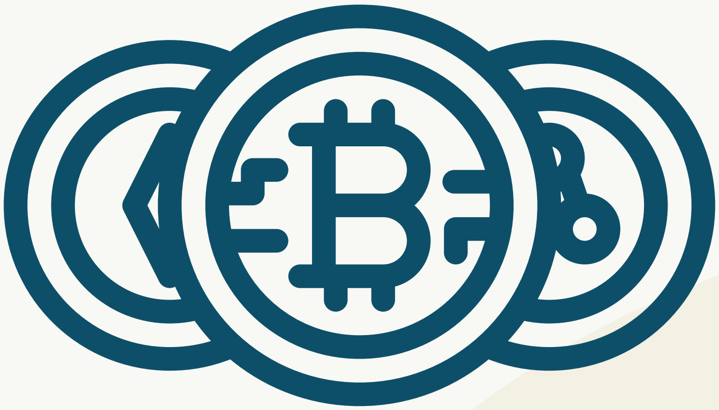
»STOCK VS BOND LONG-TERM PERFORMANCE

Excessive inventories caused by the Pandemic are being reported by major retailers, causing price reductions in some areas. Supply chain shortages and disruptions are diminishing.

Trucking, rail, and freight rates are all below their peaks earlier this year and falling. The price of oil appears to have peaked last month and is also off its highs. Worker shortages are being reduced. Supply and demand are slowly equalizing. The red-hot housing market is cooling with dramatic increases in mortgage interest costs. Although housing prices are still at a peak.

With housing affordability at an extreme low, the inflationary impact of rising home prices and rents will start to subside and become a neutral factor on future Consumer Price Index numbers. This is important because about 40% of monthly CPI data is affected by housing related data.

THERE ARE SOME POSITIVE SIGNS EMERGING ON THE INFLATION FRONT.



Worldwide we are seeing an economic slowdown. Europe is on the edge of a recession as is the United States. Asia is experiencing considerable slowing in its economic growth. Much of this growth reduction can be traced to the war in Ukraine, an unknown-unknown before February this year. Now the future projection and consequences of this war are an unknown. Further escalation will intensify the chaos it has already seeded. In a protracted conflict, which politically and geographically does not increase beyond its present limits, economies worldwide will adjust and the initial inflationary impact will be gradually neutralized. If the conflict widens, inflation will be much more difficult to control.

The stock market experienced its worst first six months of a new year since 1970. The bond market also showed a sharp decline as interest rates rose. There was no safe harbor for investors.

Stock and bond prices have lost more than $10 trillion this year.

THE CRYPTICS OF CRYPTO

Crypto currencies experienced an even greater collapse eliminating about 60% of their total value. Investors in crypto currencies lost in 2022 over $2 trillion. In 2000 the Super Bowl was dominated by ads sponsored by Dot.com startups. In 2022 Super Bowl ads were dominated by Crypto currency start-up companies. Both were high speculation segments of the economy which, soon thereafter, collapsed violently. In hindsight these two embryonic areas of high speculation should have been recognized as a sign of general overvaluation in the securities market. Technology stocks in many instances this year plunged 30 to 70 percent in value, even for the major entities like Amazon and Meta Platforms.

Investors now understand the outlook for the rest of 2022 and 2023 is clouded, but they recognize that some of the fear of the unknown depth of a recession has already been recorded in the present level of prices. In past recessions the S&P 500 Index has fallen an average by 26%. The S&P 500 decline at its bottom this year was 21%. An unknown portion of investors' unquantifiable future fears has been priced into the market.

Other traditional measurements show the same thing, but at present levels none indicate that the bottom of this bear market has been reached. There are several useful statistical indicators, which combined have had a good level of accuracy in predicting over and under valuations of security prices in the long term. No measurement technique is infallible, and none are accurate in predicting short-term market price swings. The short-term is inscrutable but the above referenced indicators have a good record of forecasting long-term above and below average returns on investment from present price levels. For better or worse, they indicate patience is warranted.

Since 2008 the NASDAQ 100 Index, which is heavily oriented to technology stocks, has produced a positive return every year until 2022. Every decline in this major index since 2008 has taken no longer than six months to recover its losses from its former peak. We believe expectations for a fast and complete recovery, like in the past 14 years, need to be reevaluated. Reasonably good market timing will recover much of the decline experienced this year for individual investors within the next 12 months but the major stock market indexes, in our opinion, could take a couple of years to regain their old highs. The long-term argument for common stock investing is still as valid as always. Common stocks outperform almost all other asset classes over the long term. Since 1988 the S&P 500 Index has shown an average annual return of about 10%. But there have been wide fluctuations during the last 34 years as investors gravitate between exuberance and panic.

Some more financial and economic pain is probable in the near-term. For a short time, financial loss and high inflation will coexist. Demand for food and energy are basically inelastic and inflationary fires in these two categories will cool last.

Rising interest rates and resolve to fight inflation by the Federal Reserve will be slow to affect food and energy pricing. Prices across the board will be volatile but within months we expect to see an erratic but declining trend.

A restrictive monetary policy, high interest rates, a decline in personal wealth, the normalization of the labor market and the spending of Pandemic savings will all eventually cure inflation. By mid 2023 we expect to see a reacceleration in corporate earnings growth and the resuscitation of a more normal textbook economic environment. An attractive opportunity to recommit cash reserves should occur within the last half of 2022.

There are no Hall of Fame stock market timers but a focus on changing fundamentals should provide a useful guide to determine the abatement of fear and the emergence of increasing optimism. Only the unknowns of a broadening of the war in Europe, and the resolve of the Federal Reserve to curb inflation would alter our more positive outlook for recovery in stock prices longer term. Failure by the Federal Reserve could result in a repeat of 1970's stagflation.

BY MID 2023 WE EXPECT TO SEE A REACCELERATION IN CORPORATE EARNINGS GROWTH AND THE RESUSCITATION OF A MORE NORMAL TEXTBOOK ECONOMIC ENVIRONMENT.

2022

BUILD YOUR WEALTH

To Fund Your Passions

GKV Capital Management is an independent investment advisory firm registered with the Securities and Exchange Commission since 1975. We provide portfolio management services for our clients which include individuals, families, charitable trusts, corporations and retirement plans. We are an independent, fee-only advisor. We do not receive commissions and we do not sell any financial products. We have a fiduciary responsibility to put our clients' interest first.

Client accounts are separately managed and tailored to meet the specific needs, including risk tolerance, investment objectives, and tax consequences of each client. Client assets are held at an unaffiliated brokerage firm.

With extensive expertise in security analysis, we make direct investments on behalf of our clients buying individual securities. This eliminates costly mutual fund fees and increases the flexibility to manage volatility. We actively allocate capital to take advantage of investment opportunities altering exposure to individual companies, industry sectors, and asset classes in anticipation of the changing investment and economic environment.

We are transparent in all facets of our asset management practice and believe it is important for our clients to know what they own, why, what their performance is, and what they are paying in fees. We build comprehensive portfolios for our clients with a goal of reducing volatility and producing prudent growth.
We protect and build wealth at GKV Capital.

GKV CAPITAL

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