Independent Investment Advisory

GKV Capital Management

Quarterly Update

Third Quarter 2021

GKV
CAPITAL

Third Quarter Review

Stocks to the Moon

Looking Ahead

Opening Thoughts

For nearly fifty years GKV Capital Management has been managing investment portfolios. In 1975 Peter started the firm with a notion that he could bring clients a higher level of investment expertise and service than the large financial institutions where he started his career. He named the firm after his two children at the time, Greg and Kristen Vogel.

Greg grew up steeped in the firm, riding his bike to the office to see dad and program the IBM computer the firm purchased in 1984 to track investment performance. Greg spent the first decade of his career at larger financial institutions, leaving Bank of America Securities as a managing director in 2001. He formally joined GKV Capital in 2003.

Recently we announced the addition of Brett Rocine to our investment management team. Brett has joined GKV Capital Management as a Private Wealth Advisor.

Brett is working out of the Walnut Creek office and will be interfacing directly with GKV Capital clients to help support their financial goals. GKV Capital has always taken a team approach to servicing our clients. Peter and Greg will continue to manage portfolios and are always available to all our clients. The addition of Brett will increase the depth of our team to provide the best possible service, particularly in financial planning.

Brett has comprehensive wealth management expertise and has been advising clients for over 10 years. Prior to joining GKV Capital, Brett was a leading financial advisor at both JP Morgan Chase and Fidelity investments. Brett was a top Advisor at JP Morgan Chase in Marin and a multiple-year President's Circle winner at Fidelity Investments.

Not much has changed here at GKV Capital in the last forty years. Peter is still making investment selections and meeting with our very long standing clients. Greg continues to research investment opportunities and manage portfolios. We are always looking for ways to best serve our clients without becoming one of the giant firms where each of us got our start. We are proud of what we do for our clients and appreciate your trust in us to protect your financial future.

GKV Capital Management is an independent registered investment advisor.
For more information about us please call (805) 497-2616 or visit **gkvcapital.com**

3Q21 Data Points

DJIA YTD	10.6%
S&P 500 YTD	14.7%
NASDAQ YTD	10.6%
US Bond YTD	-1.6%
10-Year Treasury Yield	1.55%
S&P 500 LTM Dividend Yield	1.38%
S&P 500 EPS Next 12-MTH	$210.75
S&P 500 P/E	20.4x

Third Quarter Review

Equities took a pause in the third quarter after more than a year of tremendous gains. Corporate earnings rebounded faster than anticipated from the pandemic lows in early 2020 and with the better-than-anticipated economic rebound, stock performance has also surprised to the upside. The extreme economic displacement caused by the pandemic fostered a volatile market, an unprecedented panic followed by a dramatic rebound. Consider that from the March 23rd, 2020, pandemic low the S&P 500 gained a staggering 93% by the close of the third quarter 2021. That's a gain of 53% annualized.

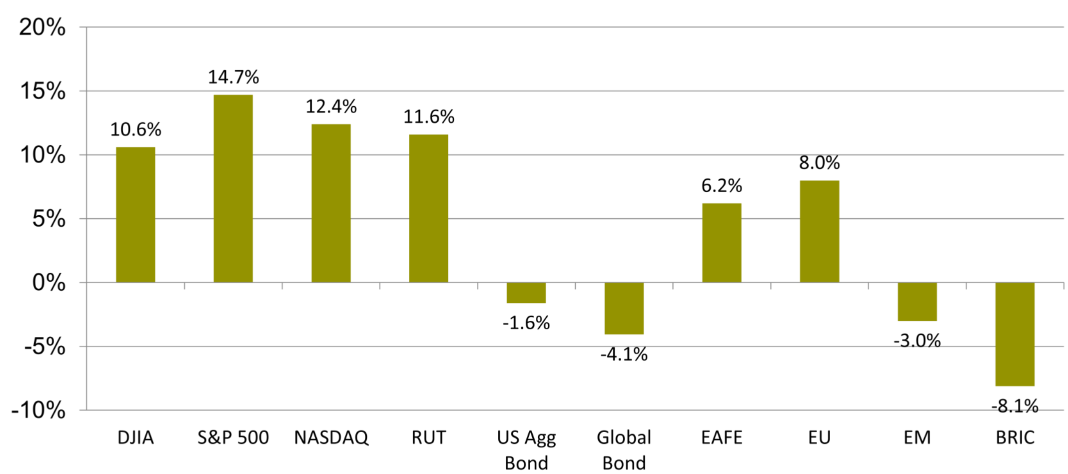
For the first three quarters of 2021, the S&P 500 is up 14.7%. Although the gains so far this year are impressive, in the third quarter the S&P 500 gained only 0.2%. The Dow Jones Industrials are up 10.6% year-to-date while the index declined 1.9% in the third quarter. Similarly, the technology biased NASDAQ ended the third quarter up 12.4% for the year but gave up 0.4% in the last three months. Small cap companies, as measured by the Russell 2000 index, soared in the first quarter with prospects of fully reopening but have given back some of the early gains, closing the quarter up 11.6%.

The economic disruption of the pandemic continues to affect the various sectors of the economy differently. With a focus on a reopening economy, the worst performers of last year are still outperforming last year's winners through the third quarter. Energy remains the best performer up 38% followed by financial services, up 27%. The other major sectors are all up double digits through the third quarter with the notable exceptions of consumer staples, up 2.6% and utilities up 1.7%. Consumer staples include household goods, food, beverages, hygiene products and other essential items. The sector held up well in 2020 but has not participated in the reopening boom since demand for consumer staples hasn't changed much throughout the pandemic.

Estimates for earnings of the companies in the S&P 500 continued to be revised higher through the third quarter justifying much of the tremendous stock gains earlier this year. The current forecast for 2021 is for the total earnings of the combined S&P 500 to reach $198.12, which is nearly 6% higher than the $187.29 forecast at the close of the second quarter. The forecast for 2022 is now $217.31 putting the S&P 500 at a somewhat pricy P/E multiple of 19.8. Earnings growth is impressive, and estimates continue to be revised higher, but the rate of those upward revisions has slowed appreciably which explains much of the weaker equity market performance in the third quarter relative to the first six months of the year.

The U.S. equity markets through the first three quarters of 2021 outperformed the global equity markets. The MSCI EAFE (Europe, Australia, Far East) closed third quarter up 6.2%, Europe is up 8.0%, and emerging markets closed September up only 3.0% as slow vaccine rollouts and new waves of infection continue to keep economies from fully reopening. Global economic growth is expected to have shrunk 3.5% in 2020 due to the pandemic but is expected to rebound sharply by 6% in 2021. Comparatively, GDP growth in the U.S. is expected to increase 5.9% in 2021 and 3.8% in 2022 after a contraction of 3.5% in 2020. It has been some time since international equity markets have managed to outperform U.S. equities. The largest U.S. companies have significant international sales and therefore provide real exposure to the global economy in our view, eliminating the need to worry too much about diversification into international equities. The benefits of globalization to emerging

2021 YTD Major Index Performance

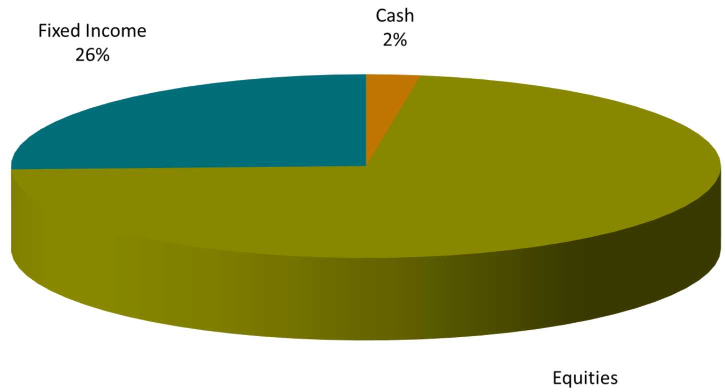


economies seem to have slowed over the last decade while political risks remain. We expect that emerging markets will outperform U.S. equities for some periods but for the present, we have little to no investment exposure.

At the height of the pandemic, unemployment spiked to 14.7% in April last year and has subsequently declined to 5.2% by the end of September. For context, following the 2008 recession, the high point for unemployment was just over 10% in October of 2009 but took until 2015 to get back to 5%. Unemployment remains elevated but has bounced back as well as could be hoped. We expect to see continued, albeit slower, improvement over the next twelve months. Consumer spending has remained strong driving retail sales far above pre-pandemic levels. Retail sales for August were up more than 13% from a year ago.

Inflation fears continue to keep interest rates from returning to last year's lows. The 10-year treasury ended the third quarter at 1.52%, up significantly from 0.93% at the start of the year but down from the end of the March quarter when yields hit 1.74%. Most economists continue to believe that much of the increase in inflation this year is transitory due to supply imbalances brought on by the disruption of the pandemic. Certainly inflation will be watched carefully as the supply and shipping bottlenecks ameliorate. Rising interest rates have had a negative impact on bond prices taking the U.S. aggregate bond index down 1.6% through the third quarter. We expect the rate of increase in interest rates to slow, but the likely long-term trend of rising rates will continue to put pressure on bonds for the foreseeable future.

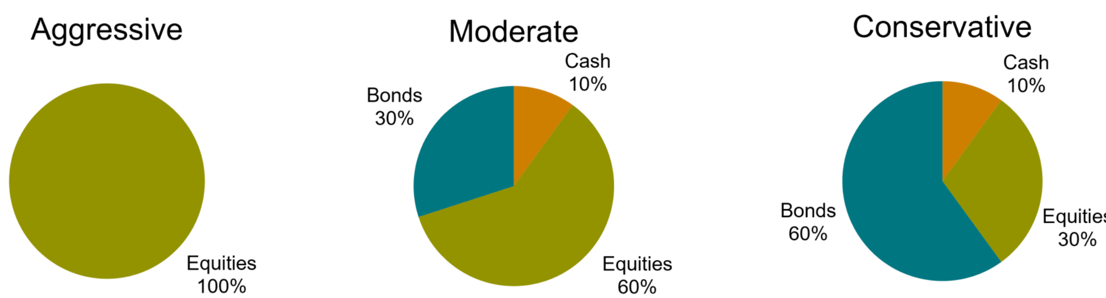
GKV Firmwide Asset Allocation



GKV Capital Firmwide September 30, 2021

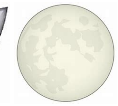
We ended the third quarter fully invested firmwide. Our equity holdings totaled 72%. While we ended 2020 overweight technology and companies we expected to benefit from the effects of the pandemic, we have subsequently rebalanced sector holdings with the expectation of increased broad economic activity, particularly in energy, select industrials and financial services. Fixed income positions remain an important part of portfolios, however we have steadily reduced our allocation to the asset class over the last year. Fixed income totaled 26% of assets under management on September 30th, 2021, down from 31% a year ago.

Long-Term Historical Portfolio Returns and Volatility



	Aggressive Total Return	Aggressive Std. Deviation	Moderate Total Return	Moderate Std. Deviation	Conservative Total Return	Conservative Std. Deviation
3 Year	14.2%	20.4	10.0%	13.3	7.0%	8.2
5 Year	15.2%	16.6	10.3%	11.0	6.7%	7.0
10 Year	13.9%	14.9	9.3%	9.9	6.1%	6.4
15 Year	9.7%	17.1	7.3%	11.3	5.7%	7.3

Performance Data for periods ended December 31, 2020
Annualized monthly standard deviation
Bond Index is Barclays US Agg TR USD
S&P 500 Index Total Return

Stocks to the Moon  

"My investment in GameStop was based on the fundamentals"

- Keith Gill "Roaring Kitty"

Let's start with a prediction- the S&P 500 is going to hit 6,000. Just how good would 6,000 be? On September 30th the index ended the third quarter at 4,307. So then 6,000 would represent a 40% return from present levels.

A 40% return looks pretty attractive. Particularly compared to 10-year treasury yields of 1.6%, or money market yields of less than 0.5%. The problem with our forecast is that we haven't established a time frame for exactly when we will realize our prediction. There's obviously a big difference between a 40% return this year and a 40% return over then next 10 years.

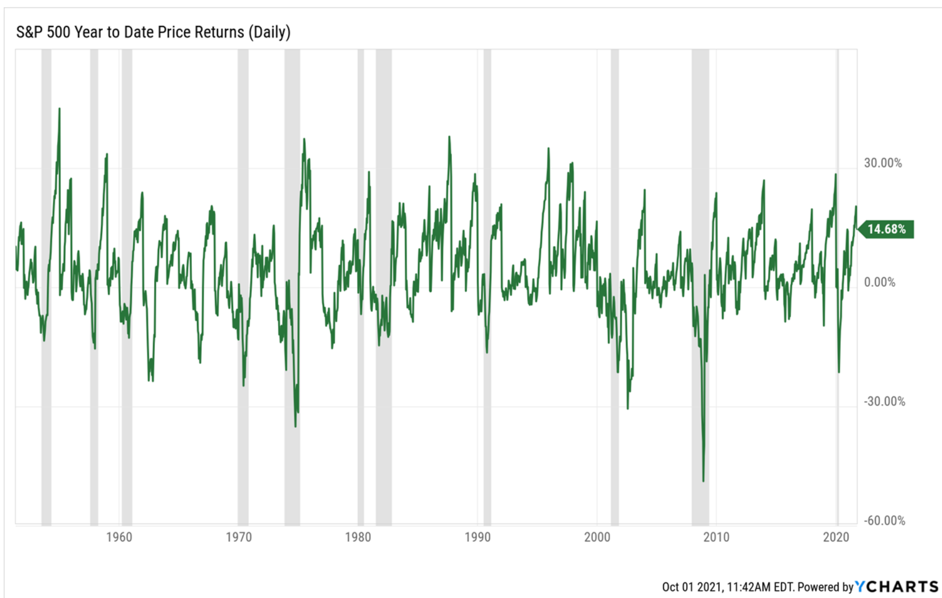
For the first three quarters of 2021, gains in the stock market have been good. The S&P 500 is up 14.7%. The last five years stocks have performed well above long-term historical averages, recording more than 15% annual gains and this year is on track to continue the trend. Going further back, the last fifteen years have been nearly as good, returning slightly less than 10% annualized.

So, using long-term historical averages, it might take five years to reach our 6,000 prediction. Then again, as we just pointed out, more recent returns have been well above historical norms. Maybe it will take only three years.

The other critical part left out of our forecast is the volatility we will encounter along the way. While it is a fact that the S&P 500 has annualized a 9.7% return over the last ten years, the volatility month-to-month and year-to-year has been significant. For any given period the index was up as much as 27% or negative 7% two-thirds of the time. Taking a long-term view, returns appear stable and consistent but the upwards sloping trendline is far from assured. Negative 7%, or even worse one-third of the time is rather alarming when you're staring at unrealized losses and your financial future is at stake. The chart to the right on this page shows the daily year-to-date price return for the S&P 500. Although the average annual return is 8.8% since 1956, the path to get there looks a lot like a seismograph during a terrible earthquake.

Despite the significant caveats- both timing and volatility, we are confident in our prediction. The economic fundamentals are going to get us there. It's just a matter of time. If we take a step back we can walk through how we get to our 6,000 prediction, and by showing how we get there, we can better understand what are some of the hurdles we might encounter along the way.

S&P 500 Annual Price Returns



The value of a company, the value of a stock- or any investment vehicle for that matter- can be determined based on the cash flows that the business generates. The trick is knowing for certain what the future cash flows are going to be. Economic conditions can change and customers can be fickle, making a future forecast difficult. Let's assume for a moment you know what the earnings of a particular business will be next year. Let's say the business will return $100,000 in cash at the end of the year. What should you be willing to invest for that $100,000 return? The answer generally depends on how significant the perceived risk of actually receiving that

$100,000 is. Certainly if you thought the risk was minimal, committing $1,000,000 for a year to receive $100,000 would be worthwhile. A 10% return is very attractive. On the other hand, tying up $5,000,000 for a 2% return is not all that great. If I offered you $100,000 to let me borrow $1,000,000 for a year, and you thought I was good for it, you should take it. Particularly if I'm willing to put up collateral.

When Wall Street analysts talk about the fundamentals of a company, they are referring to the future expected financial results. The income statement and cash flows and the fiscal health of the balance sheet are necessary in the analysis. Investors are continually evaluating the expectations for future profits to determine the correct value of a company. The common valuation shortcut is a price-to-earnings ratio. It's calculated simply by dividing the stock price by the earnings per share. Using the example above, a $100,000 return on $1,000,000, has a P/E multiple of 10x while a $5,000,000 investment returning $100,000 would have a P/E of 50x. You're paying a lot more for the same cash flow.

Where things get messy is when investors have different opinions about what the future cash flows will be. Let's go back to our example. What if the future payments were uncertain. If there was reason to believe that I might receive $1,000,000 from the $5,000,000 loan instead of just $100,000, then the calculus changes. If the $5,000,000 investment returns 20%, or a P/E of 5x then suddenly the $5,000,000 is a far better deal than the smaller $1,000,000 returning $100,000.

Is a stock cheap or expensive? What about the market overall? It depends on the future earnings and the expectations of those earnings. If expectations are low and the company earns more than expected, the stock will rise to account for the increased earnings expectations. If expectations are high and the company is unable to meet ambitious expectations, the stock will fall to reflect the true earnings results.

For a long time, Keith Gill, also known as *Roaring Kitty* or *DeepF***ingValue* on the Reddit board WallStreetBets, believed GameStop was undervalued. Most investors, including some very smart hedge funds, saw a dying mall-based video game retailer, Mr. Gill thought the long-term fundamentals could turn around. GameStop is not a tiny company. Revenue in 2019 totaled $8.2 billion but it lost $673 million that year. Before the GameStop story exploded via the Reddit boards, the stock languished below $5 a share. It closed the third quarter at $175. Clearly the sentiment around the expectation for future earnings has changed. In the short-term, Mr. Gill made a lot of money off the change in sentiment. It remains to be seen whether the company can revise its business plan and start earning money again. So far in 2021 the company has reduced its losses, but sales continue to decline, and the business model will have to be completely redeveloped for the company to justify its $13 billion market capitalization. We are skeptical.

Earnings for the S&P 500 have more than bounced back from the pandemic economic shutdown. Earnings estimates for the S&P 500 in 2022 are now expected to hit $217.31. This represents a 19.8x P/E multiple which is somewhat above the 18x historical average but not by a considerable amount. We would be hard pressed to call the market inexpensive, but that depends on earnings. With the strength of the reopening economy and a consumer flush with stimulus cash, earnings estimates have been steadily revised up pushing stocks higher. In other words, there is strong justification for the heady returns in the market over the last eighteen months. Furthermore, without something to cause a reduction in the earnings outlook, there is little rational justification for a dramatic correction. Investor "feeling" that the market is due for a correction is not enough to cause a correction on its own.

As always there are risk factors that we are paying close attention to. It is important to evaluate these risks through the lens of corporate earnings however. Rising inflation could force a revision of appropriate P/E multiples for stocks. If investors decided that 18x earnings is a more appropriate valuation due to higher inflation and what would necessarily be a higher interest rate environment, the S&P would trade down to 4,000 before resuming a march toward our target of 6,000. Most economists and the Federal Reserve view recent inflation as transitory due largely to supply imbalances and supply-chain issues post pandemic. Again, time will tell.

The dysfunction in Washington and politics in general can be a concern. However, fiscal policy and debt ceiling conflicts rarely have significant or lasting impacts on corporate earnings. Political theatre can have a short-term impact on sentiment but in our significant experience it is rarely lasting.

The economy is growing. There are likely to be some detours along the way, but economic growth will continue. Periodic disruptions, while significant are worked out. Energy shocks, runaway inflation, asset bubbles, and pandemics are disruptive, but people continue to work, generate income, spend and the economy continues to grow. Some businesses fail and they disappear or are subsumed by healthier companies. The major stock indexes are comprised of the leading companies. The declining leaders of yesteryear are removed after a time as innovative new companies grow up to take their place. Throughout the process the value of the market climbs. It will hit our 6,000-point target. The question is when.

Looking Ahead

About the third week after the start of a new quarter, companies begin reporting their results for the previous quarter. As the results are announced, analysts update their projections based largely on the guidance issued by management from each of the companies.

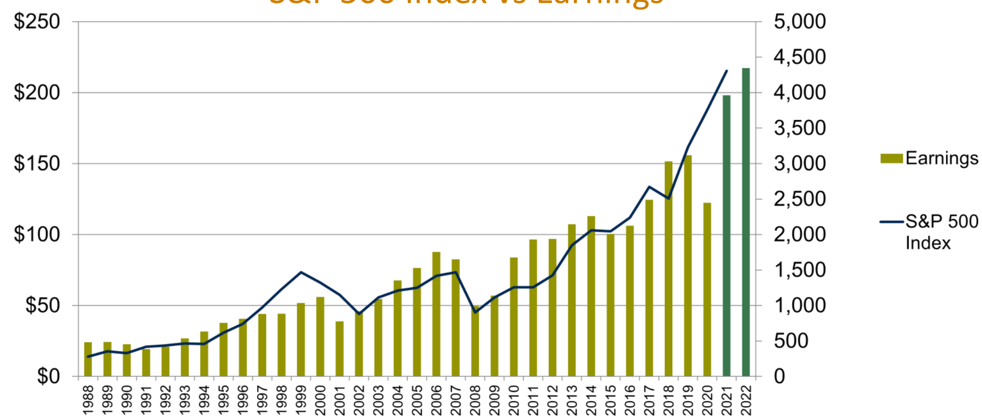
So far this year, the results have been well ahead of expectations. Of the 500 companies that comprise the S&P 500, for the second quarter, 431 exceeded analyst estimates while only 53 came up short. Companies usually try to set themselves up to exceed the estimates, but 86% exceeding estimates is well above the 71% average since 2013.

As a result of the positive second quarter results, analysts have continued to revise upward their previously revised forecasts for 2021 and 2022. The current earnings forecast in 2022 is $217.31 per share for the combined S&P 500. At the close of the first quarter on March 31st, the 2022 forecast was $200.02.

As you can see on the chart on this page, the earnings growth has reaccelerated dramatically since the forced economic shutdown last year due to COVID. Earnings for 2021 are expected to hit $200 per share, representing 62% growth from 2020. It's this strength in earnings that has driven the stock market.

While the comparison from the dismal earnings of 2020 to 2021 looks fantastic, the comparisons going into 2022 will be tougher. There may be some further revisions to the $217.31 forecast in 2022, but they are likely to be considerably more modest than the significant upside surprises we have experienced with the reopening of the economy. The current forecast represents 10% earnings growth, and while very healthy, we expect a further slowdown looking farther ahead into 2023.

S&P 500 Index vs Earnings



Profit margins are already at historic highs with the second quarter coming in at 13.6% for the combined S&P 500 companies. Future earnings growth will have to come from growth in sales (revenue) and stock repurchases rather than increased profitability. In addition to the risk of inflation causing higher interest rates and necessitating lower P/E multiples, there is also concern that companies may have trouble passing on higher input costs. Lastly, higher labor costs may further reduce profit margins.

The outlook for growth remains positive, albeit a more normalized growth trajectory after the initial spike exiting the pandemic. We anticipate some continued appreciation in equities this year and next, but expect gains to more closely track earnings realities.

S&P 500 Earnings and Index Valuation

	2014	2015	2016	2017	2018	2019	2020	2021E	2022E
S&P 500 EPS	$113.01	$100.45	$106.26	$124.52	$151.60	$155.84	$122.38	$198.12	$217.31
EPS y/y growth	5%	-11%	6%	17%	22%	3%	-22%	62%	10%
S&P 500 Index	2059	2044	2239	2673	2507	3231	3756	4308	
Index y/y return	11%	-1%	10%	19%	-6%	29%	16%	15%	
Trailing P/E	18.2x	20.3x	21.1x	21.5x	16.5x	20.7x	30.7x	23.2x	
Forward P/E	**20.5x**	**19.2x**	**18.0x**	**17.6x**	**16.1x**	**26.4x**	**19.0x**	**19.8x**	

Southern California
299 W Hillcrest Dr.
Suite 119
Thousand Oaks, CA 91360

Northern California
1350 Treat Boulevard
Suite 260
Walnut Creek, CA 94597

Phone: 805-497-2616
www.gkvcapital.com
E-mail: greg@gkvcapital.com

Independent Investment Advisory

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 Management

Build Your Wealth to Fund Your Passions