2023

GKV CAPITAL

SECOND QUARTER

MARKET REVIEW AND OUTLOOK

What Recession?

2Q23 DATA POINTS

DJIA	3.8%
S&P 500	15.9%
NASDAQ	31.7%
US BOND INDEX	2.1%
10-YEAR TREASURY YIELD	3.81%
S&P 500 LTM DIVIDEND YIELD	1.54%
S&P 500 12-MONTH EPS	$228.23
S&P P/E	18.0x

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Opening Thoughts

We find there is often a disconnect between perception and reality when it comes to the stock market and the economy. While most people understand that the value of the stock market is forward looking, it's easy to get wrapped up in negative media headlines with the perception of bad times ahead. For nearly a year now, the media has been fixated on a pending recession. The pent-up demand from the pandemic is exhausted, inflation has hit the highest levels since the early 1980s and short-term interest rates have moved up dramatically. To fight inflation, the Federal Reserve has had to slow growth and may push the economy into recession. And to compound matters, the hyper partisanship in Washington has caused further economic uncertainty. Republican or Democrat, the perception is that the other side is destroying the country.

We anticipated slower economic growth. No genius on our part, virtually everyone forecasted slower growth. Whether a formal recession is declared or not is immaterial in our view. The prospect of slower growth is enough to reduce equity valuations, particularly for expensive growth stocks (namely technology).

The worst may well be behind us. The broad S&P 500 index declined 19% in 2022 in anticipation of slower growth. Despite the slowdown, the economy continues to make progress, albeit more slowly. Consumer confidence bottomed back in June of last year. It's no coincidence that corporate earnings bottomed out last June as well. Corporate earnings for June of this year topped $51.80 for the combined companies in the S&P 500 resulting in 10.5% growth over the second quarter of last year. And the stock market this year reflects this. The S&P 500 is up 16% through June 30th. If you paid too much attention to the negative economic headlines this year and sold your stocks, you missed a nice rally.

The economy could get worse. Unforeseen events can derail economic growth. But the macroeconomic data points are positive. Inflation is heading in the right direction. Interest rates are unlikely to go much higher. Unemployment remains near all-time lows at 3.5%. Household income data is positive, and earnings are expected to increase by more than 10% this year over last. Gains in the stock market may moderate in the second half of the year, but there is reason to be optimistic for the overall economy and the stock market.

2Q23 Review

The first half of 2023 recorded strong performances for the major U.S. stock market indices. Equities bounced back after sharp losses in 2022 despite a backdrop of high inflation, rising interest rates and recession fears.

The broad S&P 500 index gained 15.9%, the Dow Jones Industrial Average gained 3.8% and the technology dominated NASDAQ Composite Index gained 31.7% in the first two quarters of 2023. The Russell 2000 Index, which tracks small companies, gained 7.2% through June 30th. The gains in the first half of 2023 closely mirrored the losses in 2022. The worst performer last year was the NASDAQ, down 33%, while the Dow Jones Industrial Average declined 9% in 2022. The Barclays Aggregate U.S. Bond Index gained 2.1% as interest rates continued to move higher to counter the highest inflation in more than thirty years.

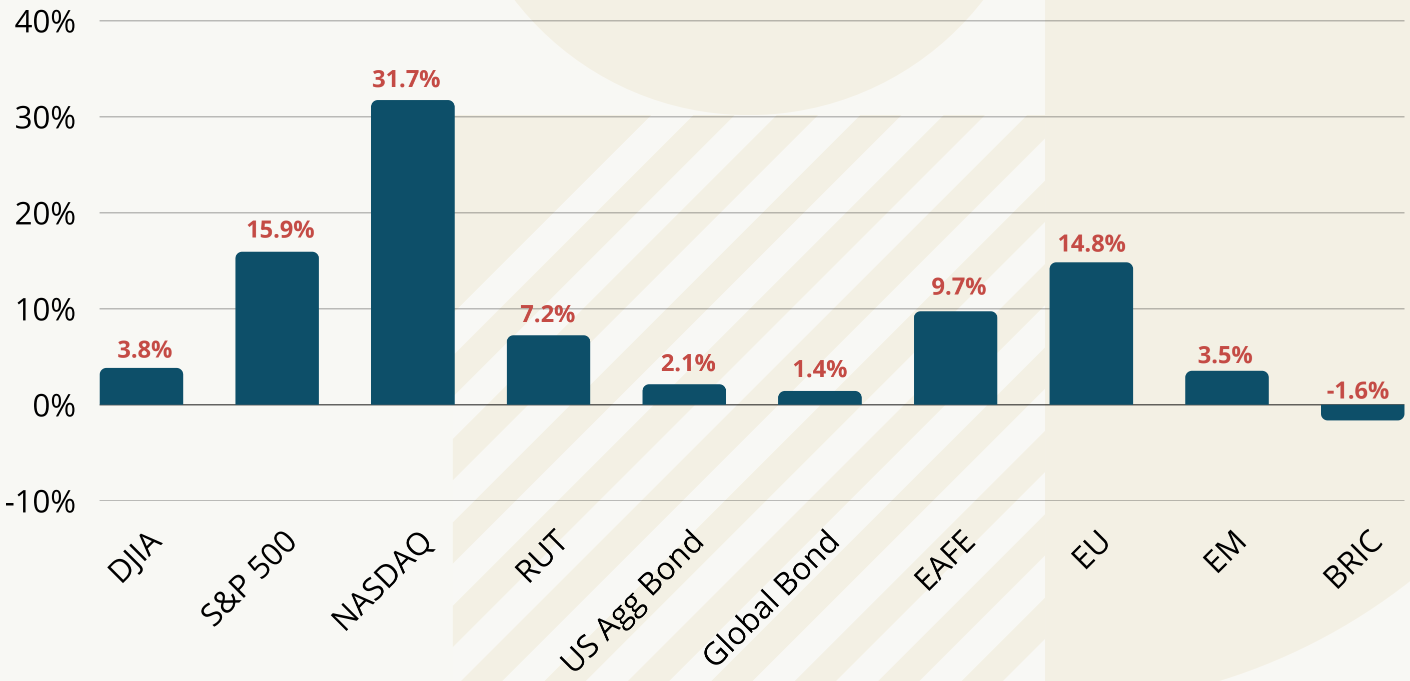
While the major indices recorded significant gains for the first half of the year, the advances were very uneven. Gains were concentrated among just a few sectors and within those sectors, just a few companies. On the surface, the gains appear impressive, but many U.S. stocks have not participated in the rally.

The best performing sectors were generally the worst performers last year. Many high-growth, high valuation companies sold off in 2022 with the expectation of a recession that would dramatically curtail consumer spending and corporate investment. Although growth has slowed, the anticipated recession failed to materialize. In fact, corporate earnings have rebounded slightly while employment and household income have remained robust keeping the consumer spending. Gains this year have been led by technology, up 42% (artificial intelligence), communication services (social media) up 36% and consumer discretionary, up 32% (autos). These three sectors were all down more than 25% in 2022.

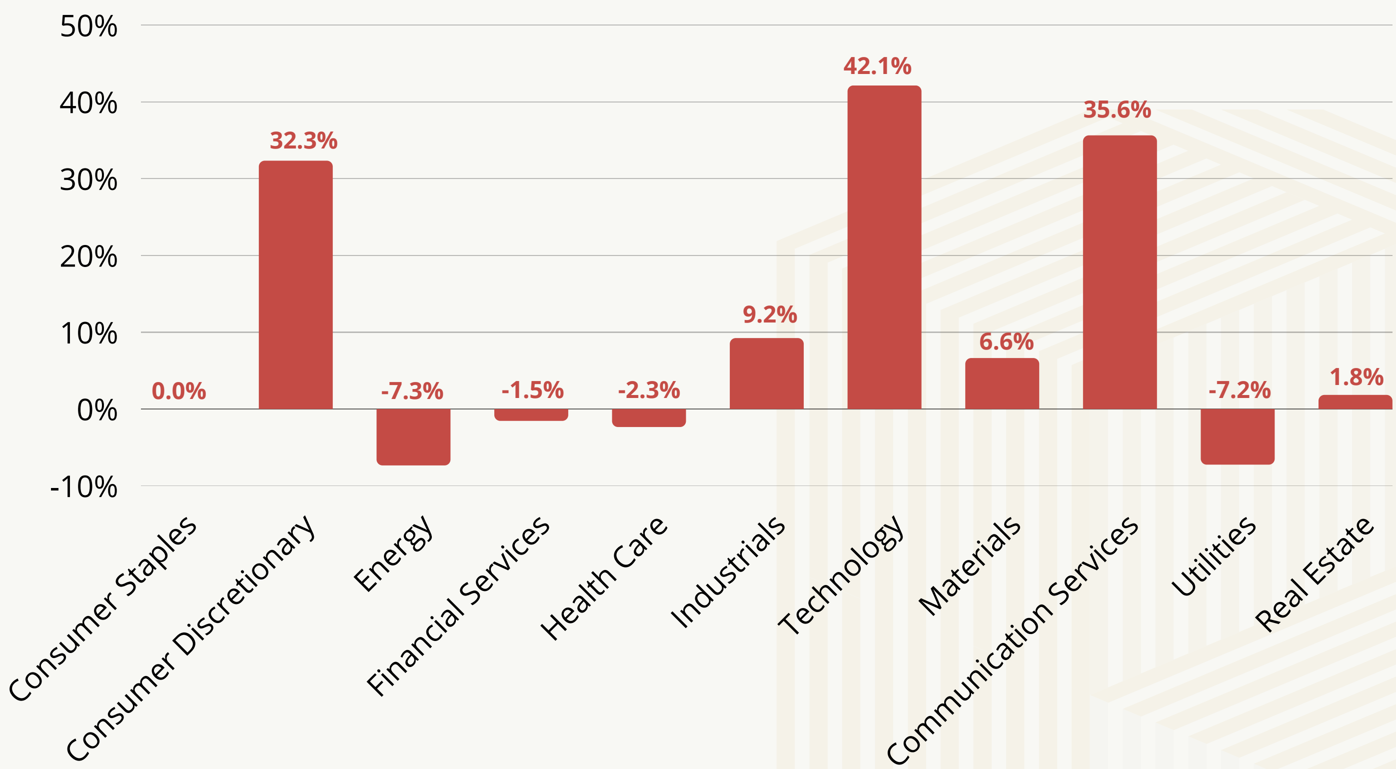
Conversely, the best performers in 2022 have been the weakest so far in 2023. The energy sector declined 7.3% and utilities lost 7.2% in the first half with the expectation that slower growth will translate to lower energy demand and dividend yields for defensive utilities are competing with higher yields on many fixed income securities including risk free U.S. Treasury bonds.

Globally, equity markets remain correlated, at least for the developed markets. Europe, Asia and North America have all performed in unison the last decade or so. The MSCI EAFE (Europe, Australia, Far East) closed June 30th up 9.7%, Europe up 14.8%, and emerging markets up a meager 3.5%. Elevated inflation has been a global phenomenon and central bankers around the globe have been forced to increase interest rates, slowing growth and impacting

2Q23 MAJOR INDEX PERFORMANCE



2Q23 YTD SECTOR PERFORMANCE



equity market returns this year. One bright note for U.S. multinational companies is a stabilization of the dollar. In 2022, U.S. corporate earnings were negatively impacted by unusual strength in the dollar forcing higher prices for U.S. goods abroad. Through June 30th, the dollar is down 0.55% against a broad basket of global currencies.

The principal driver for the performance of a company stock is the expectation of future earnings. Greater earnings will result in higher valuations or higher stock prices. Broad economic growth will have an impact on those future earnings. Of course, certain companies can thrive despite an economic downturn and conversely a poorly run company can fail despite a growing economy, but it is useful to track broad economic expectations as measured by gross domestic product forecasts both domestically and globally. Just as a rising tide lifts all boats, a strong economy makes it far easier to grow corporate earnings.

The macroeconomic data for the U.S. economy remains positive despite higher than desired inflationary pressures and higher interest rates to slow demand to mitigate those pressures. The unemployment rate remains near all-time lows at 3.5%. Retail sales for July were up 1.98% from a year ago. U.S. disposable income also increased in July, up 7.3% from last year, faster than inflation. Household debt appears manageable at 9.6% in March which is well below the long-term average of 11.1%. Despite the rapid increase in interest rates, the U.S. economy has been more resilient than many economists anticipated this year. As a result, GDP forecasts have been adjusted higher in 2023 to 1.9% from the 1.3% forecast at the start of this year.

Like the U.S., global growth has slowed with the increased cost of capital due to higher global interest rates. The global GDP forecast for 2023 is 2.7% which is a slight increase from the 2.6% forecast back in January. While the U.S. economy has been slightly stronger than expected the forecast for Europe is unchanged while China appears to be weakening. The extent of the economic weakness in China is somewhat unclear and may materialize as a significant risk factor for global growth in 2023 and 2024.

As interest rates increased this

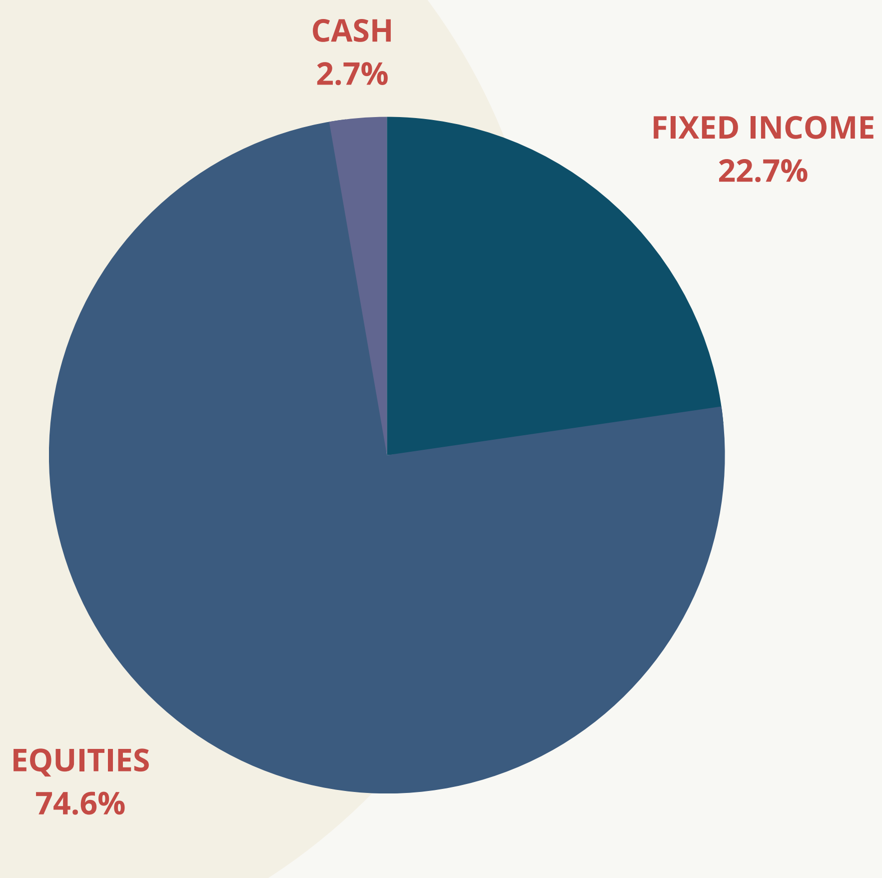
year, the expectations for corporate earnings have been reduced. At the start of the year, analysts anticipated $226 in earnings per share in 2023 for all the companies in the S&P 500 combined. On June 30th, the revised forecast has been reduced to $219 per share. This reduction is only modest and given the broad expectations for an imminent recession, the revised estimate should be viewed positively in our opinion. If the 2023 forecast of $219 holds up, it will represent an 11% increase over 2022 earnings of $197 per share.

The 10-year treasury yield ended the second quarter at 3.81% essentially unchanged from 3.88% at the beginning of the year. The U.S. Federal Reserve increased the Federal Funds Rate to 5.5% from 4.75%. at the start of 2023. With slowing inflation data, we anticipate that we will see only marginal further increases this year. There is a well-known lag effect between rate increases and impact on the economy and we are likely to see continued effects, both intended and unintended, from the rapid increase in rates from last year's ultra-low levels. One of the more obvious impacts is on 30-year mortgage rates which are hovering at 7%.

The moderation in interest rate increases has stabilized the bond market after last year's historic rout. The U.S. Aggregate Bond Index closed the June quarter up 2.1% this year. The Global Bond index recorded a 1.4% gain through June 30th. If we are at the tail end of the rate increases, the bond market is poised to deliver positive returns this year, particularly for short-term maturities with 2-year Treasurys yielding nearly 5%.

Firmwide, we ended the June quarter nearly fully invested with 2.7% of assets in cash, 22.7% of assets in fixed income securities and 74.6% in equities. If the economy were to show increasing signs of weakness, we would expect to increase our short-term fixed income exposure to benefit from current relatively high yields and possible interest rate reductions.

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



GKV FIRMWIDE

Asset Allocation

What Recession?

In our first quarter report issued in early 2022 during a period of declining stock prices and increased apprehension we wrote:

Betting on incurably high inflation for the next two years is a misplaced hypothesis in our opinion. Inflation will moderate. Employment will stay strong. Supply chain inflation will ease, and restrictive monetary policies will diminish but not crush demand. This better investing environment will not occur immediately. Current fears will slowly fade, not quickly disappear.

At the beginning of 2023 we again wrote at the conclusion of our quarterly report:

There are many positives in our current economic picture which belie a severe economic recession in 2023 …. The strength of the financial system, corporations and individuals along with very low unemployment and solid wage growth will prevent a mild downturn in economic growth from becoming a severe recession. The current ghosts of economic demise will dissipate, and growth will continue.

Now in the summer of 2023 economists, financiers and Wall Street analysts who had been proclaiming the coming of a severe recession are capitulating to the reality that the economy will avoid a recession, despite the dramatic rise in interest rates and monetary tightness which began in early 2022. Most of the economic and financial community for the past 18 months steadily predicted the economy and corporate profits will fall into a recession. They said this would begin by mid-2022, and when it failed to happen, their forecast of economic hardship was postponed to the fall, and then winter. Despite its delay, the prediction of a recession was never changed. It was still proclaimed with strenuous certainty. When their predictions of recession failed to occur on time, they blamed it on the “lag” effect of the economy to Federal Reserve policy. This year the erroneous forecast of recession was moved to the spring of 2023 and now to the fall and winter of 2023. Finally, after six quarters of economic growth beginning at the advent of 2022, economists and the financial community are changing their forecasts of pending recession to mild economic slowdown for the latter part of this year.

THE SCARY HEADLINES OF A RECESSION CREATED AN EXCELLENT BUYING OPPORTUNITY

Where do we go from here?

Annual GDP Growth

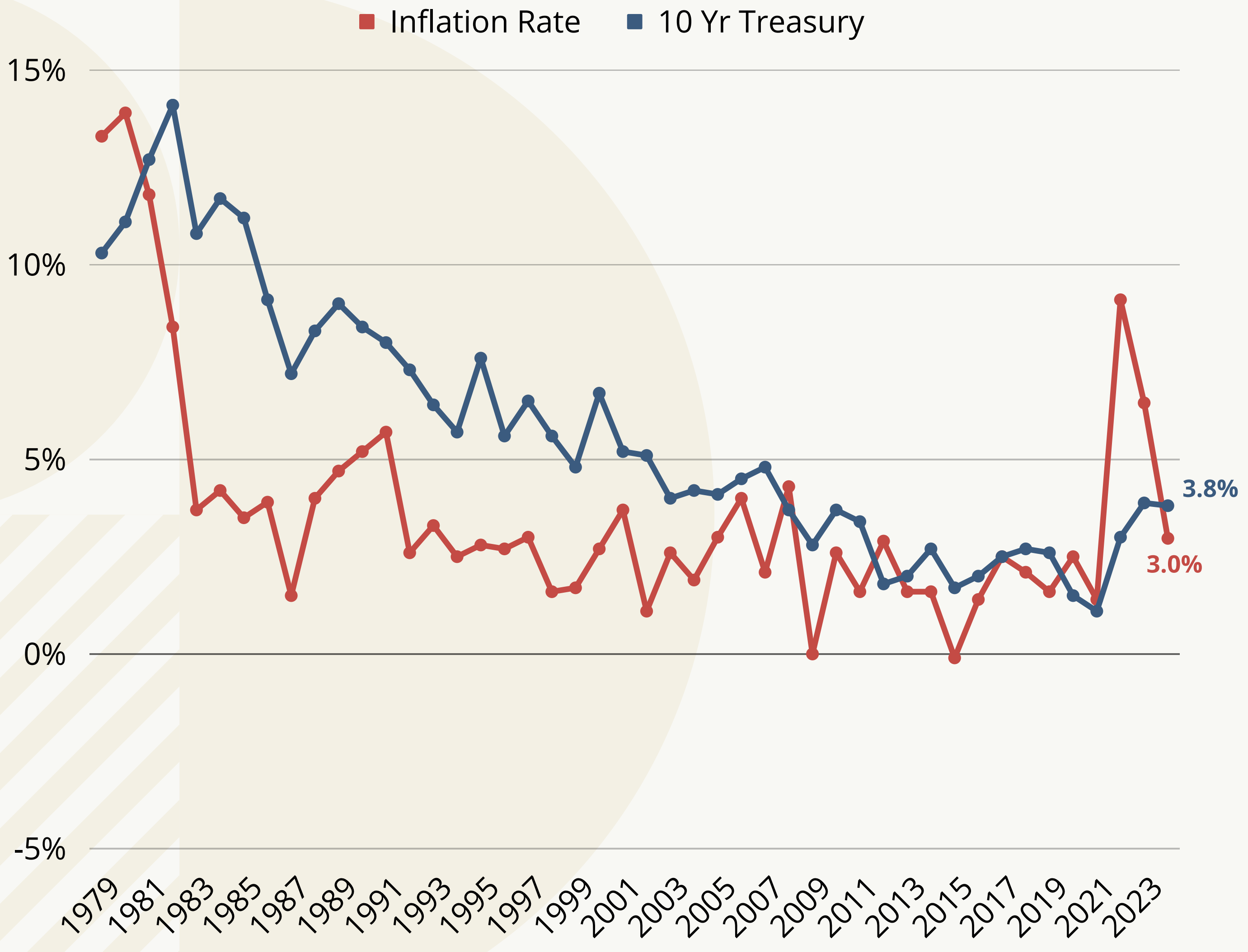
	U.S.	EU	World
2017	2.2%	2.4%	3.6%
2018	2.9%	1.9%	3.6%
2019	2.3%	1.2%	2.9%
2020	-2.8%	-6.5%	-3.1%
2021	5.9%	5.1%	6.1%
2022	2.1%	3.5%	3.3%
2023E	1.9%	0.8%	2.7%
2024E	0.5%	1.0%	2.4%

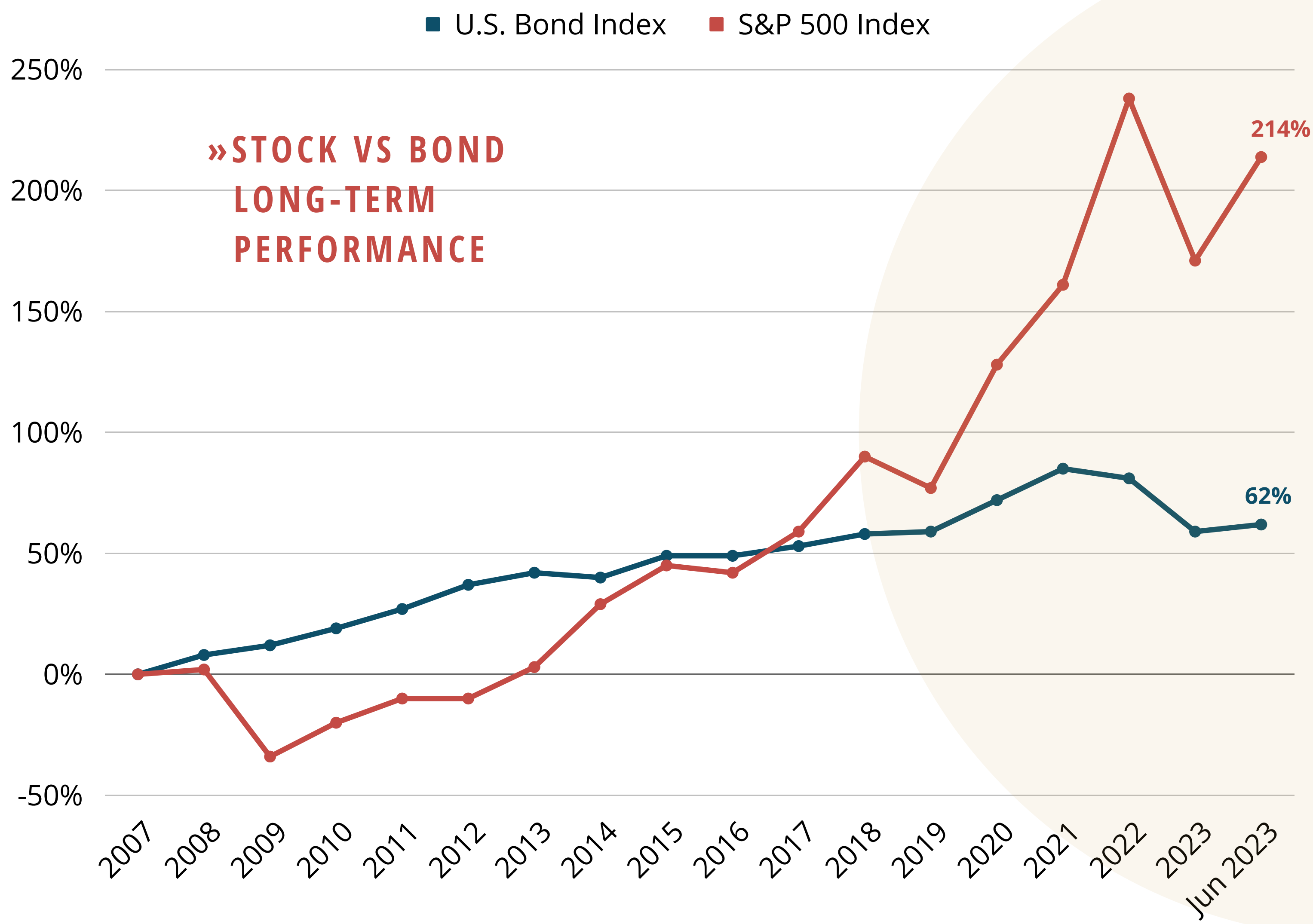
Their repeated forecasts of imminent economic hardship since early 2022 made media headlines. Negative news sells. The media continued to proclaim the "pending recession" for the past eighteen months, and many investors finally accepted the prediction as an inevitable truism. Uncertainty was pushed into investors' minds in response to the constant drumbeat of recession. Fear started to grow and in response stock prices began a steady decline throughout 2022. By year end 2022 the losses were significant. As 2023 began, the recession forecast was again pushed further into the future, but now investors were becoming more skeptical of its probability. At GKV Capital we never believed all the ingredients were present to cause a recession. Rising interest rates historically have been a catalyst for a recession, but the strength of the labor market, business priority to retain workers and not lay them off, rising wages and strong consumer demand argued against it. Household balance sheets are healthy. About 49% of US homes have equity values at least half their worth. Corporate profits are not in decline across numerous industry groups.

Now the consensus has shifted to our opinion that monetary tightness alone would not precipitate a recession. An increase in interest rates from 0% to 5.5% in eighteen months is an historically dramatic increase, but zero percent interest rates caused by the pandemic were the abnormality, not the 5 ½% rise. The two major catalysts for an improving stock market environment were the plateauing of interest rates and a decline in the rate of inflation. According to Chairman Powell, disinflation has been occurring without any real costs in the labor market. In the first quarter of 2023 investors started to focus on these two factors and moved away from the to-date erroneous prediction of a soon-to-occur recession. With inflation declining, an end to interest rate increases seemed to be near. Inflation has steadily fallen for the last twelve months, and in response the rise in interest rates has slowed and has very possibly ended. The economy never slipped into a recession and the pessimists are now turning more optimistic. The fear of recession is dissipating while a more positive economic outlook, is in ascension. The commentary has moved from the shrill recession headlines to a more positive posture that a recession may be avoided. In the second quarter of 2023 the US economy grew at an annualized rate of 2.4% which is close to its normal rate. In our judgement, history will show 2023 as a year of modest economic growth and corporate profit growth, and in hindsight the fears and selloff in stock prices in 2022 were excessive and represented an excellent opportunity for investors.

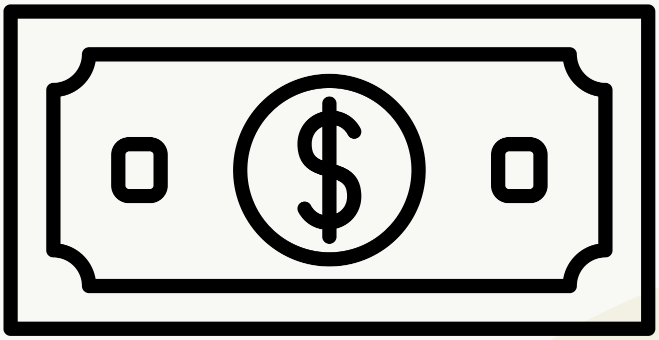
The forecasting error of a recession was the principal factor leading to the decline in common stock prices in 2022. With a revision in expectations toward continuing economic growth this year and in 2024 investors have slowly put aside skepticism about future prosperity and channeled this optimism into greater confidence about future stock market valuations. Simply stated, the pessimism last year that the Federal Reserve would wreck the economy was wrong, and the perception that many areas of the economy are strong and should remain favorable-to-improving for the next several years is growing in acceptance among investors. The Federal Reserve has finally predicted no recession this year. The most anticipated recession of our time has been pushed out indefinitely.

10 YEAR TREASURY YIELD & INFLATION RATE





Inflation will not return to 2% anytime soon. This is a theoretical goal which looked achievable as a result of the distorted environment created by the pandemic. It is not necessary to have 2% inflation to have sustained prosperity. In our opinion, an inflation environment of 2-3.5% will be with us for the foreseeable future. Interest rates will also not retreat to a range of 0-2% in the near term. They will probably settle in the 3-4% range for the next several years. Monetary policy will remain conservative for an extended period as the Fed reduces its balance sheet. Interest rates of 3-4% and a more consistent, stable monetary policy should support more predictable economic and corporate growth for the next few years. The labor market will remain healthy and consumer demand should show acceptable growth well into 2025. The business investment environment will experience above normal trend line growth for the next several years as a result of the end of the trend toward globalization. The disruptive effects of the pandemic are more and more in the rearview mirror. Technology advances, like artificial intelligence, will provide significant stimulus to a major part of our economy for years to come. Commodity prices will probably be more stable during the next five years than they were during the last 5 years. War and its expansion beyond its present scope is the major unknown negative, but it is a factor which does not belong in any rational investment equation as a critical parameter.



The scary headlines of a recession created an excellent buying opportunity. Although common stocks have performed well this year, even beyond our positive expectations, we believe it is highly probable that prices will be higher at year end and that a rally can continue into 2024. The positive effect of a weaker dollar internationally has not yet been reflected in corporate profits. For the stock market, earnings represent the sum of all expectations. They reflect for investors what is happening in the world. Earnings have shown small growth in 2023, but better than expected, and the stock market has responded. We expect 2024 to show even better growth in earnings. The rise in stock prices shows investors now believe in a return to good earnings growth.

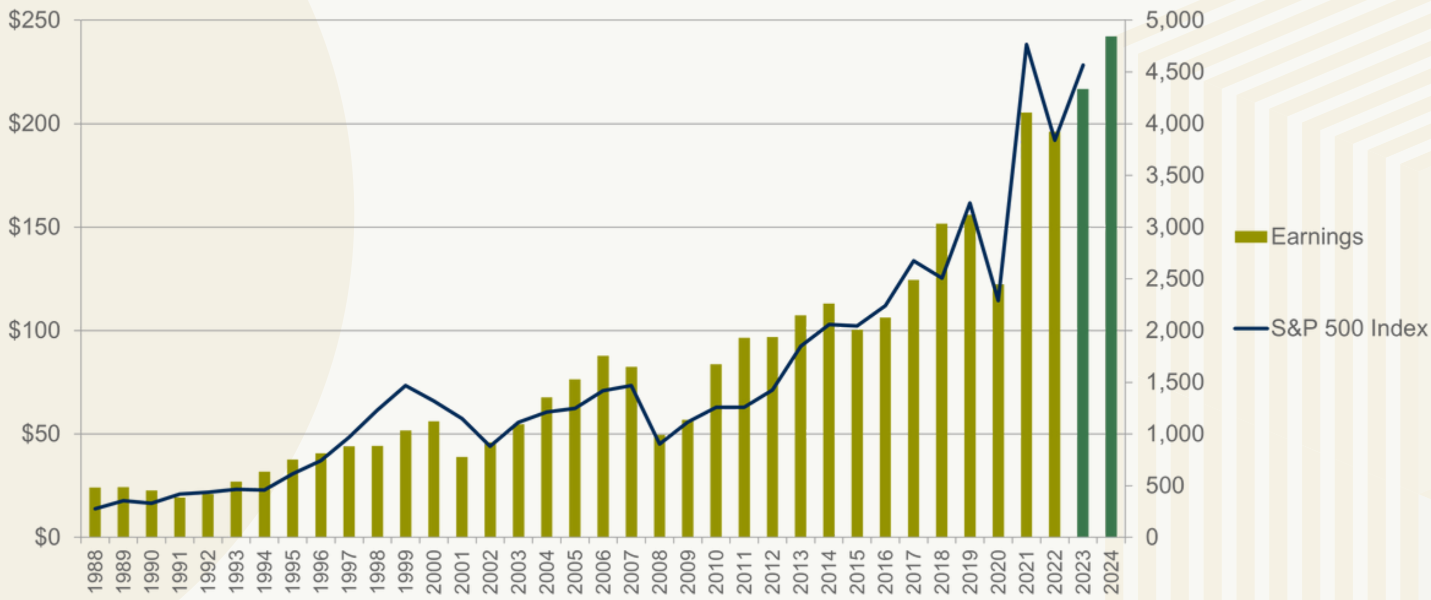
IF YOU SEARCH FOR REASONS NOT TO INVEST...YOU WILL FIND THEM

We also look for bond prices to rally. The present inverted yield curve will revert to its normal pattern of lower short-term rates and higher long-term rates. Bonds will make a positive contribution to investor portfolios over the next several years. We think an asset allocation of approximately 70% in common stocks and 25% in fixed income, with the remainder in cash reserves, is the optimum diversification for the foreseeable future. But flexibility and the constant reassessment of market risk is a cornerstone of our investment management. We are not interested in the accuracy of predictions, but instead focus on the catalysts which can change the investing environment.

If you search for potential problems, reasons not to invest, you will find them. There will always be potential disasters around the corner. Investors must discern which are Chimeras, scary fictional monsters that should be discounted, and which are real possibilities. The real risk comes from black swan events, those events that no one saw coming. They are so rare that they are impossible to predict. A pandemic, hurricane Katrina, a massive financial crisis, or a global war. We know they can happen, but their possibility should not dictate your investment strategy. Living in California, a major earthquake is always possible and should require some level of preparation, but it should not keep you from entering tall buildings or driving across an overpass.

The scary recession headlines have faded. Employment is robust and consumers are in solid shape. Economic growth has certainly cooled and as a result not all companies are thriving. The flawed business models are more apparent in the weaker economic environment. The quality companies continue to thrive. This is what we refer to as a stock pickers market where prudent investment selection becomes more important.

CORPORATE EARNINGS VERSUS THE S&P 500 INDEX PERFORMANCE



Company valuations, the price of a stock, is ultimately derived by expected future cash flows. While corporate earnings are not always equivalent to cash flows due to the vagaries of accounting, it is a reliable proxy. We closely track corporate earnings and earnings expectations to determine the relative valuation of the stock market. With earnings growth, we should expect to see appreciation in the overall stock market index. In the chart above we show annual earnings for all of the companies in the S&P 500 against the value of the S&P 500 index. The significant drop in earnings in 2020 due to the Covid pandemic followed by the rapid reacceleration is readily apparent.

	2016	2017	2018	2019	2020	2021	2022	2023E	2024E
S&P 500 EPS	$106.26	$124.52	$151.60	$155.84	$122.38	$205.36	$196.95	$219.42	$244.06
EPS y/y growth	6%	17%	22%	3%	-22%	68%	-4%	11%	11%
S&P 500 Index	2239	2673	2507	3231	3756	4766	3840	4450	
Index y/y return	10%	19%	-6%	29%	16%	27%	-19%	16%	
Trailing P/E	21.1x	21.5x	16.5x	20.7x	30.7x	23.2x	19.5x	20.3x	
Forward P/E	**18.0x**	**17.6x**	**16.1x**	**26.4x**	**18.3x**	**24.2x**	**17.5x**	**18.2x**	

2023

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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