BRAVE
Family Advisors

2022 Update

May 2022

"Defense wins championships"
Paul "Bear" Bryant

Dear Clients and Friends,

We are sending this brief note to update you on our thinking on the markets in light of the recent challenging action.

The U.S. markets are off to their worst start to a year in eight to nine decades. The S&P 500 is down 13% for the year, the Nasdaq is off 23% from its high, and the bond market is down over 9%. The very unusual correlation between the stock and bond markets is due to the root cause of the declines: surging inflation is causing the withdrawal of the massive monetary stimulus that has supported asset prices over the last two years.

We have been worried that market valuations had reached unsustainable levels and that a significant correction in equity and fixed income markets was likely (please see our February client letter); however, that doesn't make the current experience any less uncomfortable. Fortunately, we took action earlier this year in most of our managed client accounts to reduce risk levels. Nearly all equity portfolios include holdings of gold, SQQQ (an inverse ETF), and significant cash levels. We began reducing duration in our fixed income portfolios over two years ago and they currently have an average duration of approximately one year. The result of these actions is that equity allocations are 20-30% below target and fixed income losses are about one-third of those of the benchmark.

We wish that we could argue markets were at levels that would allow us to be more constructive on near-term returns after these declines. Unfortunately, U.S. stock prices continue to trade at historically expensive valuation levels. By many long-term measures, the U.S. equity market remains as highly valued as it was at the peak of the dot-com bubble in 2000 and the high in 1929. The U.S. total market capitalization as a % of GDP remains well above the level seen at the peak of the internet bubble in 2000 **(Chart 1)**. The current CAPE ratio (Cyclically Adjusted Price to Earnings ratio) of 36 indicates that stocks are still at among their most expensive levels in the last 100 years only exceeded just before and just after the 2000 peak **(Chart 2)**. U.S. stocks have begun correcting their extreme valuation relative to those in other regions of the world, but are still more than three standard deviations above the 50-year average **(Chart 3)**. Within the U.S. market, growth stocks are finally correcting relative to value stocks; however, they remain at about the same level as the peak seen at the height of the dot-com bubble **(Chart 4)**. In the fixed income market, interest rates have moved up significantly, but real rates are still highly negative suggesting that there may still be significant room for further increases.

Our view is that this inevitable correction in financial markets has further to go before we will feel comfortable positioning our client portfolios closer to their respective benchmarks. Until then, our defensive positioning should cushion the damage. We have enjoyed almost thirteen years of exceptional returns; we are optimistic that the current decline will wring out the excess and set the stage for the next bull market.

As always, we welcome your comments and questions. Please don't hesitate to call, visit, or email at any time.

Your team at the BRAVE

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Chart 1: Wilshire 5000 Total Market Capitalization to US Annual GDP

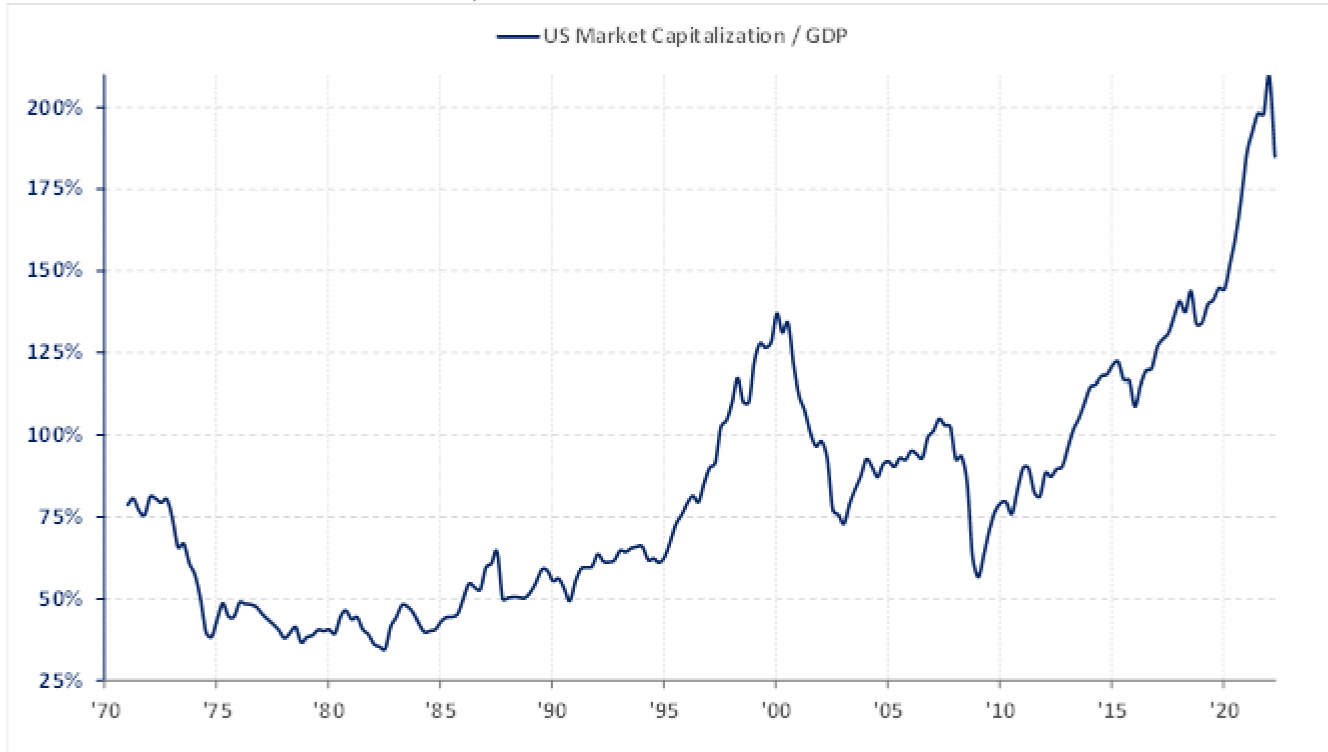

Chart 2: Long-term Historical Cyclically Adjusted PE Ratio with Recessions

Chart 3: MSCI United States Index vs. MSCI Europe Index

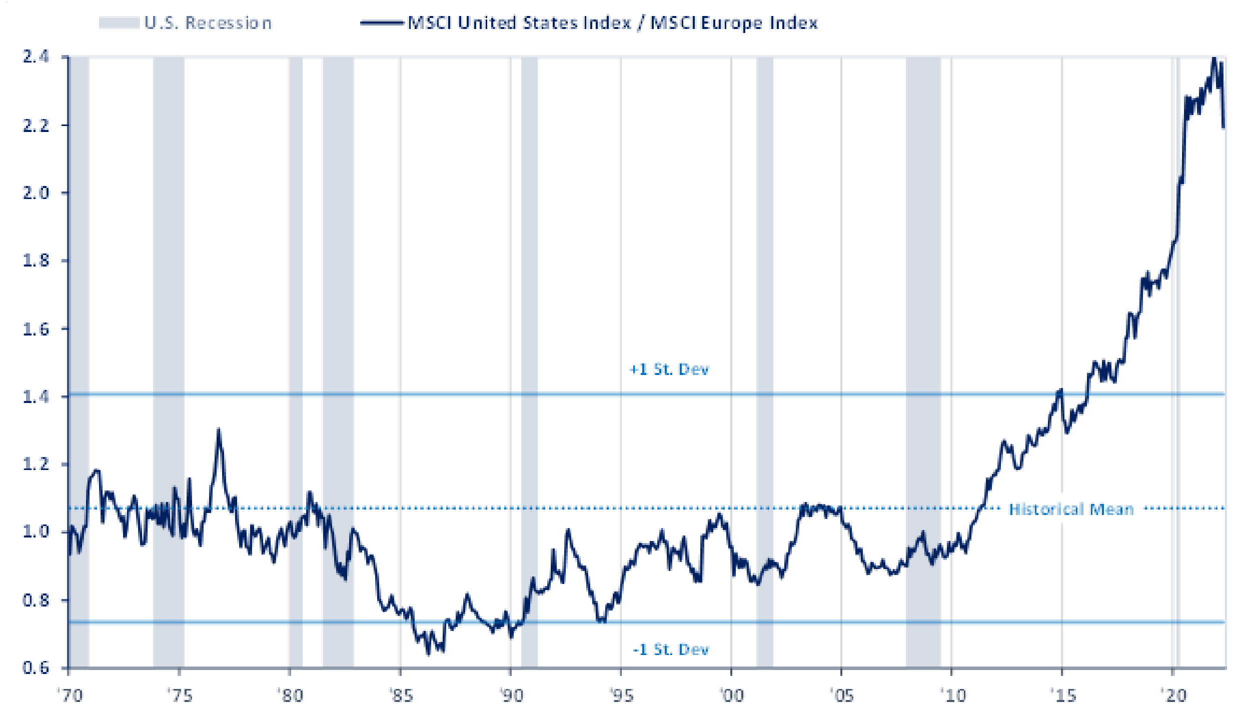

Chart 4: Russell 1000 Growth Index vs. Russell 1000 Value Index

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