HOLLENCREST
CAPITAL MANAGEMENT

100 Bayview Circle, Suite 500
Newport Beach, CA 92660-8903
Main: 949.737.7700
Fax: 949.737.7703
clientcommunication@hollencrest.com

2023 Q2 Outlook

April 1st, 2023

Economy: Hollencrest sees modest economic growth as likely for the remainder of 2023 with a recession now looking more probable in 2024, but with the risk of a headline-grabbing catalyst pulling a recession forward into the latter half of 2023.

- It appears economic growth may be decelerating, but data released in recent quarters still shows growth. Per the Bureau of Economic Analysis, real GDP registered a 2.6% annualized growth rate in Q4 of 2022, down from a rate of 3.2% growth in Q3. As of March 31st, the Atlanta Fed's GDPNow forecasting tool predicts Q1 2023 GDP will come in at a 2.5% annualized growth rate, but with personal consumption expenditures growing at a strong 4.6% annualized rate. Employment is high and the labor market is tight, which has helped sustain both growth and inflation through continuing growth in consumption of goods and services.

- Issues that have recently emerged with regional banks exacerbate any economic deceleration or deterioration. While the idea of a "no-landing" scenario where the Fed achieves price stability and reverses to an easier policy stance without a recession has gained some exposure in headlines, Hollencrest only sees the possibility of either a broad, traditional recession or a less painful "rolling recession," with probabilities skewed towards the former. We believe we are already well into a rolling recession and only time will tell how Fed policy and these emerging issues with major banks reverberate through the economy.

- If economic contraction is confined to the more sanguine "rolling recession" outcome, then we have already begun to roll through housing and tech. Now financials are squarely in the crosshairs, and we are skeptical that it stops there. Issues that are now showing themselves in the banking industry point to further deterioration across the broader economy as lending behavior changes and the availability of capital contracts rapidly. Revisiting some of our favorite whiteboards from Macro 101, we recall that {Velocity * Money Supply = Price * Output}. A rapid decline in lending equates to a de facto reduction in the velocity of money in this equation, and we know that the Fed has been acting to reduce the money supply since early 2022. This means that prices (inflation) and output (real economic growth) will both come under pressure.

- Be careful what you wish for as it relates to a pivot in Fed policy - a message from the past couple of quarters that we feel compelled to reiterate. Investors continue to rejoice (buy risk assets) when data points of limited importance spark belief that the Fed will suddenly reverse course prior to their inflation targets being achieved. We do not expect the Fed to

This exhibit contains content written by Hollencrest and may include additional information supplied by third party research providers. The views and opinions expressed are subject to change without notice. This material is provided for informational purposes only and does not constitute an offer or solicitation to purchase or sell any security or commodity or invest in any specific strategy. It is not intended as investment advice and does not take into account each investor's unique circumstances. Information has been obtained from sources believed to be reliable, but its accuracy, completeness and interpretation cannot be guaranteed. Past performance is no guarantee of future results.

be that proactive, if only to preserve their credibility for future cycles by sticking to what was previously communicated. More importantly, a major change in Fed policy would likely be a negative indicator of where the economy is at and where it is headed. History shows that a shift back to easier policy most commonly precedes a further decline in stocks. This is likely because the demand destruction caused by tighter policy becomes so advanced and entrenched by the time policy is changed that a deeper than expected economic pullback becomes unavoidable. While many supply-side inflationary pressures have corrected, making the Fed's job a little less challenging, conditions in the labor market have barely begun to ease. Unfortunately, the labor market may be the most important part of the US economy's supply-side, and we suspect the Fed holds this view. We have a hard time seeing a true change in policy until unemployment moves to a level more commonly associated with recessions.

Stocks: The S&P 500 ended Q1 at 4,109, up over 7% for the quarter. We expect stocks to be range bound on the upside from here with risk to the downside if macro conditions deteriorate.

- The stock market's upside appears limited with valuation multiples currently sitting at high levels in our view, especially relative to returns achievable in bonds and cash equivalents. As we enter Q2, technicals are fairly strong, especially in cap-weighted and more tech-focused indices like the Nasdaq. Momentum is to the upside, meaning short to intermediate term gains are possible. We are biased towards reducing overweights in stocks as the market rallies into more overbought conditions, especially given the macro outlook described above.

- The earnings side of valuation creates risk to the downside. Year-over-year earnings are already providing challenges, and, if an economic contraction takes hold, forward expectations could fall rapidly. Multiples would also contract in this environment, meaning stocks could fall substantially. Given our concerns about limited upside potential, our outlook becomes asymmetric and pushes us into a more cautious stance.

- Hollencrest continues to hold significant amounts of our equity allocation in cash alternatives, holding dry powder to take advantage of oversold conditions in a stock market drawdown or to redeploy when we have higher conviction in sustainable gains. We exit Q1 with some contradiction amongst our indicators, leaving us ready to reduce equity exposure even further if the market becomes more overbought.

Bonds and Rates: Treasury yields on the long end of the curve have moved largely as we expected so far this year, and we believe the 10-year's 2022 peak yield of approximately 4.25% will not be revisited. Instead, we see 3.5% as close to fairly valued with a high likelihood 3% is breached if macro conditions deteriorate further.

- Peak Fed Funds for this cycle is approaching, and we still see no reason to predict anything contrary to what the Fed is guiding toward over the coming months. How long it takes them to reverse course and start cutting rates is a function of how long it takes rates at the current level to stifle demand. The Fed will wait as long as it can, meaning a rate cut could be a 2024 event.

This exhibit contains content written by Hollencrest and may include additional information supplied by third party research providers. The views and opinions expressed are subject to change without notice. This material is provided for informational purposes only and does not constitute an offer or solicitation to purchase or sell any security or commodity or invest in any specific strategy. It is not intended as investment advice and does not take into account each investor's unique circumstances. Information has been obtained from sources believed to be reliable, but its accuracy, completeness and interpretation cannot be guaranteed. Past performance is no guarantee of future results.

- Credit spreads remain stubbornly low given elevated macro risks. Some volatility crept into corporate and high yield markets with stresses exhibited by the regional banks, but spreads are not yet at a level that we consider restrictive or indicative of distress. This continues to be a very important indicator we monitor daily, and we expect these spreads could widen later this year if liquidity evaporates and creates a self-fulfilling credit crunch.

- Appropriate management of cash has become an even bigger focus with the stresses shown by regional banks. The inverted yield curve should be a negative for banks as short-term costs of capital outpace what can be made on longer-term assets purchased at very low yields. Market forces should make this a reality for banks large and small as depositors seek to make meaningful returns and banks are forced to pay more for deposits. Hollencrest has formalized a cash management service to assist our clients with earning appropriate returns on assets that must be held aside for liquidity and are not otherwise eligible for investments that involve some level of risk. Please contact your advisor at Hollencrest if you are interested in learning more.

This exhibit contains content written by Hollencrest and may include additional information supplied by third party research providers. The views and opinions expressed are subject to change without notice. This material is provided for informational purposes only and does not constitute an offer or solicitation to purchase or sell any security or commodity or invest in any specific strategy. It is not intended as investment advice and does not take into account each investor's unique circumstances. Information has been obtained from sources believed to be reliable, but its accuracy, completeness and interpretation cannot be guaranteed. Past performance is no guarantee of future results.