GKV Capital Management

Quarterly Update

First Quarter 2022

First Quarter 2022 Review

Globalization in Decline

Opening Thoughts

Stock markets are volatile. There's a reason financial professionals must always hedge any talk of investment performance with "over the long-term" and "past performance is not indicative of future results". Despite the disclaimer, the long-term past performance is the reason anyone invests. Yes, stocks in the short-term are volatile, but an annual average return of more than 8% for the S&P 500 since 1956 is hard to pass up.

If the economy continues to grow, stocks will appreciate. Of course, this doesn't happen in a straight line. There will be fits and starts. At GKV, we actively manage accounts for the current economic environment. We reduce exposure to equities as it becomes apparent that the economic cycle is entering a downward phase. Conversely, we increase risk as we expect the outlook to improve. We don't pretend to be able to get it exactly right, but the result is that we can generally maintain performance while reducing volatility.

2022 has been challenging. Uncertainly has increased. And when investors are uncertain the market becomes more volatile. So far, 2022 has been a waiting game to determine whether earnings can be strong enough to move the market higher or will fighting burgeoning inflation take interest rates too high and force a recession. We asked our Magic 8-Ball which scenario was more likely, but the only response was an unhelpful "Ask again later".

2022 is shaping up to be a tug-of-war vacillating between positives and negatives depending on the day. So far it's a stalemate. The macroeconomic data is positive. Consumer demand is strong. There is money to spend and the pent-up demand from the pandemic has not yet been sated. Retail sales numbers keep moving higher. Corporate profit margins are at all-time highs above 12%. Unemployment is back to historic lows below 4%.

Then there's that inflation problem. It's been a while since we had to worry about inflation and it's unclear how much of a problem inflation will really be. It is apparent growth is slowing. It had to slow after the rapid reacceleration coming out of the pandemic. The question is, does it have to slow so much that we need to be concerned about a recession?

The economic fundamentals are in good shape, but many of the data points are in the rear view and are not necessarily indicative of what we should expect. Given the uncertainty, we have reduced some of our exposure to the markets and raised cash. Despite this, earnings are holding up. We expect favorable results for the first quarter and if earnings meet, or better, exceed expectations we believe the market can move higher from here.

So, we, like the market, find ourselves uncertain. An imminent recession in the U.S. seems unlikely at this juncture. However, growth is slowing. How much growth slows will determine whether the markets can move higher or lower from here. Expect volatility to continue in the meantime.

1Q22 Data Points

DJIA YTD	**-4.6%**
S&P 500 YTD	**-5.0%**
NASDAQ YTD	**-9.1%**
US Bond YTD	**-5.9%**
10-Year Treasury Yield	**2.32%**
S&P 500 LTM Dividend Yield	**1.27%**
S&P 500 EPS Next 12-MTH	**$231.42**
S&P 500 P/E	**19.6x**

First Quarter 2022 Review

It's been a difficult start in the stock and bond markets for 2022. After two years, we are clearly moving past the Covid pandemic. Economic activity has rebounded. Unemployment has fully recovered and consumers, the driver of the U.S. economy, are in great shape. Against this backdrop, high demand and constrained supply has resulted in a resurgence in inflation after a 35-year hiatus. Interest rates are rising fast as the Federal Reserve pivots to respond to rising prices. Meanwhile a ground war rages in Europe. All this feels a bit more like the 20th century than the 21st. The result in the markets has been a new year of uncertainty, prompting investors, including us, to reposition holdings to reduce exposure to risk.

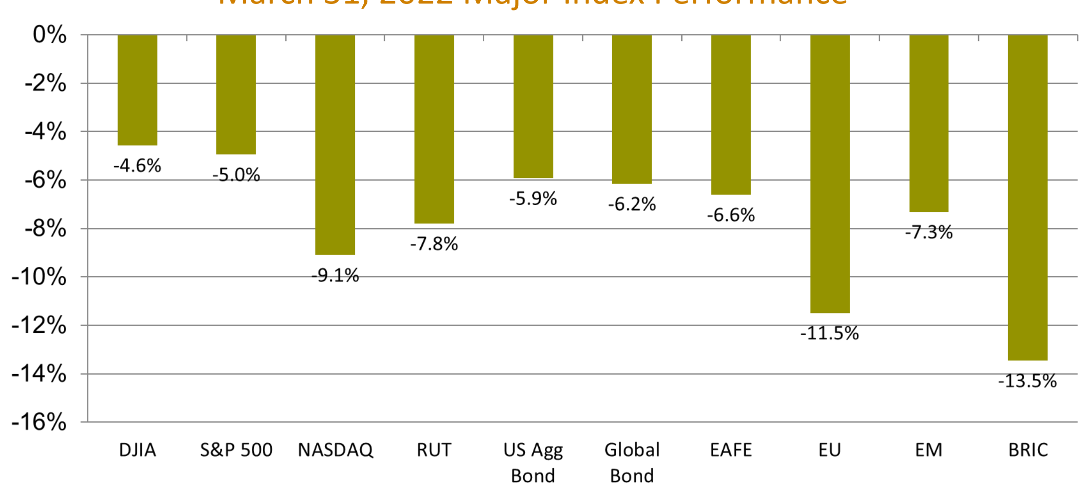
For first quarter of 2022 the S&P 500 is down 5.0%, the Dow Jones Industrials down 4.6% and the NASDAQ, which is disproportionally weighted towards technology companies, declined 9.1%. Small cap companies, as measured by the Russell 2000 index, declined 7.8%.

Only the energy and utility sectors recoded positive performances in the first quarter. The energy sector was the hardest hit during the pandemic, losing more than 37% in 2020. Since then, demand for all types of fuel has bounced back to pre-pandemic levels. The energy sector was the best performing in 2021 gaining 48% to wipe out the pandemic losses. The industry, however, is still ramping production back up after the unprecedented fall off in demand. For example, U.S. oil production in January this year is still 11% below production in January 2020, just before most of us ever heard of Covid. With demand far outstripping supply, prices have risen dramatically even before Russia's invasion of Ukraine. As the single largest energy supplier to Europe, the war in Ukraine and the economic sanctions in response have further curtailed supplies, driving prices higher. Production will increase and prices will stabilize and even fall modestly, but it will take time. In the meantime, high prices are creating a windfall for the energy sector resulting in continuing outperformance for the sector. The energy sector gained another 38% in the first quarter of 2022. Utilities managed to cobble together a 4% gain for the first three months of 2022. The other nine sectors all declined ranging from a 12% loss for communication services to a 1.6% loss for consumer staples.

Despite rising concerns around inflation, rising interest rates and geopolitical crisis, the outlook for earnings of the companies in the S&P 500 remains positive. There is broad expectation that rising interest rates will necessarily slow economic growth in the coming twelve months, but that slowdown has yet to show up in analyst earnings estimates. The consensus estimate for the March quarter is for $51.17 which reflects a slight downward revision from the $51.46 estimate held by analysts on December 31st. For the full year, 2022, the estimate is $225.50 which has been revised up from $220.11 at the end of last year. This forecast would result in year-over-year earnings growth of nearly 10%. At the end of March, the S&P 500 index closed at 4,530 resulting in a 2022 price-to-earnings ratio of 20.1x. This valuation is on the higher side of the historical average 18x.

The U.S. equity markets continued to outperform most of the global equity markets in the first quarter. The MSCI EAFE (Europe, Australia, Far East) ended the first quarter down 6.6%, Europe finished down 11.5%, and emerging markets ended the quarter down 7.3%. Rising prices globally and the economic fallout from the war in Ukraine and Russian sanctions are likely to have a more significant negative impact in Europe and emerging markets. Global GDP growth is slowing and while it had been forecast to grow 4.4% in 2022, we expect this estimate to be reduced as the year progresses due to the impact of higher prices, higher interest rates, and

March 31, 2022 Major Index Performance

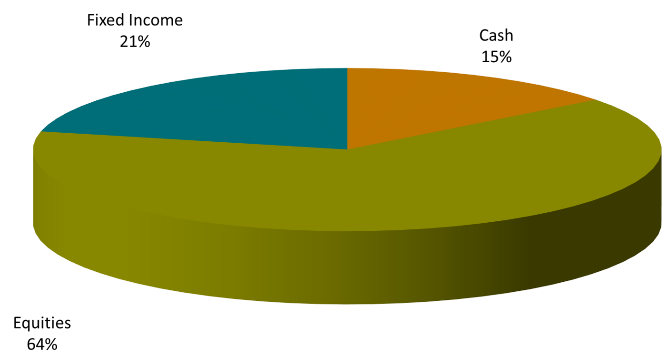


Ukraine war consequences. From our vantage we continue to favor U.S. based equities over foreign markets.

Macroeconomic data particularly related to the health of the consumer continues to be very positive. The unemployment rate has returned to pre-pandemic levels hitting 3.6% in March. The two greatest challenges for companies currently are keeping up with demand and finding workers. Both are positive problems to have, although both issues will continue to drive inflationary pressures. Retail sales for February 2022 were up more than 15% from a year ago. U.S. disposable income also increased in February, up 4.4% from last year.

As inflationary pressures began to build last fall it was hoped that the rising prices due to supply constraints were merely a transitory side effect exiting the pandemic. The inflation rate for February hit 7.9%, a level not seen since the early 1980s. The compounding impact of the war in Ukraine promises to further increase supply pressures for key products, fuel and food. Lastly, frantic demand for workers is pushing wages higher creating a feedback loop that may prove difficult to break out of. To combat inflation, interest rates are rapidly moving higher. The 10-year treasury ended the first quarter at 2.7%, up dramatically from 1.5% at the beginning of the year. We anticipate several rate increases from the Federal Reserve as the year progresses. Rising interest rates have had a negative impact on bond prices resulting in a 5.9% negative performance for the U.S. aggregate bond index in the first quarter. With rising interest rates, we anticipate continued negative pressure on bond prices through the year. The global aggregate bond index finished even lower, declining 6.2% in the first quarter.

GKV Firmwide Asset Allocation

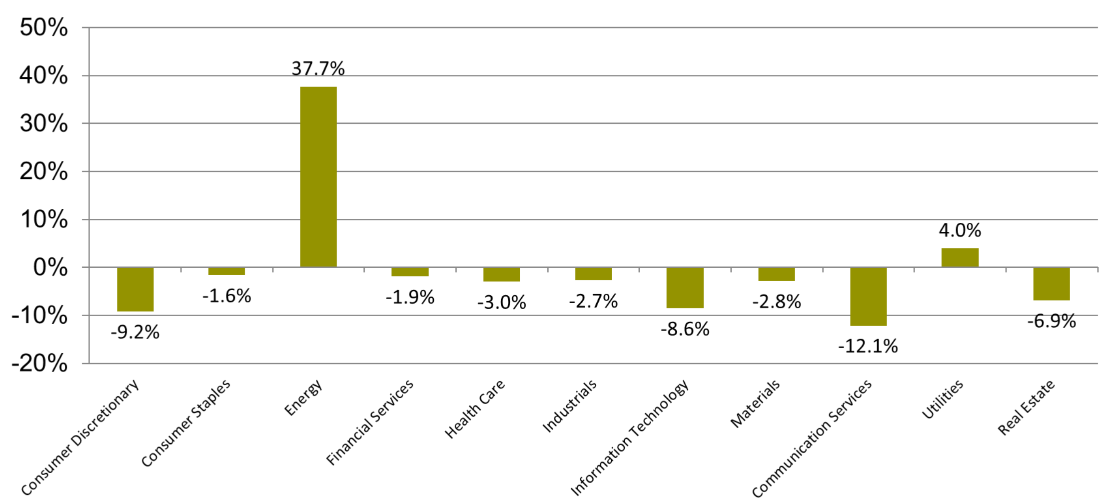


GKV Capital March 31, 2022

We manage separate accounts for each of our clients. Every client has their own risk appetite and tax consequences to consider. As a result, none of our client portfolios look the same. Despite this disclaimer, it is worthwhile to look at the summary of our asset allocation broadly across the firm. On March 31st equities totaled 64% of assets across all our client portfolios, fixed income positions were 21% of assets and cash increased to 15%. By comparison, on September 30th, 2021, equities exposure totaled 72%, fixed income 26% and cash 2%. We have been steadily reducing risk by raising cash since last fall.

Based on the positive macroeconomic data, particularly related to the strength of the consumer, we remain cautiously optimistic. However, equities are not inexpensive and uncertainty around inflation, Federal Reserve policy changes and geopolitical crisis have prompted us to increase caution.

March 31, 2022 Sector Performance



Globalization in Decline

"Globalization has created this interlocking fragility. At no time in the history of the universe has the cancellation of a Christmas order in New York meant layoffs in China ."

\- Nassim Nicholas Taleb

It's truly amazing. In the middle of a pandemic, from the comfort of my home I can have a video conference call with a client. I can email an update of their portfolio performance directly to their inbox. I can make a few trades, alter their exposure to technology stocks or increase energy holdings. And then I can go shopping. Buy clothes manufactured for Lululemon in Canada with fabric made in Taiwan or order groceries to be delivered to my doorstep or get lunch to be delivered by DoorDash. Except toilet paper. It seems the world is out of toilet paper.

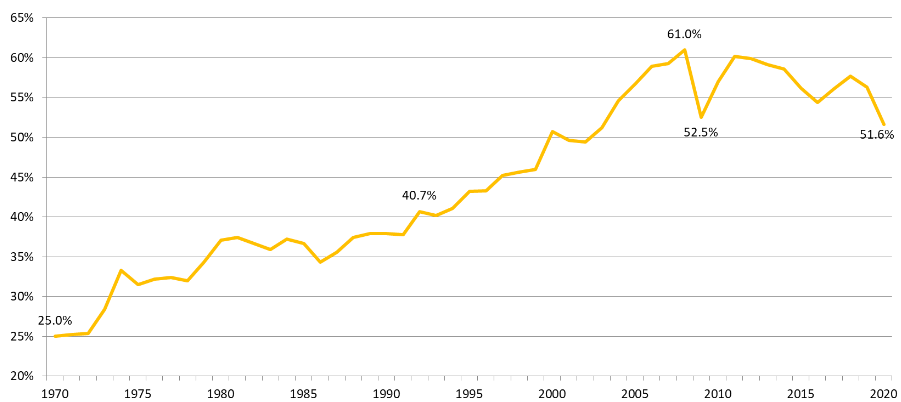
Communications technology has made the world smaller and commerce vastly more efficient. We have become accustomed to cheap products at Costco or Wal-Mart or Amazon and not only are the prices low, but you don't even have to leave the house.

The combination of technology and a stable geopolitical landscape enabled a steady expansion of global trade over the last fifty years. In 1970 trade worldwide accounted for 25% of global GDP, meaning one quarter of all goods produced were traded with international partners. By 2000, global trade had doubled to 50% of all goods and services produced.

Rising global trade thrived in the post-Cold War era with relative peace and gains in technology making geographic location irrelevant. Manufacturing and design could chase greater efficiencies in labor costs anywhere in the world. Parts and finished products could reliably and rapidly be shipped wherever and whenever necessary. Food prices, until recently have remained stable and mostly affordable around the world. Globalization worked largely because the system was reliable. Essential parts could come from China or Vietnam, be assembled in Mexico, and shipped to Canada. Production costs in markets with inexpensive labor significantly outweighed transport costs.

Although there are arguably negative consequences of the globalization of trade, the benefits have been measurably significant. Over the period, income per capita accelerated dramatically both in developed markets as well as emerging economies. Just as important, globalization enabled more goods to be produced and distributed more efficiently, relegating inflation to the economic textbooks. Gross domestic product (GDP) worldwide has increased more than 850% from 1973 while income per person doubled between 1985 and 2000 and doubled again from 2000 to 2019. In percentage terms, less developed countries have seen greater gains than developed economies, however the gains have been tremendous across the board. Global cooperation has truly benefitted everyone. Despite already having the highest income, the U.S. also doubled income per capita from 1985 to 2000 and then increased income another 77% between 2000 and 2019. Meanwhile, global inflation has been consistently low and steady, running below 4% for more than 20 years.

Trade Share of Global GDP



The trend toward globalization has stalled and recently, has started to run in reverse. The world trade share of GDP output peaked in 2008 at 61%. In 2020, global trade as a percentage of worldwide GDP totaled only 51.6%, the lowest level since 2003. We suspect this pullback from globalization is more than transitory. Instead of an economic tailwind accelerating growth and reining in inflation, the increasing nationalism has become a headwind, increasing production costs, and reducing economic growth over the long-term.

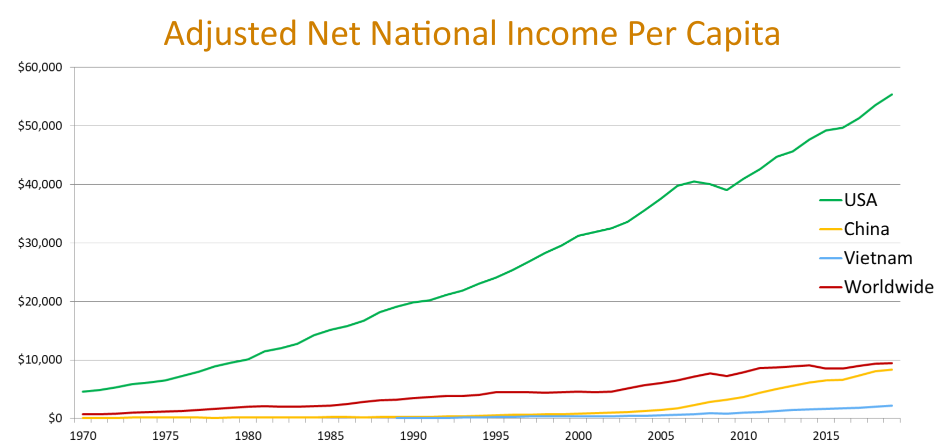
The Pandemic and the Ukraine war have highlighted the weakness of globalization. It makes businesses dependent on worldwide far-flung supply chains which can easily and quickly break down because of pandemics or political sanctions. It is also being reexamined as the world becomes split between democracies and autocracies. Neither wants to continue the economic risks of being dependent on their political rivals' conflicting economic system. There is also significant distrust among countries espousing different economic systems and liberties.

The decline in global trade started gradually, initially due to nationalism including perceived threats to national security and political pressure to protect jobs. In 2016 when the British voted to leave the European Union and we elected President Trump, the decline accelerated. A "decoupling" of the global economy into Chinese and Western portions has been accelerating for some time. The Trump administration's implementation of tariffs and later targeted sanctions against Huawei demonstrated a willingness to use economics for strategic leverage. Targeted intellectual property export restrictions showed China and the world the importance of economic independence and manufacturing. To avoid the possibility of sanctions from the West, alternative sources for parts and manufacturing are strategically necessary. Western companies, in turn, began to diversify their own manufacturing supply chains away from a dependence on China. The trend has accelerated.

Politics for the last decade have turned sharply inward. Nationalism and protectionism have become more popular around the world. Global trade increased with an understanding that all participants would enjoy greater economic production, higher wages, and cheaper goods. Nationalism is necessarily predicated on a view that economic competition is a zero-sum game. That there are winners and losers with each country maneuvering to be the winner. A cynical belief that any policy benefitting anyone else is probably bad for us, is becoming the accepted erroneous thinking. Tariffs and protectionist economic policies have always punished both trading partners. As any student of simple game theory is aware, more can be accomplished through cooperation but that requires trust between partners. The increased combativeness between China and the West and now Russia's invasion of Ukraine followed by significant economic sanctions is reinforcing the strategic importance of economic autonomy.

The Covid pandemic demonstrated just how fragile globalized supply chains are. The pandemic did more than simply alter consumer demand, it showed that a quarantine shutdown in China has the power to idle an auto assembly plant in the Midwest due to a shortage of microchips. When it takes nine months to receive the couch you ordered because of shipping backlogs in Long Beach Harbor you quickly realize just how interdependent economies have become.

The pandemic forced companies to again reevaluate the fragility of their supply chains and source manufacturing and distribution alternatives. Global supply chains are proving to be more fragile than imagined. And now, the unprovoked Russian invasion of Ukraine is poised to accelerate a reduction in global trade. To be clear, we are not arguing that the sanctions against Russia are misguided, only that the sanctions have added a new urgency for China, the U.S., and Europe to reduce economic dependence. The economic sanctions on Russia have clearly demonstrated the effective weaponization of trade and the strategic imperative for any country to source back up supplies of energy, commodities, technologies, and parts to protect their economies. Relying on Asia for microprocessor manufacture and delivery is a problem strategically here in the U.S. even if the microchips are designed domestically.



As horrible as the events in Ukraine are, there will be little near-term impact on U.S. equities. Stock valuations will always be tethered to earnings and growth expectations. There simply isn't a lot of direct economic exposure from U.S. companies to Ukraine or Russia to make a material difference. We do believe that there are material long-term implications however. Globalization surely isn't dead, but we suspect we are entering a period where the benefits of steady increases in global trade are gone, and gradual reductions may persist slowing growth and further increasing prices.

The surprise coming out of the pandemic has been the rapid rise in inflation. Massive stimulus not only kept the consumer afloat through the pandemic, income, at least in the U.S., actually increased though 2020 and 2021. With supply chains disrupted and demand high, prices have jumped. Flush with cash and pent-up demand, the consumer is ready to buy. The price of oil has jumped significantly simply because production was reduced during the pandemic. Oil production in the U.S. totaled 352.5 million barrels for the month of January. That's still 11% below production in January of 2020. It takes time to ramp production back up. The Russian invasion of Ukraine added gasoline to the fire. Increased demand coupled with reduced supply plus sanctions to Europe's largest single energy supplier can only result in higher energy prices.

Unfortunately, we don't believe that there will be a resolution to the conflict in Ukraine anytime soon. Sanctions will remain in place for some time and may continue to increase. Europe will have to go through a long and expensive process of reducing its energy dependence on Russia. The world has changed. It has been shifting for some time, but the pandemic laid bare the dependencies of global trade and its strategic weaknesses. The broad economic sanctions against Russia have further demonstrated the strategic importance of economic independence.

Inflation will require higher interest rates which will reduce economic growth to some extent in the near-term. It is not apparent that Europe will have to go through a recession. It is even less likely here in the U.S., and while a recession may not be likely, growth will certainly slow affecting equity valuations. Slower growth would require a downward readjustment in price-to-earnings.

Instead of globalization boosting economic growth as it has since the end of the Cold War, nationalism, protectionism, and strategic manufacturing necessities will curtail global trade. This isn't a disaster for economic growth or stocks, but we may need to rein in growth expectations and by extension stock market performance assumptions. The S&P 500 over the last 10 years has produced a remarkable 14% compound annual growth. This is nearly double the long-term average. Growth in equities will continue and with rising inflation, it becomes even more important to remain invested, however with the headwinds of inflation, nationalism, and increased geopolitical uncertainty, expected returns in the stock market are likely to be closer to long-term averages of 7.5% in the coming years.

Corporate earnings always remain the key variable in determining the direction of stock market valuations. Short-term considerations such as geopolitical crisis or monetary policy changes will affect short-term stock prices but in the long-term, earnings are what matters. Rising wage costs, supply chain costs, capital costs will put pressure on corporate profit margins despite our expectation that demand will remain strong. Operating margins peaked in the June quarter last year at 13.5% which was an all-time high this century. Profits can decline quite a bit and still be healthy. Earnings growth rates may decline but are still likely to remain positive through an economic slowdown. Stock prices have been adjusting to these realities and so far in 2022, stock performance is negative across all the major indexes. This reflects the numerous uncertainties, but it also reflects a recognition that earnings growth will slow from the torrid growth of the last 18 months. Stock market weakness this year is also in response to rising interest rates. The future value of earnings is less in the present when discounted at higher interest rates and higher rates also increases the cost of capital. It costs more to borrow resulting in less investment in new projects and equipment and slows earnings growth. Thus, like the Pandemic it is important to be cognizant of a peak in inflation and interest rates. After the Pandemic lockdown in the first quarter of 2020, it was important to recognize the catalysts which would propel a rise in stock market values from their severe collapse in the first few months of 2020. The two catalysts at that time which produced a reversal in stock prices were the extraordinary monetary and fiscal stimulus and the peaking in the rate growth of new Covid infections. These two events occurred well before a renewed surge in economic growth in the country. Investing at that juncture, even while pessimism was high, was very rewarding. Today, there are again two catalysts which will propel the stock market into positive territory from its year-to-date losses. The first critical variable is the rate of growth in inflation. When it levels off and starts to decline, the stock market will begin a sustainable advance. Integrated with a lessening in the rate of inflation will be a peaking in the rise of interest rates. These two catalysts should occur near each other and yield a positive environment for stock market valuations.

The U.S. economy has always been resilient and the growth marvel of the world. There have always been periodic scares, but the recoveries have always occurred, and they moved fast. Valuations of stock prices were extended when we entered 2022 but with the current correction in prices the S&P 500 index's price-to-earnings ratio has fallen from approximately 21x estimated forward earnings to 19x. We believe a price-to-earnings ratio for the S&P 500 index of 18x to 19x is reasonable and offers an attractive opportunity. 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.

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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