JARVIS® NEWSLETTER: FINALLY, WE'RE LESS FED UP WITH THE FED

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OVERVIEW

This week we will come right out and say it: it's looking like time to get off the fence and start putting cash to work in this market.

This entire year has been dominated by talk of inflation and interest rates, as we read the tea leaves from the US Federal Reserve to determine the upcoming course of monetary policy.

We are finally getting the signs that the Federal Reserve is looking to let up off the gas pedal on the rate hike regime that has plagued markets throughout 2022. On Wednesday of this week, we heard from Fed Chair Jerome Powell, who suggested that the Federal Reserve may slow the pace of its interest rate hikes beginning as soon as December. This flies in the face of market expectations and previous indications that aggressive monetary policy out of the US Central bank would continue far into the future.

Key Takeaways

- What is/isn't Working?
- Opportunities Abound: But It Is Time to Look for New Market Leaders
- Conclusions

And market participants responded as positively as you might expect to the apparent shift in policy out of the Fed, leading us to state that "Finally, we are less fed up with The Fed." We saw higher stock prices across the board on Wednesday, but especially in the tech heavy NASDAQ, where we saw a more than 4% increase in index value in just a single afternoon.

Inflation readings are also starting to show signs of a peak. Also on Wednesday, we received the Personal Consumption Expenditures (PCE) survey, which is a measure of inflation that we know the Fed watches closely

as it determines the course of interest rates. The core price level (ex-food and energy) according to the PCE rose just 0.2% in the month of October, below market expectations. This is yet another positive data point for inflation.

We have been clear over the past few weeks that our view on markets is becoming significantly more optimistic, as we have begun to see the pace of inflation cool significantly in recent months. Along the same lines, we have seen major progress with respect to interest rates: mortgage rates have fallen nearly a full percentage point from recent highs above 7% and the ten-year US Treasury rate now stands at just above 3.50%, after topping at nearly 4.25% in early November. We see volatility decreasing, with the VIX Index now close to normal at a reading of 20.

With interest rates beginning to drop, our view is that the window to lock in generous rates of interest in corporate bonds and other fixed rate securities is closing rapidly. We are also seeing the stock market to move higher, as fears of recession begin to subside. The upshot from our point of view is that we think investors holding cash need to move quickly to find a suitable home for uninvested funds. For those investors seeking guidance, we are always here, standing ready to share with you some of our ideas of how to proceed. Don't hesitate to reach out. You can set a meeting directly on my calendar here.

Also make sure to watch this week's Jarvis YouTube Update (and like, share, and subscribe!). CEO Noland Langford and I cover the week's events related to the Fed, along with our thoughts of how investors need to look to new leadership in the next bull market and away from the types of stocks that worked in the last bull, namely large cap tech and software stocks.

Head to our website and sign up for our mailing list, so you can receive our weekly updates in your inbox every Saturday morning. As always, we are back with new reports from our analyst team for subscribers to our research service again this week. Remember, subscribers receive 6-10 full length stock reports each month, the type of which we use to make our own investment decisions in-house. Head to our subscribe page to gain access to the research.

With that all being said, let's get into it!

Below is the performance data of key indices, ETFs for the five trading days between 11/23/22 and 12/1/22:

Index	Close Price (12/1)	Weekly Return (%)	Year-to-Date (%)
S&P 500® (US Broad-Market Index)	4076.57	+1.22	-14.47
Nasdaq Composite (Tech+)	11482.45	+1.75	-26.61
Russell 2000 (Small Company Index)	1881.68	+0.97	-16.20
Oil Price (WTI futures)	81.22	+4.21	+7.99
Bitcoin (BTC)	16967.13	+2.18	-63.36
iShares 20+ Year Treasury Bond ETF (TLT)	105.76	+2.43	-28.63
Consumer Discretionary Select Sector Fund (XLY)	146.15	+2.53	-28.51
Health Care Select Sector SPDR Fund (XLV)	139.42	+2.26	-1.04
Energy Select Sector SPDR Fund (XLE)	90.85	-1.47	+63.69
CBOE Volatility Index (^VIX)	19.84	-2.51	+15.21

WHAT IS/IS NOT WORKING?

The basis of our "What's Working?" and the "What's Not Working?" segments in our newsletter is our Jarvis securities evaluation system. We use patterns we see in the data to identify pockets of strength and weakness.

Once again, we saw a strong week in the markets, with 10 of the market's 11 sectors higher on the week. The leaders came from the Communication Services sector (up 2.52% for the week), Consumer Discretionary (+2.35%), and Health Care (+2.32%). The one sector that we saw lose ground over the last week was Energy, which lost 1.67% in value over the last week of trading.

One of the areas in world markets most under pressure this year has been the Chinese Stock Market. It does appear that there are indications of a changing Covid policy in China, amid a number of high-profile protests in the country. After nearly 3 years of draconian Covid policy, we have seen significant damage both to the Chinese economy, as well as supply chains globally. With those headlines, we saw incredible progress in Chinese equities over the past week, with **KraneShares CSI China Internet ETF (KWEB)** gaining 17.11% in value over the past week. We also saw 9-10% increases in other China-related ETFs, including **The Emerging Markets Internet & Ecommerce ETF (EMQQ), iShares MSCI China ETF (MCHI),** and **iShares China Large-Cap ETF (FXI).** We continue to be skeptical of direct ownership in China stocks or China-related ADRs. Our favorite way to play a China recovery is **Starbucks (SBUX)**, which itself gained nearly 4% in value during the week.

We don't see much of a pattern in the other Best Performing sectors beyond just the traditional "risk on" type sector ETFs, including **ARK Innovation ETF (ARKK)** and **Renaissance IPO ETF (IPO),** both of which gained more than 5% on the week.

It is also interesting to note the strength of the **United States Oil Fund, LP (USO)**, which gained nearly 6% in value on the week. The reason we find this interesting is that energy stocks in the **XLE** fell on the week despite higher oil prices. We remain oil stock bulls precisely because of the decoupling of energy stocks from the price of oil. We are confident that these companies will continue to cash flow consistently, even if oil were to fall to $50-60 per barrel.

On the other side of the ledger, the biggest loser on the week was **United States Natural Gas Fund, LP (UNG)**, which lost more than 6% in value. Predictably with energy the only sector falling this week, the list was dominated by energy-related industry ETFs: **Alerian MLP ETF (AMLP), SPDR S&P Oil & Gas Exploration & Production ETF (XOP), Invesco S&P SmallCap Energy ETF (PSCE),** and **Energy Select Sector SPDR Fund (XLE).**

Beyond that, the worst performing ETFs were those that bet against both the stock and the bond markets, including **Direxion Daily 20+ Year Treasury Bear 3X Shares (TMV), ProShares Short QQQ (PSQ), ProShares UltraShort 20+ Year Treasury (TBT),** and **ProShares Short High Yield (SJB).**

OPPORTUNITIES ABOUND, BUT NEW LEADERSHIP EMERGES

Most investors are aware of the notion that "software is eating the world". If you made money investing over the last 5-10 years, it is likely that much of that profit came from the software and the technology industries. We saw 5, 10, and even 100-baggers coming out of tech, through incredible stories like **Shopify (SHOP), Nvidia (NVDA), Advanced Micro Devices (AMD),** and **Microsoft (MSFT)**, among many, many others. We must note that many of the most successful stocks correlated with companies that had yet to turn an economic profit and carried extreme valuations, with price multiples to sales of 10x, 20x, 50x (and sometimes even higher!)

Over the last 18 months, we have seen many of the "pandemic darling" stocks pull back in a major way, with many of these stocks falling between 50-90% from their high-water marks. Combining the fact that these stocks were such outperformers for such a long time, with the idea that they seem to be trading at "bargain" prices relative to where they stood in 2021, it is logical for investors to wonder whether they should pile back into the same sorts of stocks that made them oodles of money over the past decade.

Psychologically speaking, recency bias is so difficult to overcome for investors, both professional and non-professional. As advisors ourselves, we understand the pitfalls of cognitive and emotional biases in investing and a huge part of our job is fighting against those biases.

We have just gone through an awful period in markets and investors' nerves are frayed. Our approach in our office is to look at things with a total blank slate, forgetting what worked before and considering what might work in the future. We are still growth investors, but we think it is time to look beyond tech for growth, which in recent years had become synonymous in the investing public. But as investors with a few cycles of experience will probably know already, new bull markets tend to rise with new leaders, not from sectors the drove the previous bull market.

As we hew toward this "blank slate" approach and look for new leadership, a few sectors really stand out for us. We like areas of the market that have some component of being defensive investments, paired with revenue growth and low valuations. We have spoken often in this space about a couple of the sectors that we like in that regard: energy and insurance, which offer what we call around the office "defensive growth".

But beyond energy and insurance, one sector seems to stand above the rest for us, offering reasonable valuations, defensive growth, being of a non-cyclical nature, and performing admirably in a very weak market and that is healthcare. As you can see in the chart below, healthcare stocks, as represented through the **Health Care Select Sector SPDR Fund (XLV)** have held up quite well in a difficult 2022, down only a fraction of 1% year-to-date:

In this space we have spoken multiple times about a particular stock in healthcare that is one of our favorites: **InMode Ltd (INMD)**, an Israeli-based leader in elective surgery technology. This continues to be one of our top ideas. This is a company with strong revenue growth, the potential to disrupt a huge addressable market (plastic surgery), and a very palatable price/earnings ratio of 18x at the time of writing.

But you already know we like **INMD.** We have many other areas of healthcare that we think also deserve consideration by the average investor. As CEO Noland Langford stated on this week's YouTube update, healthcare is one of the original growth sectors, with many of the component stocks offering growth rates in the high single-digits to mid-teens. Couple that growth with valuations of 30x price/earnings or lower, in most cases, and some with sizeable dividend yields, we think healthcare offers something to growth and income investors, alike.

We think there is a place in most portfolios for health insurance names like **United Healthcare (UNH)**, and **Cigna (CI)**, both of which have been stellar performers in 2022, against the run of the overall market action. We have long admired these types of companies for their stable profitability, pricing power, manageable valuations (UNH has a P/E of 26 and CI has a P/E of 15), and the general fact that healthcare is an indispensable expense for all consumers. This gives healthcare that defensive component that should sustain the businesses, should the economy backslide into recession. (Note: we are now expecting the US economy to avoid recession in 2023.)

Additionally, we are warming to some drug stocks and biotech stocks, names that we had not considered earlier in the year. Two such stocks have stuck out to us in this space: **Amgen (AMGN)** and **Gilead Sciences (GILD)**. We like the fact that both companies pay annual dividends in excess of 2.5% and also note with regard that these stocks are more than 20% higher on the year, again in a very difficult market environment.

But what really excites us about these names are the drug pipelines. Amgen has a strong group of therapeutics that attack plaque psoriasis, cancer, asthma, among a number of other conditions. The pipeline in the oncology side of the business shows quite a bit of promise in gastric and prostate cancers. In the latest earnings call, Amgen announced that the company delivered more than 21% yearly growth in profits, so business is booming there.

Gilead had fallen on hard times since the stock's peak in 2015. The company had such success with its treatment for HIV with retroviral drugs that patients were starting to become cured, effectively shrinking the company's total addressable market for treating that condition. However, Gilead remains on the cutting edge in oncology, with cell therapy products showing promise in treating lung cancer, lymphoma, and other cancers. Overall, the company can deliver strong returns to investors, with a return on total capital in excess of 20% over the last 12 months.

InMode, Amgen, and Gilead are just a small subset of the healthcare companies we think are poised to continue performing in 2023 and beyond. To learn whether these stocks make sense for your portfolio, give me a call.

TAKEAWAYS FROM THIS WEEK

Finally, it feels like markets are moving in the investors' favor. With interest rates starting to drop on the back of more benign signals out of the Federal Reserve, we think the time is now for investors with cash on the sidelines to consider getting back invested, whether it be through stocks or in the bond market. The window to lock in high fixed rates of return does, in fact, appear to be closing.

We know investors have a hard time letting go of yesterday's winners in order to move on to tomorrow's top performers. We encourage a "blank slate" approach to determine the best investment plan for upcoming recovery. In our minds, a great place for investors to look would be healthcare, which offers defensive growth, reasonable valuations, and generous dividends. At Left Brain, we are building a formidable list of healthcare stocks.

We hope the newsletter helps you make sense of a difficult time in markets! We know that finding suitable investment opportunities in individual bonds and income securities can be daunting for the individual investor. Please contact me directly at (630) 547-3316 briand@leftbrainwm.com, or schedule time directly on my calendar if you want to engage a professional money manager like Left Brain to figure out to do with cash in the bank.

Thanks again for your continued support of the Jarvis Newsletter.

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