Fortunato Asset Management

Q3 2021 Market Update and Newsletter

Third quarter market performance was rough around the edges. Though the S&P 500 index was flat for the quarter, there was lots of action. Large tech, and to a lesser extent Financials propped up the market. All other sectors were down, emerging markets were down significantly, industrials were down 4%. Value and small cap investors absorbed blows. October and early November have seen a bounce back in those sectors that suffered in Q3. This was the first quarter since Q2 2020 in which investors have been brought back to the reality that stock prices can also go down – even with massive stimulus.

Tiptoeing towards Stagflation?

How does this play out? Record stimulus, particularly the inflation-inducing fiscal variety. A newly passed $1.2T infrastructure bill that contains $550B in new projects. A proposed BBB social infrastructure bill which could add another couple trillion dollars.

Versus

An economy that grew 13.4% in Q3 year over year and 6.7% after inflation. That means the government-suppressed headline inflation came in at 6.7%. The inflation rate continued to hold strong at 6.2% in October 2021. These are the highest inflation rates we've seen in 13 years. We will face ever more difficult GDP comparables going forward.

With that in mind, "Stagflation light" is a possibility.

Will high inflation persist? I think so, at least for a while, for the following reasons:

-As the labor market tightens we'll see even more wage increases. The U.S. labor force has become, let's say fickle and particular about taking employment.

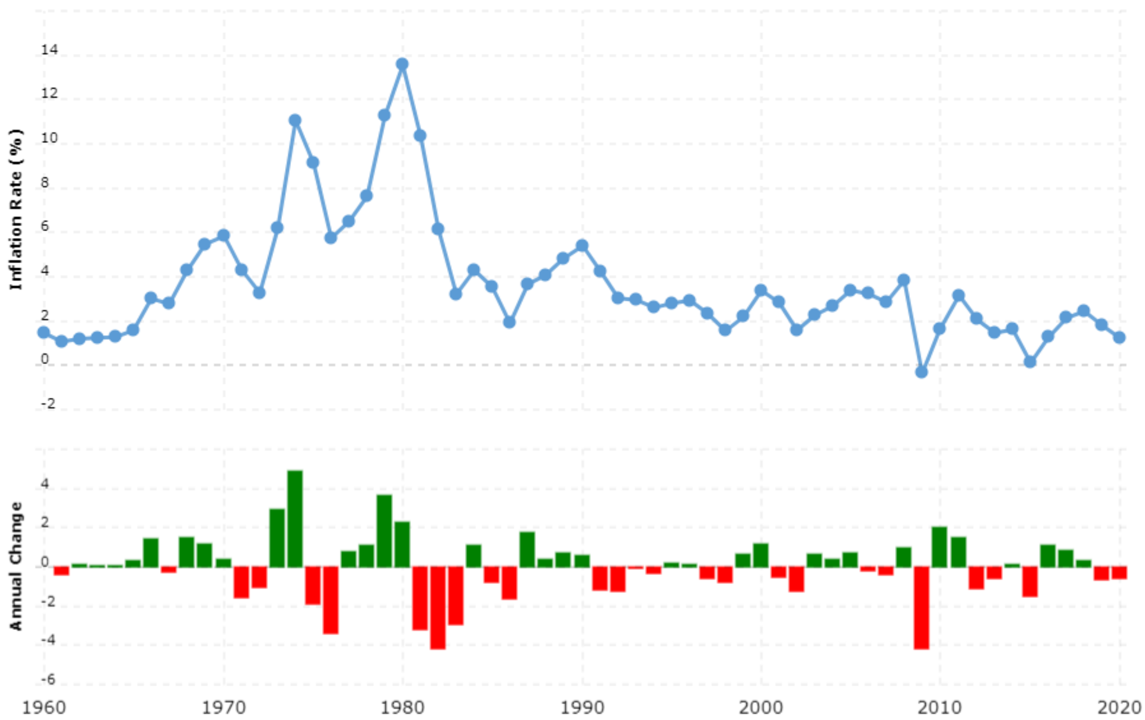
-Millennials have entered the spending years. Household formation is increasing and demand for goods and services rising from this generations increased spending.

-Supply Chain may remain broken for a while. Many CEO's I speak with say the supply chain problems we are facing will not be remedied any time soon.

-Policy. There is political pressure to maintain easy monetary policy, even in the face of increased inflation. I think policy (interest rate increases) will lag inflation.

While 70's style stagflation is unlikely due to the continuing benefits of worldwide labor, and globalization, I do believe inflation is set to persist at a level we have not seen in years. As a guess, I would put it between 3% to 5% in the consumer price index.

One fact we must deal with as investors, as the chart below shows, we have had inflation every year since 1950 save for two which were basically flat. The blue line never dips below zero – not even in a recessionary year like 2020. As Milton Friedman famously said, "inflation is always and everywhere a monetary phenomenon." We know that our government desires inflation to be able to inflate away government debt. We know they will print ever more money in the future to satisfy political ends.



Source: Macrotrends

Whether or not we will have persistent high inflation or stagflation leads me to a question I receive from time to time, "what to invest in to protect against inflation?"

Here are a few thoughts:

- How about an insurance company we invest in that prices its insurance products as a percentage of beneficiaries' salary. This pricing model allows it to cash in on wage inflation trends seen in the market today. The company's disability, sickness, and life insurance products cover lost income instead of medical treatment costs, partially shielding the company from rising medical costs. Finally, rising interest rates will increase interest on its fixed income portfolio.

- Or, what about a real estate investment trust (REIT) that we own, that has long term leases with built in annual rent escalators based on the

CPI inflation rate, rather than fixed price increases of 1 or 2% a year. The secondary inflation protection here is the real estate itself.

- Next, we have a junior gold mining stock that makes significant cash flow and has increasing production with bright prospects.

All three of these should work well in a persistent inflationary environment.

Cash is King When Nobody Wants It

Famous Berkshire Hathaway Vice Chairman Charlie Munger recently noted, “The world is full of foolish gamblers and they will not do as well as the patient investors.”

Usually when nobody wants to own an asset, it’s a good time to buy it. Right now the asset is despised is cash, for the obvious reasons above.

More desirable for speculators/gamblers are tech, electric vehicle, SAAS, and wind and solar energy stocks, vacation destination real estate, beach real estate, some suburban real estate, Crypto of all sorts, and mysteriously, bonds.

I’m not a fan of cash long term, but short term it’s great to have some dry powder for future opportunities. Opportunistic patience, disciplined research, and an optimistic outlook will win out.

Our Strategies, Fees, Costs and Alignment

Below is a recap of each strategy and fee structure for Qualified Clients:

Fortunato 1 Growth and Value Strategy. Invests in a combination of reasonably priced growth stocks and value stocks. No Management Fee.

The Performance Fee is 25% over a 6% per annum return with price breaks at $1M and $2M. On the first 6% return, no fee. Goal is a 14% average annual return over time.

(Note: Due to overlapping similarities in holdings and performance we have closed Fortunato 2 Concentrated Value Strategy for now).

Fortunato 3 Dividend and Income Strategy. Invests in a conservative mix of government short term bonds, mortgage-backed securities, dividend paying stocks, and preferred stocks. Fee is .55% of assets under management. The goal is a 6% average annual return over time.

I maintain a substantial portion of our family's savings in the Fortunato strategies, aligning my interests perfectly with investors. Many thanks to Brittany Rowland and Heath Martin for their valuable ongoing contributions to research, administration, and technology and thanks for reading!

We wish you peaceful, safe, and slightly gluttonous Thanksgiving week..

=S Dee

not intended as a complete analysis of every material fact regarding any security, country, region, or market.