Fortunato Asset Management

Q4 2021 Market Update and Newsletter

Large Potholes Not Minefields

Even though the market ended 2021 with a Santa Clause rally, the last few months were full of churn, stock and sector rotation into and out of and into again the same issues and industries. It was an extremely difficult period as around 80% of stocks experienced at least a 10% pullback at varying times. The difficulty was masked by the index averages, propped up by a few mega cap stocks.

Going forward, there are a few themes to guide investments with regard to rising interest rates, inflation and playing some defense. I believe we will have increased volatility in the form of 8 to 12% market corrections rather than the 3 to 4% pullbacks in 2021. This was my thought heading into the year when we raised cash at the end of 2021. We've already had one nearly 10% correction. As of this writing the S&P 500 sits at around 5% below its peak.

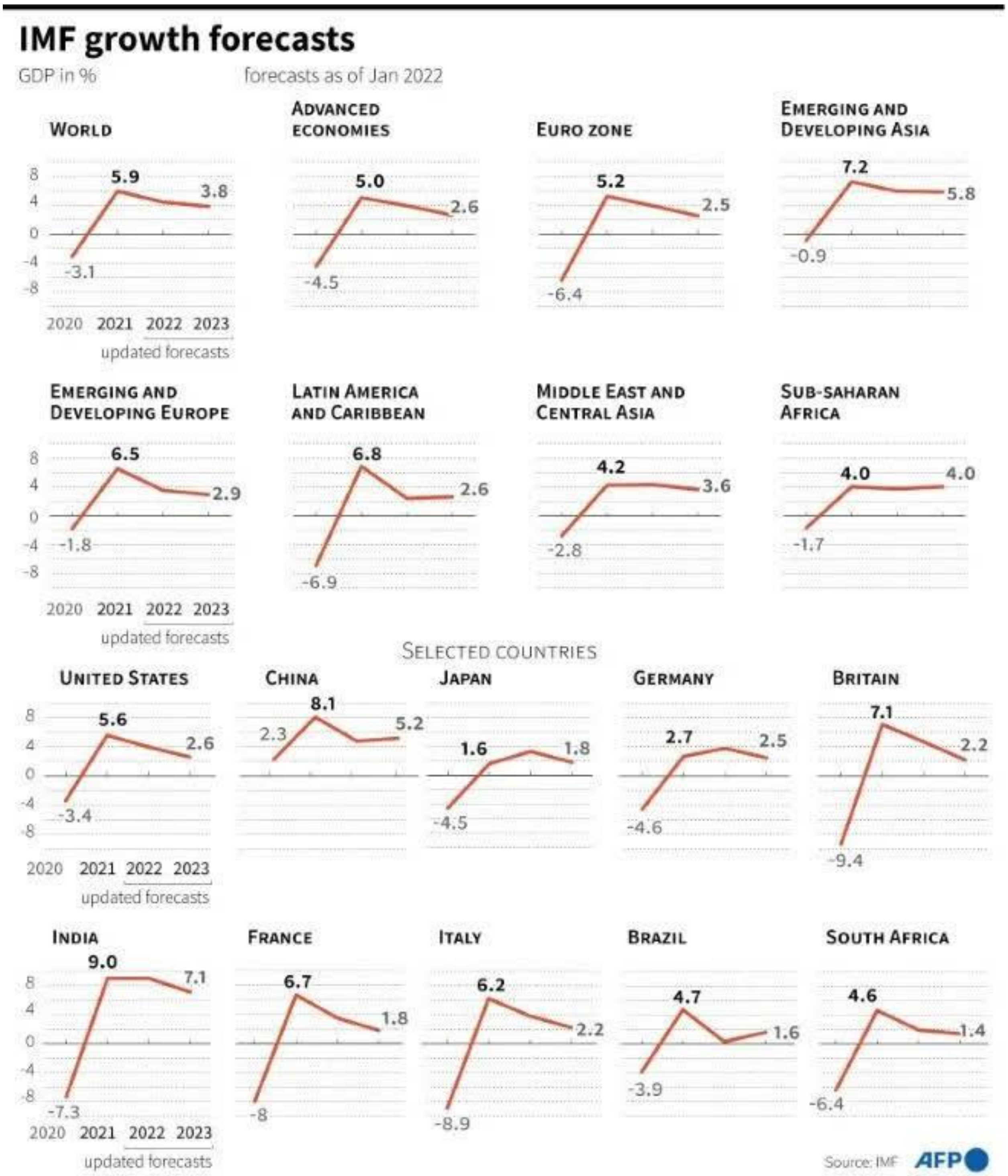
When you're defending the jump shot, don't leave your feet until the last 1000th of a second, lest your opponent fake the shot, and blow by you to the rim. That is, don't take the bait on a small dip in a richly valued stock nor on a quick pullback. Time and patience during these first 6 months of 2022 should yield some good opportunities. After all what's the rush? The market still sits near the most expensive levels ever, with an S&P 500 yield of just 1.3% and a Price/Sales ratio of 3X. As we have just seen with 25% declines in a day for Paypal and Facebook (Meta) shares, it can get severe quickly. Palantir is down nearly 50% since November.

The specter of tightening monetary policy in the form of tapering the Fed's bond buying and raising interest rates is going to be especially painful for the most speculative securities, crypto and real estate. This past decade is the first in the last 100 years you could buy a basket of stocks trading above 10X sales and do better than the overall market. In every other prior decade, that was a formula for disaster. That will change in 2022. There is no more extraordinary stimulus on the way. In this type of environment, the market changes its attitude from "tell me a good narrative" to "demonstrate the story with figures."

We've seen the incredible inflationary impacts of fiscal stimulus and a related unorganized strike by the workforce. Nearly every earnings call I listen to echoes the themes of drastically increased materials prices, supply chain problems, and labor cost increases. One company I follow (Ebix) was forced to raise the salaries of their software developers in India by 50% to fend off poachers. A mining company (Argonaut) saw the cost estimate of developing a previously scheduled gold mine in Guatemala skyrocket 70%. Let's talk Cheerios. General Mills missed earnings and the stock dove 4% on soaring raw materials and freight and labor costs. These conditions are unrelenting. Companies are having a difficult time finding the people they need.

So where does the year go from here? A few large potholes in the first half maybe through the summer, but avoid a recession (minefield) would be my guess. I think we will end up flat or slightly positive for the year. Inflation will come down, but remain elevated in the 3 to 3.5% range while economic growth slows to trend. The IMF prediction has U.S. economic growth slowing to 2.6% by mid 2023.

Below are IMF economic forecasts for the world and large economies:



So far during this more volatile year, despite holding heavy cash equivalents, we're cautiously energized about some of the opportunities opening up. Despite the head winds, good companies find ways to overcome challenges and increase earnings. Analyst estimates for S&P earnings growth in 2022 are 9%. Whatever happens we will be disciplined in our approach to finding value and remember the following:

"The stock market is a device for transferring wealth from the impatient to the patient." -WB

Our Strategies, Performance, 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. In 2021 the return was 8.8%.

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, enjoyable Covid free spring.

=S Dee