NEPSIS®

1st QUARTER
2023 UPDATE

THOUGHTS FROM THE FOUNDER: PATIENCE IS A VIRTUE — "The ability to wait for something without getting angry or upset is a valuable quality in a person."

As we finish up the first quarter of 2023, and look back at 2022, there is no question that last year had the potential to test one's patience. If you have been following our updates over the last 15 months, you would have heard us say that 2022 would be difficult.

Nevertheless, as I have always said, "We are long term investors in businesses." Many investors lose patience when it comes to investing because they are primarily interested in immediate gratification. However, investing is a LONG-TERM process! I believe and continue to believe our portfolios are very well positioned for the long term!

For almost nine years, we have not favored bonds. In this current environment, we continue to prefer owning great dividend producing companies as opposed to owning bonds. We continue to closely monitor the companies we own, diligently research potential companies to invest in, and attentively analyze overall economic and industry trends. At this point, oil, healthcare, and financials (insurance), remain our favorite sectors, just as they have for the last 2 years.

Lately, the big question investors have been asking is, "Will we have a recession?" I ALWAYS answer with a YES!!! We will have a recession in the future.

WHEN? Well, that's the million-dollar question! Remember, we are not in the business of making these types of predictions! Many have predicted that we will see a recession in the second half of 2023. History has taught us that markets start moving higher 6-9 months before the actual recession.

At of the end of the first quarter 2023, indexes and portfolios are higher, despite the regional banking situation and predictions of a recession. When all is said and done, if markets and more importantly, the value of the businesses we want to own go down, we will view that scenario as a buying opportunity!

I conclude with one of my favorite quotes, "Stick to the knitting!". We commit to this process, "Process Before Progress®".

Thank you again for your continued confidence in Nepsis® and Investing With Clarity®!!

Respectfully,
Mark Pearson
Founder & CIO
Nepsis, Inc.

If you have questions or need additional information about your portfolio, please contact your advisor for more information.

MARK PEARSON
President & CIO

"STICK TO THE KNITTING!"

- MARK PEARSON

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"Mr. Gorbachev; Tear Down this Wall!"

— former President Ronald Reagan

Charles D. Etzweiler, *MBA, CIMA®, CMT, CFP®*
Chief Research Officer & Senior Vice President

As we have highlighted in the past, adult pathways to learning are very different than those of a child. Knowing that financial jargon, investment vernacular, and economic verbiage can be painfully dry to many people, we try our best to pave a route for investors to best understand the rationale behind the positioning of their investments by simply relating to past experiences.

Those previous encounters that were either joyful in nature or monumental from a historical perspective tend to have the strongest tether to grasping new concepts. A very good article on this can be found on the link below and we summarize their thoughts by the following: *"Adult learners have much more life experience than youths. They've learned a lot from their experience, and they continue to learn by building on what they already know. Because of this, there is a greater pool of examples you can likely pull from to illustrate a lesson. By tying a lesson to something practical and personal, the connection between the material and the experience makes the learner more engaged. The more experience an individual has, the more connections there are to make."* See the following link for the entire article.
https://www.seedsofliteracy.org/differences-bt-adult-youth-learners/.

In past Clarifiers, we have highlighted songs, sporting events, movies, and political events in order to create a more enjoyable learning environment for those who find high-level finance drab or confusing. In that light, for Q2 2023 in our lead article we reference the famous speech given by former President Ronald Reagan on June 12, 1987, a little over two years before the Berlin Wall was torn down. According to Wikipedia at https://en.wikipedia.org/wiki/Tear_down_this_wall. *"The Berlin Wall Speech was delivered by United States President Ronald Reagan in West Berlin on June 12, 1987. The speech is commonly known by a key line from the middle part: "**Mr. Gorbachev, tear down this wall!**". President Reagan called for the General Secretary of the Communist Party of the Soviet Union, Mikhail Gorbachev, to open the Berlin Wall, which had encircled West Berlin since 1961. Though Reagan's speech received relatively little media coverage at the time, it became widely known after the fall of the Berlin Wall in 1989. In the post-Cold War era, it was often seen as one of the most memorable performances of an American president in Berlin after John F. Kennedy's "Ich bin Ein Berliner" speech of 1963."*

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"MR. GORBACHEV; TEAR DOWN THIS WALL!" *(Continued from last page.)*

So how does this famous speech relate to investing and our topic for Q2 2023? We will describe in the section below the following chart:

Source: Strategas as of 02.22.2023

Before we directly address the contents of the chart, as we spoke last quarter, our belief is that the world economy is in a state of De-Globalization as the United States, Western Europe, and Japan embark on the concept of "Reshoring to Ensure." In our opinion, if Globalization and the Outsourcing of Jobs and Factories from higher-priced Developed Markets to lower-cost Emerging Markets led to lower inflation and interest rates, then it would be logical to assume that De-Globalization would lead to higher inflation and interest rates, at least moving up towards historic averages.

Moreover, we used the Rule of 20 to describe the relationship between Inflation and a gauge for how much one may desire to pay for a future dollar of corporate earnings, what we refer to as the P/E or Price-Earnings Ratio. According to data at *https://tradingeconomics.com/united-states/inflation-cpi#:~:teflation%20Rate%20in%20the%20United,percent%20in%20June%20of%201921* the average rate of Inflation over the last 110 years is 3.3%. Using our Rule of 20, the average P/E Ratio is approximately 16.7X. Taking that into consideration, we focus back on our chart above. From 1953 to 1989 (we will call the Pre-Berlin Wall Era) a span of 36 years, the average P/E Ratio was 13.8X on a TTM (trailing twelve month) basis. However, since the collapse of the Berlin Wall in 1989 (we will call it the Post-Berlin Wall Era), a period spanning 34 years, the average TTM P/E Ratio was 19.4X. Ironically, if you add the two periods together and take the average them together you get a 70-year P/E Ratio of 16.6X, which perfectly aligns with our Rule of 20 and the 110-year average inflation rate of 3.3%.

So, the major question is why such a disparity between these two timeframes and more importantly, why the dramatic premium given to stocks since the collapse of the Berlin Wall? We believe the chart below paints that picture (yellow highlight and red arrow added.) for us. The collapse of the Berlin Wall led to the dismantling of the Soviet Union and the opening of Eastern Europe, Russia, and North Central Asia to free trade and capitalism for the first time in half a century.

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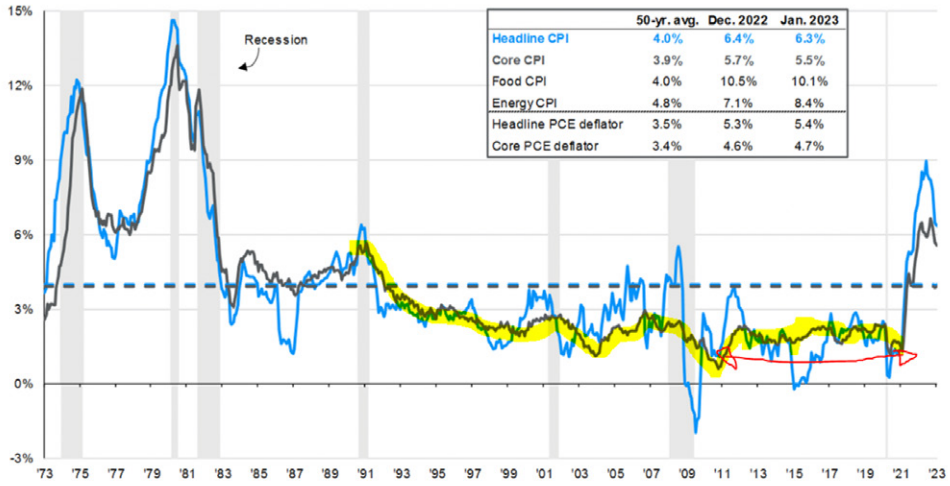
"MR. GORBACHEV; TEAR DOWN THIS WALL!" *(Continued from last page.)*

Additionally, with the signing of NAFTA in 1993 and China entering the WTO in 2001 led to unfettered trade in the Western Hemisphere and Southeast Asia respectively. In all reality, aside from Cuba and North Korea, the entire globe traded freely amongst one another. Because these regions had significantly lower wages and lower cost of operations, the developed world led by the US, Western Europe and Japan outsourced jobs and factories to these regions. This significantly brought down both costs and ultimately inflation to levels we had not seen since the early 1930s during the Great Depression. Also, led by coordinated Central Bank Policy that brought and kept rates near or below 0% for most of the period of 2010-2021, as referenced by the second chart below, we reaped the benefits of "cheap money." This so-called cheap money allowed investors to pay a significant premium for stocks in the Post-Berlin Wall Era as noted by the 19.4X P/E in the chart on page 2.

So the big question on the table; "Is the area of cheap money and low inflation over?" We believe so as one must really grapple with the question if the phenomenon we called Globalization (which was led by former totalitarian regimes embracing Capitalism and specifically open and free trade) has reversed course, what must we make of it? Adding to the skepticism surrounding both the military motives of Russia and China, coupled with a desire of regions around the world such as Western Europe, Japan, and the US to have on one's own soil medicine, intellectual property, jobs, and factories when the next virus-led pandemic strikes, our belief is that we settle back at least at average interest rates and inflation over the next five years or so.

CPI and Core CPI (% change vs. prior year, seasonally adjusted)



https://am.jpmorgan.com/us/en/asset-management/protected/adv/insights/market-insights/guide-to-the-markets/

United States Fed Funds Rate

TRADINGECONOMICS.COM / FEDERAL RESERVE

This recalibration must, in our estimation, lead to a ratcheting down of the P/E Ratio likened to the Pre-fall of the Berlin Wall Era. The good news is that asset managers who have a deliberate selection process based on sound fundamentals can easily pivot to the "New World Order" that will be required in a higher inflation and interest rate environment. We believe we are ready for the task before and the new challenges we likely will face in the second half of the 2020s decade.

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FINANCIAL SECTOR UPDATE

As we go to draft with our Quarterly Update, we face a brand-new issue in the capital markets and that is the solvency of regional banks across the country.

In particular Silicon Valley Bank and Signature Bank have garnered the headlines. However, many financial institutions must address their Asset/ Liability Management (ALM) policies as they manage through an inverted yield curve. If the Fed remains adamant in curtailing inflation, this issue is unlikely to be over anytime soon.

As it pertains to our models, we remain significantly underweight in the Financial Sector and own no banks outright. Our belief is that this sector will remain under pressure until the Fed pauses and ultimately pivots to reduce rates. This may not fully take course for another 12-18 months.

Stay tuned as we walk through this issue.

As Nepsis, Inc. continues to grow, we appreciate your continued confidence and support. We believe successful investing requires Investing with Clarity®. We look forward to continually providing you with the Clarity needed to be a successful investor long-term.

Respectfully,

Mark Pearson
President, Founder & CIO
Nepsis, Inc.

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