Kirr, Marbach & Company, LLC
Registered Investment Adviser
621 Washington Street • Columbus, Indiana 47201 • 812-376-9444 • www.KirrMar.com
Mark D. Foster, CFA Mickey Kim, CFA Matthew D. Kirr David M. Kirr, CFA

"Yesterday's home runs don't win today's games."
— Babe Ruth

Q4-2022 Update
January 9, 2023

Dear Clients:

We are glad to put 2022 in the rearview mirror. As the headlines have blared, it was the worst year for stocks since the depths of the Global Financial Crisis in 2008 (4th worst for the S&P 500 since 1945) and worst year for bonds *ever*. According to *The Wall Street Journal*, the Bloomberg U.S. Aggregate bond index dropped 13%, far eclipsing the previous worst year in data going back to the 1970s, when it declined 2.9% in 1974.

This time last year we thought reasonable assumptions were 1) returns in 2022 would be more modest than 2021 (when the S&P 500 had a total return of 28.71%--the 12th best calendar year return since World War II) and 2) volatility would be higher (the S&P 500 had only 55 days in 2021 when the index rose or fell by 1% or more and the maximum "drawdown" was just 5.2% vs. the historical average of 14%).

Fast forwarding twelve months, the S&P 500 had a total return of *minus 18.11%* and volatility exploded (the S&P 500 had 122 days in 2022 when the index rose or fell by 1% or more, *63 of those negative*, and the maximum drawdown was 25%). Trillions in market value was vaporized in stocks and bonds.

There was drama galore in 2022. Inflation started the year at a 40-year high, driven by excessive monetary stimulus from the Federal Reserve ("Fed") and $5 trillion of COVID-relief fiscal stimulus. The Fed slashed short-term interest rates to 0% at the start of the pandemic in early 2020 and restarted "quantitative easing ("QE"), purchasing $80 billion of U.S. Treasury Bonds and $40 billion of mortgage-backed securities on the open market *each month*, which kept longer-term interest rates low. This caused money supply to explode to the upside, which combined with supply chains that were still recovering from the pandemic to send prices soaring. Russia's invasion of Ukraine added fuel to the inflation fire.

The Fed and its 400 Ph.D. economists predicted with great confidence as recently as late 2021 that elevated inflation readings were due to "transitory" factors that would soon self-correct. When it became apparent this wasn't to be, this same group slammed on the brakes, aggressively changing course to "quantitative tightening" and increasing short-term interest rates from 0% at the start of the year to 4.25%-4.50% in a rapid-fire series of jumbo bumps (increments of 0.25% (March), 0.50% (May), 0.75% (June), 0.75% (July), 0.75% (September), 0.75% (November) and 0.50% (December)).

The speed and magnitude of the increase in interest rates was the proximate cause of the pain for stocks and bonds in 2022. While inflation has likely peaked, the yield curve has inverted (long-term interest rates lower than short-term rates) and leading economic indicators have rolled over, both indications the U.S. economy will soon be in a recession (if not already in one).

The pain is real. Pessimism is high. Fear is extreme and understandable. We're heavily invested alongside you and feel the same emotions. Still, while there are undoubtedly more shoes to drop in 2023 that could cause stocks and bonds to drop further, we believe 1) much of the bad news has already been priced into the market, 2) the regime change from 0% interest rates will finally force investors to focus on company fundamentals and stock valuations, which is how we've invested for the past what will be 48-years on May 1, 2023 and 3) it is difficult times like these that present opportunities for long-term investors in a world obsessed with short-term results.

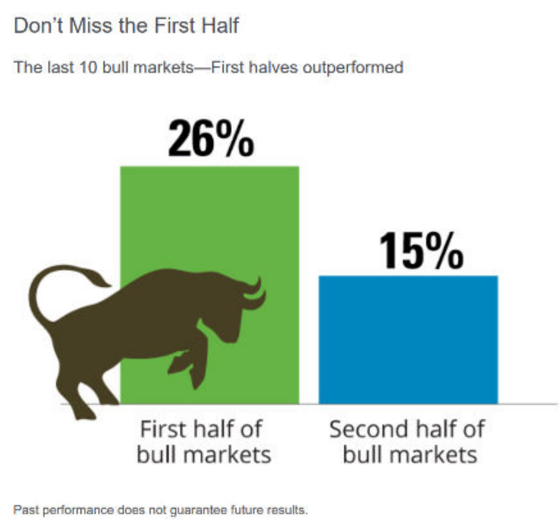
What Were You Thinking and Feeling On These Three Dates?

We have a little historical quiz for you. What did **Wednesday, October 9, 2002, Monday, March 9, 2009 and Monday, March 23, 2020** have in common? All three days were unremarkable, except for the fear and anxiety permeating investors' psyches. The markets had endured brutal declines, with no end in sight. Do you remember what you thought and how you felt on those three dates? If you were like us, the gloom and despair were almost overwhelming.

Clearly, the "dust had not settled" nor had things "gotten back to normal," yet those dates were the market lows for the dot-com, Global Financial Crisis and COVID-19 crashes, respectively. Looking back with the benefit of perfect 20:20 hindsight, what would you have done? Past performance doesn't guarantee future results, but as you can see in the table below, all three dates would have been great opportunities to buy stocks (with the lowest average annual return of 10.37% implying you would have doubled your investment every 6.9 years (72/10.37%), ***even with a terrible 2022***).

	S&P 500 Total Return Through 12/31/2022	S&P 500 Average Annual Return Through 12/31/2022	Rule of 72/ Years to Double
Wednesday, October 9, 2002	636.48%	10.37%	6.9
Monday, March 9, 2009	645.59%	15.65%	4.6
Monday, March 23, 2020	79.28%	23.44%	3.1

Furthermore, according to Ned Davis Research and Morningstar, "being there" and invested when the turn occurs is vitally important, as the first halves of the last ten bull markets far outperformed the second halves. If you miss that first move up, you simply cannot catch up. For example, from March 24-26, 2020, the S&P 500 surged 17.6%, the ***biggest three-day advance in more than 80 years***. Stocks continued higher, with the S&P 500 posting its ***best 100-day rally in more than 80 years.***



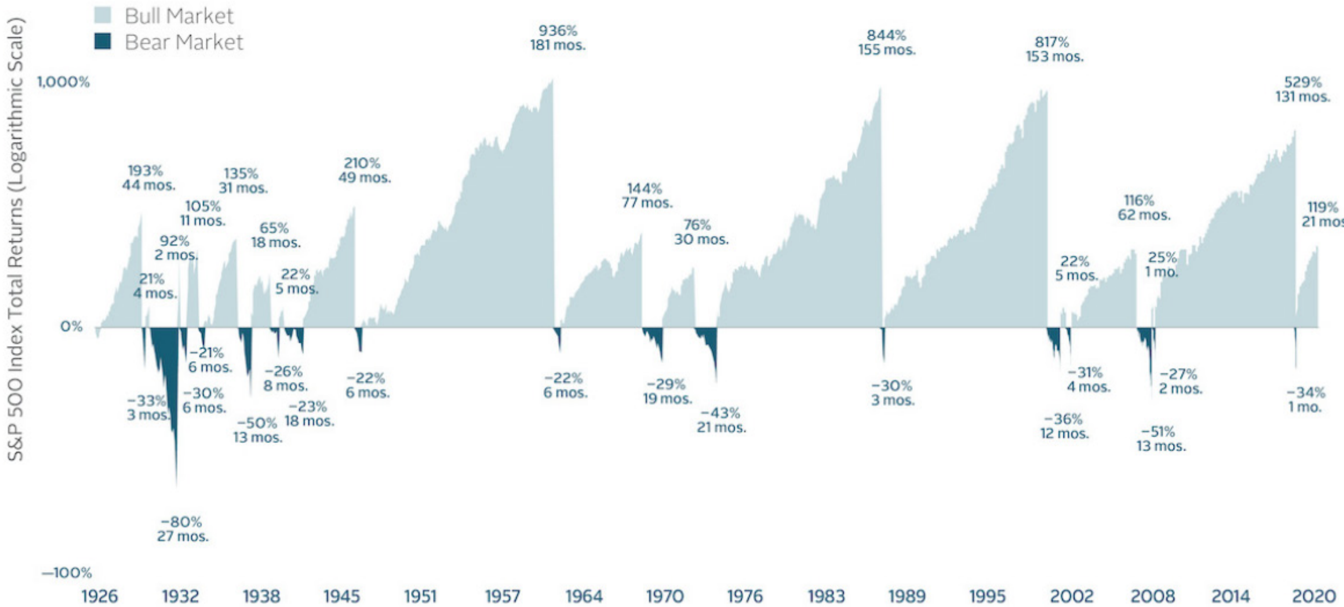
In a fantasy world, you would be invested in stocks when they were going up and out of the market when they were going down. Unfortunately, "market timing" is a fool's errand, as you have to get the "out" and the "in" right. It just can't be done consistently. Schroders performed a "what if" exercise going back to January 4, 1988 (assuming you invested $1,000 in the S&P 500 on that day) and ending on June 30, 2022 (about **34 years**). As you can see, the penalty for missing the market's best days would have been severe.

Invested Whole Time	Missing 10 Best Days	Missing 20 Best Days	Missing 30 Best Days
$31,223	$14,304	$8,443	$5,366
	54.2% Less	*73.0% Less*	*82.8% Less*

Finally, we came across the illustration at the top of the next page from Dimensional Fund Advisors that shows bull and bear markets in a unique manner we've never seen before. Again, past performance is no guarantee of future results, but bull markets have historically lasted much longer than bear markets. In other words, over long periods of time it has paid to be bullish and ride out the tough times. You have to take the good with the bad.

Exhibit 1: S&P 500 Index Total Returns

January 1926–December 2021



Source: Dimensional Fund Advisors

Mega-Cap Technology Stocks Tumbled in 2022

Over the past decade or so, mega-capitalization technology stocks were the market's "home run hitters" and drove the capitalization-weighted indices like the S&P 500 ever higher. Surging prices for stocks like Facebook (now Meta Platforms), Amazon, Apple, Netflix and Google (now Alphabet), collectively the "FAANG" stocks, increased their market capitalizations and index weightings. If you didn't own the FAANGs, it was tough to match the performance of the S&P 500, which led to the explosive growth of index "investing."

With interest rates essentially 0%, 1) investors were faced with "TINA" (There Is No Alternative to stocks), 2) since P/E ratios are directly correlated with interest rates, valuation didn't matter as it was possible to justify almost any P/E and 3) a dollar of earnings 10 years from now was worth the same as a dollar of earnings today.

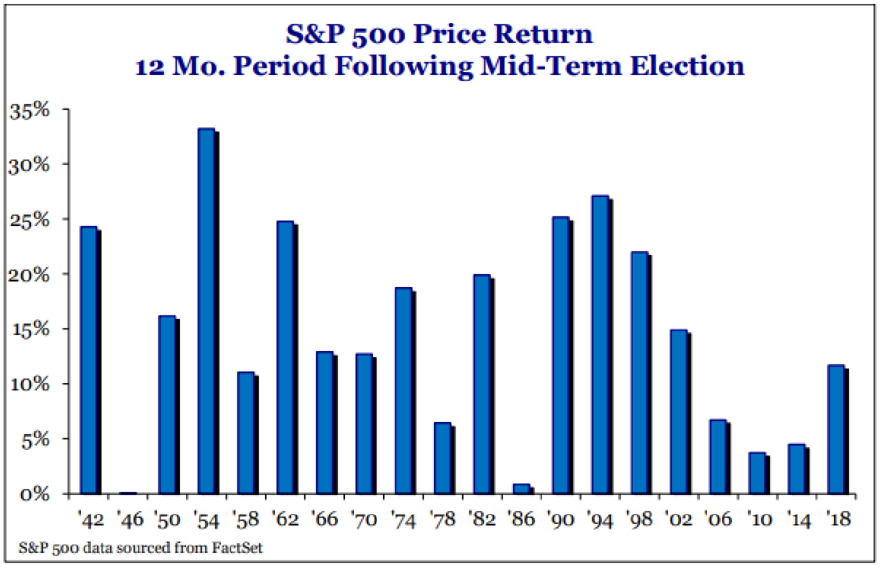
When interest rates spiked, all of this reversed, with disastrous results. According to data from Y-Charts, the market capitalization of the S&P 500 plummeted by about $8.2 trillion in 2022, with the "FAANGs" accounting for about $3.2 trillion of the fall. "TINA" turned to "TARA" (There Are Reasonable Alternatives to stocks). Valuations and P/Es mattered again. A dollar of earnings far in the future was suddenly worth much less than a dollar of earnings today. ***We are excited about this sea change.***

2022 Performance	Price	Market Cap ($ Billions)
S&P 500	**-19.4%**	**($8,230)**
"FAANGs"		
Facebook (Meta Platforms)	-64.2%	($602)
Netflix	-51.1%	($136)
Amazon	-49.6%	($854)
Google (Alphabet)	-39.1%	($776)
Apple	-26.8%	($835)
TOTAL		**($3,203)**
Other Former Home Run Hitters		
ARK Innovation ETF	-67.0%	
Invesco QQQ ETF	-32.6%	

History suggests, but does not guarantee, stocks will recover in 2023

First, according to Sam Stovall, Chief Investment Strategist of CFRA, the decline in price for the S&P 500 (-19.4%) made 2022 the 4th worst since 1945, behind 2008 (-38.5%), 1974 (-29.7%), and 2002 (-23.4%). However, following all 21 down years since 1945, the S&P 500 gained an average 14.2% in price the following year, rising 81% of the time. This compares favorably with the S&P 500's average 8.9% price gain for all years and 71% frequency of gain.

Second, according to Strategas, the S&P 500 has not declined in the 12-months following a midterm election since at least 1942 (2022 was a midterm election year).



As Stovall said, "time will tell if history repeats or if the market continues to retreat."

COVID put "Globalization" in ICU and Putin pulled the plug; now what?

The seeds of the second great age of globalization were sown more than 30 years ago with the fall of the Berlin Wall on November 9, 1989. With the end of the Cold War, the world benefitted from a global "peace dividend" and the perception improvements in transportation and communication gave countries and companies a great opportunity to look far beyond traditional borders.

During this "golden age" of globalization, many U.S. companies "offshored" production to countries with cheaper labor—primarily in Asia and particularly in China. Distant sources of supply could be counted on to deliver goods "just in time." "Globalists" point to enhanced economic growth and standards of living for these countries, higher profits for U.S. corporations and importers and low-priced goods for American consumers.

In short, "interdependence" was both good and safe, as cross-border trade and economic self-interest led everyone to act in good faith as "citizens of the world."

The fabric of globalization has actually been fraying for the past 20 years as the world became a more dangerous place (9/11), the risks of economic/financial interconnectedness exploded (Great Financial Crisis) and countries began to look inward and enact "protectionist" policies like tariffs to reduce imports and subsidies to make domestic companies more competitive.

The combination of COVID and Russia's invasion of Ukraine delivered the *coup de grace* to globalization by exposing the fragility of this interdependence and risks of offshoring. Countries and companies can no longer depend on their foreign trading partners and far-flung supply chains. This will cause a shift in focus from "where can I get it cheapest?" to "where can I get it safest and surest?"

In other words, companies and countries will value "just in case" over "just in time," with enormous implications, positive and negative.

One of the biggest local positives of the shift of focus towards greater *in*dependence and supply chain robustness will be the of onshoring of high-tech manufacturing. Three years ago, Senators Chuck Schumer (D-NY) and Todd Young (R-IN) started drafting a precursor bill (the Endless Frontiers Act) that would eventually morph into the U.S. Innovation and Competition Act before finally becoming the Creating Helpful Incentives to Produce Semiconductors and Science Act (CHIPS Act).

Semiconductors are vital components in products ranging from vehicles to consumer electronics to advanced military weaponry. The $280 billion CHIPS Act includes about $52 billion to incentivize semiconductor manufacturers to construct domestic semiconductor fabrication plants, or "fabs." These investments will reduce our reliance on Asia (particularly China), where over half of global semiconductors are currently sourced and make the U.S. (whose global market share of semiconductor manufacturing plummeted from about 40% in the 1990s to just 12% in 2021) more competitive and self-reliant.

The CHIPS Act passed the Senate on a bipartisan basis last August, with support from every Democrat and 17 Republicans. On the House side, 24 Republicans joined Democrats, sending the legislation to President Biden to sign into law.

Since the CHIPS Act passed, over $200 billion of projects have already been announced in 16 states, redistributing high-tech investments and jobs across the country, including many rural communities. Minnesota-based semiconductor manufacturer SkyWater Technology has committed to build a 600,000 square foot, $1.8 billion state-of-the-art manufacturing facility at Discovery Park District, a 400-acre mixed-use development adjacent to Purdue University, eventually creating 750 new jobs. In turn, Purdue has launched the Semiconductor Degrees Program (SDP), which will educate both graduate and undergraduate students.

American taxpayers are also receiving new federal incentives to build and buy local. Embedded in the Inflation Reduction Act ("IRA") are subsidies for buying American made Electric Vehicles ("EVs"), with strict requirements on where cars are manufactured and components are sourced. Taxpayers receive up to $7,500 and $40,000 in tax credits for purchasing USA-made passenger EVs and commercial EVs, respectively. This greatly increases the competitiveness of domestic auto manufacturing. The IRA also includes many other clean energy incentives, which Credit Suisse expects to generate $1.7 Trillion in new investment over the next decade.

The biggest negative of the pendulum swinging from "offshoring" to "onshoring" will be higher prices to consumers and stubbornly higher inflation, as we lose the benefit of buying foreign-sourced goods subsidized by cheaper labor and other production inputs. This could also lead to higher interest rates, as the Fed will likely revise its inflation expectations above its 2% target in place for many years.

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Over the past year, we rebuilt the Iron Curtain around Russia with trade sanctions and military aid for Ukraine. We've also begun paving a road to resilience, reducing reliance on China. While it's too early to declare victory on either front, we can be certain "onshoring" is creating local opportunities by injecting tremendous resources into the once rusty American manufacturing sector, which "populists" argue has led to the "hallowing-out" of the middle class.

Our Forecast for 2023

This is the silly season when "experts"/soothsayers/prognosticators make loud predictions for the markets and economy. ***They don't know!*** According to *The New York Times*, a year ago the consensus forecast was the S&P 500 would reach 4,825 by the end of 2022, a slight increase from the 4,766 level at the end of 2021. In reality, the S&P 500 actually closed 2022 at 3,839. ***Nobody*** forecast that level and the consensus missed by a whopping 20%. This horrible miss was actually an *improvement* over 2021, when the median forecast was off by an astounding 25%.

For long-term investors, we believe it's much more effective to embrace uncertainty and focus on understanding the business forces that determine the arc of an individual company's fortunes and to assess how those fortunes could be impacted by a range of macroeconomic developments, rather than guessing the unknowable. ***We invest in companies, not ticker symbols, and believe the stocks of companies with strong profitability and earnings, trading at relatively attractive valuations will do better than high P/E stocks, particularly if rising rates continue to compress P/Es dramatically at the more expensive end of the spectrum.***

We saw a presentation by Jay Moreland, CFP at a conference a few years back and immediately became clients of his Behavioral Finance Network (https://behavioralfinancenetwork.com). Jay's expertise is helping investors understand the behavioral biases that are hard-wired into our brains and are dangerous to our long-term financial health and how to overcome them. We think he's brilliant and he's allowed us to share *his* forecast for 2023.

Jay's Only Forecast That Matters For 2023

Most investors love economic and market forecasts. With the markets so uncertain and volatile, our brain craves some sort of idea of what the future holds. But the markets are unpredictable – evidenced by the fact that no one can consistently predict them with accuracy. Of course, a certain forecast will be right from time to time, just like a broken clock. But market forecasts are not reliable, no matter what your brain tells you.

Unlike market and economic forecasts, my forecast is reliable and robust because it is based on enduring investment truths and investor behavior. These factors are more dependable than market outcomes and more important to an investor's well-being.

Forecast For 2023

In full disclosure, the following forecast is nearly identical to my forecast from last year and years prior to that.

- The economy/market will do something that surprises us (and the experts). In hindsight we will wonder how we didn't see it.
- The financial media will emotionalize headlines and short-term market moves to entice you to tune in - so they can achieve better ratings.
- Investors who watch the news and stock market often will experience more stress than those that don't.
- Investors that move to cash, waiting for a "better time," will suffer significant uncertainty and anxiety about when and how to get back in.
- Your investment decisions and reactions to market events will have a significant impact on **your personal investment return.**
- You will be tempted to change your investment strategy based on market performance, expert forecasts, and/or your personal beliefs about the future.

Conviction, patience, and discipline are virtues every investor should develop. They aren't easy, yet they are essential for your success. As your adviser, one of our most important roles is helping you ignore the noise and focus on what really matters to your financial success.

We wish you a prosperous, fulfilling, and happy 2023. Thank you for allowing us to be your trusted partner along the journey.

We're your "go-to" trusted financial advisor for investments and so much more

Since KM opened its doors for business on May 1, 1975, our singular goal has been to be a ***friendly, knowledgeable, trustworthy and reassuring source of financial guidance to our clients.*** Our founding values remain:

- **Loyalty.** We act as ***fiduciaries*** to our clients. Our interests are aligned with yours.
- **Humility.** We don't know what's going to happen next, but we've navigated through numerous bull and bear markets, economic booms and busts, market bubbles and crashes and seen investment fads come and go.
- **Discipline.** We focus on the **long-term** voyage.
- **Responsibility.** We do what we say we're going to do.

Zach Greiner, CFP® zach@kirrmar.com
Matt Kirr matt@kirrmar.com
Maggie Kamman, CFP®, CMA maggie@kirrmar.com

Our focus since we started more than 46 years ago has been managing portfolios for clients and delivering great client service. A couple years ago we decided to invest in elevating our level of client service and increasing our "value proposition" to our clients by adding **Zach Greiner, CFP® and Maggie Kamman, CFP®, CMA** to our business as Associate Directors of Client Service (joining **Matt Kirr**, Director of Client Service).

We are proud Zach and Maggie have been awarded certification as **CERTIFIED FINANCIAL PLANNER,** the standard of excellence in financial planning, by the CFP Board. CFP professionals like Zach and Maggie have met ***rigorous*** education, training and ethical standards. CFPs are required to master subjects including **financial planning, insurance planning, investment planning, tax planning, retirement planning and estate planning.**

Financial planning can help you set and reach your goals throughout your life—whether you want to buy a house, save for your kids' college education, live a fulfilling retirement, leave a legacy for your children or make a difference through philanthropy.

Zach and Maggie are here to assist and guide you, so feel free to reach out if you're wondering if you have enough money to retire on or have any other financial question, ***even if it's unrelated to your investment with KM.*** If they don't have the answer, we have a network of experts they can tap. Additionally, Zach, Maggie and Roger Lee, CFA, CPA, Director of Research have developed a presentation on investing basics geared towards younger, less experienced investors. The presentation highlights the ***vitally important distinction between investing and speculating***, which we think this is a critically important message in the current speculative frenzy with meme stocks and cryptocurrency. Our experience is sometimes younger folks are more receptive to messages delivered from someone other than a parent/grandparent!

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812 376-9444
800 808-9444

812 376-3889

www.kirrmar.com
www.kmpartnersfunds.com

621 Washington Street
Columbus, Indiana 47201

Past performance is not a guarantee of future results.

The S&P 500 Index is an unmanaged, capitalization-weighted index generally representative of the U.S. market for large capitalization stocks. This index cannot be invested in directly.

INDIANAPOLIS BUSINESS JOURNAL

Investors court "TARA" following messy divorce from "TINA"

Mickey Kim, CFA and Roger Lee, CFA, CPA

November 25, 2022

From 2009-2021, U.S. stocks (particularly the mega-capitalization "FAAMG" stocks; Facebook (now Meta Platforms), Apple, Amazon, Microsoft and Google (now Alphabet) were driven by the rallying cry, ***There Is No Alternative ("TINA")***, in reference to an unprecedented era of ***ultra-low interest rates*** and ***massive liquidity*** fueled by the Federal Reserve ("Fed"). Bond yields approaching 0% forced investors out onto the risk spectrum and turn to "riskier" assets like stocks in hopes of generating returns.

This all came to an abrupt halt in 2022, with soaring interest rates in response to persistently sky-high inflation reminding investors ***There Are Reasonable Alternatives ("TARA")*** to stocks for generating portfolio returns once again. The regime change from TINA to TARA has sweeping implications for every investor that we'd like to summarize in preparation for 2023.

The most readily apparent effect of TARA is the rebirth of *risk-free* returns. With the Fed's target for short-term interest rates currently at 4% (likely peaking around 5% next year), investors can once again earn decent nominal returns with no risk. After a long hiatus during TINA, FDIC-guaranteed CDs and government bonds are once again an attractive place to park idle cash, while earning 4-5%. Civic-minded investors are also returning to tax- exempt municipal bonds, where yields of 4-5% have pushed tax-equivalent yields north of 7%.

On the downside, the road from TINA to TARA has led to one of the worst years in history for the U.S. bond market. As interest rates rise, bond investors demand higher yields, crushing the price of previously-issued bonds now paying below-market rates. Indeed, supposedly "safe, investment-grade" bonds have shed almost ***$3 trillion*** in value. While the bloodbath in bonds has been devastating, investors can once again earn reasonable income lending to the government or their favorite "blue chip" companies.

Warren Buffett famously said, "it's only when the tide goes out that you learn who has been swimming naked." Indeed, ultra-low interest rates were the tide that lifted all boats. The end of TINA's reign was marked by a bubble in highly speculative assets, from initial public offerings (IPOs), to special purpose acquisition companies (SPACs), to "meme" stocks (GameStop), to cryptocurrencies and nonfungible tokens (NFTs).

During TINA, individual investors were driven by the fear of missing out ("FOMO") as prices soared "to the moon." What financial titan John Pierpont (J.P.) Morgan said in the 1800s remains true today; "nothing so undermines your financial judgement as the sight of your neighbors getting rich." With the return of TARA, FOMO has been replaced by the FOBD (the fear of being decapitated) as speculative assets have come crashing back to Earth (Sam Bankman-Fried's FTX just the most recent example).

Buffett also observed, "interest rates are like gravity on valuations. If interest rates are nothing, values can be almost infinite. If interest rates are extremely high, that's a huge gravitational pull on values."

We think the major silver lining of the return of TARA will be the outperformance of fundamentals-driven, "value" investing versus momentum-driven, "growth" investing. Indeed, as of the end of October the S&P 500 Value Index had a year-to-date return of -7%, while the S&P 500 Growth Index lost a whopping -27%.

A stock represents fractional ownership of a business. Businesses exist to make a profit and the value of any business is the cash it will generate over its life. Period. It doesn't matter if today's wunderkind runs the company or tweets about a stock "going to the Moon," ***cash*** is the where the rubber meets the road. The trick for investors is forecasting those cash flows and then applying the appropriate discount rate to determine the present value of that stream, sometimes known as the stock's intrinsic value.

Intuitively, $1 of profit today is worth more than $1 of profit five years from now. Less intuitively, the discount rate is directly impacted by interest rates and the ***higher the discount rate, the less future cash flows (particularly those far in the future) are worth today.*** Going back to Buffett's observation, with interest rates approaching 0%, investors were able to justify astronomical valuations on high revenue-growth companies that were hemorrhaging cash now, but told a compelling fairy tale about how they were going to mint cash in the distant future.

These "growth" stocks had price momentum on their side as they rose steadily and relentlessly higher and the strong wind of ultra-low interest rates at their back for more than a decade. With interest rates now significantly higher and momentum turning decidedly negative (Meta/ Facebook down a mind-blowing 67% in 2022), these same stocks will now be fighting the gravitational pull of higher interest rates. Conversely, stocks of companies in stodgy/decidedly un-sexy businesses ("value" stocks) that generate a significant amount of profits and cash now will benefit, by comparison.

TINA was fun and thrilling. She made investing seem easy and you feel like a genius. Unfortunately, in the harsh light of day, it was inevitable she was going to break your heart. TARA isn't nearly as glamorous or exciting, but she's the one you can happily grow old with.