

Atherean

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Dear Atherean Wealth Management client:

Enclosed is your portfolio summary report for the quarter ending December 31, 2021, a summary of your investment objectives and target asset allocation as per our records, and an investment advisory fee statement for the first quarter of 2022. It is important that you review your investment objectives and target asset allocation and let us know if any of it is incorrect or if there are any changes to your overall financial profile or liquidity needs. For a full report of the holdings in your accounts we encourage you to refer to your statements generated by the custodian.

Economic Review and Outlook

The U.S. gross domestic product grew at a nominal 6.9% annualized rate in the fourth quarter of 2021, catching up further to its long-term trend¹ as the U.S. economy continues to move closer to operating at its full potential². We believe that a scenario of sustained inflation over the next few years or so is plausible. Leading indicators such as the GDI (Gross Domestic Income) suggest that the aggregate U.S. economy is on the verge of running hot and that an output gap is imminent within the next few quarters. Indeed the consumer goods portion of the economy has already been running above full-potential for quite some time as evidenced by the supply chain issues witnessed on a day-to-day basis. Despite this, the consumer service economy has continued to operate below its full potential and its long-term pre-pandemic trend³.

Equity Markets – Recent Performance and Valuation

Market volatility returned in January as the Fed continued to adjust its outlook and policy in response to new inflation data. The year 2021 was the third consecutive year of gains for the U.S. large-cap (S&P 500) index, the U.S. mid-cap (S&P 400) index, and the U.S. small-cap (S&P 600) index. For 2021 the S&P 500 index was up 29%, the S&P 1000 index up 25%, and the Europe, Australasia, and Far East (EAFE) up 12% on a total return basis.

¹ In recent quarters economic growth has been much higher than its long-term trend on a percentage basis as the U.S. economy continues to snap back from the COVID crisis. Over the three years ending December 31, 2021 U.S. nominal output grew at an average rate of about 4.5%

² U.S. potential GDP, the level at which the economy operates when it is at full employment

³ Source: U.S. Bureau of Economic Analysis from MRB Partners, *U.S. Economy: Beyond Omicron, Still Decent Growth Ahead*, January 25, 2022

Earnings growth continues to be spectacular in the U.S. with consensus earnings for Q1 of 2022 projected to increase 17% year-over-year for U.S. large-cap stocks and 35% year-over-year for U.S. small-cap stocks⁴. We believe that the interplay between a strong economy and related earnings growth, which is positive for stocks, and rising interest rates in response to inflationary pressures, which is negative for stocks, particularly growth stocks, will be key features of the valuation environment in the near future. Valuations remain historically high with the S&P 500 currently trading at a forward P/E multiple of just under 24 and the Shiller CAPE ratio recently hitting a level of over 39.

Portfolio Management

As stated previously we believe that in the near future equity markets will be provided with a tailwind from sustained economic and earnings growth while at the same time rising interest rates will provide a headwind for valuations, particularly for those of highly-priced growth companies. While the Fed will remain focused on the strength of the economy and consumer-related price level inflation (specifically, CPI and PCEPI inflation) and not asset price inflation, asset price risk remains in place as a result of higher interest rates, particularly with regard to speculative assets and highly-priced equities. As discussed in previous quarterly updates interest rates affect the opportunity cost of investing in equities and this is most pronounced for highly-priced growth stocks. Thus far in 2022 we have seen significant unwinding of the speculative bubble which has been occurring over the past few years⁵ in growth equities and other assets with questionable intrinsic value as expectations of further rate hikes continue to materialize.

On the economic side, we believe that a period of sustained inflation is plausible given the long-term, secular, structural trends related to labor market dynamics and productivity. We believe that commodity producers are poised to benefit from rising price levels as their revenues are linked to freely-floating commodity prices and are therefore more efficiently market-driven than most other goods and services.

In the fourth quarter we took a position in Southern Copper Corp (SCCO)⁶. The company has been in its current form since 2005 when a series of transactions resulted in the Mexican conglomerate Grupo Mexico completing the purchase of Southern Peru Copper. With copper being a significant component in construction, the electrical network, and the electrification of vehicles⁷, we see demand remaining strong and indeed copper prices are currently at an all-time high⁸. Water shortages⁹ and political conflict related to new mining operations in top copper-producing countries Chile and Peru¹⁰ are creating barriers to entry for opening new mining projects and restricting the supply, and we believe that existing, seasoned operators are in a position to benefit. Southern Copper Corp is the fifth-largest copper producer globally and has the largest copper reserves

⁴ Source: Bloomberg, from MRB Partners, *Too Early To Write-Off U.S. Small-Cap Stocks*, January 13, 2022

⁵ As of the writing of this letter Bitcoin is down 44% from its high in November of 2021 and the ARK Innovation ETF is down 56% from its all-time high in February of 2021

⁶ The securities which we discuss in this letter are not necessarily allocated to all of our client accounts. Whether or not we choose to allocate a particular security to your account will depend on your risk tolerance, investment objectives, tax situation and objectives, and liquidity needs. Nothing printed in this letter should be construed as a solicitation or an attempt to effect transactions in securities.

⁷ In electric vehicles copper is a major component of electric motors, batteries, inverters, wiring and charging stations. Battery electric vehicles typically contain about 180 lbs of copper and hybrid electric vehicles typically contain over 80 lbs of copper. This compares with about 20-50 lbs of copper in conventional vehicles. Source: Copper Development Association Inc.

⁸ Spot copper prices hit \$4.31 per pound on COMEX (Commodity Exchange Inc.) as of the writing of this letter, close to their all-time high. The previous all-time high set in March of 2011 was broken in mid-2021

⁹ Water shortages in Peru have resulted in copper producer Antofagasta revising its production forecasts to between 660,000 and 690,000 tons of copper for 2022, down between 4% and 9% over 2021

¹⁰ The Las Bambas mine in Peru, one of the largest mines in the country, has faced repeated protests since it opened in 2016 (Source: Reuters). Operations at Peru's Antamina copper-zinc mine, the country's largest copper mine, were suspended in October of 2021 due to an ongoing roadblock set by protesters (Source: Reuters)

in the world¹¹. At a forward price-to-earnings ratio of just over 16 versus just under 24 for the S&P 500 we believe that we are getting equity in company which is poised to benefit substantially from the current macro-economic environment at a reasonable price.

Investment Philosophy

As discussed previously, global equity markets have rallied for the past three consecutive years as of the end of 2021 and only two of the past ten years (2012-2021) have been years in which the S&P 500 was down. Between 1928 and 2021 the S&P 500 index was down in one of approximately every three years. We firmly believe that it is important to have a long-term perspective, as compounding in equities is steady over the long-term but not always consistent from year to year. We are long-term bullish on the companies in which we invest, the free-market principles characterized by the global economy and the United States in particular, and economic prosperity and growth in general. In 1947 the annualized output of the United States was approximately \$250B, and in 2021 it was just under \$24T¹², which represents an almost hundred-fold increase. Short-term market movements have a tendency to elicit emotional responses, and the human brain has a tendency to place a greater weight on recent events and to assume that such events will continue into the future¹³. One need only to take a look at newspaper headlines from market tops and bottoms to realize how irrational market sentiment can be. Needless to say we view our equity investments as partial ownership in the underlying enterprises and we determine their value using our own judgment and analysis. We thus view day-to-day fluctuations in market prices as having the potential to be irrational and oftentimes not indicative of the underlying value inherent in the investments. In the words of the value investor Benjamin Graham: "if you are a prudent investor or a sensible businessman will you let Mr. Market's daily communication determine your view as the value of your ... interest in the enterprise?"¹⁴

As always, we are available to discuss your investment portfolio, discuss your financial plan, or address any other questions or concerns which you may have. Please feel free to reach out via phone or email if you would like to speak with us.

Sincerely,



Atherean Wealth Management, LLC

¹¹ Source: Wood Mackenzie Ltd, from SCCO Company Presentation, May 2021

¹² Source: U.S. Bureau of Economic Analysis

¹³ Availability bias is known as an information-processing cognitive bias where recent events are given a greater weight than careful analysis would suggest. See, for example, *Judgment under Uncertainty: Heuristics and Biases*, Amos Tversky; Daniel Kahneman, Science, 1974

¹⁴ Benjamin Graham, *The Intelligent Investor*, 1949