Atherean
Wealth Management, LLC

101 Hudson Street, 21st Floor
Jersey City, NJ 07302
Ph: 1-347-409-1499
cgething@atherean.com
http://www.atherean.com

July 29, 2022

Dear Atherean Wealth Management client:

Enclosed is your portfolio summary report for the quarter ending June 30, 2022, a summary of your investment objectives and target asset allocation as per our records, and an investment advisory fee statement for the third 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 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

In the United States real GDP contracted for the second consecutive time at a rate of 0.9% in the second quarter, however we believe that the broad macroeconomic picture is currently very clouded[1]. Many economic indicators are implying a weakening of the U.S. economy however other indicators suggest that the economy is still in solid condition[2]. Needless to say consumer-based and wholesale inflation both remain high, and the Fed has responded with the fastest four-month rise in the policy rate since 1981[3]. In the U.S. consumer savings continue to be high and household debt and debt-servicing levels are significantly lower than they were just prior to the Global Financial Crisis of 2008.

[1] Macroeconomic data is giving very mixed signals about the strength of the U.S. economy, but the bottom line is that we believe that the probability of a recession is somewhat lower than what the market consensus is indicating. We are in an unusual period as the divergence between two measures of economic activity, specifically gross domestic product (GDP) and gross domestic income (GDI), are at a multi-year high. These metrics both measure the same thing, i.e. the quantity of U.S. output and hence the strength of the U.S. economy, but are arrived at via different means. In the majority of periods these two numbers are in sync, however in recent quarters the GDI metric has been showing steady growth of the economy while GDP metric has been showing contraction of the economy. Source: U.S. Bureau of Economic Analysis and MRB Partners, *U.S. Economy: Risks Rising, But Recession Forecast Is Premature*, July 15, 2022

[2] GDP metrics, including the FRB Atlanta data discussed previously as well as ISM PMI® data indicate that the economy is weakening. However other metrics, such as unemployment and gross domestic income (GDI) data and consumer spending data recently released from payment-processing companies including Visa (V) indicate that the economy is still on solid footing.

[3] Source: U.S. Federal Reserve and MRB Partners, *U.S. Fed: Awaiting A Break In Inflation*, July 28, 2022

Equity Markets – Recent Performance and Valuation

U.S. equity market volatility and derating continued in the second quarter as interest rates continued to increase and be volatile across most portions of the treasury yield curve[4], and we believe that some probability of a recession and concommitant earnings growth slowdown has already been priced into the U.S. equity markets. Year-to-date as of the end of the second quarter of 2022 the U.S. large-cap (S&P 500) mid-cap (S&P 400) indices are each down 20%, and the U.S. small-cap (S&P 600) index and the Europe, Australasia, and Far East (EAFE) index are each down 19% on a total return basis. Valuations have come down but remain historically high with the S&P 500 currently trading at a forward P/E multiple of just under 20[5] and the Shiller CAPE ratio recently settling in at a level of just under 29[6] as of the writing of this letter.

As we have discussed in previous quarterly updates, over long, multi-decade time periods, the S&P 500 has been down in approximately one out of every three years and we believe strongly that in order to successfully invest in equity markets one must have a long time horizon. While we do not believe in reversion to the mean, i.e. that multiple consecutive years of gains will necessarily beget years of losses, we are not at all surprised that equity markets have recently experienced a downturn. As we have stated previously, although we do attempt to opportunistically time our entries and exits from individual stock positions, we are not in any way market timers in a broader sense.

Portfolio Management

A substantial number of stocks are currently at multi-year lows as a result of the current macroeconomic and interest rate environment. The number of buying opportunities which we have recently seen greatly exceeds what we saw approximately a year ago, when high equity market and risk asset valuations made solid bargains rare and hard to come by. In the most recent quarters we have had the good fortune of being able to choose our new equity positions from a large group of solid and compelling prospective options. In the first half of 2022 we implemented four new positions in our actively-managed equity portfolios. We have found two types of bargains recently: (1) growth-type monopolistic/duopolistic stocks which ordinarily and in the majority of cases have been historically too expensive for us to prudently purchase but have recently become purchasable, and (2) certain cyclical stocks which have recently become what we believe to be irrationally inexpensive due to what we believe to be macro-behavioral biases. We will next discuss one stock from each of these categories which we purchased in the second quarter.

As discussed in our previous quarterly update, we believe that companies with monopolistic, duopolistic, or oligopolistic characteristics are extremely attractive in any environment, but even more so during an inflationary environment as they, all else being equal, will be able to raise their prices more easily than companies operating in highly fragmented and/or highly competitive markets. Along these lines, in the second quarter we took a position in Adobe (ADBE)[7]. Historically, due to its high margins and consistently-high growth rate, the company has in the majority of cases traded at P/E ratios exceeding 50. However, primarily as a result of the recent rising interest rate environment and concommitant selloff in growth stocks, we have seen ADBE's

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[4]Treasury yields have been volatile across all durations as the bond market continues to digest inflation data, which has had a hawkish effect on bond markets, and weak economic data, which has had a dovish effect on bond markets. For example, the two-year treasury yield climbed almost a full point (100 bps) during the first few weeks of June in response to heightened inflation expectations, then subsequently gave up a good portion of those gains in a short amount of time as the market sentiment began to focus on the possibility of an economic slowdown and/or recession. The ten-year treasury yield has similarly been volatile as the sentiment oscillates between higher long-term inflation expectations and lower long-term growth expectations.

[5] As of July 11, 2022 for Q2 2022 forward earnings estimates. Source: Standard & Poors via YCharts

[6] As of July 8, 2022. Source: Robert Shiller via YCharts

[7] 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.

forward P/E ratio decline to below 30, resulting in what we believe to be a unique buying opportunity. We believe that there is a reasonable probability that the company will be able to continue to generate low double-digit revenue, free cash flow, and earnings growth in the near future, as Adobe holds a significant portion of the market share in several segments whose overall total addressable market is believed to be growing at high double-digit annual rates[8].

In the second quarter of 2022 we also took a position in homebuilder LGI Homes Inc[9]. LGI Homes began operating in Texas in 2003, and since then has diversified geographically into about three dozen regional markets throughout the United States. In the most recent year (2021) the company had over 10,000 home closings, up from just over 400 in 2010, an over 20-fold increase, and the company's tangible book value per share has grown at an impressive 30% annualized rate since 2014. LGI Homes was one of the few homebuilders in the United States that was able to sequentially grow its revenue and number of closings in each year throughout the 2008 housing bust[10], a period of time when the homebuilding sector as a whole suffered a significant slowdown and contraction. Due to a fear of decreased housing demand resulting from higher mortgage rates and the possibility of an economic slowdown, homebuilding stocks have pulled back substantially in 2022, with the S&P 1500 homebuilding index down almost 38% from its high reached near the end of 2021 as of the end of the second quarter of 2022, compared with a 20% pullback for the broad-based S&P 1500 index. When we took the position in LGIH it had a price-to-tangible book value of roughly 1.6 and a forward P/E ratio of just over 5, both of which are historically low, and we believe that the recent price pull-back is a gross over reaction. A significant portion of LGIH's homes sold are entry-level homes, and we do not believe that there is an oversupply of homes of this type as there was just prior to the housing bust of 2007-2008. While rising mortgage rates will undoubtedly increase the cost of home-ownership, we believe that, for entry-level home-owners, home-ownership remains substantially more attractive than renting, as U.S. rents increased at an almost 15% annualized rate for the twelve-month period ending 6/30/2022[11]. We also believe that there are macro behavioral biases at work related to the housing bust of 2007-2008, which have resulted in what we believe to be an irrational downgrading of the homebuilding sector as well as other housing-related industries.

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

Atherean Wealth Management, LLC

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[8] The total addressable market for Adobe products is expected to increase from about $150B to about $200B between 2023 and 2024 (Creative cloud is projected to grow from about $41B to about $63B between 2023 and 2024, Document cloud from ~$21B to ~$32B, and experience cloud from ~$85B to ~$110B). Source: Adobe 2021 Analyst Day presentation

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[10] According to company officers, LGI Homes was the only production builder in Builder Magazine's top 200 builders to increase its revenues and closings in each year between 2007 and 2009. The company has had a year-over-year increase in both its number of closings and its revenues in each and every year since at least 2007, just prior to the housing bust. Sources: *LGI Homes in Texas Stands Out,* Builder Magazine, March 9, 2009, *2022 Builder 100 Ranking*, Builder Magazine, 2022, and company filings

[11] The Zillow Observed Rent Index (ZORI) for the United States increased 14.8% for the 12-month period ending 6/30/2022. We believe this real-time metric to be a more accurate measure of market rents than other metrics such as CPI Rent from the Bureau of Labor Statistics, which is backward-looking. Source: Zillow