WINTER 2023 | VOL. 31 | NO. 1

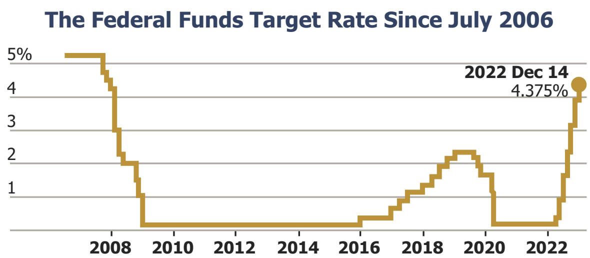
DVI
David Vaughan Investments

QUARTERLY PERSPECTIVE

THE TAMING OF INFLATION

Will Williams
Chairman, President & CEO

According to the Chinese calendar, 2022 was the 'Year of the Tiger' – a fitting moniker considering that taming the inflation tiger proved to be Fed Chairman Jerome Powell's principal focus for the majority of the year. High rates of inflation (initially viewed as transitory in nature) became increasingly entrenched throughout our nation's economy. It's hard to fathom that the Fed Funds target rate at the start of the year was practically zero – despite a headline inflation rate in excess of 7%.



Source: The Federal Reserve Bank of New York

Suffice it to say, the Fed was way more than a bit behind the curve. Fast forward 12 months, and the Fed has just executed the most aggressively restrictive monetary policy since the early 1980s. Beginning with a modest 25 basis point increase in March, they proceeded to increase rates six more times through December; ending with the highest Fed Funds rate since 2007 (a target rate range of 4.25 – 4.5%).

Looking ahead, all eyes will be fixed on future monthly economic data releases to see if the Fed can somehow manage to break the back of inflation, without breaking the overall economy in the process.

Shortly after the shocking news of the Russian invasion of Ukraine in late February, and just prior to the widely expected first Fed rate increase in mid-March, many commodity markets peaked. In some markets (e.g., crude oil, basic metals, wheat and lumber) the declines have been substantial as highlighted in the commodity price trends table on page 3. Unfortunately, even when commodity prices soften, it doesn't always translate into lower finished good prices. Manufactures tend to push through price increases quite rapidly but try to hold the line on finished product prices despite declining materials costs. Look no further than 2022 S&P 500® earnings; where there's a forecasted 10% increase in annual revenue. Much (if not most) of that increase isn't attributable to higher sales volumes, but rather to a series of price increases implemented throughout the year. In fact, full-year earnings per share estimates for the S&P 500 continue to show an increase of 2-3%, as revenue increases have more than offset deteriorating operating margins due to higher expenses.

Continued on Page 3

IT'S NOT OUR MONEY

Brian Christensen, CFA
Senior Vice President & CIO

Another year has come to a close and another year where greed and stupidity in the financial markets made headlines. Quite honestly, the news surrounding the recent failure of FTX Trading Ltd. and the arrest of firm founder Sam Bankman-Fried didn't surprise me in the least – given that FTX was built on a foundation of cryptocurrency trading. Don't get me wrong, at some point in the future I expect we'll have a couple of widely accepted digital currencies. Unlike the crypto of today, however, these currencies will have both a store of value and the backing/support of governments.

As I followed the continuing saga of FTX (along with the activities that led to its bankruptcy), the most shocking reveal was the firm's total lack of any transparency, governance, risk management or internal controls. At its peak, FTX was valued at $32 billion. The FTX investor list was a veritable 'Who's Who' of investment firms: Sequoia Capital, Tiger Global, SoftBank, Temasek Holdings, Thoma Bravo and even the Ontario Teacher's Pension Fund were onboard. Additionally, FTX paid millions for a litany of corporate sponsorships, among them FTX Arena (home of the NBA's Miami Heat), a Formula 1 racing team, and FTX logos on Major League Baseball umpire uniforms.

In a nutshell, the investors in FTX weren't at all worried about risk management and transparency. Few if any ever even asked. The rollercoaster was entirely driven by FOMO (the Fear Of Missing Out).

Legendary investor Warren Buffet referred to crypto as 'rat poison;' positing that he wouldn't give $25 for the lot of it. In testimony to Congress, Jamie Dimon, CEO of JPMorgan Chase (the world's third largest bank) called crypto a 'decentralized Ponzi scheme.' Leaders at the Central Banks of some of the world's largest economies are equally as skeptical:

- The European Central Bank stated "Bitcoin is also not suitable as an investment. It does not generate cash flow (like real estate) or dividends (like equities), cannot be used productively (like commodities), or provide social benefits (like gold). The market valuation of Bitcoin is therefore based purely on speculation."

- Minneapolis Federal Reserve bank President, Neel Kashkari added that the "entire notion of crypto is nonsense. Not useful for payments. No inflation hedge. No scarcity. No taxing authority. Just a tool of speculation and greater fools."

- And back in September 2021, The People's Bank of China went so far as to make all digital currency activities illegal.

Continued on Page 4

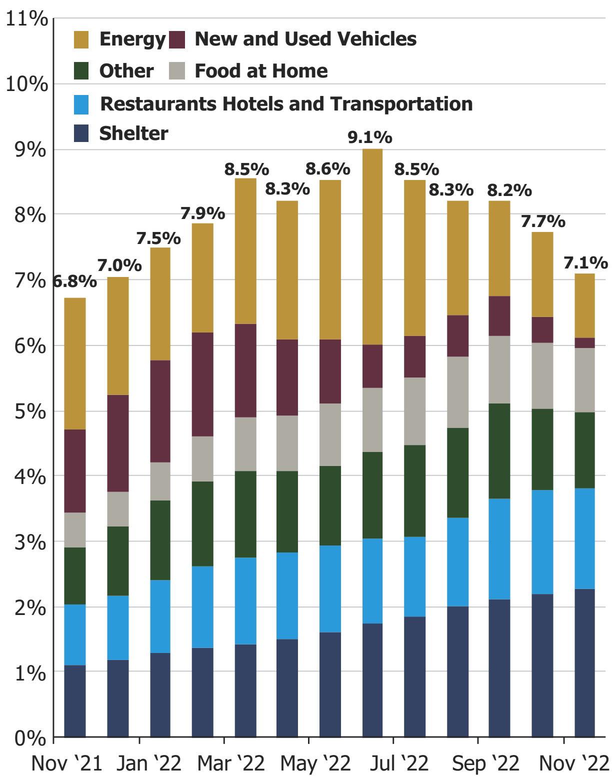
In an interview on CNBC, journalist Andrew Ross-Sorkin questioned Bankman-Fried about internal controls and risk management at FTX, as well as the level of due diligence performed by prospective investors. Bankman-Fried's response spoke volumes:

"What you're thinking about primarily, is upside. Right? What you're thinking about primarily is investing in a private company, and thinking might this 3x, might this 5x, might this even 10x on the upside cases and yet there's some chance that will go down there's some chance that maybe it will go down to zero. But that's counterbalanced by the upside propositions here….You know, rather than you're at the point where you're dwelling on all of the various precise downside scenarios and risks for a prospective venture investment, that means you're not investing."

THE TAMING OF INFLATION *Continued from Page 1*

Contributors to Headline Inflation

Contribution to y/y % change in CPI, not seasonally adjusted



Source: JP Morgan Guide to Markets

Despite evidence of softening economic activity in certain sectors such as housing and consumer discretionary (e.g., automobile sales), the jury is still out on whether this will translate at all into lower wage inflation. While there's been a spate of headlines reporting increased layoff activity across the technology sector, keep in mind that technology only represents 3-4% of the U.S. workforce.

Bank of America's chief economist recently commented that as a result of early retirements and reduced levels of immigration, the U.S. is short around 4 million workers compared to the pre-pandemic workforce. This supply and demand disequilibrium must be addressed before wage pressures will satisfactorily abate.

As we turn the page to 2023, it's hard for me to imagine a return to the 9.06% peak inflation level we witnessed in June 2022 – as that was driven by a confluence of negative news, unusual circumstances and supply chain disruptions. That's the good news. The Fed, however, will need to look long and hard at the cost-benefit of trying to reach a 2% inflation target anytime in the immediate future. The amount of near-term economic destruction required to once again achieve that rate would be significant. An economic soft landing, the ideal outcome, will take both time and patience.

2022 Commodity Price Trends

	Price 12.31.21	Market Peak Date	Market Peak Price	Price 12.31.22	%Change YTD	Decline[%] From Peak
Commodity Indices						
Bloomberg Commodity Index	$ 561.65	3.08.22	$ 834.50	$ 612.10	8.98%	-26.65%
Goldman Sachs CRB Index	$ 99.17	3.08.22	$ 140.58	$ 112.81	13.75%	-19.75%
Energy						
WTI Crude Oil	$ 75.21	3.07.22	$ 130.50	$ 80.51	7.05%	-38.31%
Natural Gas	$ 3.56	8.23.22	$ 10.03	$ 4.08	14.61%	-59.32%
Food						
Corn	$ 5.93	4.29.22	$ 8.25	$ 6.79	14.50%	-17.70%
Soybeans	$ 13.13	6.09.22	$ 18.07	$ 14.97	14.01%	-17.16%
Wheat	$ 7.71	3.08.22	$ 13.64	$ 7.91	2.59%	-42.01%
Live Cattle	$ 1.40	12.29.22	$ 1.59	$ 1.58	12.86%	-0.63%
Industrial Mtls / Building Supplies						
Copper	$ 4.46	3.07.22	$ 5.04	$ 3.82	-14.35%	-24.21%
Aluminum	$ 39.82	3.07.22	$ 58.07	$ 33.13	-16.80%	-42.95%
Lumber	$ 1,147.90	3.04.22	$ 1,477.40	$ 370.90	-67.69%	-74.90%
Precious Metals						
Silver	$ 23.35	3.08.22	$ 27.50	$ 24.18	3.55%	-12.07%
Gold	$ 1,828.60	3.08.22	$ 2,078.80	$ 1,830.10	0.08%	-11.96%

2.24.2022 (Russian Invasion of Ukraine)
3.17.2022 (First FOMC Rate Hike)

Source: FactSet

IT'S NOT OUR MONEY Continued from Page 2

So, why have so many people not heeded the warnings? FOMO. Sam Bankman-Fried thought he was following the philosophy of Effective Altruism (EA). EA is a social movement that places a priority on doing good, so others can be helped as much as possible. Bankman-Fried's investment philosophy was to go for broke because anything less was a disservice to the EA mission. Unfortunately, he appears to have forgotten that the money in his charge wasn't his.

At DVI, our investment process is founded on risk management. Our Investment Committee understands that it's far more important to be great risk managers than stock pickers. And, thanks to the diligence and guidance of our Chief Compliance Officer, Mike Price, we operate with full transparency every day. We never lose sight of who the money we manage belongs to.

P.S. Don't let the DVI staff Christmas picture fool you. I'm still here!

INVESTING AS A JOURNEY

Will Williams
Chairman, President & CEO

DVI began to publish a quarterly newsletter nearly thirty years ago. It was never about marketing or sales, but over the years we gained a greater appreciation of the need for both timely and effective communication. We learned through trial and error how important it was to provide you with a roadmap as to how we think and the framework for our decision-making.

Long ago, we decided DVI was ***not*** going to be all things to all people. We recognized the need to articulate how different we were from others in the investment management industry. 2022 proved to be a year where once again we reinforced the virtues of *'Daring to be Different.'*

Decades of experience have taught us that so much of a long-term investor's success is attributable to a few simple characteristics:

Humility If you think you have figured the stock market out, you are about to have a rude awakening. Humility is always right around the corner.

Discipline Stay in your lane. Maintain conviction in your investment beliefs despite others arguing to the contrary. The 'Fear of Missing Out' is replaced with the virtue of 'Do the Right Thing.'

Patience Your investment thesis might take time to materialize.

Optimism The impossible might be possible.

Focus Maintain a historical perspective and don't lose sight of the importance of the economic and business fundamentals. Sometimes the Return of Capital is just as important as the Return on Capital.

These concepts are simple in nature, but the ability for an investment professional to embrace and practice them day-in and day-out is rare indeed. My hat is off to the members of the DVI Investment Committee under the leadership of CIO Brian Christensen and Director of Investment Research Steve Hinrichs for their ability to stay the course and embrace the strategy of *'Unapologetically Value.'*