Harper Capital Management:

Global Markets- July 2023 Outlook:

In April we wrote the following:

How the stock market progresses during the rest of the year depends on the resolution of conflicting data. Overall inflation is coming down, but some components may remain elevated for longer. Fed Fund futures are suggesting a substantial cut in rates by January 2024- 125 bps over the next six meetings. Barring a financial crisis, we think risk assets are pricing in an optimistic scenario in terms of interest rates. We expect that the impact of rate increases globally, and the tightening of credit following the failure of multiple mid-sized banks will result in an economic slowdown and possibly a recession. The Federal Reserve will be challenged to both bring down inflationary expectations to their long-term target of 2% and avoid economic slowdown. With the equity markets trading at the higher end of their recent range, we think that there will be better opportunities to add risk to portfolios later in the year.

Equity markets performed well through the first half of the year. Through the end of June 2023, MSCI ACWI Index was +13.93%, EAFE Index +11.67% and the MSCI EM Index +4.89%. Among major developed markets. The United States (+8.29%) and Japan (+6.27%) performed well during the quarter, whereas most European markets (Europe +2.74%) lagged. On a YTD basis (through June 2023), European peripheral markets Italy, Spain, Netherlands, and Ireland have all performed well (>+20% YTD). Among emerging markets, Emerging European markets (Hungary, Poland, and Greece), India and Brazil were strong performers during the quarter. China was a laggard. On a YTD basis, Emerging European markets, Taiwan, and Brazil have been strong performers.

Since the end of the quarter, equity markets performed well in July, but have retreated by an equal amount so far in August.

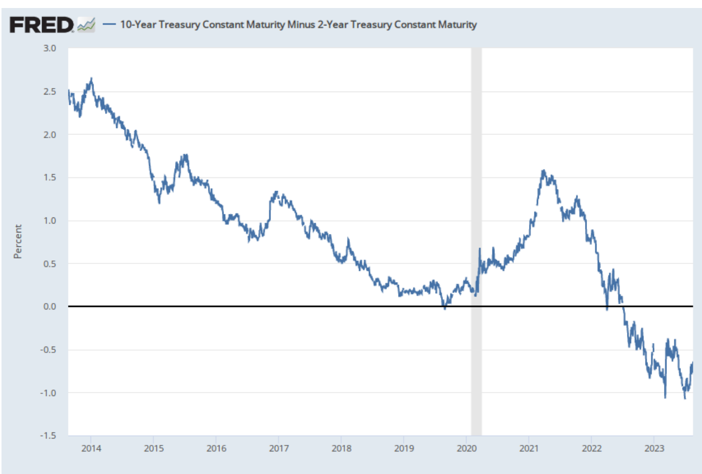
Bonds which performed well early in the year, are down significantly since then as yields have risen. The longer duration ETF TLT[1] which was +7.90% at the end of April is now -3.85% on a YTD basis (August 18th, 2023) and the aggregate bond ETF AGG[2] has moved from +3.74% at the end of April to +0.30% (August 18th, 2023). The 10-year Treasury yield is at a high for this cycle and at the highest level since the great financial crisis.

[1]https://www.ishares.com/us/products/239454/ishares-20-year-treasury-bond-etf

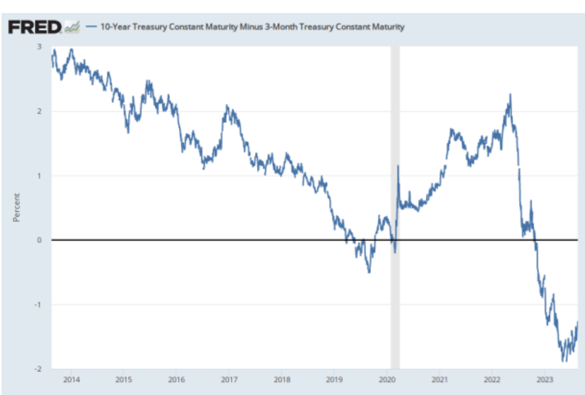
[2]https://www.ishares.com/us/products/239458/ishares-core-total-us-bond-market-etf

The 10-year-2-year and the 10-year-3-month yield spread remain inverted, but to a lesser degree than three months ago, reflecting the increase in longer-term yields and concern about core inflation remaining above the pre-Covid levels for longer than expected.

10-year- 2-year yield spread:



10-year- 3-month yield spread:

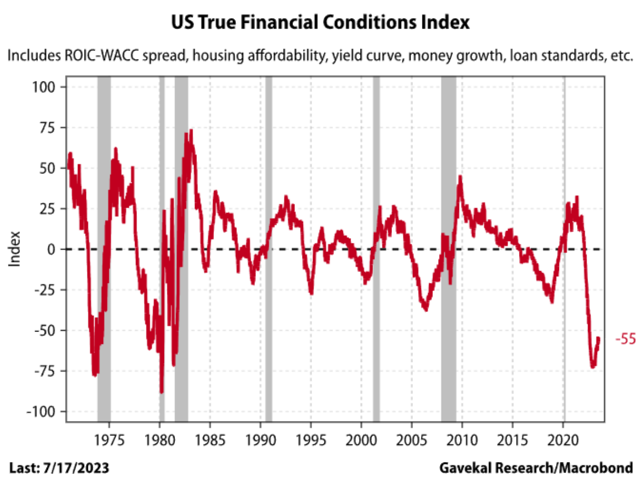


Most global equity markets rebounded from the time of the failures of Silicon Valley Bank and Signature Bank in mid-March till the end of July. This period coincided with the following all of which have been supportive of risk assets:

- Injection of liquidity by the Federal Reserve
- Reduction in reported inflation
- Excitement on the potential for Generative Artificial Intelligence (AI)
- Hopes for a recovery in China and expectations for monetary easing/stimulus

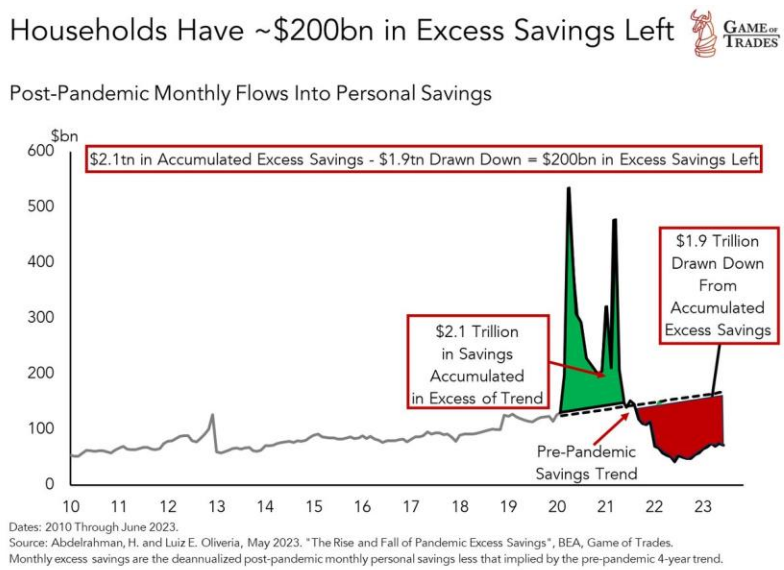
However, the market performance has been somewhat narrow with strong relative performance from the large-cap Tech stocks.

Improvement in Financial Conditions:

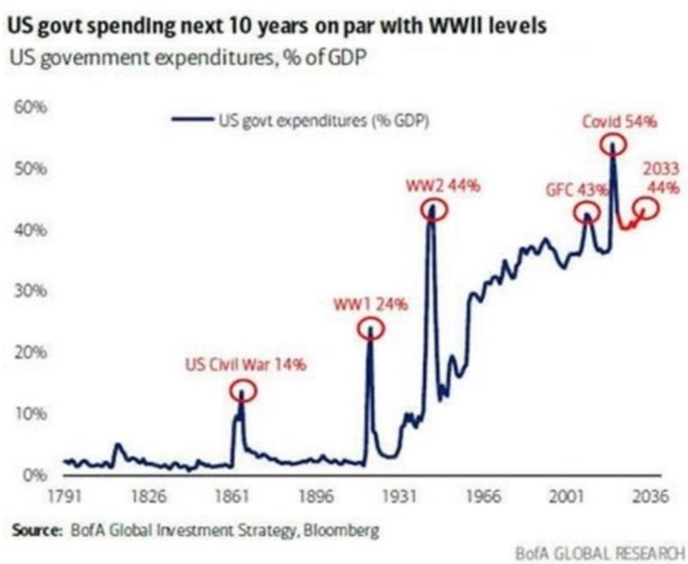


While financial conditions remain tight by many metrics, they have eased since March. The overall tight conditions have been countered by the excess savings in the system since the pandemic and the high level of government spending.

Excess savings have been supportive:



Fiscal expenditures remain elevated:



Inflation:

Figure 1: Headline and core inflation

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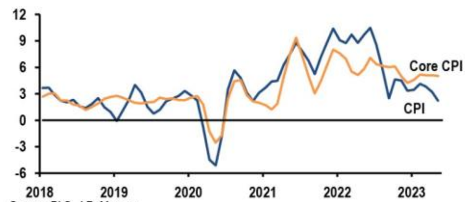

Source: BLS, J.P. Morgan

Figure 2: Core inflation decomposition

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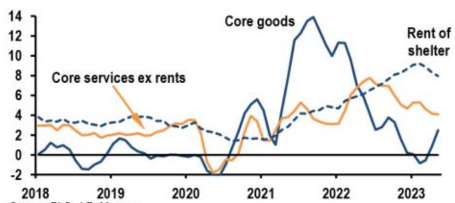


Source: BLS, J.P. Morgan

Headline inflation has eased significantly, but core (ex-food & energy) and super-core (core ex-housing) could remain above pre-Covid levels.

Weak Market Breadth:

The potential for generative artificial intelligence to be a catalyst for significant productivity enhancement and low-inflation growth has resulted in a narrow group of stocks leading the market. While a few companies like Nvidia have seen short-term earnings upgrades based on new AI-related order wins, the broader market's rise has been due to multiple expansion rather than increase in earnings expectations.

Chart 8: 48% of global stocks below pre-COVID highs

MSCI ACWI Equal Weighted Index

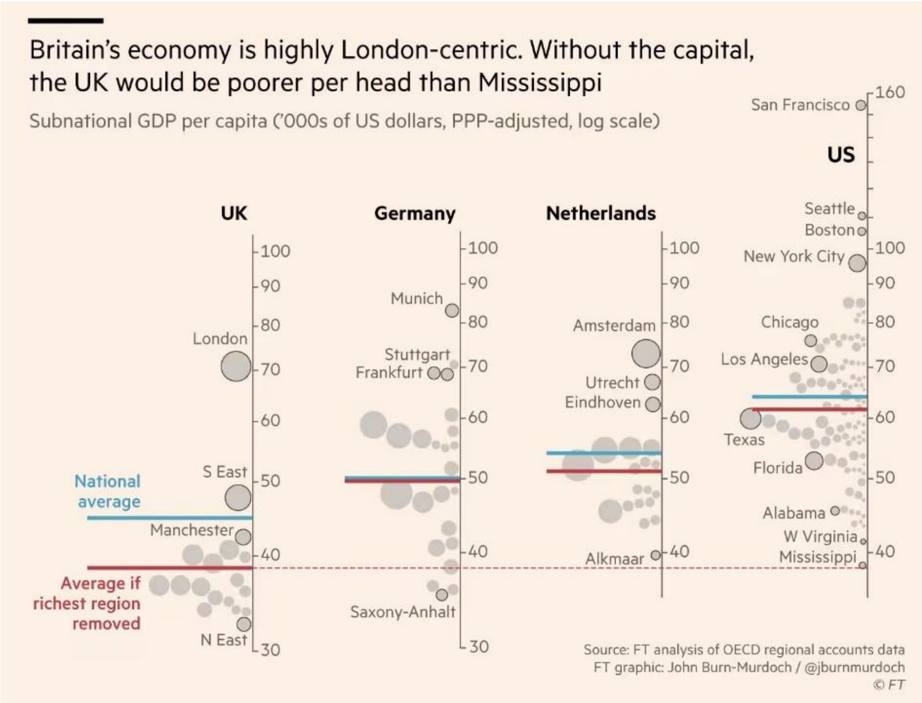
Source: BofA Global Investment Strategy, Bloomberg

BofA GLOBAL RESEARCH

Europe:

European markets performed well since the market low in October 2022 through the first half of Q2 2023 but have lagged in recent months. While valuations remain more attractive than the United States, most European economies lack the dynamism of the American economy- laggards in the technology sector, greater governmental intervention in the economic sphere, higher energy costs (often from governmental regulations) and greater dependence on exports to China. Peter Huntsman, CEO of Specialty Chemical company Huntsman recently said[3] "A broader European recovery still feels as if is yet to come…Energy prices are down from their recent historical highs but still multiple times higher than energy costs in the Americas or Asia. Energy and economic policies and regulations in Europe do not seem to adequately address the growing non-competitiveness and de-industrialization that is taking place. Europe is losing its ability to export while also seeing more raw material imported from abroad where new capacity is being added and demand in domestic markets are unable to absorb new production."

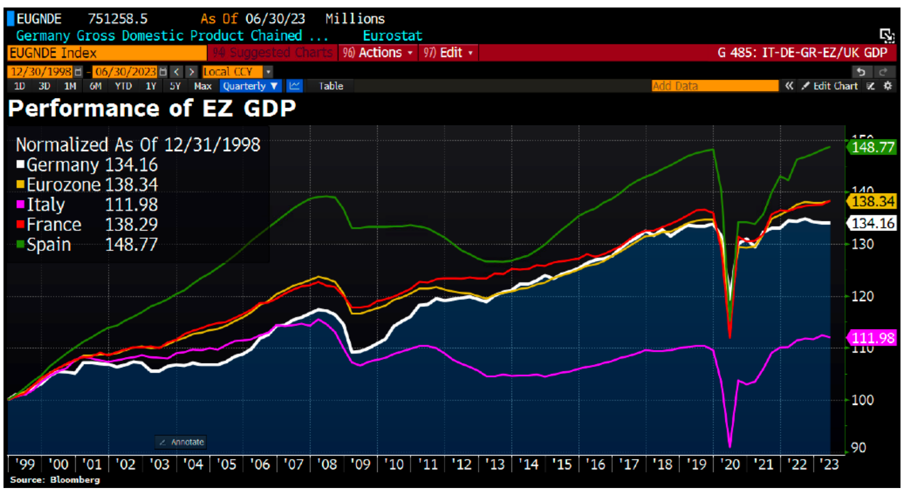
Europe falling behind the USA:



[3]https://twitter.com/tweitzendoerfer/status/1687564853597126656?s=43&t=VtlkJehYcW5euo9ED3ORZg

German dependence on China Trade:

Germany falling behind France and Spain:



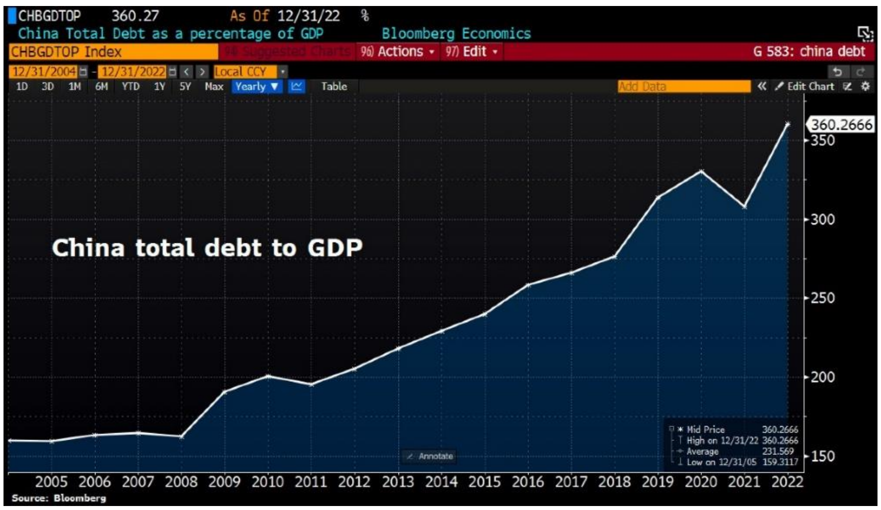
Economist Magazine- potential contra-indicator:

While the Economist Magazine front cover stories have a reputation for being contrarian indicators, we think Germany needs a strategy to reduce energy costs (the elimination of nuclear power has been a disaster) and diversify away from dependence on trade with China.

China:

Economic data from China suggest myriad problems where the traditional playbook of greater investment in real estate, infrastructure and support for exports may not be working as well. Each of these economic segments face headwinds not seen in the past- weakening real estate prices have reduced demand, productivity gains from incremental infrastructure investments are very limited and the strategic conflicts in the era of President Xi have reduced the potential for more share gains in global trade.

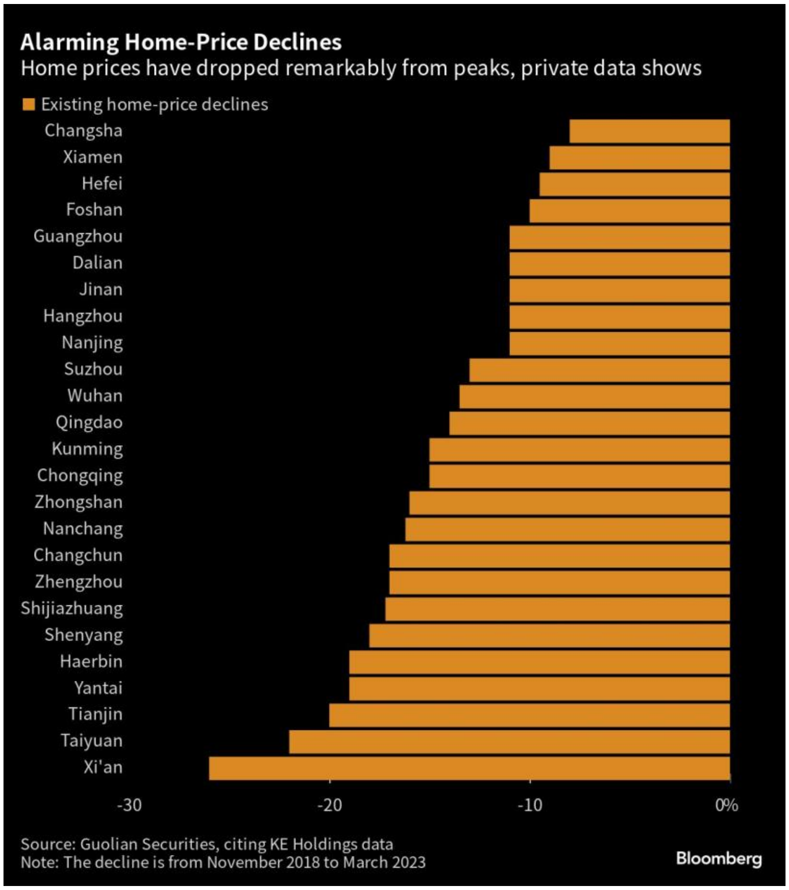
High Leverage:



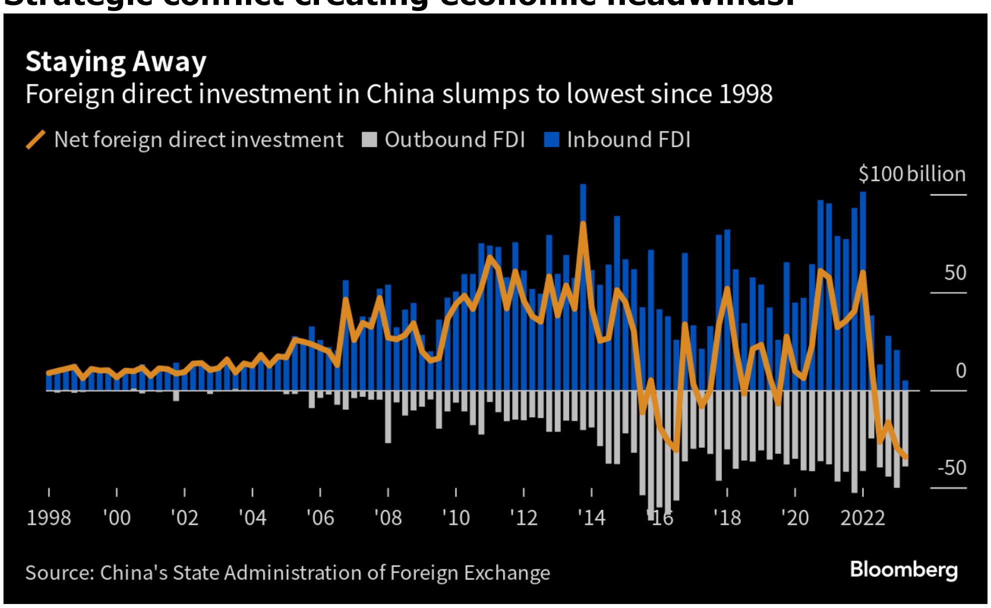
Lack of job creation:

This data set is being discontinued, with officials saying it needs refinement, but it could be for more obvious reasons.

Real Estate sector remains weak:



Strategic conflict creating economic headwinds:



Weakening currency- reflection of economic health:

For readers of our periodic epistle, the economic events highlighted by the charts above will not be entirely surprising. Healthy and sustainable economic growth has been absent for a long time and under President Xi, the country has moved away from improvements in the rule of law and from strategic cooperation with most of the rest of the world. For shorter-term investors, there are often trading opportunities. It is possible that the markets will cheer a large-scale injection of liquidity, though this will create greater long-term problems. A more sustainable improvement is possible if the government follows through on its stated desire to rebalance the economy with consumption-led growth. Such a rebalancing will inevitably lead to lower growth in the short and medium term but will be healthier for the economy as it will slow the growth in debt and reduce the extent of bezzle[4].

India:

I spent about three weeks in India last month (partly why this quarterly letter is delayed) and hope to write a separate piece on the changes in the country and its outlook ahead of national elections in 2024. India is the fifth largest economy in the world and is on pace to surpass both Germany and Japan over the next decade to become the third largest economy. There is tremendous entrepreneurial energy in the country, and it is addressing many of the problems that have held back economic growth in the past.

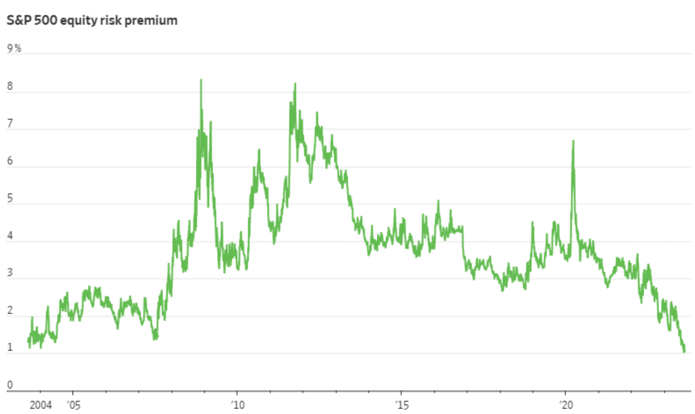
[4]https://carnegieendowment.org/chinafinancialmarkets/85179#:~:text=The%20bezzle%2C%20a%20word%20coined,its%20long%2Dterm%20economic%20value.

Outlook:

Through the end of the second quarter seven large-cap technology stocks accounted for about 75% of the S&P 500 YTD returns. We believe much of the performance is related to excitement about the potential for AI, which has the potential for making a significant impact on the global economy. Some have compared it to the discovery of fire, the wheel, or the industrial revolution, with the impact being felt over a few years rather than decades. McKinsey[5] has estimated that the new technology could add $2.6-$4.4 trillion of economic value in industries ranging from banking to life sciences. However, others like cognitive scientist Gary Marcus is more cautious[6] and believes AI models may use spurious statistical patterns in datasets and cannot learn in the flexible and generalizable way humans can. A few companies like Nvidia and Microsoft have shown the ability to monetize the interest in AI capabilities, but it is too early to say whether we will soon have wide-ranging use cases and killer apps.

Since the publication of our last Investment Letter, the US market is about 3% higher and the EAFE and EM indices are slightly lower. We continue to see potential headwinds for the global economy and for equity markets. Sub-prime auto loan delinquencies are rising, and the student loan repayment holiday will end soon. The Labor market remains strong, but unemployment rates tend to be low at the start of economic downturns.

Low Equity Risk Premium:



Note: Difference between earnings yield, using earnings for the next 12 months, and 10-year Treasury yield.
Source: FactSet

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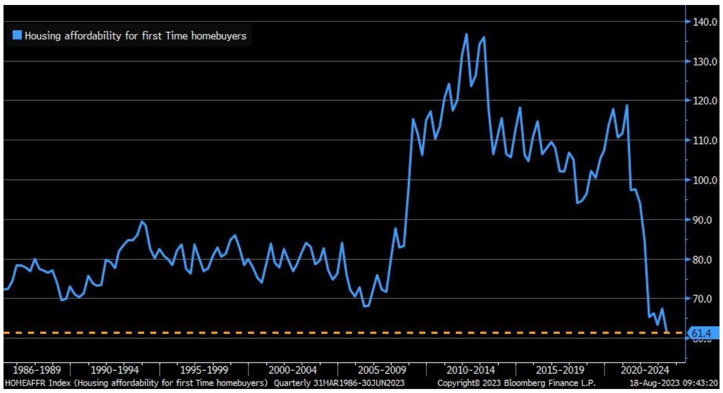
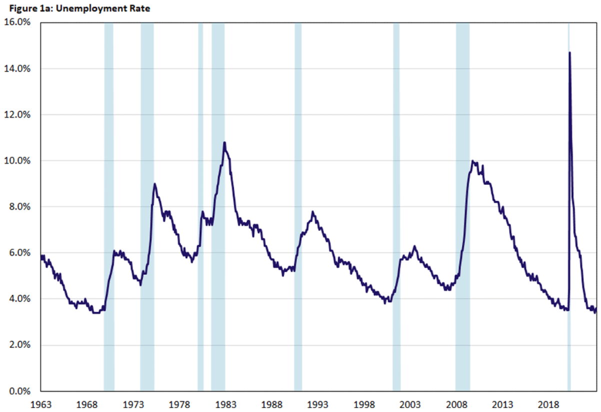
[5]https://www.mckinsey.com/capabilities/mckinsey-digital/our-insights/the-economic-potential-of-generative-ai-the-next-productivity-frontier
[6]https://garymarcus.substack.com/p/no-virginia-agi-is-not-imminent

Housing Affordability has declined:



Recessions often start with low unemployment levels:

Figure 1a: Unemployment Rate



Notes: The shaded areas represent National Bureau of Economic Research recession periods.
Source: Total unemployment rate from CPS Household Survey, SA monthly, January 1962 to March 2023 via Haver Analytics.

We expect core inflation and interest rates to stay at higher levels than during the pre-COVID period. Rates staying higher for longer will be a headwind for the global economy. We remain cautious in terms of risk.

Updates on Portfolios (detailed performances since inception can be seen in Appendix I):

2023 YTD PERFORMANCE (06/30/2023)	**Portfolio**	**Benchmark**	**Morningstar Category Median**
INTERNATIONAL VALUE	8.61%	9.28%	10.37%
GLOBAL	12.72%	13.93%	11.52%
EMERGING MARKETS	7.87%	4.89%	7.11%

Portfolio changes (03/31/2023 through 06/30/2023):

International Value: No trades

Global Equity: No Trades

Emerging Markets: No Trades

Additional Thoughts:

For 2023, the International Value (-67bps) and Global (-121bps) strategies are slightly behind their respective benchmarks, and the Emerging Markets (+298bps) is ahead. Our strategies have added significant value relative to the respective benchmarks and peer groups over time. Longer-term performance metrics:

International Value: +476bps annualized (5 years)

Global Equity: +474bps annualized (ITD, ~3 years)

Emerging Markets: +404bps annualized (5 years)

We do not manage with the goal of short-term performance, but believe that a robust and disciplined process can compound investor returns at superior rates.

We are often asked how our investment process is differentiated:

1) We seek specific market inefficiencies- durable businesses where newsflow creates short-term discounts to intrinsic value. Unilever and Amazon in 2022, Danaher and Roche in 2023 would be examples of new or additional investments we have made that fit this criteria. Second inefficiency is where the market underestimates the runway for growth. HDFC Bank, ICICI Bank and Mercadolibre are examples that fit this criteria.

2) We do take a long-term outlook of 7-10 years and the portfolio turnover data bears this out. While many investors talk about patience and time arbitrage, we think very few investors walk the talk.
3) We view risk as the permanent loss of capital and not short-term volatility. The avoidance of permanent loss of capital is the key to compounding investment returns at superior rates. The key to accomplishing this is:

- In-depth due diligence at the time of purchase
- Investing in companies that you understand well
- Investing in a manner that fits your personality and psyche
- Investing in durable businesses that can stand the test of time
- The ability to separate noise from real information in the deluge of data we receive these days

HARPER CAPITAL MANAGEMENT Performance Update June 2023

INTERNATIONAL VALUE	Portfolio	MSCI EAFE Value	Morningstar FV Category	Comment
2016	(3.20%)	6.90%	n/a	***Start date 8/1/2016***
2017	24.27%	21.43%	22.08%	
2018	(14.28%)	(14.78%)	(15.50%)	
2019	22.84%	16.09%	17.83%	
2020	7.62%	(2.63%)	0.93%	
2021	14.45%	10.89%	11.40%	
2022	(4.42%)	(5.58%)	(9.12%)	
2023	8.61%	9.28%	10.37%	***YTD 6/30/2023***
ITD	61.88%	43.06%	n/a	***Cumulative (8/1/2016 to 6/30/2023)***
ITD	7.21%	5.31%	n/a	***Annualized (8/1/2016 to 6/30/2023)***
1-year	15.34%	17.40%	15.71%	***Annualized***
3-year	12.95%	11.34%	10.67%	***Annualized***
5-year	7.69%	2.93%	3.59%	***Annualized***
5- year Analytics (as of 06/30/2023)				
Annualized Alpha	5.19			
Information Ratio	0.61			
Upside Capture	87.33%			
Downside Capture	75.11%			
Portfolio Turnover	9.86%			***Annualized***

GLOBAL	Portfolio	MSCI ACWI	Morningstar WLS Blend Category	Comment
2020	31.80%	23.10%	n/a	***Start date 7/1/2020***
2021	24.03%	18.54%	18.04%	
2022	(16.46%)	(18.36%)	(16.71%)	
2023	12.72%	13.93%	11.52%	***YTD 6/30/2023***
ITD	53.93%	35.73%	35.14%	***Cumulative (7/1/2020 to 6/30/2023)***
ITD	15.46%	10.72%	10.56%	***Annualized (7/1/2020 to 6/30/2023)***
1-year	18.55%	16.53%	14.98%	***Annualized***
3-year	15.46%	10.72%	10.56%	***Annualized***
ITD Analytics (as of 06/30/2023)				
Annualized Alpha	4.48			
Information Ratio	0.72			
Upside Capture	105.87%			
Downside Capture	89.78%			
Portfolio Turnover	18.33%			***Annualized***

EMERGING MARKETS	Portfolio	MSCI EM	Morningstar EM Category	Comment
2016	2.71%	8.67%	5.42%	***Start date 6/1/2016***
2017	41.92%	37.06%	34.17%	
2018	(11.93%)	(14.58%)	(16.07%)	
2019	19.63%	18.42%	19.26%	
2020	6.70%	18.31%	17.91%	
2021	4.94%	(2.54%)	0.08%	
2022	(7.73%)	(20.09%)	(20.84%)	
2023	7.87%	4.89%	7.11%	***YTD 6/30/2023***
ITD	71.30%	45.83%	41.65%	***Cumulative (6/1/2016 to 6/30/2023)***
ITD	7.89%	5.47%	5.04%	***Annualized (6/1/2016 to 6/30/2023)***
1-year	18.85%	1.75%	5.39%	***Annualized***
3-year	11.48%	2.32%	3.40%	***Annualized***
5-year	4.97%	0.93%	1.48%	***Annualized***
5- year Analytics (as of 06/30/2023)				
Annualized Alpha	4.56			
Information Ratio	0.38			
Upside Capture	93.21%			
Downside Capture	86.42%			
Portfolio Turnover	14.91%			***Annualized***