G-FORCE

AUGUST/SEPTEMBER 2023
MARKET OUTLOOK

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STOCKS SOAR

2023 is a sea of invigorating green for stocks with U.S. large cap leading the way. The technology sector as a whole has risen +39% led by semiconductors which is +51.9% YTD. As CAP anticipated, laggards earlier in the year are starting to converge with U.S. small-cap/mid-cap, international developed, and emerging markets showing signs of life. Our bullish, value-oriented call on U.S. regional banks is materializing with the regional banking ETF +38% from lows in May with further room to run. Bonds are struggling this year, while gold is producing some positive returns on the back of a somewhat weaker dollar.

CAP OUTPERFORMANCE

All our portfolios have outperformed their respective benchmarks over the extremely volatile last two years and are well-positioned for the next phase of the business cycle. Our value as an asset manager is vividly illustrated through this alpha: we did not over-leverage into the downturn, and we did not sell equities as the markets bottomed out. CAP was contrarian when it mattered. We tactically reduced our leverage in early 2022 as rates started to climb and increased our equity allocations as markets sold-off in 2022. We then held on for the market rebound gobbling up equity exposure when other managers sat on cash deposits. In a nutshell, we practiced what we preached.

GROWTH ON STEROIDS

Our call for a rebound in growth stocks in our 2023 Annual Outlook ("The Siren's Song") has been a huge success with growth outperforming value by +21% this year. This outperformance has been contrarian given the surge in bond yields. But the U.S. economy has been resilient despite higher yields and last year's sell-off was so extreme that the comeback makes perfect sense. Staying focused, especially during periods of extreme volatility, helps avoid selling at lows or buying at highs; the most devastating temptation for investors.

SHORT-TERM EXUBERANCE

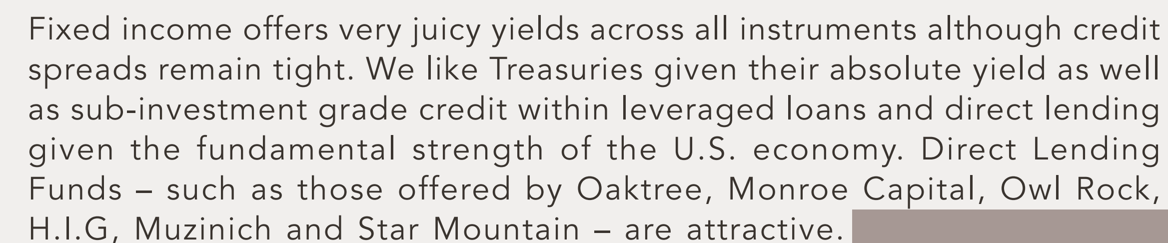
Over the last 3 months, both the S&P 500 (+10%) and Nasdaq (+15%) have risen very sharply – by more than one standard deviation above their historical mean for similar periods. This blistering rally is unlikely to be sustainable, so more subdued returns are likely over the coming few quarters. However, the market is not overextended on a one-year basis. It has simply recovered much of its losses over 2022 which CAP believes is justified.

GRAVITATIONAL FORCES

Warren Buffett once quipped that interest rates are to asset prices what gravity is to the apple. The implication for investors is to assume risk in line or slightly below your tolerance. This is especially telling given the combination of high stock market valuations and elevated rates. Our quant dashboard paints a positive short-term environment for stocks (risk, momentum, and sentiment) but a more challenging medium-term environment (valuations). Dialing back a bit of risk is now appropriate. Doing so might be painful as stocks move higher in the short term due to momentum, but will allow for a more aggressive opportunistic stance as markets present more attractive opportunities.

JUICY YIELDS

Fixed income offers very juicy yields across all instruments although credit spreads remain tight. We like Treasuries given their absolute yield as well as sub-investment grade credit within leveraged loans and direct lending given the fundamental strength of the U.S. economy. Direct Lending Funds – such as those offered by Oaktree, Monroe Capital, Owl Rock, H.I.G, Muzinich and Star Mountain – are attractive.



KEY VIEWS

REDUCE LEVERAGE: Higher for longer interest rates, as well as solid gains on equities, compel us to reduce leverage by 5% on our CAP Appreciation and High Octane portfolios. CAP High Octane maintains 5% leverage, while our other portfolios cut most leverage. When rates decline and/or valuations temper, we will again assume more leverage.

REDUCE EQUITY OVERWEIGHT: The combination of the blistering rally along with attractive yields allows us to reduce our overweight to stocks and increase our allocation to fixed income across portfolios. We're always buyers of stocks over the long-run, but we're reducing the significant overweight we imposed during the depths of the 2022 sell-off.

EXTEND DURATION: With 10-year Treasury yields at ~4.2%, longer duration instruments are again attractive. We move some of our short exposure to longer duration to take advantage of these higher yields.

MAINTAIN ALTS: Alternative investments such as commodities and infrastructure are valuable as return enhancers and diversifiers. We maintain our allocation to these assets, as they offer value compared to increasingly expensive public equities.

CAP ENHANCED GROWTH

CAP believes that a well-composed overlay program of options can add significant value to portfolios. "CAP Enhanced Growth" utilizes Einstein's three psychological factors of stupidity, greed, and fear to add value over time. We "sell greed" as markets go higher, "sell fear" as markets move lower with elevated volatility, and buy markets when stupidity reaches a crescendo (via put and call options). Our unique approach applies leverage opportunistically as the market experiences periods of fear and irrationality. Our proprietary portfolio construction methodology allows us to utilize tax efficient UCITS ETFs for offshore investors, which may save valuable withholding tax.

RESILIENCE DESPITE RATES

From a peak value of 5.4%, YoY core PCE Inflation has ticked down to 4.1%. This is encouraging but more progress is needed to bring it in line with the Fed's target of 2% per year. We believe this progress is forthcoming given the high interest rate environment. Progress should be accompanied by a decline in yields, which have reached new highs on the 10-year for 2023. A soft-landing scenario is firmly on the cards given leading indicators – namely, the resurgent stock market.

STOCKS SOAR

The 2023 ETF report card (Exhibit 1) shows a sea of green for stocks, with U.S. large cap (SPY) leading the way. From a sector perspective, Technology (XLK) – particularly semiconductors (SMH) – underwent blistering rallies at +39.7% and +51.9%, respectively. As we anticipated in our last outlook, laggards earlier in the year are catching up with U.S. small-cap (IJR), midcap (IJH), international developed (IEFA) and emerging markets (IEMG) ticking upward. Our bullish value-oriented call on regional banks is starting to reap rewards with the regional bank ETF (KRE) +38% from lows in May. We believe they have room to run higher given low valuations and a strong economy/banking sector. Bonds have struggled this year with the U.S. broad aggregate bond index (AGG) losing -0.5% YTD on a price basis and +1.3% on a total return basis including coupons. Gold (GLD) is producing positive returns on the back of a weaker dollar rising +5.9% in 2023.

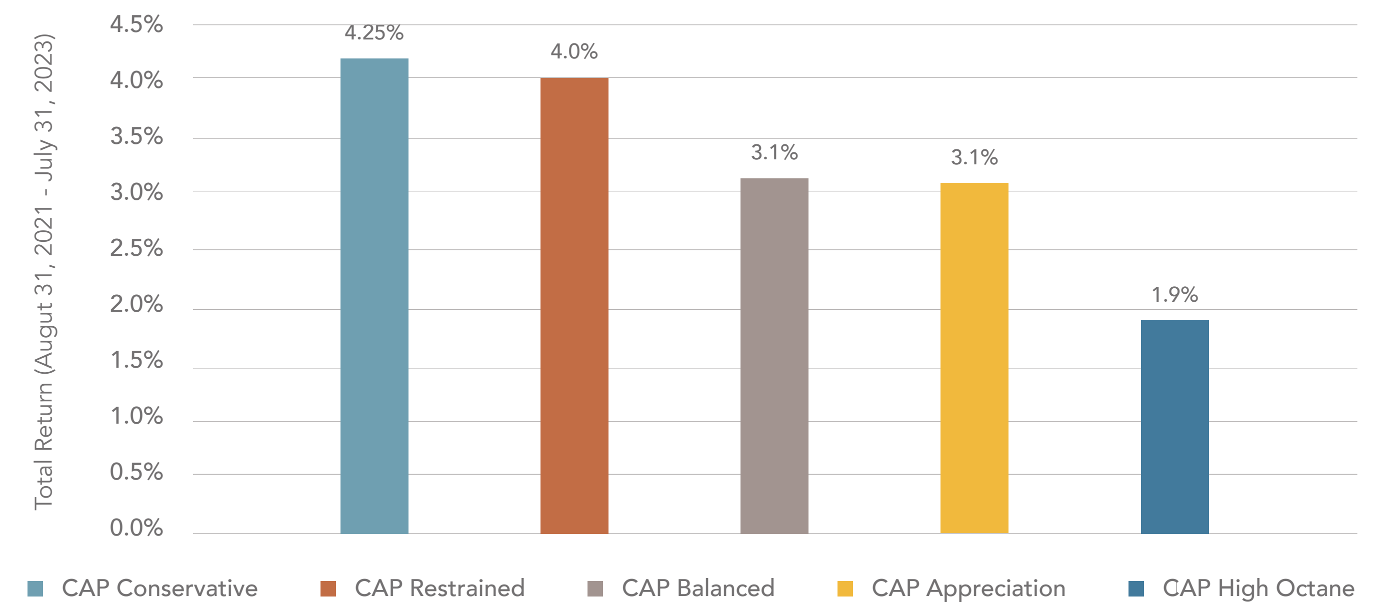
EXHIBIT 1: 2023 YEAR-TO-DATE ETF REPORT CARD

CAP OUTPERFORMANCE

"Saying…is different from doing." - Michel de Montaigne

Exhibit 2 below shows the performance of CAP Portfolios' asset allocations since August 31, 2021. All of our portfolios have outperformed their respective benchmarks over this extremely challenging period and are well-positioned for the next phase of the economic cycle. Our added-value as an asset manager is apparent due to our sound investment principles. Firstly, we did not over-leverage going into the downturn, and we did not sell equities as the markets bottomed out. Secondly, we were contrarian when it mattered. We tactically reduced leverage in early 2022 as rates started to climb and increased our equity allocations as markets sold off in 2022. We then held-on for the market rebound. In a nutshell, we practiced what we preached. Many of our clients did even better than the figures in Exhibit 2 suggest because of several factors. Firstly, their portfolios were cushioned during the downturn as a result of holding many uncorrelated alternative assets, that held up much better than publicly traded equity (in some cases showing a positive return for 2022). Secondly, many of our portfolios tilted towards growth equity, which rose significantly more than broader markets. Thirdly, we levered opportunistically, which added returns on the upside. Finally, many clients added new cash to their portfolios, which we deployed into beaten down markets.

EXHIBIT 2: ALL CAP PORTFOLIOS HAVE OUTPERFORMED THEIR BENCHMARKS OVER LAST TWO YEARS



	CAP CONSERVATIVE	CAP RESTRAINED	CAP BALANCED	CAP APPRECIATION	CAP HIGH OCTANE
CUMULATIVE ALPHA	+4.2%	+4.0%	+3.1%	+3.1%	+1.9%

Source: CAP Research. Period covers Aug 31, 2021 – July 31, 2023. Benchmarks are as follows - CAP Conservative: 30% T-Bills, 20% MSCI ACWI, 50% US Agg, CAP Restrained: 25% T-Bills, 35% MSCI ACWI, 40% US Agg, CAP Balanced: 15% T-Bills, 50% MSCI ACWI, 35% US Agg, CAP Appreciation: 15% T-Bills, 50% MSCI ACWI, 35% US Agg, CAP High Octane: 0% T-Bills, 75% MSCI ACWI, 25% US Agg. Performance shown is gross of fees based on benchmark indices.

GROWTH ON STEROIDS

"What goes up must come down." – Sir Isaac Newton

Sir Isaac Newton famously coined the above expression to describe gravity. It has some applications to finance as well, although much more limited than one might first imagine. Stocks that go up do NOT always come down, and stocks that go down, arguably usually stay down. Our call for a rebound of growth stocks in our Annual Outlook ("The Siren's Song") has been a huge winner (and an reverse of Newton's famous expression). The growth factor as captured by historical revenue growth produced a spread of +21% (Exhibit 3). This means that growth stocks have outperformed value stocks (top 20th percentile minus bottom 20th percentile) by a massive +21% in just seven months! This massive alpha is surprising due to elevated yields. But the U.S. economy continues to outperform the naysayers and doomsayers alike, so the comeback makes sense.

EXHIBIT 3: CAP FACTOR DASHBOARD - NET LONG-SHORT (HIGH-LOW)

STYLE	FACTOR	2023 YTD SPREAD
Growth	Revenue Growth	20.8%
Trade Activity	Liquidity	8.9%
Short Interest	Short Interest Days to Cover	-1.9%
Size	Market Capitalization	-2.2%
Revisions	3M Earnings Per Share Revision % (FY1)	-2.5%
Share Buybacks	1Year Share Buyback	-3.2%
ESG	ESG Disclosure Score	-4.7%
Value	Value (P/E, P/B)	-11.7%
Momentum	12-Month Momentum	-12.9%
Dividends	Dividend Yield	-13.9%
Quality	Earnings Quality	-14.2%
Multi-Factor	Bloomberg Multi-Factor Score	-16.9%
Volatility	Low Volatility	-24.8%

Source: Bloomberg. As of July 31, 2023. 2023 Year-To-Date spread shows the quantile spread between U.S. stocks with different factor exposures. For each factor, stocks are ranked from highest to lowest based on their exposure to the factor. The third column shows the difference in performance between stocks with high exposure to the factor vs. those with low exposure (top 20th percentile minus bottom 20th percentile).

Looking ahead, returns on growth stocks are likely to be more muted. Large Cap Growth may not be able to replicate its seven-month performance of +34% since the market caps of the largest companies have become top-heavy (as discussed in our last outlook titled "Supergiants"). However, profitable growth companies are likely to continue to command a multiple premium and reward investors accordingly. Thus, tilting to small-cap growth is likely to be more rewarding towards the latter part of 2023.

SHORT-TERM EXUBERANCE

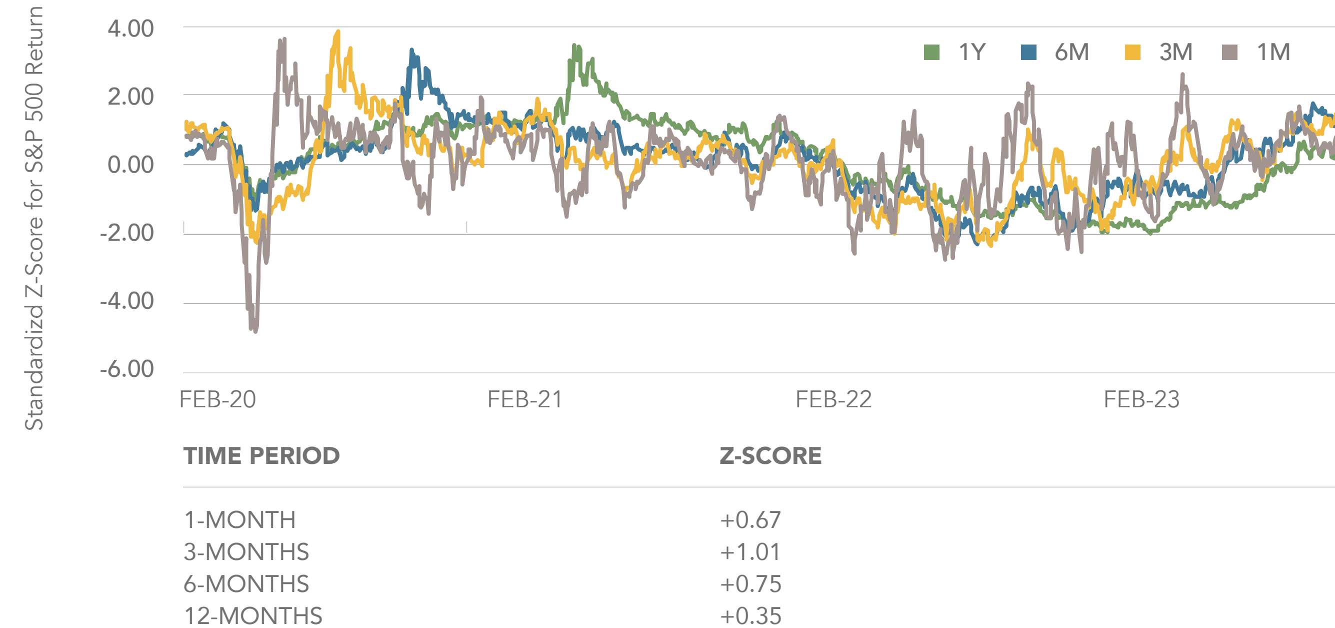
"Far more money has been lost by investors trying to anticipate corrections, than lost in the corrections themselves." – Peter Lynch

A rally of the magnitude we have witnessed this year has the potential to create short-term exuberance. Momentum chasers – including quant funds and technical traders – buy stocks that have gone up and sell stocks that have gone down, adding fuel to rallies and worsening sell-offs. Exhibit 4 and 5 show the extremeness of the current rally in the S&P 500 and Nasdaq Composite. We calculate a standardized Z-score over periods up to a year. Z-score is a statistic that shows how far from the average observation the current value of a variable is, measured in terms of standard deviations. The calculation takes the current value of the variable (in this case total returns on the stock market) subtracts the average value observed over history for the variable and divides by the standard deviation (or average variability) over its history. A figure above +1 in Exhibit 4 and 5 indicates that the rally has been extreme relative to historical standards.

Where do we stand today? As Exhibits 4 and 5 show over the 3-month period, both the S&P 500 (+10%) and Nasdaq (+15%) have risen more than one standard deviation above their historical means. This blistering rally is unlikely to be sustainable, but the z-scores also show that the market is not massively overextended on a one-year basis. It has simply recovered much of its losses over 2022.

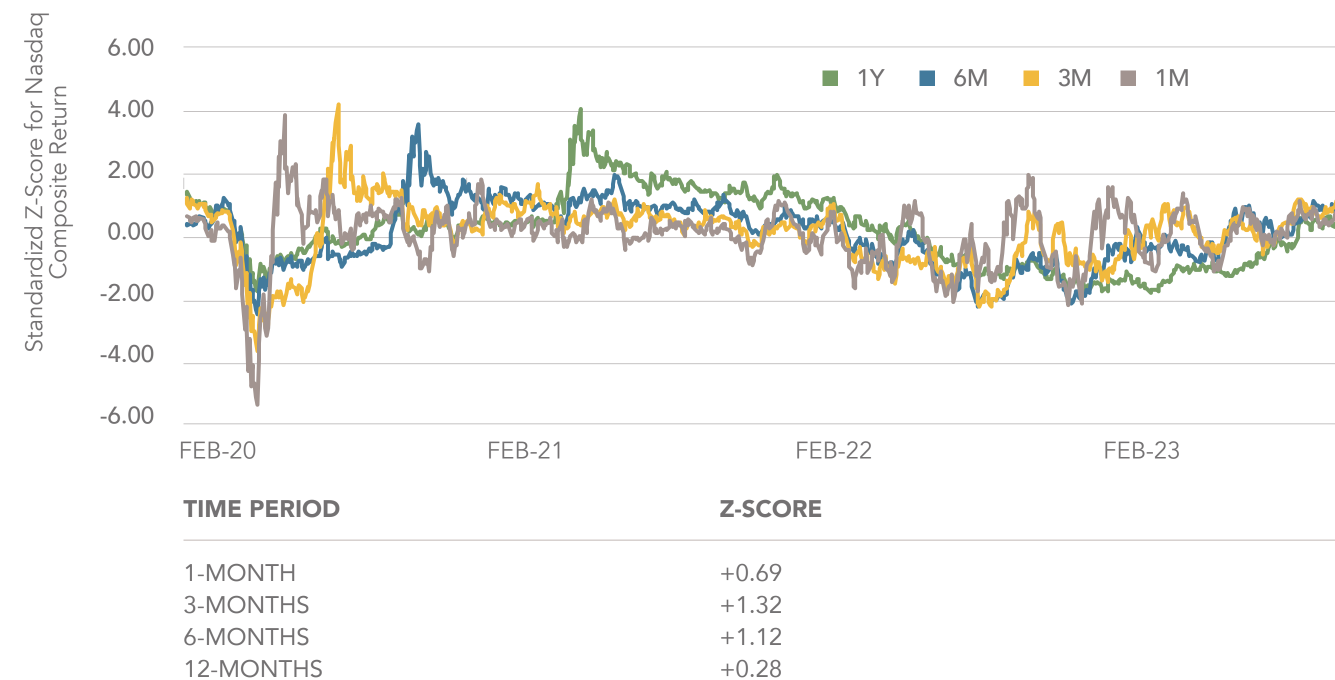
Remember that monthly or annual returns on stocks are independent (i.e., there is no relationship between one monthly/yearly return and the subsequent month or year). This is also known as the "gambler's fallacy? in erroneously believing that a hitting red is more likely on a roulette wheel because we have seen a string of blacks. Nonetheless, short-term sentiment is very bullish (Exhibit 6). In addition, forward looking returns over the short-term for stocks are likely to be more subdued than we've seen so far in 2023. We address the asset allocation implications of these observations in our "Key Views and Portfolio" section.

EXHIBIT 4: S&P 500 EXTENDED ON A 3-MONTH BASIS



TIME PERIOD	Z-SCORE
1-MONTH	+0.67
3-MONTHS	+1.01
6-MONTHS	+0.75
12-MONTHS	+0.35

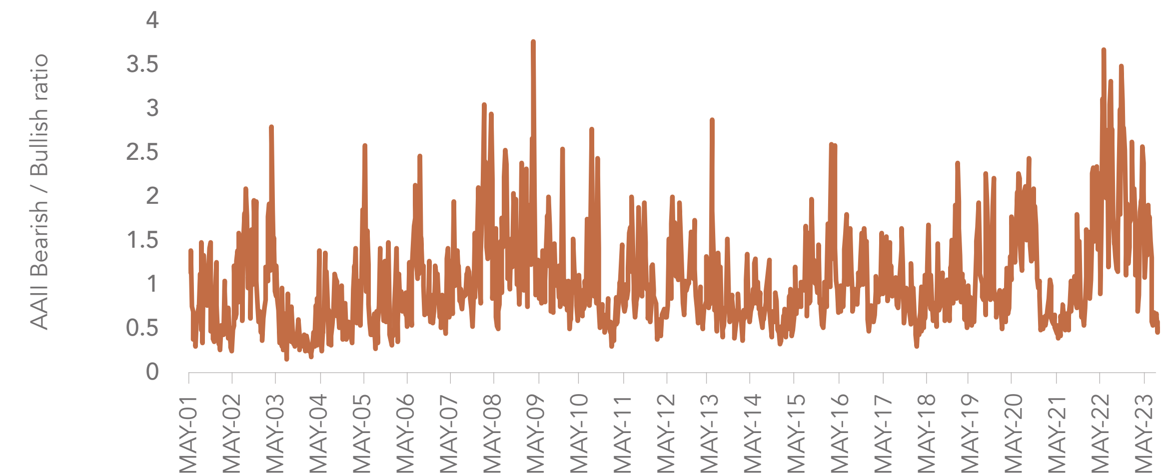
EXHIBIT 5: NASDAQ EXTENDED ON A 3- AND 6-MONTH BASIS



TIME PERIOD	Z-SCORE
1-MONTH	+0.69
3-MONTHS	+1.32
6-MONTHS	+1.12
12-MONTHS	+0.28

Note: Z-score calculated the number of standard deviations away from the long-term average the current value of a variable represents. For example, a +1 z-score tells us that the current value is +1 standard deviation away from the mean. In a normal distribution, approximately 68% of values lay within +/-1 standard deviation of the mean. Only 32% are outside +/-1 standard deviation, implying only 16% are above +1 standard deviation. In other words, a +1 standard deviation z-score has a less than 16% probability of occurring.

EXHIBIT 6: BULLISH SENTIMENT SUGGESTS EXUBERANCE



Source: Bloomberg

HIGH VALUATIONS

"The intelligent investor is a realist who sells to optimists and buys from pessimists." – Benjamin Graham

Exhibit 7 shows our quantitative dashboard, which covers four key areas of the market to help us gauge its likely future trajectory. A brief explanation of each factor is in order:

VALUATION is a poor short-term indicator but powerful long-term indicator of returns. Low valuations lead to greater long-term returns (e.g., March 2009 Global Financial Crisis) and high valuations lead to poorer long-term returns (e.g., March 2000 Dot Com bubble).

RISK is a prescient short-term measure of the market environment. The higher the VIX Index, the riskier the environment.

MOMENTUM is a powerful short-term indicator, but lousy long-term indicator of returns.

SENTIMENT is a great short-term contrarian indicator of returns. Exuberance is followed by pessimism and rinse and repeat.

Exhibit 8 paints a positive short-term environment for stocks (risk, momentum, and sentiment) but a more challenging long-term environment (valuations). The implication for investors is to manage risk carefully; take risk in line or slightly below your risk tolerance. We feel dialing back a bit of risk is appropriate. Doing so might be painful as stocks move higher in the short term due to momentum, but is likely to allow for a more aggressive stance as markets present more attractive valuation opportunities in the future. More on this in our "Key Views" section.

EXHIBIT 7: CAP QUANTATIVE DASHBOARD

CATEGORY	FACTOR	RECENT READING	Z-SCORE	COMMENT
VALUATION	S&P 500 Price-to-Sales ratio	2.6	1.7	NEGATIVE
	S&P 500 One-Year Forward Price-to-Earnings ratio (Exhibit 8)	21.3	0.7	NEGATIVE
	Slope of Treasury Yield Curve: 10Y-3M	-147.3	-2.5	NEGATIVE
RISK	CBOE VIX Index	13.6	-0.8	POSITIVE
MOMENTUM	S&P 500 Index 12-month return	13.4%	0.4	POSITIVE
	NYSE Advancing vs. Declining issues (Exhibit 9)	3897	0.9	POSITIVE
SENTIMENT	S&P 500 Equity Put/Call ratio	0.7	0.7	POSITIVE
	AAII Bulls vs. Bears (Exhibit 6)	1.9	0.5	NEGATIVE

EXHIBIT 8: S&P VALUATIONS ARE AT ~21X 2023 ESTIMATED EARNINGS

Source: Bloomberg

EXHIBIT 9: RALLY BROADENS AS BREADTH IMPROVES

Source: Bloomberg

However, as Exhibit 10 shows, international markets trade at steep discounts to U.S. markets. There are rational reasons for this:

EUROPE has struggled economically post the Global Financial Crisis, the Europe Debt Debacle and Brexit, and does not have a meaningful tech sector.

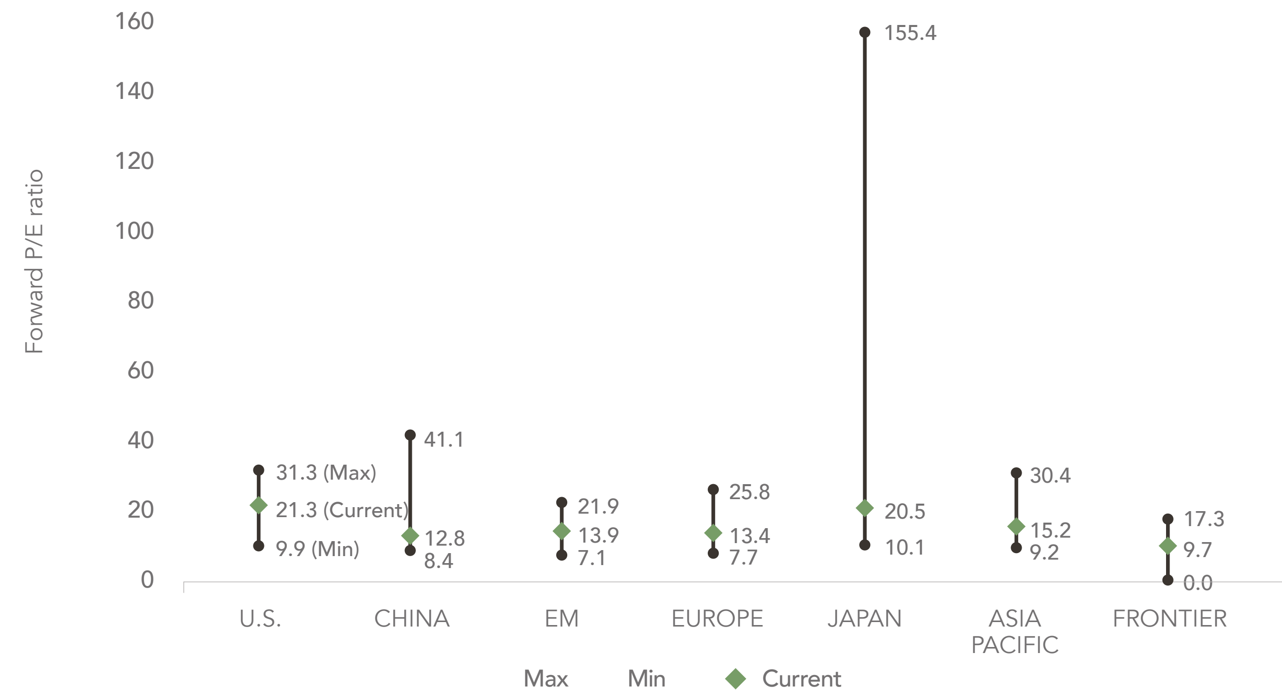
EMERGING MARKET valuations have declined as China is held back by Xi's ill-informed power consolidation and his crackdown on big tech, while Brazil has elected a socialist government.

ASIA PACIFIC markets have significant commodity exposure and are thus more cyclical, which tend to attract lower multiples.

FRONTIER MARKETS suffer from poor governance and political instability, thus reducing the valuation multiple investors are willing to pay.

Overall, we are now overweight EM, Asia-Pacific and Frontier Markets and have been reducing our underweights to Europe and Japan. The Vanguard FTSE Developed Asia Pacific ex-Japan

EXHIBIT 10: U.S. EQUITY MARKETS TRADE AT A SIGNIFICANT PREMIUM TO INTERNATIONAL



Source: Bloomberg. Indices used are as follows: S&P 500, CSI 300, MSCI Emerging Markets, Eurostoxx 50, Nikkei 225, MSCI Asia Pacific, MSCI Frontier Markets.

JUICY YIELDS

"Interest rates are to asset prices what gravity is to the apple." - Warren Buffett

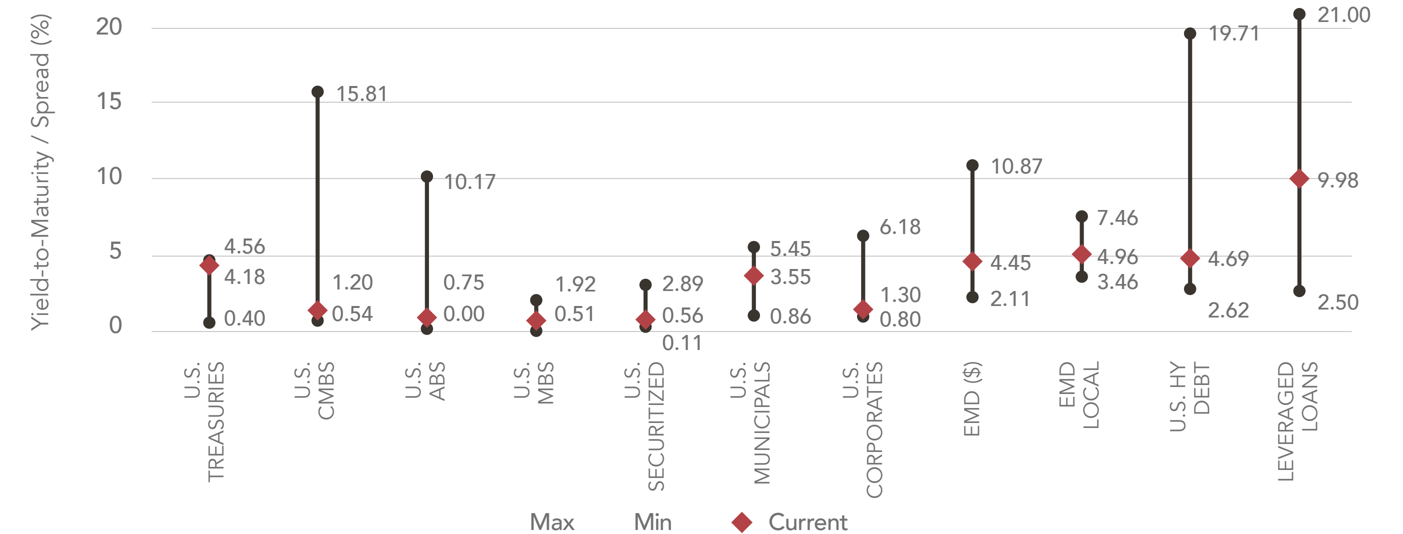
Fixed income offers very juicy yields across all instruments (Exhibit 11), although credit spreads remain tight. Credit spreads represent the compensation premium that investors demand over risk-free Treasuries. Tight spreads suggest that investors are complacent. We like Treasuries given their absolute yield as well as sub-investment grade credit (leveraged loans and direct lending), given the fundamental strength of the economy. Direct Lending Funds – such as those offered by Oaktree, Monroe Capital, Owl Rock, H.I.G, Muzinich and Star Mountain – are attractive here.

KEY VIEWS

Exhibit 12 captures our key views across asset classes and Exhibit 13 summarizes our portfolios. Our key trades for August/September are as follows:

[1] We still regard Treasuries as risk-free, despite Fitch's recent downgrade. We believe the U.S. will not default on its debt as it has a printing press available and the world's most robust economy/asset base in history, as well as its military industrial complex to defend its global hegemony if needed.

EXHIBIT 11: TREASURIES OFFER VERY JUICY YIELDS WHILE SPREADS ARE TIGHT ACROSS PUBLIC MARKETS



Source: Bloomberg. Figures for Treasuries and EMD Local are Yield-to-Maturity and Yield-to-Worst. Figures for Leverage Loans are Yield-to-3Y takeout. Figures for all others are option-adjusted spreads. Period covers Dec 31, 2007 – July 31, 2023.

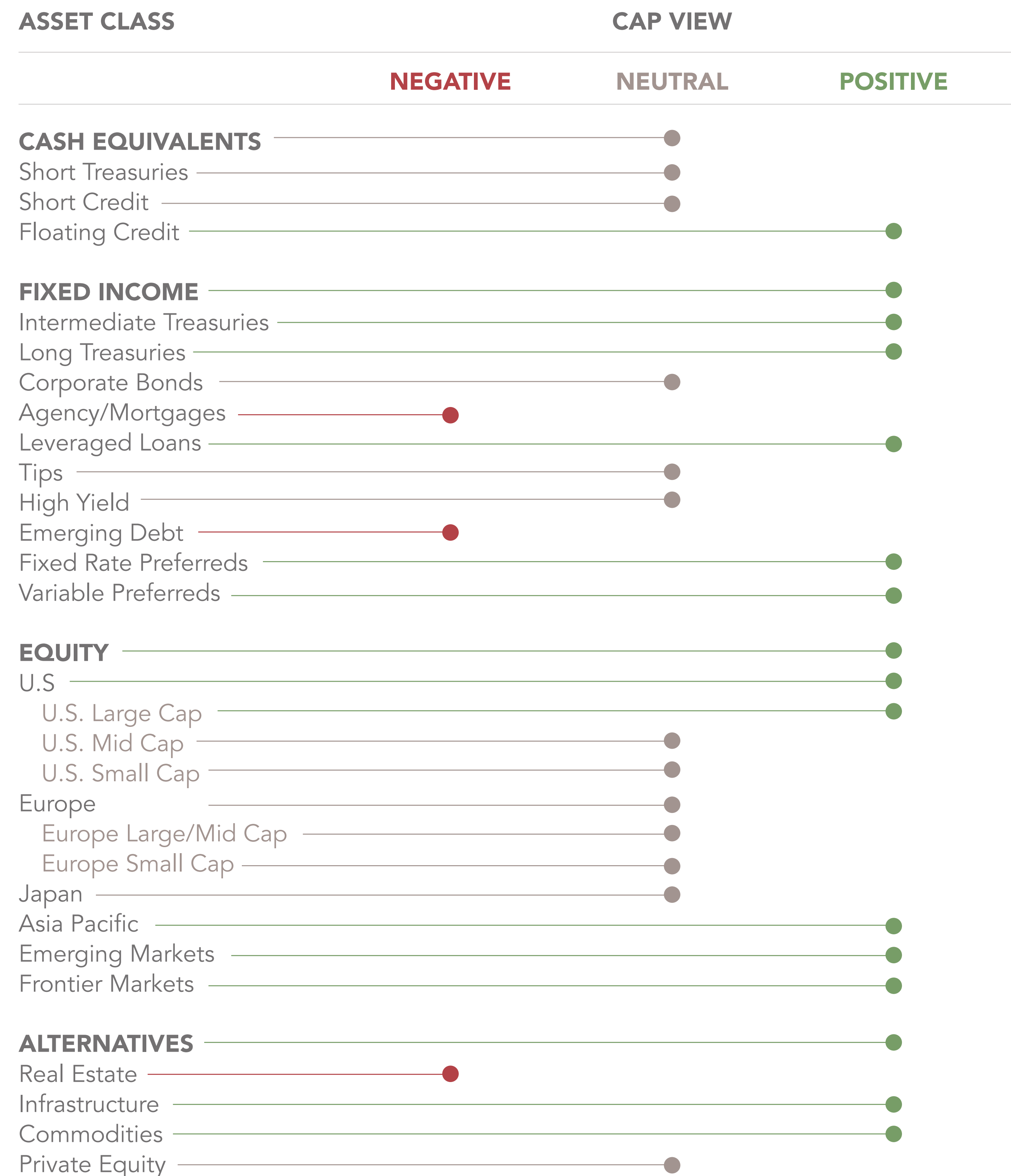
REDUCE LEVERAGE: Higher for longer interest rates, as well as solid gains on equities, prompt us to reduce leverage by 5% on our CAP Appreciation and High Octane portfolios. CAP High Octane maintains 5% leverage, while our other portfolios cut most leverage. There will be a time to again take leverage when rates decline and/or valuations become attractive. However, the spread between borrowing costs and expected stock returns is now at the lower end of the spectrum.

REDUCE OVERWEIGHT TO STOCKS: The combination of the blistering rally along with attractive yields allows us to reduce our overweight to stocks and increase our allocation to fixed income across portfolios. We continue to like stocks in the long run but are reducing the overweight we imposed during the depths of the 2022 sell-off.

EXTEND DURATION: With 10-year Treasury yields at 4.2%, the yield on longer duration instruments is attractive once again. We shift some of our short-term duration exposure to longer duration to take advantage of this income opportunity.

MAINTAIN ALTS: Alternative investments such as commodities and infrastructure are valuable as return enhancers and diversifiers. We maintain our allocation to these assets, as they offer value compared to publicly traded stocks. Real estate should provide a nice yield and there may be scope for overweighting it once the Fed moves into rate-cutting mode. We are not there yet though. Private equity valuations should recover as there is a lag effect from rising public equity valuations given the latter's embedded leverage.

EXHIBIT 12: CAP KEY INVESMENT VIEWS FOR AUG/SEPT 2023



Source: CAP Research

EXHIBIT 13: AUGUST/SEPTEMBER 2023 PORTFOLIO ALLOCATIONS

ASSET CLASS	SUB-CATEGORY	CAP CONSERVATIVE	CAP RESTRAINED	CAP BALANCED	CAP APPRECIATION	CAP HIGH OCTANE [1]	UCITS VEHICLE [2]
CASH EQUIVALENTS	Short Treasuries						
	Short Credit						
	Floating Credit						
	Total Cash Equivalents						
FIXED INCOME	Intermediate Treasuries						
	Long Treasuries						
	Corporate Bonds						
	Mortgages & Lev Loans						
	TIPS						
	High Yield						
	Emerging Debt						
	Fixed Rate Preferreds						
	Variable Preferreds						
	Total Fixed Income						
EQUITY	U.S. Large Cap						
	U.S. Mid Cap						
	U.S. Small Cap						
	Europe Large/Mid Cap						
	Europe Small Cap						
	Japan						
	Asia Pacific						
	Emerging Markets						
	Frontier Markets						
	Total Equity						
ALTERNATIVES[3]	Real Estate						
	Infrastructure						
	Commodities						
	Private Equity						
	Total Alternatives						
TOTAL							
	Leverage Range						
	Portfolio Yield						

CLIENT PRIVILEGED

[1]CAP Appreciation and High-Octane portfolios typically have between 0% and 5% leverage. [2]UCITS or 'undertakings for the collective investment in transferable securities' are investment funds regulated at the European Union level. [3]Real estate includes REITs, private equity real estate, public / private timber, and agriculture companies / assets. Infrastructure includes public companies with exposure to infrastructure activity, MLPs and private investments in infrastructure assets. Commodities include physical commodities, commodity futures and public and private companies engaged in the industrial metals, energy, precious metals, grains, and livestock industry. Totals may not reconcile due to rounding.

CAP ENHANCED GROWTH

"Risk comes from not knowing what you are doing." – Warren Buffett

CAP believes that a well-thought out options overlay program can add significant value to portfolios. We have consistently used options to both hedge risk and take advantage of alpha opportunities. For example, in our Nov/Dec 2022 Outlook titled "Catalysts on the Horizon", we recommended a high-octane Japanese Yen trade using digital call options. The Yen subsequently staged a blistering rally yielding handsome profits of +400% annualized over a very short period.

UNDERSTANDING OPTIONS

Options are derivative contracts whose value depends on the value of an underlying asset (hence the term derivative). Exhibit 14 shows the two types of options contracts – a call and a put – along with definitions of each. Options often receive a bad reputation since they are equated with extreme leverage and reckless speculation. However, like any investment strategy, the key to success rests with the practitioner. When utilized prudently and thoughtfully, options have the potential to add very significant upside and downside value to portfolios.

EXHIBIT 14: TWO TYPES OF OPTIONS CONTRACTS

CONTRACT TYPE	DESCRIPTION	PAYOFF STRUCTURE
CALL OPTION	A call option gives the holder the right to buy the underlying asset at a given strike price at a certain date in the future. For example, one $200 strike call option with Dec 31, 2025, expiration on Apple stock gives the holder of the call option the right to buy 100 shares (each contract represents 100 shares) of Apple stock at $200 each on Dec 31, 2025, regardless of the price of Apple at the time.	Profit or loss; LONG CALL; 0; -200; 30; 40; 50; Stock Price at Expiration
PUT OPTION	A put option gives the holder the right to sell the underlying asset at a given strike price at a certain date in the future. For example, one $150 strike put option with Dec 31 2025 expiration on Apple stock gives the holder the put option the right to sell 100 shares (each contract represents 100 shares) of Apple stock at $150 each on Dec 31, 2025, regardless of the price of Apple at the time.	Profit or loss; LONG PUT; Stock Price at Expiration; 0; -200; 30; 40; 50

Source: CAP Research, https://www.chittorgarh.com/

If an investor thinks a stock will go up, they can buy a call option and pay a premium (like our long Yen call option). If they think a stock will decline, they can buy put options and pay a premium. In addition to buying options, investors can write or sell options and collect these upfront premiums. Conceptually, buying a call and selling a put are equivalent as they're both bullish on the underlying exposure. Similarly, buying a put and selling a call are equivalent as they're both bearish on the underlying exposure. Exhibit 15 shows how an investor can employ calls and puts to reflect a bullish or bearish view.

EXHIBIT 15: BOTH CALLS AND PUTS CAN BE USED TO EXPRESS A BULLISH OR BEARISH VIEW

	BULLISH	BEARISH
CALL OPTION	Buy	Sell
PUT OPTION	Sell	Buy

Source: CAP Research

EINSTEIN'S PILLARS OF PSYCHOLOGY

"Three great forces rule the world: stupidity, greed and fear." – Albert Einstein

We apply Einstein's crude framework of human psychology to profit using options. Cycles of greed, fear, and stupidity are always at play in markets to varying degrees.

GREED comes to the forefront when markets are buoyant and rising with subdued volatility.

FEAR comes to the forefront when markets are declining sharply with elevated volatility.

STUPIDITY comes to the forefront when the markets experience large shocks, like the Global Financial Crisis or COVID-19, and trade at unreasonably low valuations with elevated volatility.

CAP looks to be contrarian in all the mentioned instances as that's when money is made. Exhibit 16 shows a simplified version of the roadmap we aim to use to add value through options.

EXHIBIT 16: USING EINSTEIN'S PILLARS TO ADD VALUE USING OPTIONS

EMOTION	MARKET DYNAMIC	CAP RESPONSE	RETURN TARGET
GREED	As markets trend higher, investors become greedy and are willing to pay high prices for call options (to bet on the market going higher).	We sell call options when the price is right and collect handsome premiums. We would still hold the underlying exposure (as CAP always believes in being invested in the market) with juicy premiums acting as a hedge to a potential pull-back.	+2-4% + Market beta
FEAR	As markets decline sharply, investors become fearful and are willing to pay high prices for put options as insurance against potential market losses.	We sell put options when the price is right and collect handsome premiums. We would build exposure to the underlying (as CAP always believes in being invested in the market) with "fear" premiums acting as supplemental income to a market recovery.	+5-8% + Market beta
STUPIDITY	If markets reach unreasonably elevated or depressed levels, we seek to be contrarian and take advantage of mispricing.	We buy puts or sell calls if markets are underpricing potential risks. This allows us to hedge exposure without selling out of the market (as CAP always believes in being invested). We buy calls or sell puts if we believe markets are too cheap to ignore. This allows us to rapidly increase gross notional exposure to the market with capped downside.	+5-10% + Market beta

Source: CAP Research

The above roadmap is simplified because periods of greed, fear, and stupidity are only clear with hindsight and rarely in the present moment. However, option pricing provides a valuable tool to potentially overcome this shortcoming and identify these regimes in real time.

Options pricing is based on the market's estimate of future volatility – also called "implied volatility." While details of options pricing are beyond the scope of this outlook, in general, high volatility leads to expensive option prices ("higher premiums") and low volatility leads to cheaper options prices ("lower premiums"). Fundamentally, we believe fear is present when implied volatility is high and greed is present when implied volatility is very low; stupidity is apparent when prices are very low and implied volatility is very high. An example of the stupidity regime was late 2022 when CAP's conviction was to increase exposure to beaten-down, growth equity.

In practice, the roadmap in Exhibit 16 can be applied to any index (U.S. and international), bond (government, corporate), commodity (energy, grains, softs, metals, meats), currency (USD, EUR,

GBP, JPY) or crypto (Bitcoin/Ethereum) market, as well as individual stocks for which there are active options markets (1000+). This provides CAP with a very large opportunity set to look for cycles of greed, fear, and stupidity. Accordingly, there is significant scope to enhance long-term portfolio returns using the roadmap in Exhibit 16.

BRINGING IT TOGETHER

Our proprietary CAP Enhanced Growth Strategy brings the ideas in the roadmap together. Exhibit 17 illustrates the evolution of markets over the last five years and how our strategy would have hypothetically traded given market moves. We would sell greed (via put and call options) as markets go higher, sell fear (via put and call options) as markets move lower amidst elevated volatility, and buy markets when stupidity reaches a crescendo (via put and call options). CAP's unique approach applies leverage opportunistically as the market experiences periods of fear and stupidity. Overall, leverage levels are prudent and appropriate for long-term investors who can be liquidity providers during periods of market panic.

EXHIBIT 17: MARKET GYRATIONS PRESENT PROFIT-MAKING OPPORTUNITIES

Source: Bloomberg

The key to investment success with this strategy is that the framework is applied consistently (e.g., daily, weekly, and monthly), and concurrently. A critical implementation principal is that we profit from selling both greed and fear simultaneously while always holding the underlying exposure (i.e. index, stock, bond etc). This may seem contradictory but it is possible in options markets. For example, we can sell upside (greed) beyond a +5% increase in markets while also selling protection (fear) beyond a -5% decline in markets. This makes the strategy unique compared to other plain vanilla derivative strategies (such as covered calls), which are commonly available as pre-packaged, market solutions. This complexity requires a knowledgeable and experienced options practitioner and careful management of portfolio risk – especially during periods of heightened volatility. CAP's scope to add value if applied skillfully can be very meaningful and demonstrable as part of a larger, multi-asset class mandate.

THE CAP ADVANTAGE

There are two key unique advantages that CAP Enhanced Growth brings to the table that render the strategy especially powerful:

FIRSTLY, it can be implemented using tax efficient UCITS ETFs, which may prevent our non-U.S. investors from paying the 30% dividend withholding tax which is applied to U.S.-listed ETFs. Approximately 10-20% of an investor's return is derived from dividend income, so a 30% withholding tax could meaningfully decrease total return. For example, the Invesco S&P 500 UCITS ETF (Ticker: SPXD) has outperformed the U.S. listed SPDR S&P 500 ETF Trust (SPY) given its insulation from withholding tax due to its unique synthetic construction methodology. CAP implements CAP Enhanced Growth using tax-optimized vehicles through proprietary portfolio construction and management techniques.

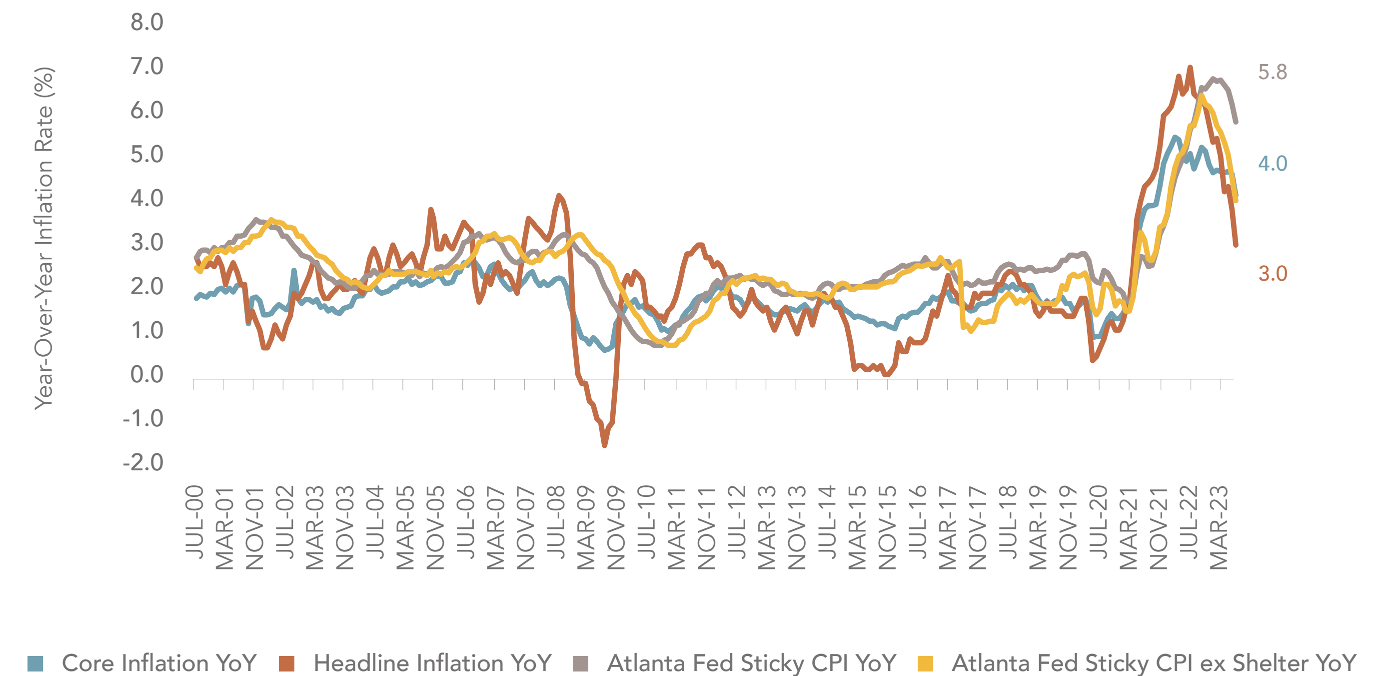
SECONDLY, given our long-term focus and access to cheap borrowing, CAP Enhanced Growth can apply leverage when the opportunity presents itself (i.e. periods of "stupidity" within the aforementioned framework) and be patient. The key to successfully applying leverage opportunistically is prudence, experience, and skill – all of which we bring to the table.

CAP believes that CAP Enhanced Growth offers a thoughtful and high-octane way to enhance long-term performance as part of a diversified, multi-asset class portfolio.

INFLATION COOLS

From a peak value of 5.4%, YoY core PCE Inflation, which excludes volatile food and energy prices, has ticked down to 4.1% (Exhibit 18). This is clearly encouraging, but more progress is needed to bring it down to the Fed's target of ~2% per year. We believe this progress is forthcoming given the current interest rate environment. The Atlanta Fed's sticky core CPI (ex-Shelter) reading at 4% underscores the risk to this outlook.

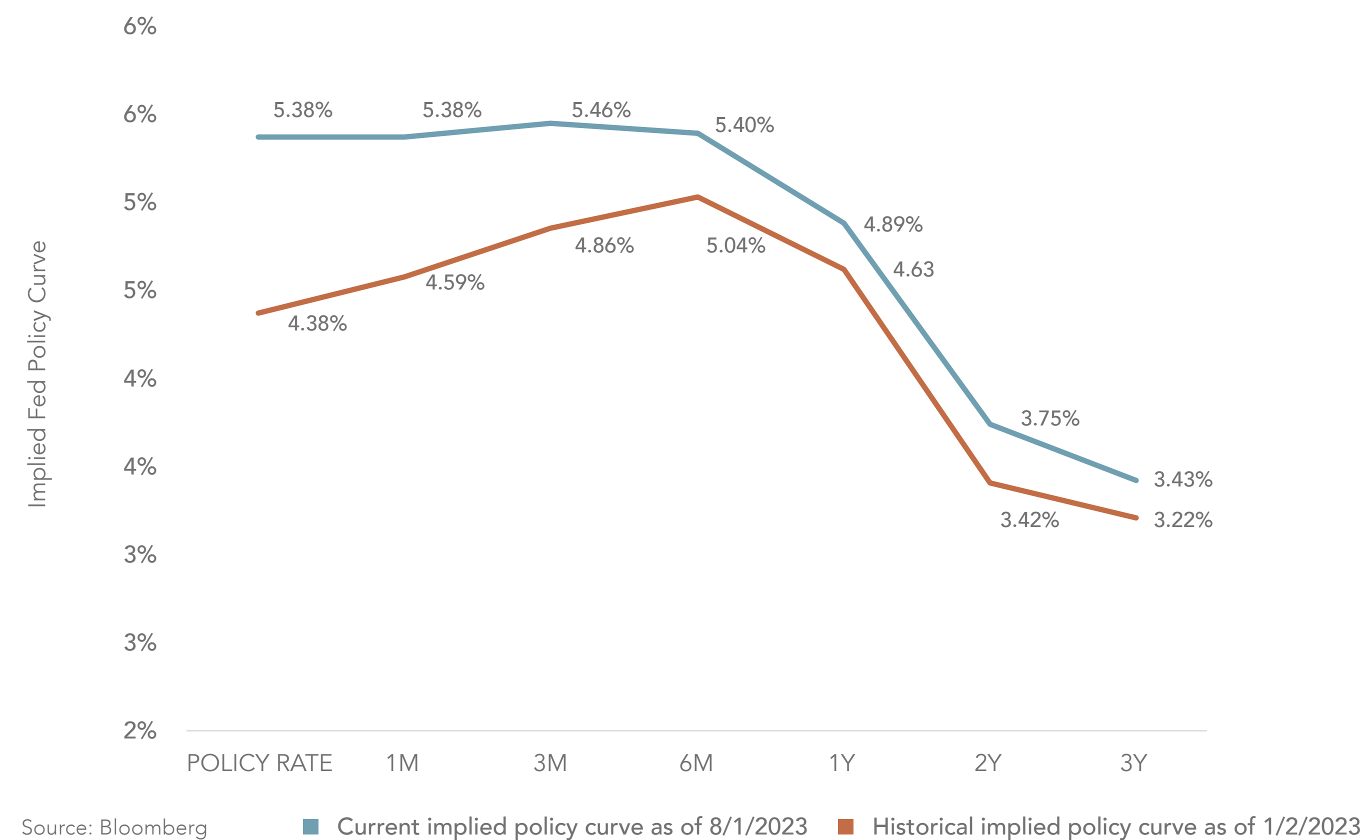
EXHIBIT 18: CORE INFLATION IS DROPPING BUT MORE PROGRESS NEEDED



FED STAYS PUT

Futures prices suggest that the bond market expects the Fed to remain firm over the next six months (Exhibit 19). The policy rate projection over this time remains at ~5.5%, which matches the current overnight rate. This is a reasonable assumption given that progress has been slower on the core inflation front. Given the rapid rate of tightening and lag effect, we are optimistic that inflation will continue to cool faster than Larry Summers (and other doomsayers) have pontificated, providing further market support as we enter a new business cycle.

EXHIBIT 19: THE MARKET PREDICTS RATE CUTS BEGINNING IN EARLY 2024



Source: Bloomberg ■ Current implied policy curve as of 8/1/2023 ■ Historical implied policy curve as of 1/2/2023

RESILIENCE DESPITE RATES

Our macro dashboard captures a range of lagging, coincident, and leading indicators (Exhibit 20). With the Fed now on hold, we do expect some economic deterioration over the short-term. For example, weakness in the labor market is a key goal of the Fed's monetary policy and we expect unemployment to rise over the coming few quarters. The yield curve remains steeply negative suggesting further disinflation and potentially a recession should the economic impact of high rates spread. As we've articulated throughout the last year, CAP's conviction is that the U.S economy will undergo a "soft-landing" without any meaningful, recession in the cards. The mostly positive leading indicators below underpin this conviction. The stock market also agrees.

Source: Bloomberg, CAP Research

EXHIBIT 20: CAP MACRO DASHBOARD AUGUST/SEPTEMBER 2023

INDICATOR	LATEST READING	POSITIVE/NEUTRAL/ NEGATIVE
U.S. Output Gap (Q1 '23)	-0.8	POSITIVE
Nonfinancial Corporate Debt as % of GDP (Q4 '22)	+78.1%	NEGATIVE
St. Louis Fed – Smoothed Recession Model (May '23)	+0.6%	NEUTRAL
Conference Board Index of Leading Economic Indicators (YoY change) (June '23)	-7.8%	NEGATIVE
Industrial Production (YoY change) (June '23)	-0.4%	NEGATIVE
ISM Manufacturing Index (June '23)	+46	NEGATIVE
ISM Services Index (June '23)	+53.9	POSITIVE
Senior Loan Officer Survey – Small Business Lending (Q2 '23 Reporting Stronger Demand)	-53.3%	NEGATIVE
Building Permits (YoY change) (June '23)	-8.1%	NEGATIVE
Real Personal Income Ex-Transfer Payments (May '23)	+1.6%	POSITIVE
Consumer Expectations Gap (Present Situation Minus Expectations) (June '23)	+45.6	POSITIVE
Non-farm payrolls (June '23 3M avg)	+244	POSITIVE
U.S. Unemployment rate (%) (June '23)	+3.6%	POSITIVE
12-M U.S. Export Growth (May '23 YoY change)	-6.4%	POSITIVE
S&P 500 6M Price Change (%) (July '23)	+15.5%	POSITIVE
Treasury spread (10Y - 3M in bps) (July '23)	-160	NEGATIVE
High Yield spread (bps) (July '23)	+414	POSITIVE
M2 SUPPLY 3M GROWTH RATE (MAY '23)	**-1.3%**	**NEGATIVE**
FEDERAL FEDS 1YR IMPLIED TARGET RATE (JULY '23)	**+4.8%**	**NEUTRAL**
5 YEAR AHEAD 5 YEAR INFLATION BREAKEVEN RATE (JULY '22)	**+2.4%**	**POSITIVE**
FISCAL POLICY STANCE (GOVT REVENUE - SPENDING)		**NEUTRAL**
CURRENT MONETARY POLICY STANCE		**NEUTRAL**

Source: Bloomberg, St Louis Fed, Bank of International Settlements, CAP Research

APPENDIX: SHARIAH-COMPLIANT AUG/SEPT 2023 PORTFOLIO ALLOCATIONS

ASSET CLASS	SUB-CATEGORY	CAP CONSERVATIVE	CAP RESTRAINED	CAP BALANCED	CAP APPRECIATION	CAP HIGH OCTANE
MURABAHA						
SUKUK						
EQUITY	U.S. Large Cap					
	U.S. Mid Cap					
	U.S. Small Cap					
	Europe Large Cap					
	Europe Mid/Small Cap					
	Japan					
	Asia Pacific					
	Emerging Markets					
	Frontier Markets					
	Total Equity					
ALTERNATIVES	Real Estate					
	Infrastructure					
	Commodities					
	Total Alternatives					
	Portfolio Yield					

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Notes: Real estate includes REITs, private equity real estate, public / private timber, and agriculture companies / assets. Infrastructure includes public companies with exposure to infrastructure activity, MLPs and private investments in infrastructure assets. Commodities include physical commodities, commodity futures and public and private companies engaged in the industrial metals, energy, precious metals, grains, and livestock industry. Totals may not reconcile due to rounding.

NOTES

IMPORTANT DISCLOSURES

The information contained herein is provided for informational purposes only, represents only a summary of topics discussed, and should not be construed as the provision of personalized investment advice, or an offer to sell or the solicitation of any offer to buy any securities. Rather, the contents including, without limitation, any forecasts and projections, simply reflect the opinions and views of the authors. All expressions of opinion reflect the judgment of the Advisor as of the date of publication and are subject to change without notice. There is no guarantee that the views and opinions expressed herein will come to pass.

Furthermore, the information contained herein contains certain forward-looking statements, often characterized by words such as "believes," "anticipates," "plans," "expects," "projects," "might," "may,""likely," and other similar words, that indicate future possibilities. Due to known and unknown risks, other uncertainties and factors, actual results may differ materially from the expectations portrayed in such forward-looking statements. Readers are cautioned not to place undue reliance on forward-looking statements, which speak only as of the date of this report.

Additionally, this document contains information derived from third party sources. Although we believe these third party sources to be reliable, we have not conducted an independent verification of such third-party content and make no representations as to the accuracy or completeness of any information derived from such third-party sources and take no responsibility therefore. Information related to the performance of certain benchmark indices is provided for illustrative purposes only as investors cannot invest directly in an index. Past performance is not indicative of or a guarantee of future results. Investing involves risk, including the potential loss of all amounts invested.

Asset allocation recommendations are provided as a general guideline and do not take into account the specific circumstances of any individual client which could cause such recommendations to vary from the recommendations presented.

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