CAZ Investments
Quarterly Letter

Will the Music Stop?

The froth and excess of the stock market were on full display in the 1st quarter. The broad market indices increased at a modest pace, but that was not the real story. The investment headlines were dominated by two major factors, frothy market behavior and fears of inflation. We will address both in this letter, but to be sure everyone hears the key message we believe they need to hear we will state it right up front. All investors should be fully aware of the amount of euphoria that is rampant in markets and not get swept away by complacency. Be on guard, know where your risks are and be sure you have adjusted your asset allocations to protect yourself against the "what if" factor. **We remain a 1 on the CAZ Scale and believe that the risk/reward from these valuation levels remains heavily tilted to the risk side of the equation.** No one knows when the music will stop in this dangerous game of musical chairs, but when it does people will be unpleasantly surprised by the speed and ferocity of the decline.

Look Ma, Free Money

There is an old wall street adage that says when your shoeshine person is giving you stock tips it is time to sell. Well, what does it mean when the vendor at a fresh vegetable market is readily giving out tips on how to profit from cryptocurrencies? Yes, that is a true story that was experienced by one of our team. Worse, it is not an isolated incident. We know of hundreds of stories of Lyft drivers, hairstylists, waitstaff etc. eagerly boasting about how much money they were making in Crypto, Reddit board stocks, and option trading. Does that mean that stocks have to fall? Of course not, but what it means is that the music is getting very faint and is likely to stop soon. There are countless charts we could post to make this point, such as retail option trading volume, retail margin borrowing, etc, but those are really not necessary to show as our readers only have to remember the Game Stop craziness to agree with this premise. The Reddit board mania earlier this year will likely go down as the "canary in the coal mine" of this cycle. Watching that illogical behavior was even more extreme than the excesses of the 1999 tech bubble, and that is a BIG statement! The concept was scarily simple: "let's find a really heavily shorted name and all go buy it and drive up the price to make the shorts cover and then we will make a ton of money…better yet, let's go buy a bunch of call options in order to accelerate the process…and even better yet, let's tell everyone in the world what we are doing so they can join us in this market manipulation. What do fundamentals matter you ask? Nothing of course, this is all about market mechanics and bullying investors to create a profit. Actually, the worse the target's business the better because it will have a lot more funds short the stock, which is why we want to drive up the price to make those shorts cover." That hypothetical conversation was actually occurring between real people who decided that they would make a game out of investing, and just manipulate hundreds of thousands of retail investors to create profits for themselves. Market manipulation has always been illegal, but this was permissible, at least allowed

to occur, because it was done in a public way. And it was the major story for weeks, creating a ripple effect across markets of all types, including changing the dynamics of trading for countless businesses and institutional investors.

There were thousands of social media messages about how it was literally a foolproof strategy and anyone who was not on the bandwagon just "didn't get it" and were passing up free money…. How did it end? Like you would expect, badly. Like any pyramid type scheme, those who got in early, created the hype and built a following made a lot of money, and those that were late to the party got burned. The long-term ramifications of this new method of manipulation will not be known for years, but suffice it to say it will be fresh in the mind of professional investors and they will keep their heads on a swivel to try to avoid being crushed by a herd of message board traders. For us, the key takeaway is that the shocking amount of money awash in the system, created by the government, is triggering some very unintended consequences and it is a warning sign for any rational investor. The sage advice of the wall street adage referenced above does not mean to necessarily sell everything, but it would be highly unwise to ignore the obvious warning signs and not take action to protect one's portfolio.

<u>The Battle Between Growth and Inflation</u>

It is hard to ignore the clear signs of inflation in our world right now and the bond market has taken notice in a major way, with the 10-year U.S. Treasury more than doubling in yield. Even so, rates are still at historically low levels. Rates have stabilized in the last few weeks and there is a real tug-of-war now occurring. Everyone wants the economy to continue to recover from the pandemic and everyone wants that to happen without a lot of inflationary pressures. Can that happen? Yes, theoretically, but it is very hard. Usually, inflation will take hold or growth will wane. What will win this time is virtually impossible to predict, but it will be the key driver of interest rates, and thereby stock market valuations. There are good reasons why the eyes of the market are fixated on this issue.

Between the monetary and fiscal stimulus created by Federal Governments, the system is awash in liquidity and there is no way to know how it will all be utilized. Balance sheets, both business and consumer, are as healthy as they have been in decades and people are ready to spend money after being effectively forced by the pandemic to moderate their consumption. This tsunami of spending is driving demand for real estate, which is creating shortages in key inputs, which is forcing prices higher for things like lumber at an astonishing rate. The visibility of this ripple effect is clear to all market participants and yet the government continues to tell us that inflation is really not a major concern. Maybe they are right but perhaps the former Treasury secretary is correct when he said just this week that the Federal Reserve was being irresponsible and will find itself having to overcorrect because they waited too long to act.

Perhaps the government is factoring in the likely significant dampening effect that higher taxes will have on the economy, by draining liquidity from the system and putting it back in the hands of the government… feel like there is a circular reference there? You are not alone if you come to that conclusion.

Perhaps there is a master design, or perhaps there is simply an overreaction to the pandemic, which is leading to an under reaction to the inflationary pressures, which is uncorrelated to the decision to spend massively on infrastructure, which has nothing to do with the choice to dramatically increase taxes…. Clear as mud, right? If you are not confused yet, please let us know as we have a job for you!

What does this mean for your investments? That is actually pretty simple, if one will step back and look at the forest and not the trees. Virtually every asset is unquestionably expensive, and growth from this point is going to likely be accompanied by material wage and cost inflation. In the past, supported by most every law of economics, that has always led to rising interest rates and valuation compression. Thus, investors need to assume they are going to be forced to deploy capital in an environment where it is going to be very difficult to deliver returns from traditional stocks and bonds. Therefore, we strongly encourage investors to avoid plain vanilla fixed income instruments, have floating rate exposure in their income bucket, and have uncorrelated/cross-cycle investments in their growth bucket. That is where we will be putting our personal money and we will make sure you know what we are doing so you can invest alongside us.

Our firm is growing very quickly with a number of new Team members and new Shareholders. In case you missed the notice, we sent announcing the transaction, we have accepted a minority, non–control investment from a consortium of veteran financial services professionals. The group includes Tony Robbins, thrice named to the *WORTH 100* most influential people in global finance. This strategic alliance builds upon the elite list of shareholders that have been instrumental in the execution of our highly differentiated business model that is dedicated to the alignment we have with the investors who invest alongside our personal capital.

There will be no impact on any of our existing investment vehicles and investors do not need to take any action. No one on our Team is selling any portion of our ownership and we are heavily invested in the future creation of value for our investors. We are extremely confident this growth capital will enable us to expand our business at an accelerated pace, providing those that invest alongside us with even more exclusive access to innovative investments, with enhanced economics.

As referenced in our notice, CAZ will celebrate our 20-year anniversary in August, and we are thankful that you have elected to partner with us. Your confidence in us is valued, and we will continue to endeavor to deploy our capital in the best risk-adjusted way and invite you to participate in what we are doing. We also encourage you to introduce us to those that you know who would benefit from unique investments that they will not likely be able to access in any other way.

We look forward to seeing you very soon and wish you and yours the very best!