Dear Investors,

You placed confidence in me to handle a portion of your savings. First and foremost, I appreciate the trust you've shown. It means a lot more than you might think.

I am writing to share an overview of our year-end review for 2023 and offer insights into the outlook for 2024. This letter serves as a brief summary, with more in-depth details about my investment strategies provided in the following pages. Your balance information can be found on the last page.

What an unprecedented and tumultuous year it has been! We witnessed a significant shift in interest rates, escalating from nearly 0% to the highest point in 15 years. This prompted a reconsideration of investment choices, with many contemplating the shift towards bonds. The challenges extended further with the occurrence of bank failures, and despite efforts, inflation remained persistent, resisting a decline to the targeted 2%.

Despite the challenges, I'm pleased to report that we outperformed the market once again this year, achieving a total return of 50.74%.

What did we do differently than last year? Collateralized options writing which is buying bonds and using them as collateral for selling options. In this approach, an investor holds bonds in their portfolio, and the value of these bonds serves as collateral. This collateral is then used to secure the selling of options contracts. Implementing this strategy enabled us to introduce a second risk-free income stream on top of our returns.

As for the market, despite the persistent issues reported in the news throughout the year, what fueled this market's upward trajectory? Treasury pulling their various levers to put liquidity back into the market and the optimism that interest rates would decrease throughout 2024. I will explain more on this in the next pages.

As we step into 2024, we confront high expectations of lower inflation, reduced rates, and perhaps one of the most anticipated election years. It's a time that demands careful

consideration in choosing where to invest, yet it also presents a significant opportunity for achieving high returns. While history may rhyme, it doesn't repeat itself verbatim. Macroeconomic cycles typically unfold over a longer duration than anticipated, and despite thorough analysis, some variables may go unnoticed. Therefore, it's essential to maintain a flexible framework, stay informed about historical trends, and continually assess the current situation. It's useful to look for points of invalidation or pivots and be ready to incorporate new variables into your evolving framework, ensuring it adapts to the ever-changing landscape.

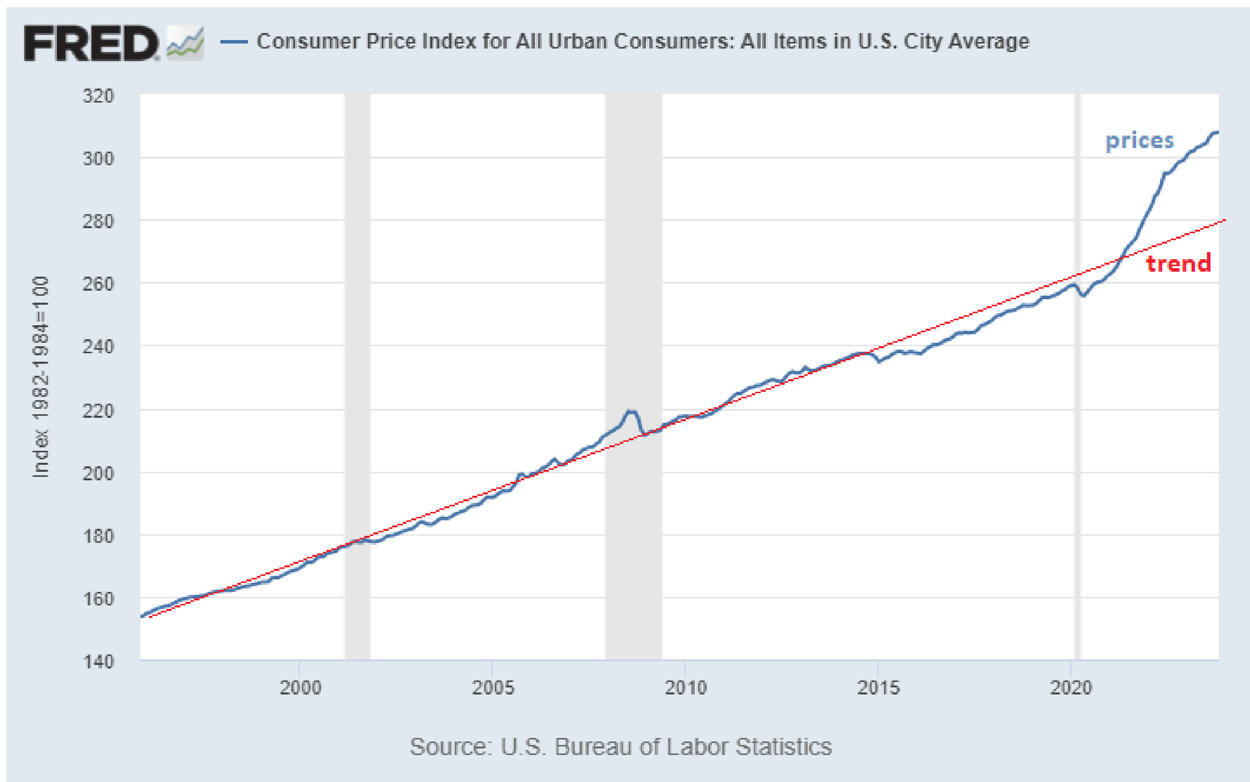
I remain dedicated to achieving optimal returns for our investors, and I will consistently monitor the market, making adjustments to our investment strategy as necessary. Your ongoing support and investment are truly valued, and I want to express my gratitude once again for the trust you've placed in me.

Best regards,

Daniel Selenica

Fiscal and Monetary Divergence: The Fed vs the Treasury

The consumer price index has risen by a cumulative 19% since the beginning of 2020, marking a four-year span. In a scenario where the Federal Reserve consistently meets its 2% annual inflation target, the index would have increased by approximately 8% during this period. The sustained elevation in prices is the reason why, even though there may be a slowdown in the rate of change, inflation continues to feel high for many individuals.



During the period when the Federal Reserve aggressively increased interest rates, the Treasury faced an annualized interest expense surpassing $1 trillion. This led to significant refinancing hurdles for many non-investment grade companies and real estate owners. Concurrently, the dollar index strengthened to twenty-year highs until September 2022, resulting in stagnant exports and a contraction in manufacturing. The foreign sector, as a whole, reduced its total holdings of Treasuries, contributing to a highly illiquid Treasury market in September 2022. The yield curve inverted, and overall, the entirety of 2022 proved to be challenging for most asset prices.

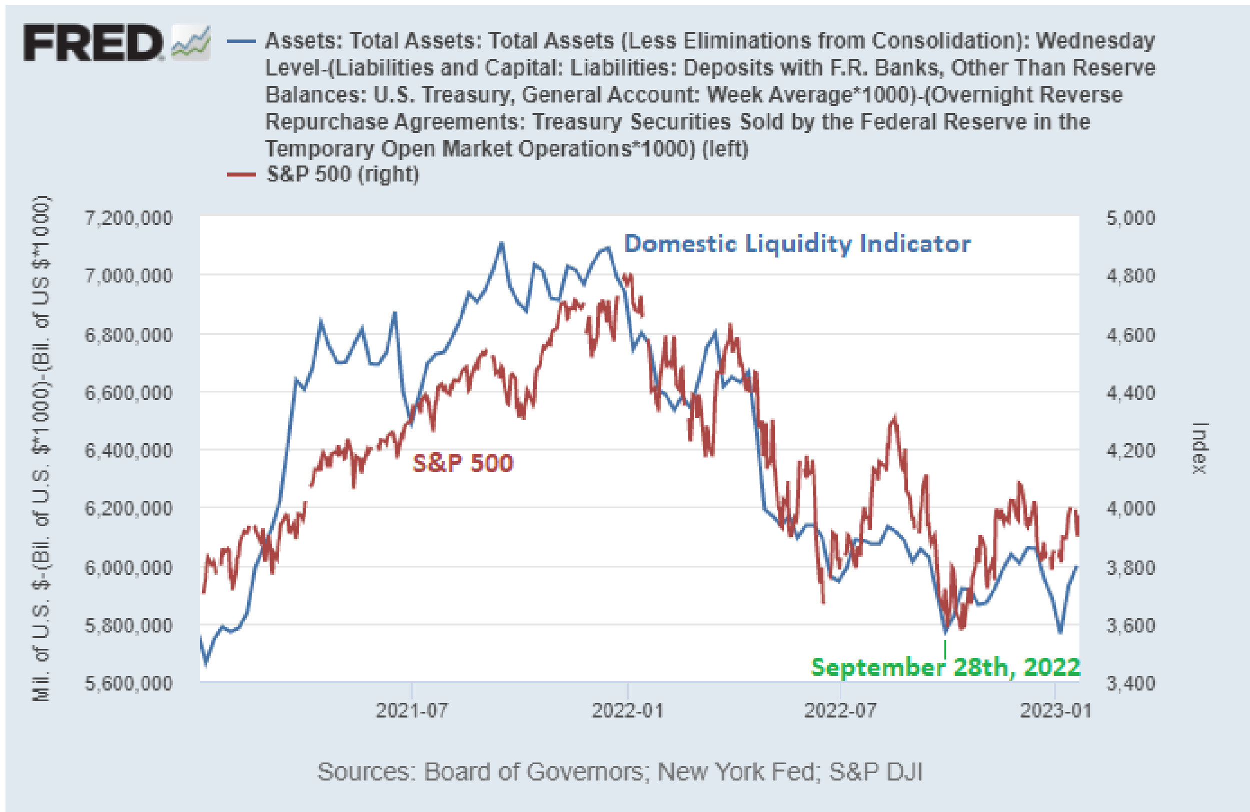
Surprisingly, two crucial sectors fared much better than anticipated: large investment-grade companies and homeowner consumers. This resilience stemmed from their substantial commitment to long-term fixed-rate debt at low interest rates, rendering them largely immune to the Federal Reserve's aggressive interest rate hikes. Moreover, upper-middle-class homeowners and major corporations, holding significant cash-equivalents, began to accrue more interest income, primarily from the U.S. Treasury. This irony created an economically stimulating scenario for them, even as their less robust counterparts faced challenges.

The brunt of the Federal Reserve's aggressive interest rate increases predominantly impacted small businesses, often reliant on shorter-duration bank loans, non-investment grade corporations issuing shorter-duration bonds, commercial property developers and operators employing shorter-duration leverage compared to residential real estate owners. Ironically, even the federal government itself felt the impact, given its use of relatively short-duration debt on average.

Commencing in Q4 2022, amid challenging market and liquidity conditions, the U.S. Treasury Department took the initiative to counter the Federal Reserve's actions. They swiftly drew down their Treasury General Account, injecting money back into the financial system just as the Fed was implementing quantitative tightening measures. While some of these actions were voluntary, the debt ceiling impasse from January to June 2023 compelled them to channel all available liquidity into the market.

In January 2023, particularly anticipating the liquidity drain associated with the debt ceiling, I started to reevaluate my analysis and writings. My pessimistic outlook for the next six months lessened as I observed the Treasury's pro-liquidity measures. By spring 2023, it became evident that the escalating fiscal deficits were stimulating certain sectors of the economy despite the Fed's hawkish stance. Paradoxically, the more the Fed raised rates, the more it contributed to increasing federal government deficits, enhancing the stimulus and thereby counteracting a portion of the Fed's tightening measures.

Since the beginning of Q4 2022, domestic liquidity in the United States has exhibited a relatively stable trend. This metric, depicted by the blue line below, reflects the Fed's balance sheet minus the Treasury General Account and minus reverse repos. The comparison with the S&P 500, illustrated by the red line below, provides context for analysis.



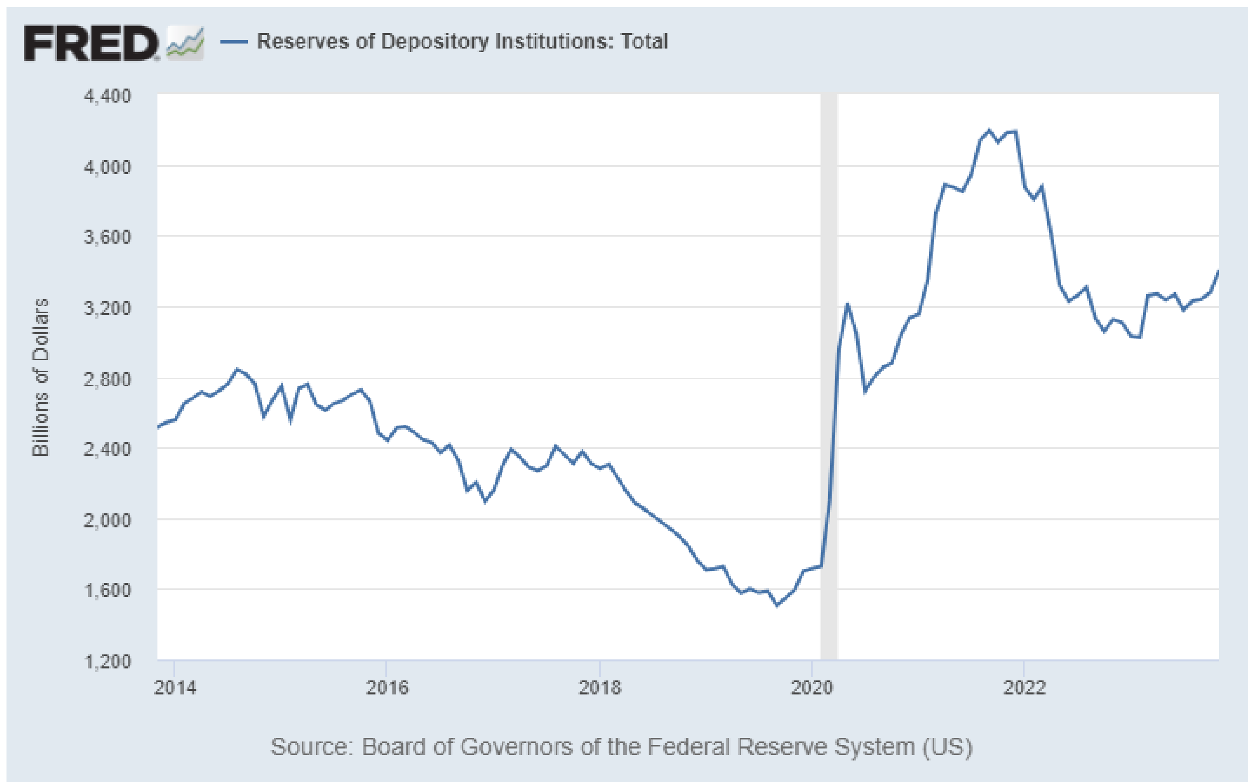
The primary force reducing liquidity has been the Federal Reserve, employing a form of quantitative tightening by allowing bonds to mature off its balance sheet each month. Conversely, the Treasury Department's ongoing drawdown of its Treasury General Account since mid-2022 has infused some liquidity back into the market. The overall outcome has been a relatively stable liquidity scenario recently.

Looking ahead, this sideways liquidity trend is expected to persist in the coming months. The Federal Reserve continues to reduce its balance sheet, which has a negative impact on liquidity. Simultaneously, the unresolved debt ceiling issue is likely to lead to lower Treasury General Account balances, paradoxically contributing positively to liquidity until the debt ceiling matter is resolved, as discussed in the next section.

The U.S. Treasury Department had the option to issue a significant amount of T-bills to replenish its general account instead of choosing long-duration bonds. This approach aimed to reduce the average duration of government debt, which, at the time, was the most costly segment of the Treasury curve for debt issuance. While this strategy might have drained cash from reverse repos, it offered a means for the Treasury to replenish its account without adversely impacting commercial bank liquidity. Approximately $2.3 trillion in reverse repos had the potential to be redirected into T-bills. Alternatively, the Treasury Department could have chosen to maintain a low cash balance for a period, gradually refilling it over time.

The following chart shows the Fed's reverse repo facility being drained. As it falls back down, it pushes liquidity back into the financial system:

Commercial bank liquidity successfully sidestepped any significant damage. Bank reserves experienced a local low in Q1 2023, just before the March 2023 banking crisis, and have been on a gradual uptrend since that time.



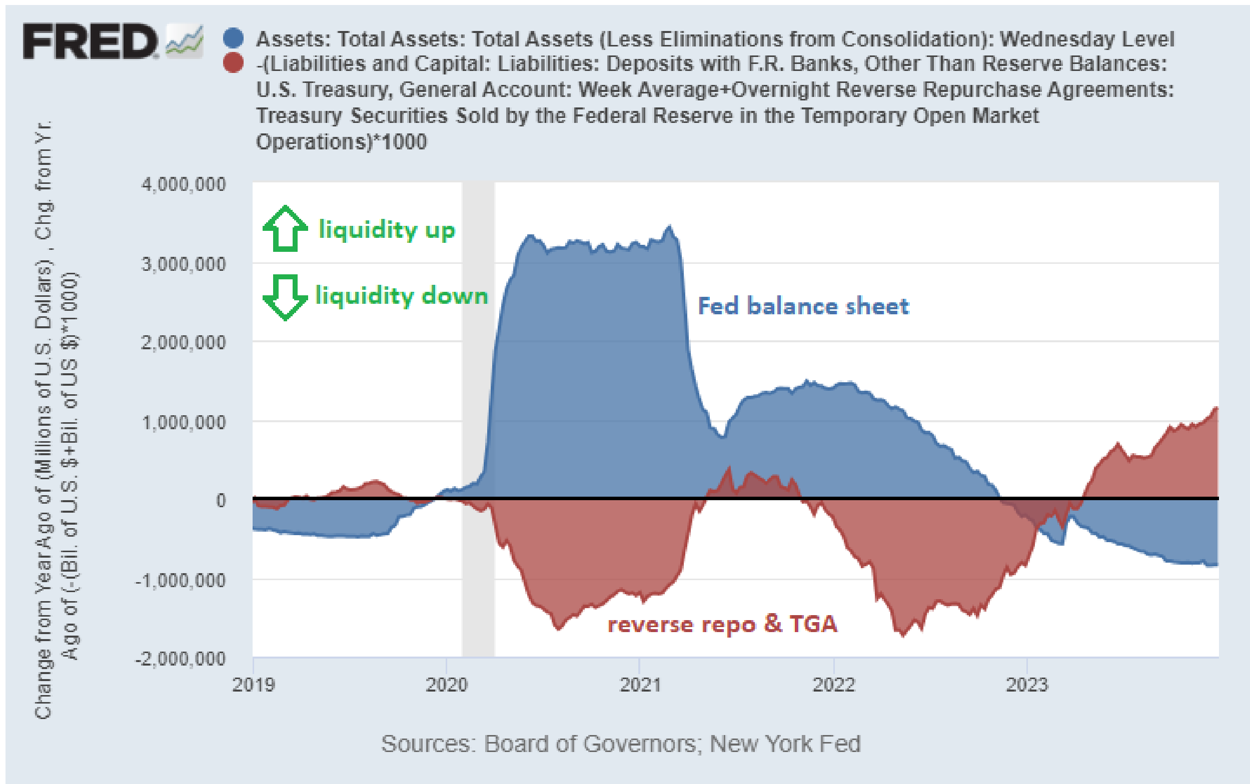
Since the fourth quarter of 2022 and throughout 2023, the U.S. Federal Reserve and the U.S. Treasury have pursued opposing policies. The Treasury, in response, has employed two distinct measures to align with the Fed's actions:

Between September 2022 and May 2023, the Treasury directed its efforts to replenish cash reserves into the financial system, countering the Fed's initiatives.

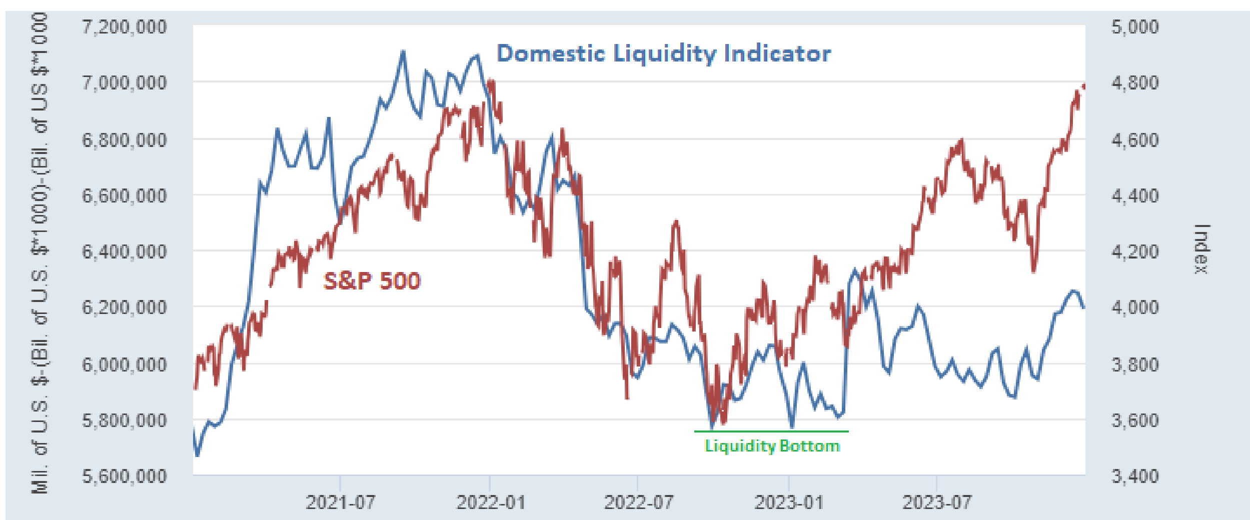
From June 2023 onward, the Treasury significantly elevated its T-bill issuance as a proportion of its overall debt issuance. This move effectively infused reverse repos back into the financial system, balancing the Fed's actions.

The accompanying chart illustrates the year-over-year change in liquidity actions by the Fed and Treasury. In this representation, higher values indicate increased liquidity, while lower values signify reduced liquidity. The Fed (blue) has consistently worked to decrease liquidity in the financial system since early 2022, while the Treasury (red), considering both its cash balances

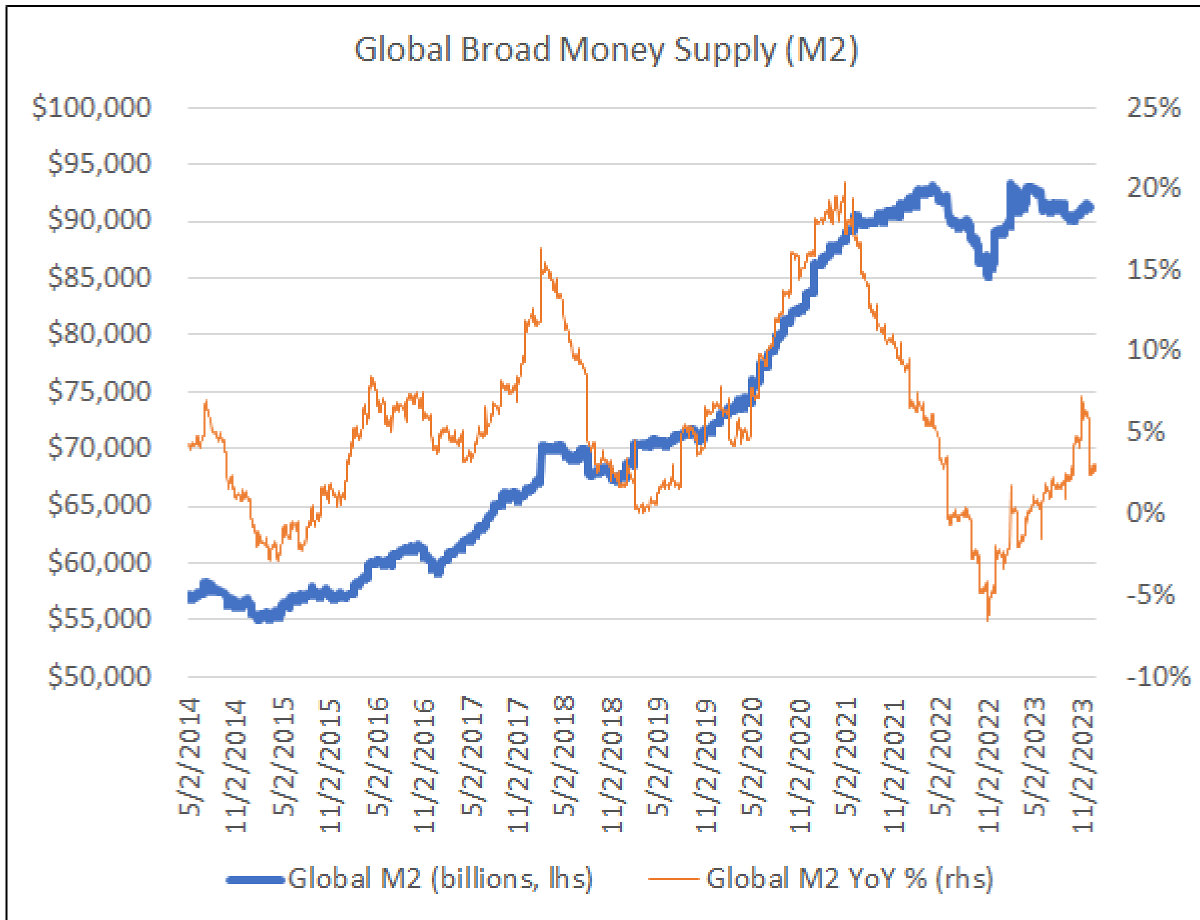
and its impact on the reverse repo facility through T-bill issuance, has been actively boosting liquidity since late 2022.



The overall outcome was a decline in domestic liquidity until Q4 2022. However, the trend then shifted, leveling off and slightly turning upward when the Treasury initiated its counteractive measures.



Regarding global liquidity indicators, the low point was also reached in Q4 2022 and has maintained a flat-to-upward trajectory ever since. My preferred measure for global liquidity involves examining the global broad money supply of major currency blocs, denominated in dollars. This metric is influenced positively by credit growth, specific types of quantitative easing, and/or a weaker dollar index, while credit contraction, specific types of quantitative tightening, and/or a stronger dollar exert a negative impact.



In a nutshell:

In 2020 and 2021, a combination of fiscal and monetary stimulus, along with supply chain disruptions due to pandemic lockdowns, led to a surge in both asset prices and consumer prices.

From early 2022 onwards, the Federal Reserve aimed to curb inflation by implementing tighter monetary policies. This involved raising interest rates (increasing the cost of debt for borrowers) and reducing their balance sheet (removing liquidity from the financial system).

However, starting in Q4 2022, the U.S. Treasury took a different approach, injecting liquidity back into the market to counteract the Fed's actions. As a result, total liquidity, which was challenging in the first three quarters of 2022, has been relatively neutral or slightly upward since Q4 2022, continuing throughout 2023.