

Q2 2023 Newsletter

Economy & Market Valuation

The US stock market as measured by the S&P 500 went up by 8.8% in Q2 2023. Naysayers about the US economy and stock market have been proven wrong. A lot of people were projecting recession in 2022 and H1 2023. Many of them were sitting in cash and missed the recent stock market rally. US stocks have risen by 25% from the bottom. We see a lot of positives happening in the US economy which point to a soft landing:

1. A record \$5.3T of money is sitting in cash. This will eventually find its way into the market when people feel that they are missing out on the rally.
2. The infrastructure spending bill and the move of manufacturing back to the US are unleashing a massive amount of spending in the US.
3. AI and migration to Cloud is increasing spend in the technology sector. We believe that we are well positioned to benefit from the Cloud and AI wave.
4. The Federal Reserve is very proactive as compared to earlier periods. We believe that the Fed is close to the peak of its current interest rate hike cycle. We may see one last interest rate hike in July. We expect to see a cut in interest rates in 2024, which is very positive for the stock market.
5. Inflation is receding and fears of runaway inflation are overblown. Inflation is within striking distance of

the Fed's target of 2%. YOY CPI as reported on July 12, 2023, was 3.1%.

We believe that this is not a time to be risk averse and sit on cash. Our judgement about the economy since Jan 2023 has proven to be correct so far. We have been fully invested and we have increased risk in the portfolio. The results are before us to see. We have outperformed the US stock market by a substantial margin in 2023. Alpha portfolio returned 25.9% in 2023 YTD, compared to the 16.9% return of the S&P 500 index, giving our Alpha portfolio an outperformance of 9%.

Of course, there are risks to the US economy. There could be a nasty recession or an escalation in the Ukraine war. But we are placing a low probability of occurrence for these events.

2023 investment strategy

We want to talk about one of our recent investments. It is in a company called Builders FirstSource (Ticker *BLDR*). This is to illustrate our investment philosophy and thinking. It is a distributor of building products to various professional builders. It is a relatively small company with a market cap of \$17B. The share price of BLDR has doubled in 2023 YTD. We invested in BLDR when conventional wisdom was to run away from all builders and building supplier companies. Reasons were obvious - impending recession and high mortgage rates are going to kill the housing market. But we went against the conventional wisdom and

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invested in BLDR. Our rationale for the investment:

1. Fundamentals of BLDR are very solid. BLDR has been growing revenue, improving margins and buying back shares. They have been increasing their market share by buying other companies. Stronger players win in a stagnant market where there are a lot of smaller players.
2. New home construction, instead of dropping, is going up. The lack of inventory of existing homes for sale is resulting in an increase in new home construction. Builders are better positioned to sell new homes as they are buying interest rate points for the new home buyers.
3. Reduction in interest rates will help companies like BLDR even more.

We hope that you are having a very good and relaxing 2023 summer.

We increased our position in AMZN and META when the stocks dropped. We have oversized positions in AMZN and META. AMZN is up 53% in 2023 YTD.

We believe in Charlie Munger's mantra.

"The first rule of compounding is to never interrupt it unnecessarily."

It does not pay to sit in cash. Now is a very good time to invest, as the perceived risks of higher inflation and recession in the US are receding.

We understand that many of you are also investing with other advisors or on your own. We urge you to compare our performance with what you are getting from other advisors.