Wealth Management Quarterly

FINTRUST CAPITAL ADVISORS

Storage & Stability in a Zero-Trust World

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EXECUTIVE SUMMARY

- **Monetary Policy:** Tightening. The Federal Reserve has indicated an intention to raise interest rates and shrink its balance sheet in 2022. The market is currently pricing in 7-8 interest rate hikes.
- **Fiscal Policy:** Accommodative. The Democrats intend to make one more budget push before the mid-term elections.
- **Economic Vital Signs:** energy prices are reaching levels associ-ated with past economic slow-downs.
- **Yield Curve Watch:** The yield curve is beginning to invert, which historically has preceded recessions.

Q1 2022: Storage & Stability in Zero-Trust World

Q: Allen, why title this WMQ "Storage & Stability, in a Zero-Trust World?"

Storage and Stability: A Modern Ever-normal Granary is one of the lessor known works by Benjamin Graham, Warren Buffet's professor and mentor. He published the book in 1937 as a study to explore "the general possibilities of storage of basic commodities as a source of stability and improvement in our national economy." Graham reasoned that storage uniquely sat at the intersection of two economic difficulties: those related to the supply and demand for commodities and those related to the defects of our monetary and credit system.

Meanwhile, cybersecurity and "zero-trust networks" were the focus of the World Economic Forum's Cyber Polygon 2021. At the event, Klaus Schwab and the Russian Prime Minister Mikhail Mishustin, hosted a technical training session in which a "modern bank" suffers a large scale cyberattack.

Money and banking systems rely on trust. *Storage and Stability* examines how trust might be created in money, whereas, Cyberpolygon looked at maintaining trust in the institutions that store our money and data during a cyberattack.

I thought it would be timely to share some insights from the book and conference because the war in the Ukraine, the American response, the Russian counter-response, the trucker protest in Canada, and supply chain issues, may have combined to move us into further into a "zero-trust world."

Q: What are the economic implications of being in a world of zero-trust?

Investors want currencies and ways to store and grow wealth that are stable. If, however, we are moving or have moved, into a world of "zero-trust," then storing and growing wealth will have new challenges and opportunities.

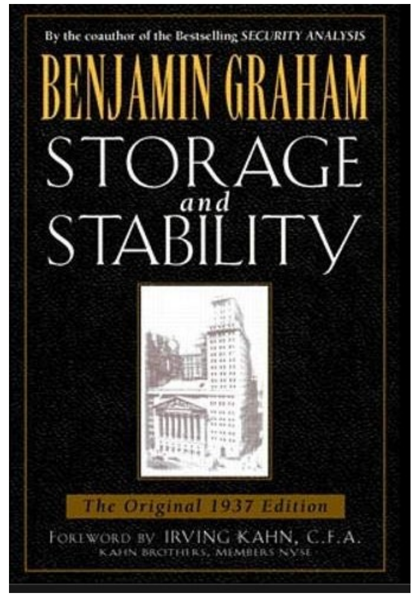
For example, a large economic implication of the move towards a "zero-trust" environment has been the creation, development, and adoption of cryptocurrencies and digital assets as a new asset class.

During the global financial crisis of 2008, trust in the banking system collapsed. At the time, many banks were effectively bankrupt, so investors started to aggressively explore ways to safely store money in the cloud.

Neutral currency, cloud storage through Bitcoin removed both counterparty and currency risk for coin holders. It shifted risk from the banks back to the individual for items like lost keys and accounts. In that regard, cryptocurrencies are a very libertarian solution.

Major Asset Class Returns	2022 YTD
T-Bills	-0.02%
Investment Grade Bonds	-5.93%
Large-cap Stocks	-4.60%
Mid-cap Stocks	-4.88%
Small-cap Stocks	-5.62%
International Stocks	-5.79%
Emerging Market Stocks	-6.92%

Source: Morningstar Direct, As of 3/31/2022



Source: Amazon

Many transformative technologies have started out in a similar early adopter fashion. Overtime, the mass market then demands those same products but it wants easier, more convenient, and more legally established solutions —think America Online, Napster, Google, and Amazon. I believe digital assets are edging ever closer to that mainstream adoption.

Q: Beyond cryptocurrencies, what are some other economic implications of "zero-trust?"

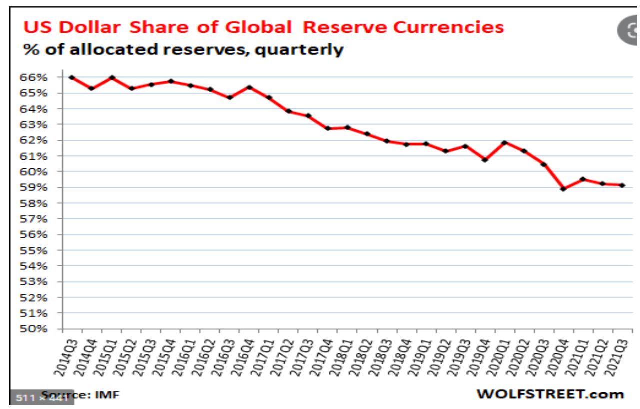
Shorter supply chains appear to be more reliable. I also think biometric applications are clearly coming. This is a real battle ground area though because it goes directly to issues of both national and individual sovereignty.

"Zero-trust networks" are an information security concept based on the principle of "never trust, always verify." It was not that long ago that a password was good enough to access computer systems. Now, we frequently need to use a two-factor authentication system, particularly for banking applications. Eventually, the world will move toward three-factor authentication. Three-factor authentication relies on something you know (i.e. password), something you have (i.e. your phone for two-factor), and something you are (biometric). Therein lies the risk to your sovereignty.

Do you control your system access and biological information or do government and corporations control you? For now, it appears that concepts like the "Green Pass" have failed due to Canadian trucker type protests. The Canadian government did briefly try to lock people's bank accounts, and people are regularly put into Twitter censorship jail, so I doubt the government will give up so easily.

The biggest economic implication of a "zero-trust" world, though will be the accelerated decline of the U.S. dollar's reserve currency status. I believe this will lead to generational changes.

Q: Why do you think the U.S. dollar is losing its reserve status?



First, it's an established trend that has trillions of reasons to continue. The US Dollar share of global currency reserves has dropped from over 70% to just under 60% today. When it drops under 50%, one will be able to say the dollar is no longer the primary reserve currency. At that point, I think things will really begin to accelerate. As a currency moves towards "zero-trust," the end result is inflation, and in the worst case scenario, hyperinflation.

The U.S. dollar is supported by the taxing and spending policies of the U.S. and the dollar's convertibility into petroleum products through the "petro-dollar." The Green New Deal climate agenda requires high levels of deficit spending, and it seeks to move the world toward "zero-carbon" emissions. Unfortunately, I am not sure it has dawned on everyone that hydrocarbons are what back the "petro-dollar" system of global trade. As a result, accelerated movement towards the United Nation's 2030 Agenda is causing a collapse in the global "petro-dollar" trading system.

Q: Can you give us a quick history of the "petro-dollar?"

Contrary to popular gold-bug and modern monetary theorist belief, the US dollar has been accepted as the world's reserve currency because it has been redeemable in stored basic commodities. Following World War II, the US dollar was accepted because

"It diametrically

Municipal and Treasury Yields (%)

Maturity	Treasury	AA Municipal	A Municipal	BBB Municipal
1 Year	1.607%	1.640%	1.830%	2.474%
2 Year	2.337%	1.873%	2.086%	2.729%
5 Year	2.462%	2.134%	2.374%	3.064%
10 Year	2.341%	2.414%	2.602%	3.379%
30 Year	2.450%	2.913%	3.003%	3.908%

Source: Bloomberg as of 3/31/2022

Q&A with the Research Team

it was convertible into both gold and the goods United States could produce. When the world no longer needed relatively expensive U.S. goods, there was a run on the gold. Nixon then closed the gold window, the Bretton Woods system collapsed, and the number of gold-bugs multiplied.

After the Bretton Woods system ended, the United States worked with OPEC to replace gold linked dollars with "petro-dollars." The oil producing countries agreed to transact in dollars and hold reserves in dollars, and in return, the US agreed to export its military power on behalf of its non-Soviet allies. Everyone needs energy to run their economies, so the U.S. dollar became a very important commodity.

Q: If the petro-dollar is collapsing, what is the replacement?

Now, that's the big question isn't it. The basic principles of diversification and convertibility are the key insights of Ben Graham. He, and if you can believe it ,Thomas Edison, both envisioned a currency backed by a diversified basket of commodities.

In his Preface, Mr. Graham recognizes that a "currency backed by, and actually redeemable in, stored basic commodities—on suitable terms—would possess an intrinsic soundness superior to that of gold and immeasurably beyond that of inconvertible paper." He is suggesting that a currency that is convertible into basic commodities can be trusted in the monetary system, whereas a paper dollar cannot be.

He continues, "the idea of storage as a solution to economic problems at least has the support of common sense. It is diametrically opposed to the topsy-turvey Alice-In-Wonderland reasoning that has marked so much of our depression thinking and policy. It rejects the argument that prosperity may be promoted by scarcity; that purchasing power may be showered in a gentle rain of greenbacks from heaven; that collapse from excessive debt may be remedied by incurring new and larger debt...the storage concept leads us away from all these absurdities into the region of the tangible, the sound, and the well established."

Even though it was written decades ago, it's a very sharp criticism of current U.S. policies. Green New Deal policies seek to create a scarcity of energy production, to encourage substitution and conservation. Green New Deal policies in California are creating other shortages. It is estimated that on January 1, 2023 at least 17% of the trucking fleet in California, or between 80,000 and 200,000 trucks will be taken out of service. If you think there are supply chain issues now, wait till 2023 when trucking capacity in California collapses. Other policies have created labor scarcities.

On the money creation side, authorities have been introducing new terms like "modern monetary theory" and "universal basic income." These are just a fancy ways of saying they want to create an absolute torrent of dollars to give to people for free to buy votes. All these policies create increasing amounts of debt, inflation, and instability.

As a result, the rest of the world seems to be quickly moving toward commodity backed currencies like those envisioned by Prof. Graham, while the U.S. seems to be gradually embracing Bitcoin and cryptocurrencies because of the ties to computing power and electricity.

Q: What suggests the rest of the world is moving away from the "petro-dollar?"

First, China launched its own crude oil futures market in March of 2018, so middle eastern crude is now traded in yuan, as well as dollars. This trade is small but it will continue to grow. We now have the "petro-yuan" system in the early stages of competing with the "petro-dollar" system.

Next, after Russia attacked parts of Ukraine, the US weaponized the financial system using social credit scoring concepts. In an attempt to collapse the Russian currency and economy, the U.S. first sanctioned Russia's access to SWIFT, which is the global banking messaging system. The U.S. also froze some of Russia's foreign reserves and the assets of certain Russian oligarchs. Even a Russian Opera singer at the Metropolitan Opera in New York was forced out for not maintaining the proper social views. The U.S. then worked with global corporations like Visa and Mastercard to sanction vendor level payment systems to create popular disruption and discord within Russia. Initially, these moves caused a sharp devaluation in the Russian Ruble.

Russia though appears to have anticipated and war gamed these moves. Since the collapse of the Russian economy in 1998, Putin has been accumulating gold and building reserves in other currencies like the Yuan. Russia also realizes Europe's Green policies have made it dependent on Russia and the Ukraine's natural resources like natural gas, grains, and seed oils. As a result, Russia quickly demanded oil and gas payments be made in Rubles, gold, or bitcoin. In short, Russia fully linked its currency to a basket of basic commodities like Professor Graham suggested. As a result, the Ruble has fully recovered. Meanwhile, the U.S. and Western powers of Europe are left with higher commodity prices and inflation.

Another sign of the "petro-dollar" breakdown is that El Salvador recently became the first country to make Bitcoin legal tender.

India is a wild card, as both the US and Russia are battling for India's cooperation. In India, economic growth has always been restrained by the amount of capital tied up in gold. Gold in India has both religious and practical implications, but at its core, the lack of trust in government currency has made gold a very practical way to protect wealth there. Cryptocurrencies like PAXG —which tie a crypto currency to a physical asset like gold —might be the key to unlocking the practicality of electronic digitized gold payments there.

Q: Any final thoughts?

Do not trust the government to maintain the purchasing power of your money. Our data suggests the inflation figures for this cycle will peak in the second quarter, but today's policies, demographics, and trends will keep upward pressure on inflation for a long time.

In closing, I think investors should maintain a diversified currency basket along side their diversified stock, bond portfolio, and real estate portfolios if they want to store, grow, or maintain stability in their wealth.

QUICK TAKE

MAJOR ASSET CLASSES

Cash and Cash Equivalents

The Federal Reserve has indicated that it intends to raise short term rates in 2022. While most asset classes have a negative correlation to short-term rates, we would point out that real interest rates continue to be negative as the 10-year realized inflation rate sits at approximately 1.97%. As a result, we believe alternative currencies like gold and cryptocurrency offer positive carry against cash, but they will be volatile as the Fed increases the attractiveness of cash at the margin.

Investment Grade Fixed Income

The yield curve has begun the year with a sharp move higher. Investment grade fixed income markets reflect an economic recovery and credit spreads remain tight. The 10-year treasury yield is once again equal to the 10-year realized inflation rate, but inflation readings have been coming in hot. We believe these inflation readings will peak in the second quarter and that investment grade corporate bonds now offer reasonable yields for the environment.

Tactical Fixed Income

Historically, fixed income and equity arbitrage strategies earn a risk premium above cash yields. Given that equity market neutral strategies historically are positively correlated to higher interest rates, we continue to favor these types of strategies.

Core Equities

Since our last report, equity prices have been under pressure due to rising interest rates, supply chain issues, the war in the Ukraine, and covid shutdowns in China. After adjusting for recessionary recovery, we believe equities are slightly overvalued relative to historical valuations, and we are beginning to grow concerned about rising energy prices. Given high levels of volatility, we would not overweight equities beyond investor risk determined allocations. Given our inflation outlook, we are also more constructive on small cap and international equities.

Tactical Equities

Due to the extreme conditions in core fixed income and equity markets, we think that tactical equity strategies may offer investors the best risk/reward tradeoffs. Tactical equity strategies, like long/short equity and option-based strategies have historically weathered bad bond markets and buffered bad equity market storms. We believe tactical equity strategies are becoming increasingly attractive on a relative value basis given low interest rates and the likely structural changes to the economy.

Other Markets

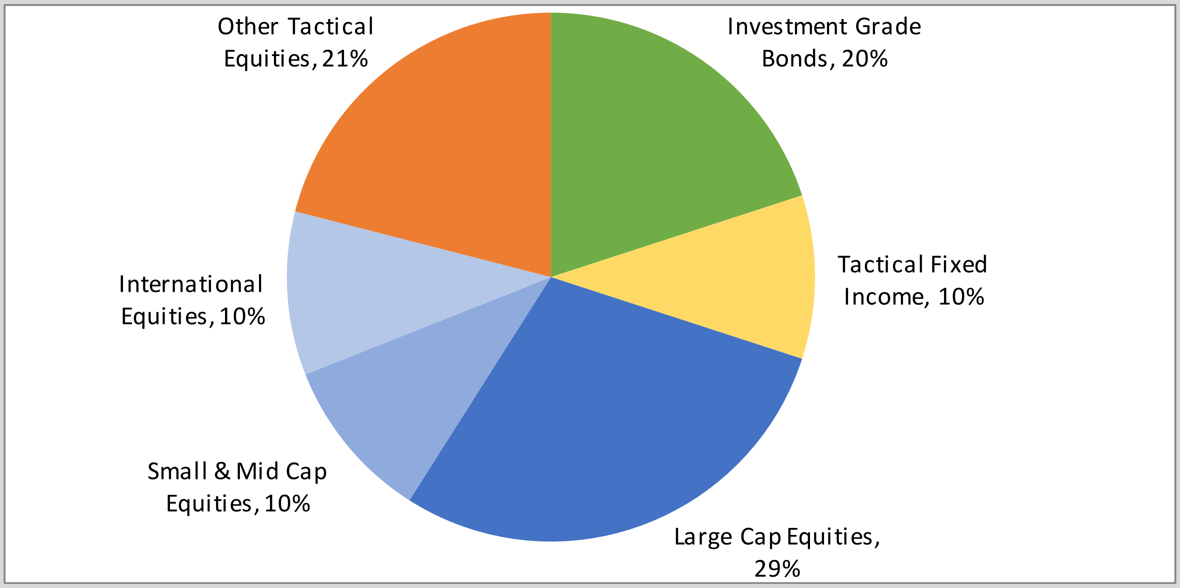
Other markets like gold, cryptocurrency, and real estate may offer diversification benefits to traditional portfolios, but some suffer from the same valuation issues as stocks and bonds.

Index Snapshot

	Earnings Yield	Dividend Yield	Price to Book
Large-cap Stocks	4.28%	1.37%	4.51
Mid-cap Stocks	5.63%	1.50%	2.51
Small-cap Stocks	5.74%	1.47%	2.00
International Stocks	6.88%	2.77%	1.73
Emerging Market Stocks	7.59%	2.60%	1.76

Source: Bloomberg as of 3/31/2022

FinTrust Allocations (70/30 Risk Profile) with Tactical



Positioning as of 3/31/2022. This model displays FinTrust's Funds & ETF Model with Tactical target portfolio guidelines. Each client situation is unique and may be subject to special circumstances, including but not limit to greater or less risk tolerance, classes, concentrations of assets not managed by FinTrust, investment limitations imposed under applicable governing documents, and other limitations that may require adjustments to the suggested allocations. Model asset allocation guidelines may be adjusted from time to time on the basis of the foregoing and other factors.

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