BOXWOOD

CAPITAL MANAGEMENT, LLC

June 22, 2022

How could we start another quarterly recap note without mentioning inflation? Well, it is finally here, just in case you haven't felt it in the pocketbook already. The market is no longer anticipating higher rates, it is feeling the effects of such. Rates up, stocks down. High growth stocks, like the core of our portfolio, are feeling the brunt of the downturn. As of this writing, the Nasdaq 100 is down around 30%.

The question is where do we go from here and has the market already priced in that ultimate destination? (Mea culpa: the market prediction from last quarter ended up being wrong)

The Federal Reserve and the Biden administration have been wrong on inflation. The administration long held onto the belief that the inflation was transitory. Inflation has been persistent. The Fed hasn't raised the policy interest rate high enough or fast enough to dampen higher prices. The Fed will need to act more aggressively and catch-up.

What does aggressive and catch-up mean?

Multiple Federal Reserve bank presidents have indicated as recently as this spring their belief that the natural rate of interest is roughly 2.5%. Using a basic definition, they mean a policy rate of 2.5% (what they view to be the "natural rate") would be neither expansionary nor contractionary for the economy.

Also, many economists assume the policy rate needs to be 3.0% higher than the natural rate to cool the economy enough to put a check on inflation. That would imply the policy rate needs to be somewhere around 5.5%. Even after the Fed's recent 75 basis point hike, the largest rate increase in 28 years, the benchmark rate is only set to a range of 1.5% to 1.75%. So, they are 3 to 4% away from a point at which their policy will dampen the economy. At the most aggressive .75% increments, it will take some time. Not only will prices cool but so will the economy.

The Fed's necessary actions will likely put the economy into recession.

In anticipation of this slowdown, the fund has raised cash over the quarter. Cash now makes up about 7.5% of the fund's value. This is the highest level of cash we have sustained since the inception of the fund.

No core positions were sold to raise the cash. In fact, the cash will later be used to buy more of our core positions. Rather, we sold the positions that were acquired at the onset of the pandemic – financials, etc. And those positions were bought using proceeds from short-term trades made at the same time.

We look forward to being able to deploy the cash, but dark days may lie ahead.

Until next time,

Todd Shorb

todd@boxwoodcapitalmanagement.com

6 Arrowood Ter
Bethesda, MD 20817