The stock market is correcting.

After bottoming out in October 2022, Artificial Intelligence (AI) breakthroughs fueled big gains in AI-related stocks. Hype fed a moonshot rally in a narrow group of AI stocks. It gave the broad market a modest lift as well, but speculation remained narrowly focused on AI. Eventually, the rally went a little too far.

Then the month of April arrived, and the real world intervened. Government statistics showed inflation to be higher than expected. Analysts scaled back rate cut expectations, and investors sold bonds and stocks.

Soon thereafter, Iran launched missiles and drones at Israel. Investors sold more bonds and stocks due to worries that escalation could threaten energy supplies. Israel retaliated, and investor selling accelerated. Even though Iran hinted that it would not return fire, selling persisted. Market leverage is unwinding. In these situations, selling begets more selling.

This correction will continue until either the forced selling ends or stocks get cheap enough to attract new buyers. For the typical correction, this happens after a decline of about 10% from the top.

Figure 1: S&P 500 - 4/19/2024

The S&P 500 peaked at 5260 in late March. A 10% correction would take it to 4735. The index is now more than halfway there.

Countless factors, known and unknown, will determine where the stock market bottoms out. The “known unknowns” include:

- How much selling will be needed to rebalance the market?
- Will inflation ease up or accelerate?
- Will Fed Policy ease in response to market tumult?

- Will Iran-Israel hostilities intensify or ease?
- Will China take advantage of America's preoccupation with Ukraine and Israel to invade Taiwan?

Vigilante Investor suggests that investors remain cautious during this period of elevated macroeconomic and geopolitical risk. Considering the relatively high level of short-term interest rates (and the low opportunity cost of holding cash), investors should maintain a substantial cushion of cash and short-term bonds.

However, investors should take advantage of opportunities to buy cheap assets. Barring an imminent hot war in Asia, this correction will soon end. Investors should seek opportunities to put cash to work, incrementally, as the S&P 500 approaches 4735.

A Word About China War Risks

Last year, this publication focused on China's extensive war preparations. The Vigilante Portfolio kept a cash hoard, in part, due to the risk of a Taiwan invasion. We plan to maintain a cash cushion, but we will take advantage of market weakness to selectively buy cheap stocks that can perform well during wartime.

President Xi has loaded the Chinese gun and aimed it at Taiwan. China is prepared to invade. Seasonal tides around Taiwan limit the timing for amphibious landings to April, May, or August, so this is a window of opportunity. Also, because America is preoccupied with Ukraine and the middle east, China can possibly take Taiwan without dealing with American intervention.

But an invasion is far from certain. When Xi looks through the sights on his gun, he may see the costly consequences of pulling the trigger.

An invasion of Taiwan could easily lead to Xi's demise. Initially, Chinese citizens would rally around their leader. But in time, reality will set it. China' s prosperity depends entirely on access to the U.S-sponsored global trading system. If China invades, it will lose access to its best customers. Exports will collapse, and so will China's economy. Unemployment, poverty, and hunger will proliferate. China's ethnic divisions will re-emerge, splintering the country and possibly bringing a violent end to Xi's rule. If Xi sees this, he will pause.

It is also possible that Xi is staging an elaborate bluff. He may be following the playbook of Sun Tzu, the ancient Chinese military strategist who showed the importance of deception and misinformation in war strategy.

For example, China has telegraphed preparations for an invasion, effectively giving advance notice to foes. This makes no sense unless Xi has a deeper strategy in mind. Also, China has planted stories about China's incredible Cyber-attack capabilities. The stories imply that China can take down the U.S grid, stop pipelines, disrupt communications, and destroy American living conditions. This may all be true. But Xi won't do it, as it would invite a retaliatory cyber-attack. Considering the destructive cyber capabilities of the U.S. military and its tendency to over-react, America's retaliation would likely send China back to the stone age.

China's cyber threat is a bluff, and that makes me wonder whether China's invasion preparations are also a bluff. Time will tell.

We do not know whether Xi will invade Taiwan. Either way, his decision will impact the economy and stock market. An invasion would collapse global trade and stock prices. The alternative to invasion, where Xi maintains the ongoing threat while negotiating for policy change, would allow the stock market to stabilize and then climb the proverbial wall of worry.

Considering the contrasting, binary outcomes, investors should cautiously deploy cash. Take advantage of bargains that surface during this market correction. Add equity risk cautiously and incrementally while retaining a comfortable cash position.

Portfolio Strategy

Sell Diamondback Energy (FANG). This stock has performed exceptionally well over the past four years. Diamondback's acquisition of Endeavor turbocharged the stock performance. The merger will deliver synergies, economies of scale, and a higher earnings trajectory for the company. This good news is already reflected in the stock price.

Some oil analysts believe that Permian oil producers, like Diamondback, are experiencing declines in well productivity rates. The expected ultimate recovery (EUR) for new wells has dropped considerably. As a result, the expected breakeven oil price for new wells has risen from around $45 to $85.

This implies that the best Permian basin fracking opportunities have been exploited. For producers to earn an adequate profit margin going forward, oil prices must rise considerably. Prices won't rise until supply falls. This means that producers face a period of declining production and profit margins… bad news for investors.

The Vigilante portfolio still holds substantial exposure to natural gas producers in the Marcellus and Haynesville basins. Productivity is still stable in those basins. The portfolio also holds substantial positions in oil & gas service companies. The service stocks trade at depressed levels and enjoy substantial upside potential.

Textron (TXT)

Textron manufactures aviation and industrial equipment. The company works mostly within the private sector, where it enjoys a reputation for delivering high quality products. Textron also produces specialized planes for the Department of Defense.

Textron's Aviation segment generates about 40% of revenues. It sells and services Cessna, Beechcraft, and Hawker planes. In addition to its private-sector clients, Textron Aviation produces the T-6 military trainer aircraft and the Air Force AT-6 light attack military aircraft. The T-6 is used in over 40 countries to train military pilots.

The Bell segment, which makes up 23% of revenues, manufactures helicopters for commercial and military use as well as tiltrotor aircraft. Tiltrotor combines the vertical lift of helicopters with the longer range of fixed wing aircraft. Bell is developing a new tiltrotor plane for the Army based on the V-280 Valor. In recent years, the Department of Defense has struggled to keep its existing tiltrotor aircraft, the V-22 Osprey, air worthy. Fatal crashes have been attributed to "Hard Clutch Engagement." The Osprey failures apparently stem from the use of materials that weaken faster than expected and a design that places too much stress on critical parts. If the V-

280 Valor overcomes these problems, it could replace the Blackhawk and lead to substantial growth for Bell.

Textron's Systems segment develops products and services for military, government, and commercial customers. It produces 9% of company revenue.

The company's Industrial segment manufactures a wide variety of products including vehicle fuel systems and specialized vehicles. Its vast offering of specialized vehicles includes the E-Z-GO golf cart. The Industrial segment contributes about 28% of revenue.

Textron looks cheap.

Table 1: Textron, Inc. as of 4/19/2024

Ticker	TXT	**EPS**	$4.57	**Expected 5-YR Growth**	17.5%
Price	$93.30	**Forward EPS**	$6.99	**Forward PE Ratio**	13.35
Book/Share	$36.22	**Market Cap**	$17.9B	**Debt/Equity**	61%
Dividend Yield	0.09%	**Enterprise Value**	$19.5B	**Net Debt/Ent Value**	8.1%

Sources: Finviz.com, Yahoo Finance

TXT trades at a forward PE Ratio of 13.35, well below the expected 5-year earnings growth of 17.5%. When the growth rate exceeds the PE ratio, the stock is selling at a bargain price. This is especially true for companies with little debt on the balance sheet, like TXT.

Investment Strategy: Buy the full position of TXT at current prices.

Figure 2: Textron (TXT) as of 4/19/2024 (Daily Chart)

Boeing Co. (BA)

The free world relies on just two companies to build large passenger jets – Airbus (in Europe) and Boeing (in America). Unfortunately, right now, Boeing is a basket case.

For years, safety and quality problems have plagued Boeing. In 2013, battery fires grounded the 787 wide body. In 2019, software and training failures led to fatal crashes of the 737 narrow-body plane. Both failures forced Boeing to halt production and ground planes while investigating and testing for a resolution.

More recently, Boeing briefly grounded 737 aircraft after a door plug flew off in flight. The accident was caused by the failure of Boeing workers to properly secure the plug with bolts. In the process of inspecting grounded planes, officials discovered that several other planes were missing the required plug bolts.

To make matters worse, whistleblowers now allege that the company is taking shortcuts in the production of 787 Dreamliners. Allegedly, the company has been fastening together portions of the fuselage by force rather than using shims to fill gaps.

Another whistleblower alleged that cockpit wiring in 787 Dreamliners is compromised by metal slivers that hang nearby. That whistleblower was recently found dead from an apparent "self-inflicted" gunshot wound. The accusation and suspicious outcome further erode confidence in the company and its aircraft.

Boeing's sad performance demonstrates the hazard of disconnected leadership. In 2001, the Seattle-based company moved headquarters to Chicago. Then in 2023, it moved to Arlington, Virginia. For over 20 years, executive management has distanced itself from manufacturing facilities (Seattle, St Louis, and Charlotte). To make matters worse, the current CEO, David Calhoun, prefers to work from home, in New Hampshire.

Nevertheless, Boeing has three things going for it:

1. Boeing is critical to the free world. It remains one of only two commercial aircraft manufacturers outside of China. It is also one of the world's largest defense contractors.
2. The Chairman and CEO resigned. The board can now hire new leadership and try to turn the company around.
3. The stock is historically cheap.

Although Boeing is now failing, it will not fail. Its customers, the U.S. government and the citizens of the free world, all need Boeing to succeed.

The next Boeing CEO may fail. If so, the stock price will continue to sink while the board searches for another leader.

Eventually, Boeing will hire a good CEO who will build a competent leadership team. Operational efficiency and product quality will improve. Along the way, insiders, encouraged by progress, will accumulate shares. The stock price will begin to rise. Eventually, earnings reports will confirm the progress, and the stock price will soar. Investors who wait for confirmation of the Boeing turnaround before investing… will miss much of the upside.

The stock looks rather expensive based on current earnings valuation.

<u>Table 2: Boeing Co, as of 4/19/2024</u>

Ticker	BA	**EPS**	-$3.67	**Expected 5-YR Growth**	NA
Price	$169.82	**Forward EPS**	$6.37	**Forward PE Ratio**	26.7
Book/Share	-$28.27	**Market Cap**	$103B	**Debt/Equity**	NA
Dividend Yield	NA	**Enterprise Value**	$141B	**Net Debt/Ent Value**	27.0%

Sources: Finviz.com, Yahoo Finance

However, the company looks cheap based on its historical market valuation. Figure 3 shows that Boeing hasn't traded at this low of a price since the 787 Dreamliner problems were resolved.

Figure 3: Boeing Co. (BA) as of 4/19/2024 (Monthly Chart)

It may take time to turn the airship around, and the next CEO may initially fail. But the free world will be patient. The world needs Boeing's production, and the company is impossible to replicate. BA will survive and eventually thrive.

<u>Investment Strategy</u>: Cautiously scale into a position in BA. Buy 1/3 of a position at current prices. Look for opportunities and/or reasons to fill up the position. If the slide continues, add another 1/3 at around $145, and another 1/3 below $125.

Genuine Parts Company (GPC)

"Established in 1928, Genuine Parts Company is a leading global service organization specializing in the distribution of automotive and industrial replacement parts."[1] The company's best-known brand, NAPA Auto Parts, operates 6,000 stores. About 75% of company revenue comes from North America, 16% from Europe, and 9% from Australasia.

If you want to add a non-cyclical investment to your portfolio, look no further. Demand for new cars may decline during a recession, but demand for repair parts never slows down.

[1] Genuine Parts Company Earnings Release, April 18,2024

Historically, GPC has performed well in all economic conditions. The company has developed a culture of success, incorporating sales effectiveness with innovative technologies and supply chain management to optimize performance.

GPC represents a stable and boring business. It trades at a forward PE Ratio that is about double the expected growth rate. Considering GPC's non-cyclical business model and low debt exposure, the stock trades at a reasonable price.

Table 3: Genuine Parts Company as of 4/19/2024.

Ticker	GPC	EPS	$8.97	Expected 5-YR Growth	7.1%
Price	$162.39	Forward EPS	$10.75	Forward PE Ratio	15.11
Book/Share	$31.60	Market Cap	$22.6B	Debt/Equity	112%
Dividend Yield	2.46%	Enterprise Value	$26.5B	Net Debt/Ent Value	10.6%

Sources: Finviz.com, Yahoo Finance

Last week, a positive earnings report triggered a 10% jump in the stock price. For this reason, I advise scaling into the position.

Figure 4: Genuine Parts Company (GPC) as of 4/19/2024

Investment Strategy: Buy ½ position of GPC at current levels and add the other half if the stock price falls below $146.

The Economy

Growth indicators rebounded in the past quarter, and inflationary pressures continue to intensify. The *Vigilante Investor* Scorecard favors Growth by a score of 3-to-1 and inflation by a score of 4-to-0.

This relentless economic recovery is driven, in part, by deficit spending. Recently, Washington supercharged its spending with the biggest infrastructure and corporate welfare programs (a.k.a. the Chips Act) in history.

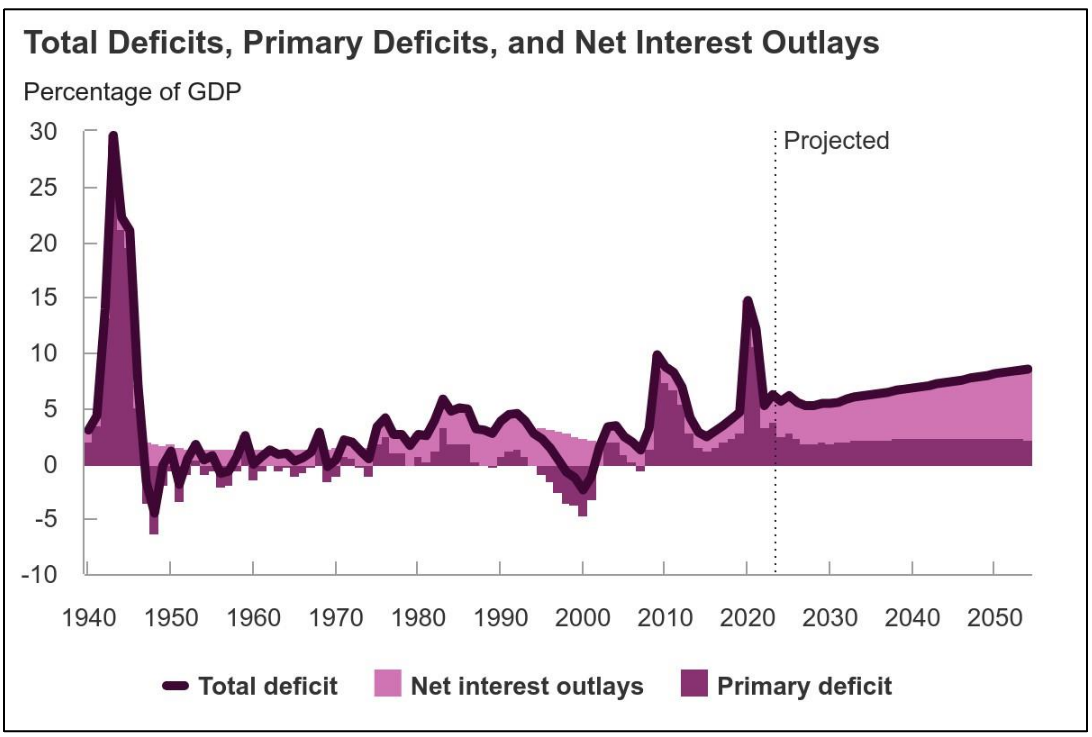
Table 4: Vigilante Investor Scorecard of Economic Conditions April 19, 2024

Score	Positive	Neutral	Negative
Growth 3 Contraction 1	US Real GDP +3.1%YOY US Productivity +2.6%YOY Global Comp PMI 52.3	Fed Signal +0.5% US Non-Manf PMI 51.4	US 2-10 Spread -0.26%
Inflation 4 Deflation 0	CPI +3.5% YOY US Wages +4.1% YOY Gold +22.0% YOY Gold / Euro +22.5% YOY	US Dollar +0.6% YOY Crude Oil -2.8% YOY	
Positive $ 2 Negative $ 0	US-Ger2YR Spread +1.98% US-Ger10YR Spread+2.12%		

Sources: Tradingeconomics.com, St. Louis Fed, and Investing.com

Despite the economic recovery, Congress and the Biden Administration continue to stimulate the economy with recession-level deficit spending.

Figure 5: Fiscal Stimulus History- Primary Federal Budget Deficits as % of GDP



Source: Congressional Budget Office Publication 59711

In 2023, the government ran a Primary Deficit (which excludes the effect of interest) of 3.8%. The deficit remains higher than recession years 1983 (3.3%), 1992 (1.4%), and 2003 (2.0%). Only the Great Recession 2009 deficit of 8.5% was higher.

So despite robust growth conditions, the government is adding recession-level stimulus to the economy. No wonder the Fed is struggling to bring down inflation!

Stock Market Valuation

Figure 6: S&P 500 Long-Term Log Chart as of April 19, 2024

The S&P index is now retreating from extreme levels. If it falls to 4400, the midpoint of the valuation range, it would present a very good opportunity for pensions and other long-term investors to load up.

Investment Strategy and Portfolio Review

We have already discussed investment strategy and recommendations for the Vigilante Portfolio. See table 5 for details.

Note that the portfolio plans to add to positions if stock prices fall further.

- Lockheed Martin (LMT) around $400
- Boeing (BA) around $145 and $125
- Bank OZK (OZK) around $36
- Genuine Parts Company (GPC) around $146

Table 5: The Vigilante Model Portfolio as of 4/19/2024

Sector	%	Selections	Symbol	Initial Price	Price Apr 19
Defense/Aerospace	14%	Rtx Corporation	RTX	$85.17	$101.56
		Lockheed Martin	LMT	$428.00	$464.14
		Textron	TXT	$93.31	$93.31
		Boeing	BA	$169.84	$169.84
Financials	16%	Chubb	CB	$165.98	$250.24
		AIG	AIG	$47.54	$74.22
		WR Berkley	WRB	$53.58	$82.40
		Bank OZK	OZK	$34.86	$44.94
Energy	26%	ProPetro	PUMP	$8.25	$8.53
		Diamondback Energy	FANG	$61.33	$200.74
		Nine Energy	NINE	$1.90	$2.71
		Coterra (Formerly Cabot)	CTRA	$18.69	$27.75
		Southwestern Energy	SWN	$4.06	$7.29
		Antero Resources Corporation	AR	$32.67	$29.29
		KLX Energy Services	KLXE	$9.94	$7.21
Agriculture	4%	Mosaic Co	MOS	$28.67	$31.00
Industrial	2%	Genuine Parts Company	GPC	$162.32	$162.32
Precious Metals	10%	Junior Gold Miners ETF	GDXJ	$46.02	$42.20
		Gold Miners Index	GDX	$29.30	$34.05
		Pan American Silver	PAAS	$21.13	$19.06
		Silver Miners ETF	SIL	$42.00	$31.41
		Newmont Mining	NEM	$53.32	$39.03
TIPS	17%	VG ST Infl Protected Sec ETF	VIPSX	$12.90	$11.53
Short Terrm Bonds	11%	VG ST Corporate Bond ETF	VCSH	$74.95	$76.43
Cash	0%	Broker Money Fund			

The ETF Model suggests adding 5% of the Mid Cap Value ETF at this time.

Figure 7: Mid Cap Value ETF Long-Term Log Chart as of April 19, 2024

Conditions for defense spending continue to improve, so we would add to the Invesco Aerospace and Defense fund if the price drops to around $96.

Table 5: The Vigilante Model ETF Portfolio as of 4/19/2024

All ETF Portfolio	%	Selections	Symbol	Initial Price	Price Apr 19
Broad Market	4%	VG Mid-Cap Value ETF	VOE	$122.88	$148.38
	5%	VG Mid-Cap Value ETF	VOE	$144.50	$148.38
	4%	VG Large-Cap Value ETF	VTV	$121.81	$155.93
Financials	4%	VG Financials	VFH	$88.21	$97.75
	14%	iShares U.S. Insurance	IAK	$84.25	$112.85
Energy	24%	First Trust Revere Nat Gas	FCG	$19.01	$27.26
Defense	10%	Invesco Aerospace & Defense	PPA	$91.40	$98.10
	5%	Invesco Aerospace & Defense	PPA	$96.00	$98.10
Precious Matals	5%	VanEck Vectors Gold Miners	GDX	$32.75	$34.05
	5%	Global X Silver Miners	SIL	$39.51	$31.41
TIPS	*10%*	VG ST Infl Protected Sec ETF	VIPSX	$12.90	$11.53
Short Term Bonds	*10%*	VG ST Corporate Bond ETF	VCSH	$74.95	$76.43
Cash	0%	Broker MoneyFund			

May peace be with you!

Steve Koomar

April 21, 2024

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