



PRUDENT SMALL CAP™

PRUDENCE • PATIENCE • PERFORMANCE

JANUARY 2023

PrudentSmallCap.com

Portfolio

	Name	Symbol	Added to Portfolio	Current Price	Action
1	TransMedics Group	TMDX	31-May-22	\$61.72	Maintain
2	Extreme Networks	EXTR	1-Aug-22	\$18.31	Maintain
3	Calix	CALX	11-Aug-22	\$68.43	Maintain
4	Aehr Test Systems	AEHR	24-Oct-22	\$20.10	Maintain
5	Harmonic	HLIT	24-Oct-22	\$13.10	Maintain
6	CECO Environmental	CECO	31-Oct-22	\$11.68	Maintain
7	DICE Therapeutics	DICE	31-Oct-22	\$31.20	Maintain
8	InMode	INMD	31-Oct-22	\$35.70	Maintain
9	<i>No Position</i>				Cash
10	<i>No Position</i>				Cash

Portfolio Performance

	2022	2021	2020	2019	2018	2017	2016
Graycell Small Cap	-31%	29%	87%	27%	8%	37%	71%
Russell 2000 (IWM)	-22%	13%	18%	25%	-11%	14%	19%

Positions Closed This Month

	Name	Symbol
1	Digi International	DGII
2	Array Technologies	ARRY

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Portfolio Update

Stocks did not have the seasonal year-end rally but instead had one of the worst monthly performances of the year. The S&P 500 lost 6% for the month and about 20% for the year, while the Nasdaq Composite fell 9% monthly and 33% for the year. The small cap indexes outperformed, declining about 7% for the month and 22% for the year.

Last year was the year of the Federal Reserve (FED) as it shifted rapidly towards a restrictive policy to rein in soaring inflation, pulling the rug out from under the market. This year too the market focus will remain on the FED and its restrictive policy, at least for the first half. The concern of a FED remaining restrictive for too long was the primary reason for a pullback last month. A key difference from last year is that the FED has already covered much of the distance to an interest rate peak. It remains to be seen how many more rate hikes will be needed to get to the peak and then for how long the FED stays there before easing rates. This will determine when a new bull market is born.

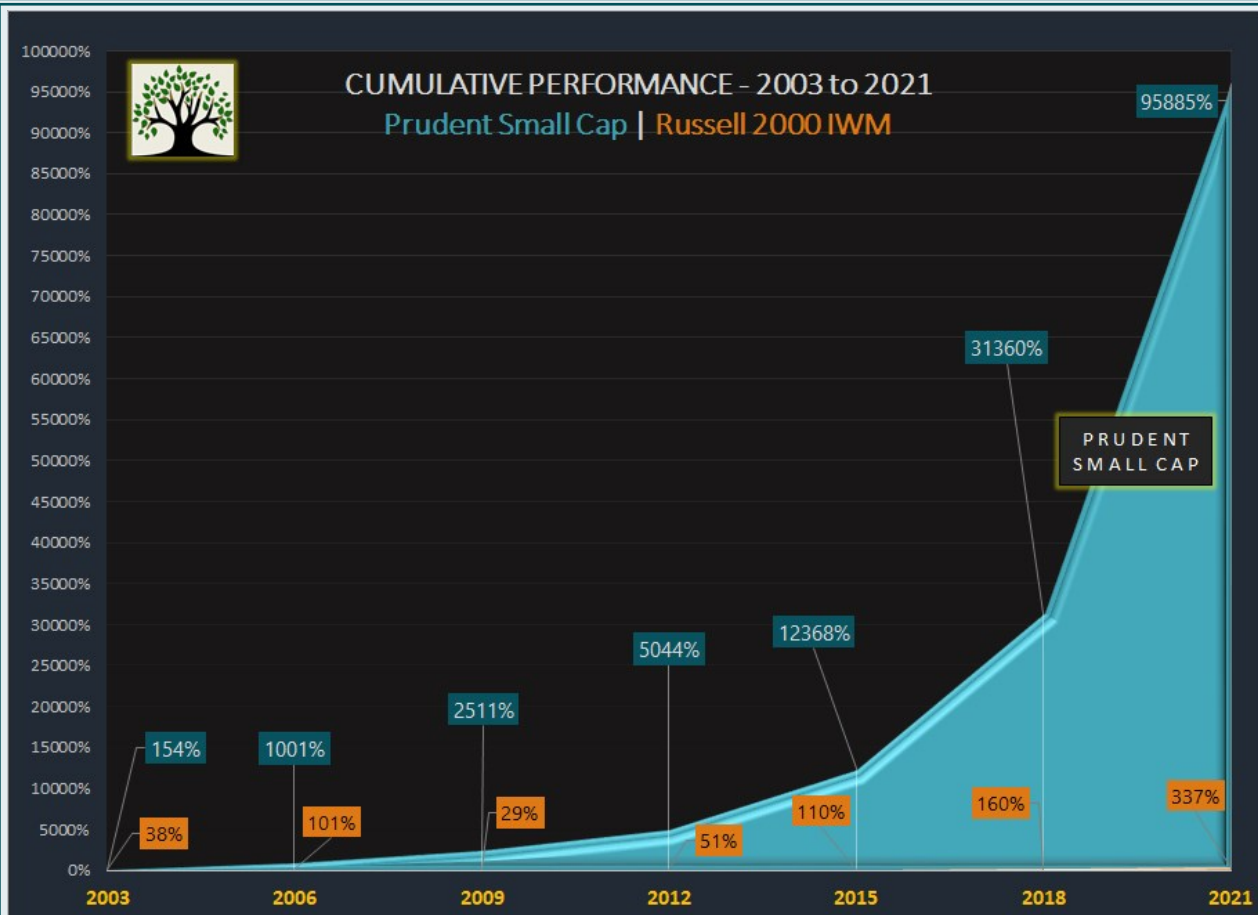
There are two likely economic outcomes at this point. One outcome is for the FED to pursue smaller rate increases to continue to bring inflation within the desired range, but the prolonged restrictive policy nudges the economy into a recession. Presently, this outcome appears to have a growing probability with the 10-year yield below the 2-year. This scenario will further pressure the stock market, including small caps. The second outcome can be for the ongoing economic slowdown to prove sufficient to get inflation within range, thus keeping further FED rate hikes limited, avoiding a recession, and improving the chance for a rate cut later in the year. This appears to be a lower probability scenario for now as employment-related metrics remain strong, although that can change. The market will rally sharply if this outcome grows in probability. The worst outcome will be for the economy to remain in its present state but with slow progress on inflation, forcing the FED to remain restrictive for a prolonged period and raise rates above the expected peak of 5.50%, from 4.5% presently.

As concerns are rising about a potential recession, the stock market in the first half can be highly volatile due to the ebb and flow of growth and inflation data. If the economy does enter into a recession, then how quickly it recovers will determine the market fortunes. One of the best times for investing is when the economy is emerging from a recession, helped significantly by a steady stream of rate cuts, and a new bull market is born. Such a scenario can occur later in the second half. Small cap stocks will perform as the economy does. The next FED rate decision will be on February 1.

During December, the Prudent Small Cap model portfolio dropped 9% and the Russell 2000 Index (IWM) fell 7%. For the year, the model portfolio was down 31%, and the Index lost 22%. The model portfolio exposure is being reduced to 80%. The next couple of weeks will have key economic data releases. Portfolio adjustments can be made intramonth based on market conditions and opportunities.

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[Click for an enlarged version of the chart](#)

During the period 2003 to 2021, the Prudent Small Cap portfolio was up over 95,000%, compared to the leading small cap benchmark Russell 2000 index performance of about 340%. The above period is from May 2003 to May 2009, and thereafter from 2012 to 2021. A \$10,000 starting portfolio tracking the Prudent Small Cap model would have surged to \$9.6 million over this period, compared to a Russell 2000 index invested portfolio growing to about \$44,000.

How did it happen? We follow our quantitative system, and stick to it. Discipline, Patience and Consistency are important keys towards building Wealth.

Please note that model historical performance for all periods is hypothetical with no trades placed, unaudited, based on our past newsletters, will vary when we revise and change models without any notice, and is not indicative of future performance.

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About

We pursue disciplined systematic investing using quantitative models, aiming to outperform the market. My name is Tarun Chandra, and I am the Editor of the model portfolio service. I was an Analyst on the Buy-side and Sell-side for 8 years. Thereafter, I worked with technology companies in a Strategy/Finance role. I have been working on model investing for many years, and believe this targeted product can tap into the potential of the Small Cap segment while managing and surviving its volatility.

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