INVESTMENT UPDATE

Third Quarter 2022

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MARKET REVIEW

Markets trended higher to start the third quarter but reversed course midway and ultimately finished lower for the period. Persistent concerns about rising inflation, the FED's aggressive response, global growth weakness, and a surging US Dollar weighed on the markets.

All major global equity markets finished in the red, with US Equities besting Non-US Equities due to the rise in the Dollar; notably, many international markets have generated superior returns this year when measured in local currencies. Dollar strength was also a driver of US Small Cap outperformance given a more moderate mix of foreign revenue exposure relative to US Large Cap. Accounting for two-thirds of US GDP, US consumption offered encouragement amid a persistently strong labor market, which in turn propelled Consumer Discretionary higher, outperforming all other sectors.

Non-US stocks sold-off, dragged lower by Emerging Market weaknesses as commodities reversed and China fears intensified. Despite continuing uncertainty surrounding the Russia-Ukraine conflict and related Energy and trade implications, Developed International markets held up relatively well, signaling that some level of depressed earnings and negative sentiment had been priced in.

Against a backdrop of stubbornly high inflation and multiple 75-basis-point FED rate increases, bond prices fell. And with global growth concerns weighing on the long-end, the resulting inverted yield curve further depressed confidence. Duration and Credit were the weakest sectors, the former affected by higher rates and the latter pressured by increased economic uncertainty. High-Yield and Floating Rate were relative outperformers, due in part to a heavy concentration of Energy-related business debt and shorter duration exposure.

> *For more than half a century, US stocks have consistently generated positive returns 12-months following mid-term elections.*

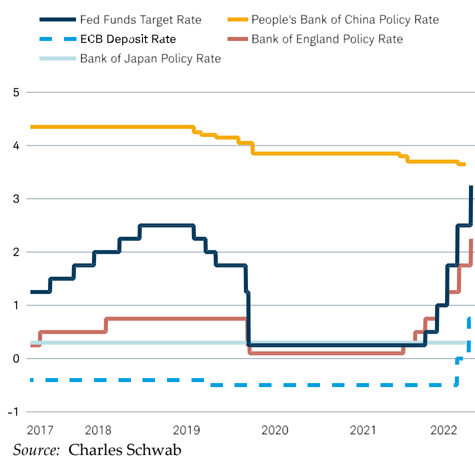
Commodities retreated materially from sizable gains made earlier in the year. Oil sold off roughly 24% due to global growth concerns and the spiking

Dollar. Gold fell more than 8%, pulling back from the high end of its trading range as some investors rotated their flight-to-safety capital into Treasuries to benefit from the higher yields.

OUTLOOK

High inflation coupled with a strong US labor market have emboldened the FED to push ahead with an unprecedented rate-raising campaign. However, with many international economies struggling with elevated levels of uncertainty, foreign central banks are not likely to follow in lock-step. This divergence in policy will support the Dollar and further pressure global commerce, likely leading to recession. Yet despite initial negative reactions, some investors are now welcoming a recession as a necessary condition to move markets higher, not lower.

GLOBAL CENTRAL BANK RATES



Source: Charles Schwab

Economists and investors alike understand that periodic recessions are necessary evils to ensure sustained, long-term structural growth. Specific to this cycle, there is a good chance that any recession will be moderate in terms of length and severity given the absence of any bubbles. Moreover, related economic weakness would likely compel the FED to reverse course (potentially as early as next year), which would converge interest rate differentials, weaken the dollar, and ultimately spur global economic improvement.

Worth remembering is that the economy and the markets are not the same thing. Effecting economic activity is neither easy nor quick, regardless of whether such change is due to natural market forces or government intervention. In contrast, investment participants can influence market momentum more quickly, often discounting future changes well in advance of observable hard data confirmation. With global equities trading markedly lower year to date, it certainly appears possible that history may be poised to repeat itself yet again.

Also worth noting is that sell-offs and rallies do not occur symmetrically, with the former often happening much more quickly than the latter. Encouragingly, an important determinant in the strength of market rallies are valuations, and this year's sell-off has helped in this regard. Currently, US equities are trading near their historical average while Non-US equities are trading at discounts, both well below where they started the year. While valuation attractiveness alone is not a catalyst, it does suggest that patient, long-term investors could be rewarded for not overreacting and panic selling.

Q3 Performance

US Large Cap	-4.9%
US Small Cap	-2.2%
Non-US Developed	-9.3%
Emerging Markets	-11.5%
Treasuries	-4.6%
Investment Grade	-5.1%
High-Yield	-0.6%
Oil	-24.8%
Gold	-8.1%

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