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PRIVATE WEALTH

SANCTUARY ASSET MANAGEMENT

CIO CORNER

August 2022

A WORD FROM
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Chief Investment Officer

August data, notably inflationary data and the jobs report, will be paramount for investors after Fed Chairman Jerome Powell made it clear at his most recent press conference that the Fed's September interest rate decision will depend heavily on economic data.

With potential peak inflation and peak investor pessimism in the rearview mirror, I remain cautiously optimistic as the current investment playing field should continue to reward. After the S&P 500 had its best July since 1939, Q3 has unequivocally kicked off with a bang with the benchmark index's largest monthly percentage gain since November 2020, surging 9.2%.

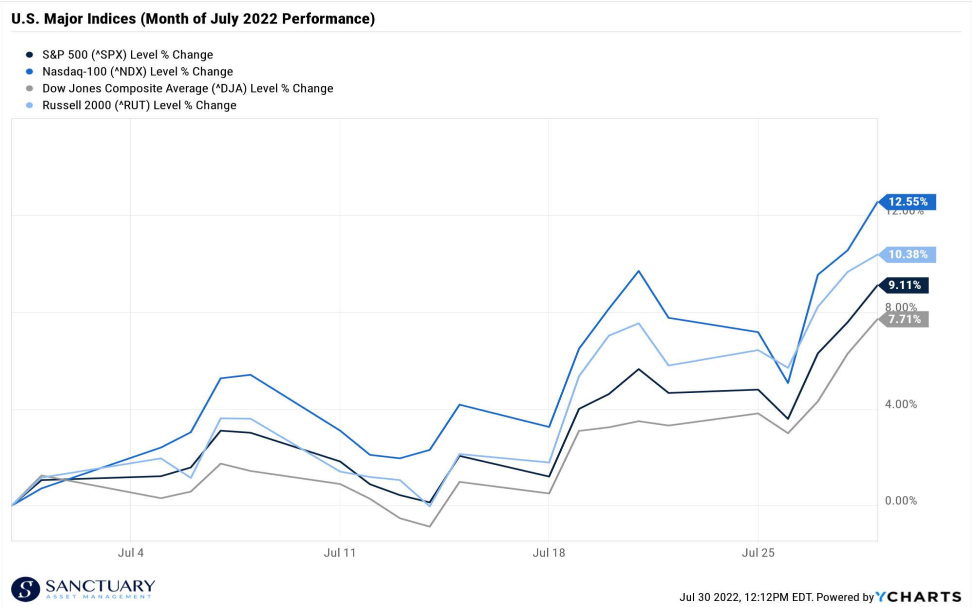
Equity markets found significant footing in the month of July as investor sentiment soured significantly in the first half of 2022. Various market participants back in late Q2 warned that earnings season would reveal massive deterioration of corporate earnings and that a recession in the United States was imminent. Neither prediction materialized. Estimates for the second half of the year, while slightly lower than a month ago, are still showing impressive gains, now expected to expand 8.8% for all of 2022, according to Refinitiv. Stocks rallied to close out the month of July, assisted by better-than-expected earnings reports and a new perspective that the Federal Reserve may not be as aggressive as its initial forecast when it comes to interest rate hikes, a.k.a. "less hawkish."

In the same manner that college football is back this month of August, so is the equity market. ("Week Zero" kicks off the season on Saturday, Aug. 27. Most other FBS programs will begin their season in traditional Week 1 action the following weekend.) Investors still have significant concerns to contend with, including lingering inflation, persistent supply chain issues and tightening Fed policy. However, my lonely view back in mid-June that the stock market (shared on CNBC) had found a bottom for 2022, is now being embraced and even echoed by certain investors. My conviction was fortified after the yield on the 10-year note capitulated with a 3.49% close on June 14th.

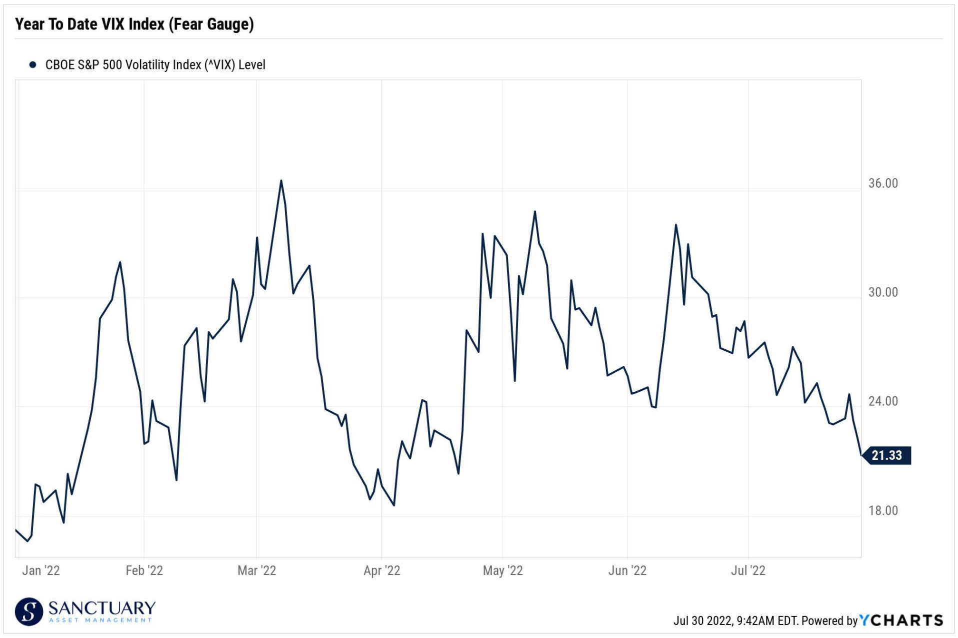
im·por·tant
adjective: of great significance or value; likely to have a profound effect on success, survival or well-being

One of my most valuable lessons or acronyms that I learned from my college football days playing at Notre Dame was "W.I.N." It stands for "What's Important Now."

As markets will continue to be volatile for the balance of the year, focusing on rebalancing, repositioning and tax loss harvesting will remain at the top of the list in regards to "W.I.N." for investors. Closing out the first month of Q3 for July, stocks finished higher across the board, with the S&P 500 turning in its best month in almost two years. The S&P 500 leaped 9.2% higher, while the Dow Jones Industrial Average rose 6.7%, the strongest monthly showing for each index dating back to November 2020. Led by Mega Tech names like Apple & Amazon, the Nasdaq rocketed 12% higher for its best month since April 2020.



Investors have recently found comfort in the idea that slowing economic growth might persuade the Fed to raise rates at a slower clip or even force considering a policy pivot, as 2023 is not too far off on the horizon. The fact of the matter that earnings season is not as "grim" as expected has also served as a catalyst. However, many skeptical traders I speak with daily are debating whether equities can hold on to these higher technical levels with headwinds like continued monetary tightening and troubling signals about the economy. This skepticism is revealed in the continued elevation of volatility represented in the CBOE's VIX index, closing the month above 21.

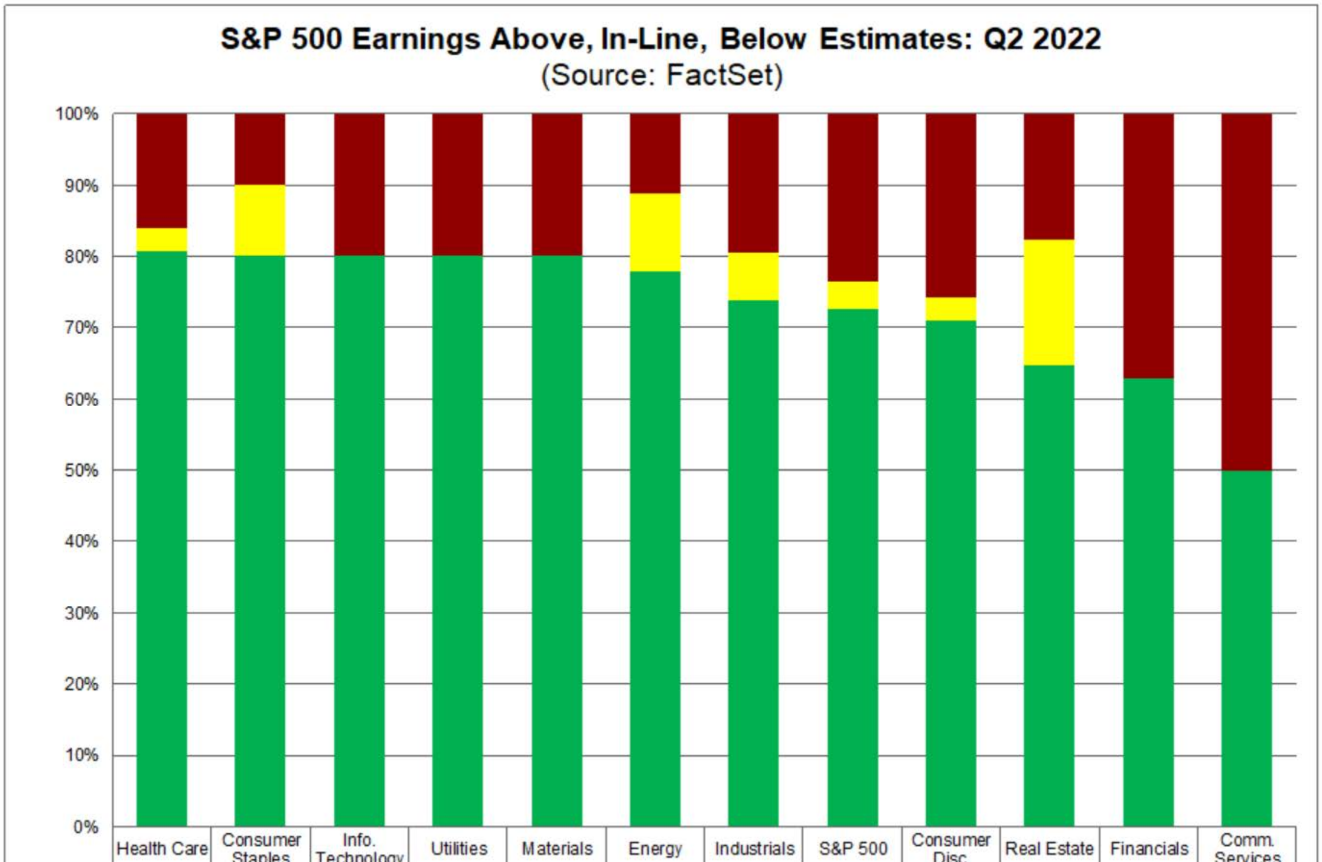


A VIX of 16 means expectations for daily S&P 500 realized movements, either up or down, are 1%. The VIX is a real-time index that represents the market's expectations for the relative strength of near-term price changes of the S&P 500 Index (SPX).

Despite the all-out blitz of a start to Q3, the S&P 500 alongside other U.S. major indices are still significantly off their highs. The S&P started 2022 way up at 4766, more than 600 points, or 600 "handles" in pit trading vernacular, higher.

Earnings Season: Mega tech has led recent gains, with Amazon and Apple adding almost $200B in market value after blowout revenues. The better-than-expected earnings season is fueling speculation that our economy will weather the perfect storm of inflation, rate hikes and slowing growth. Forward guidance has become the "W.I.N." of this earnings season. This was wildly apparent in Microsoft's Q2 earnings release. After initial selling pressure in $MSFT upon earnings data release, Microsoft shares swiftly reversed course and rose 5% in extended trading, as the software maker issued an extremely upbeat income forecast for fiscal year 2023, despite issuing quarterly results that missed on the top and bottom lines. Additionally, Energy and Health Care sectors have been considerable contributors to the increase in the earnings growth rate to close out the month of July and have been the largest contributors to the overall increase in earnings for the index since the end of the second quarter on June 30.

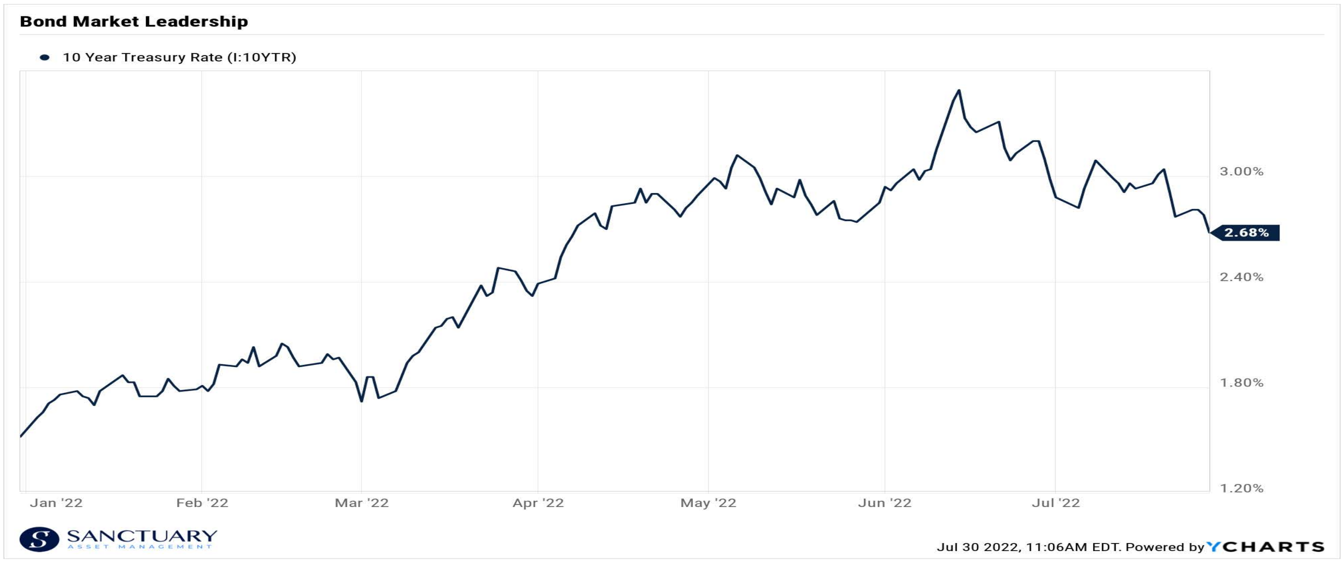
Thus far, more than half (56%) of S&P 500 companies have delivered Q2 2022 earnings reports. Of these companies, 73% have beat EPS estimates, which is impressive against this global macro backdrop, but still below the five-year average of 77%. Overall, companies are reporting earnings that are 3.1% above estimates, which is better than expected yet again, below the five-year average of 8.8%.



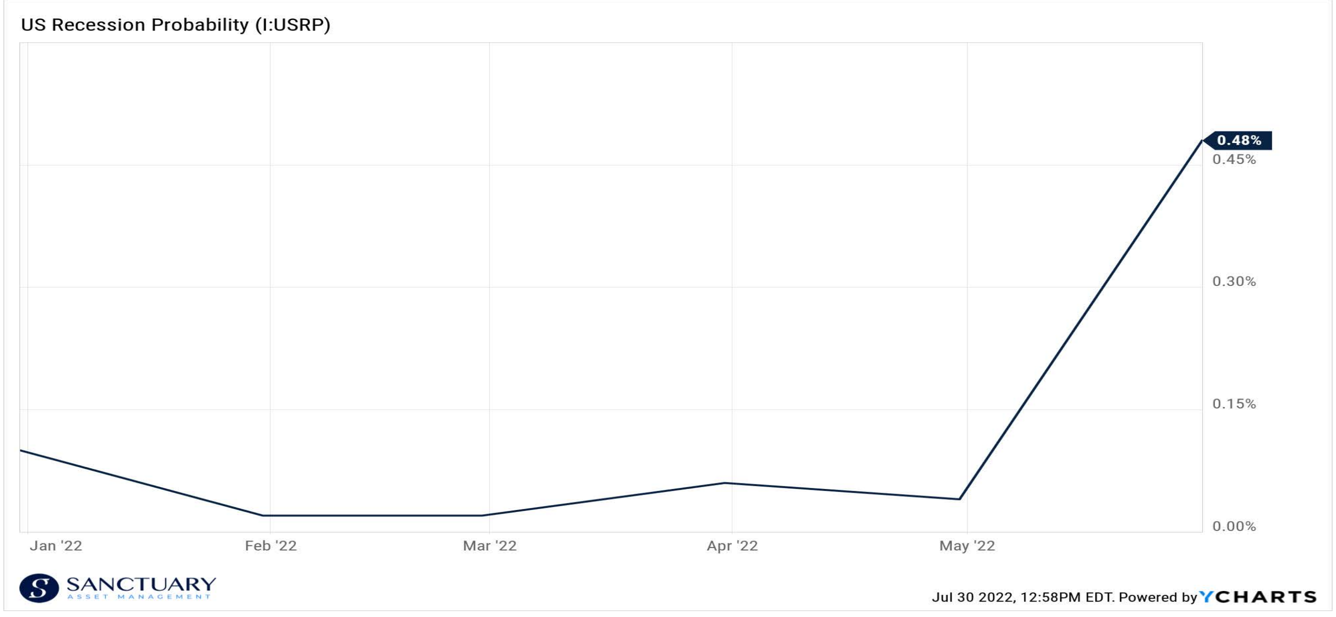
	Health Care	Consumer Staples	Info. Technology	Utilities	Materials	Energy	Industrials	S&P 500	Consumer Disc.	Real Estate	Financials	Comm. Services
Below	16%	10%	20%	20%	20%	11%	20%	24%	26%	18%	37%	50%
In-Line	3%	10%	0%	0%	0%	11%	7%	4%	3%	18%	0%	0%
Above	81%	80%	80%	80%	80%	78%	74%	73%	71%	65%	63%	50%

Federal Reserve: The Fed implemented a widely expected second consecutive 75-basis point interest rate hike in its July meeting, as Chairman Powell seeks to fight runaway inflation without tipping the economy into recession. The Fed Chairman highly telegraphed this recent move in interest rates in order to overtly exhibit to markets that the Fed remains serious about combating inflation. In 2022, it has now delivered 4 rate hikes into the marketplace inside of four consecutive meetings of 25 bps, 50 bps and back-to-back historic 75 bps. This has moved the Fed funds rate to a range between 2.25% and 2.5%. Chairman Powell dropped guidance on the scale of the next rate hike and acknowledged that "at some point" it will be appropriate to slow the pace of increases. This was an absolute touchdown for equity investors as the S&P 500 surged more than 5% in the wake of Fed Chairman Powell dropping the microphone.

U.S. Treasuries: I rely upon my years of trading U.S. Treasuries in the Chicago Board of Trade (CBOT) pits to help better understand global markets and it also serves as heavily weighted input for my forward guidance specific to equity markets. I believe bonds remain the guiding light in this endeavor as the debt instruments provide overall market leadership, and it is important to remember that the fixed income markets are larger than equity markets on a domestic and global playing field. My lonely opinion was that after touching 3.5% in June, the 10-year note would have the ability to drop back down under 2.75%, allowing equity markets (specifically the Tech sector) to heal upon this pull-back in yields. The yield on the benchmark 10-year U.S. Treasury note indeed fell in the month of July to close lower at 2.68%, the lowest yield investors have seen since April. The hecklers on Twitter have subsided too, for now that is.



Recession or No Recession?: The U.S. economy shrank again in the second quarter, the Bureau of Economic Analysis stated. GDP (Gross Domestic Product), a wide-ranging measure of economic activity, fell by 0.9% on an annualized basis from April through June. That negative "print" marks a key symbolic threshold for the most commonly used (yet often refuted) definition of a recession as two consecutive quarters of negative economic growth. This GDP data will be revised two more times and was arguably driven mostly by a decline in inventory levels. I believe that this negative GDP data was taken in stride by investors due to investors now betting that the Fed will have to slow down its hiking. Since the economy has now contracted two quarters in a row, some economists say it is a "technical recession." Others disagree on the premise that it is not yet a real recession because of labor market strength and other factors.



Energy Sector: The energy sector hit a multiyear high in June but has been down 18% since then. Still, energy stocks are by far the top-performing group this year, advancing 35%. Utilities is the second-best performing sector, with a near 3% gain.

Select Sector SPDR ETFs

Oil Names: Oil and gas stocks should continue their outperformance in light of the tight crude supplies and high inflation. Exxon (XOM) and Chevron (CVX) posted record profits during Q2, as high commodity prices boosted operations and the oil kings kept spending in check.%.

Mid-term Election Year After: As previously mentioned in my Outlook 2022, the typical year average is 6.8% Then there's Q4, which normally rises 4.1% on average. But in mid-term years, the S&P 500 has bounced even harder, averaging a 6.4% advance. Looking back at the entire 85 years as we did, you may recall that the average return of the S&P 500 for the year after the mid-term election year is 15.1%.

Elon Musk: Elon Musk countersued Twitter to end the month of July, ratcheting up the fight between the social networking company and the Billionaire, all details were hidden from the public. It is a bit of a head scratcher as to why Musk asked the court to keep details of his countersuit confidential, as he has been crushing Twitter with critical and taunting tweets on the very same social media platform that he agreed to buy and take private for about $44 billion back on April 25th, 2022. Stay tuned. This is just getting warm.

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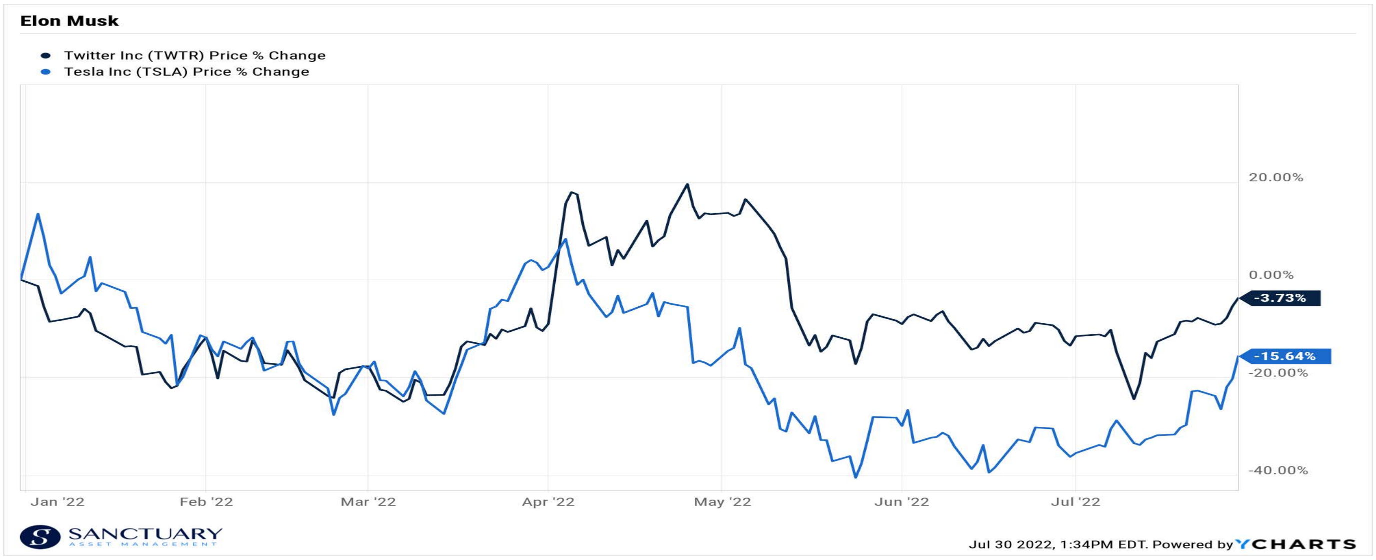

POSITIONING FOR AUGUST

With earnings season surprising investors to the upside and with investors not having a Fed meeting on the calendar this month to obsess about, my cautious optimism for U.S. equities persists. However, I am not forecasting for volatility to abate yet, as I do envision additional tumult as the summer plays out. In addition, I believe that there is unfinished business due to the lack of volume that has transpired between the 50-day moving average and the old support/new resistance level previously articulated at 4170 specific to the S&P 500 (SPX). There may be a potential game of “Pong” to be played here in the S&P 500 for any of my fellow Atari lovers.

Key Takeaway: I continue to favor essential names that offer a large-cap blend of value and growth. The Essential 40 model portfolio seeks exposure to blue-chip, value orientated companies with strong balance sheets. This model portfolio’s equal weighted design has had the ability to mitigate risk in 2022, while still offering opportunity to participate in snap back rallies like we recently enjoyed in late July. Furthermore, being mindful as well as considerate to your sector exposure should allow for potentially better outcomes in portfolios as the massive sector dislocation remains a significant theme in 2022. Lastly, I believe it has been a quite advantageous time to utilize this pullback in equity markets to evaluate any tax loss harvesting opportunities to potentially raise the cost basis in a portfolio and attempt to mitigate unrealized tax consequences.

Please reach out to further discuss at any time.

Best,

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