UNIQUE WEALTH

Executive Summary: August 2022 Unique Wealth Market Commentary

The U.S. equity markets, as represented by the S&P 500 index, rose an impressive +9.1% in July while the technology-heavy Nasdaq Composite Index rose +12.4%. This was the best monthly price performance for the S&P 500 since November 2020 (which, with the national elections and the announcement of a Covid-19 vaccine, featured a gain of +10.8%). The primary stimuli for financial markets' July advance were: (i) better-than-expected corporate profit reports; (ii) meaningful declines in U.S. Treasury security yields from their mid-June highs through July's close, and not least, (iii) gradually increasing investor perceptions that the Federal Reserve may not have to be as aggressive in tightening monetary policy as once thought (in part due to a first-half 2022 US real GDP contraction).

Factors Likely to Exert Significant Influences on Financial Asset Prices

(i) **Inflation:** Inflation rates appear to be peaking and are likely to trace a downward path to allow the authorities at the Federal Reserve to reduce the degree of restrictive monetary policy later this year or after the New Year. This "peak inflation" argument is supported by a decline in commodities across the board (i.e. oil, lumber, industrial metals). A big risk for the Fed and markets is inflation becoming anchored enough in psychology, behavior, and labor costs to remain elevated well above the Fed's +2.0% targeted annual pace of inflation.

iii. **Monetary Policy & Interest Rates:** The big question around monetary policy is whether the Federal Reserve will continue tightening well into 2023 (and beyond, if necessary) to quell inflationary pressures, or begin the process of easing policy by lowering the Fed Funds Rate sometime after the beginning of the 2023 calendar year. As of early August, the futures market pricing shows less than 100 basis points (+1.00%) of additional increase in the Fed Funds Rate by year-end (to a range of 3.25-3.50%), followed by rate cuts in 2023.

(ii) **The Economy & Corporate Profits**: The market is also grappling over the strength of the economy and likelihood of a Recession, which would put downward adjustments to earnings results in the latter half of 2022 and into 2023. The economy recently met the "technical" definition of a Recession, as GDP contracted -1.6% in Q1 (primarily due to poor performance of net exports) and -0.9% in Q2 (primarily due to inventory drawdowns). Additional signs of declining economic stamina are evidenced in a rise in companies' mentions of employee layoffs, plunging Michigan Consumer Sentiment Index, a downward-trending ISM Manufacturing PMI, and low levels of Small Business Optimism. Despite warning signs from various leading indicators, the labor market remains resilient and strong.

In our opinion, in the belief that "we are not out of the woods yet" after the price-earnings multiple contraction that has taken place in the first half of this year, we expect analysts' S&P 500 earnings estimates to be revised downward further as the year progresses, which is likely to exert downward pressure on equity prices. We therefore emphasize caution and discipline in increasing exposure to risk assets, with an emphasis on quality.

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