UNIQUE WEALTH

Executive Summary: December 2022 Unique Wealth Market Commentary

The U.S. equity markets, as represented by the S&P 500 index, rose 5.4% in November for its first back-to-back monthly gain in 2022. In order for the markets to continue to rebound, investors still need to see: (i) peak hawkishness and peak inflation; (ii) the Covid conditions in China improving and the country returning to normal growth; and (iii) some degree of relaxation in geopolitical tensions in areas of armed conflict. **We expect interest rates to remain high until recessionary economic forces intensify, with episodes of volatility for longer-duration risk assets through early 2023**.
Source: Bloomberg

Factors Likely to Exert Significant Influences on Financial Asset Prices:

(i) **Fed Policy:** On November 2nd, the FOMC raised policy rates by another 75 basis points (0.75%), bringing the Fed Funds rate to 3.75-4.00%. Absent an exogenous systemic shock, the Fed appears prepared to bring inflation down even as such a stance puts pressure on domestic growth, employment, the housing sector, corporate earnings, and longer-duration risk assets.

(ii) **Inflation:** October CPI decelerated to 7.7% year-over-year from 8.2% in September. Even as M-2 money supply growth and the prices of gasoline, vehicles, medical services, and numerous goods have begun (or continued to) exhibit weakness in recent reporting periods, these declines have so far generally been more than offset by rising prices for many services and especially, shelter costs. Housing prices make up nearly 40% of the monthly CPI report and represent a chief reason why the CPI has not yet begun to meaningfully decline.
Source: The Federal Reserve

(iii) **Interest Rates:** The yield on the 3-month U.S. Treasury bill is above the yield on the 10-year U.S. Treasury bond, which is quite often an indicator of an impending economic recession. With the 10-year U.S. Treasury bond yield (3.68%) already inverted -70 basis points (-0.70%) below the 2-year U.S. Treasury yield (4.38%), an economic recession in our opinion appears likely to ensue, as restrictive monetary policy keeps short-term rates high.
Source: Bloomberg

(iv) **US Economy & Corporate Profits:** We expect a Recession due to inflation-fighting actions from the Federal Reserve and repercussions from economic slowdowns abroad (i.e. Europe). The degree of slowing (and perhaps contractionary) economic activity in coming quarters causes us to question the somewhat sanguine analysts' bottom-up S&P 500 earnings estimates for 2023.

We prefer investing in high-quality sectors, companies, and managers using proceeds from any reduced Growth exposure to select Value and Defensive sectors, companies, and managers. For fixed income, we prefer maturities and durations along the short-to-intermediate portion of the yield curve spectrum, while preparing to build (or gradually building) exposure to longer maturities and durations if recessionary forces exert damage to the overall health of the economy. As of now, we believe that financial asset prices are likely to be driven by the degree of the Federal Reserve's inflation-fighting resolve, which in turn should exert influence on the course of the economy and corporate financial results.

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