Public

This Month in the Markets

July 2022

Equity Commentary

Was that the Bottom in the Market?

On June 16, 2022, the S&P 500 hit a recent low and was down about 23% from its all-time high, while the NASDAQ had plunged about 33%. Then we began to see a reversal. July ended up being a very positive month with the MSCI ACWI Net Total Return market posting a 7% gain. The MSCI World Value Index rose 4.6% compared to a rise of 11.5% in the MSCI World Growth Index. The fall in interest rates helped propel a return for growth as discount rates fell. The S&P 500 jumped 9.2%, while the MSCI EAFE Net Total Return Index increased 5%. The MSCI ACWI Information Technology index was the top performer, soaring 12.2% on the rotation to growth and solid large tech earnings. The MSCI ACWI Communications Services Sector was the under-performer with a gain of only 1.8% as some traditional telecoms slid on disappointing earnings outlooks.

So, was that the bottom? Where do we go from here? The honest answer is we don't know for sure, but we would suggest a great deal of negative news has been priced into the market surrounding inflation-induced growth fears and struggles in Europe over the energy crisis. This does not suggest we rally rapidly from here, however. Traditional bear markets take time to recover and are often subject to fits and starts. The last two bear markets (December 2018 Fed tantrum, and Covid 2020) offered quick V-shaped recoveries but sadly this is not typically the case. Nor are the conditions anything like those prior two when the Federal Reserve came to the rescue and, at least in 2020, cash was mailed out to a host of people. Right now, the Federal Reserve is in the middle of raising rates and quantitative tightening and congress is grappling with inflation. So, what happens in a typical recovery? Verdad Advisors has produced some excellent work at looking at 50 years of bear markets.* They found the following:

	1974	1987	2001	2008	2020
Months to Recovery	56	15	52	40	4
Further Drawdown	-28%	-8%	-40%	-47%	-17%

Source: Verdad Weekly Research and CapitalIQ

So, it typically takes a while for markets to get back to even and positive and there can be subsequent drawdowns after the initial fall. As Verdad notes:

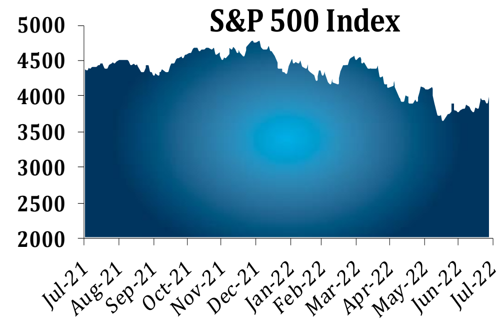
"Investors may have sighed a breath of relief in July after months of pain. And perhaps we have already seen the market's 2022 lows and this recovery will follow the rapid pace of 2020. But a broader set of base rates suggest there's reason to be cautious, that risk is still elevated, and that we might yet experience an even more significant drawdown."

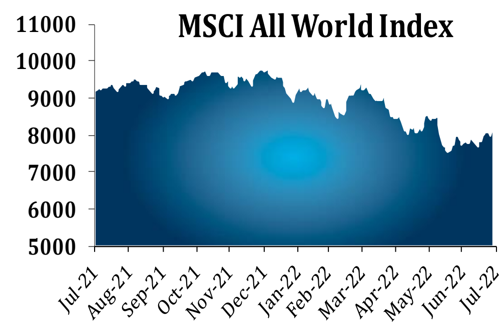
BAE Systems was the largest underperformer in the portfolio for the month, with a decrease of ~7% after the market rotated away from recent winners and value to more speculative growth names. The top performer in the month was Fiserv, up ~19%, which posted solid earnings and raised guidance for the year.

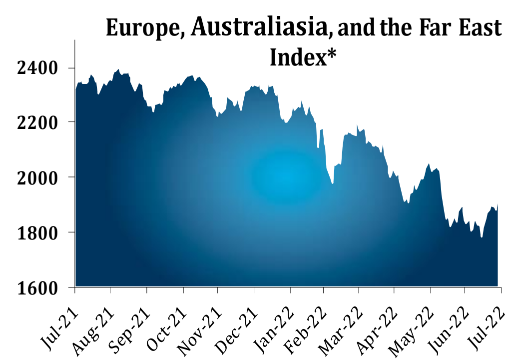
During the month, we exited ASML Holdings NV ("ASML") and Freeport McMoran Inc. ("FCX"). Our disposal of ASML revolved around our concerns surrounding sales to China which are being pressured by political concerns in the U.S. and the cyclicality surrounding semi-conductors. Our sale of FCX acknowledges the rapid fall surrounding copper prices and pressures near-term due to global concerns around the Chinese property market contraction and recession fears.

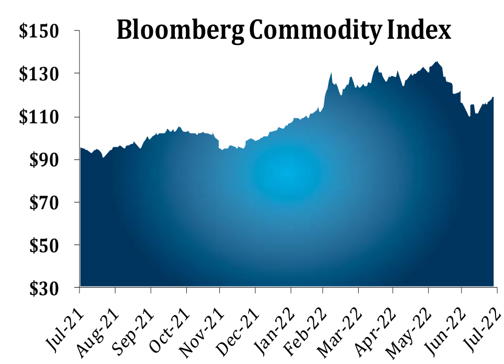
In July we bought two positions of the Vanguard Total World Stock ETF to maintain equity exposure and as placeholders as we await greater visibility from the quarterly reports of Anchor's watchlist companies.

* "Drawdowns and Rallies – Making sense of recent volatility", by Verdad Weekly Research, August 1, 2022, https://mailchi.mp/verdadcap/drawdowns-and-rallies-1306381?e=f723cc4151









*MSCI EAFE Index

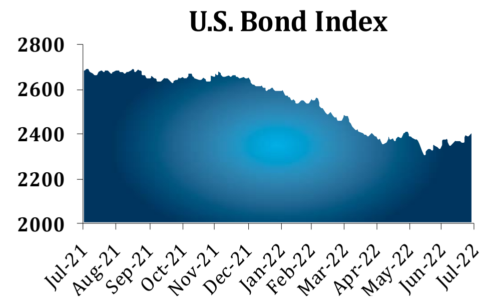
Fixed Income Commentary

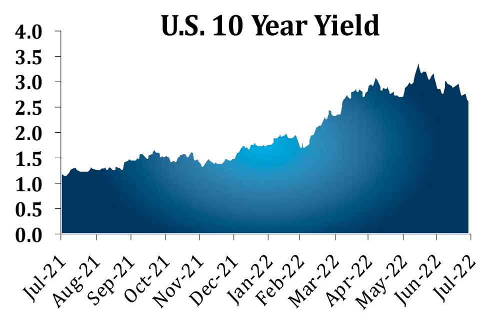
Policy Rates Move Higher

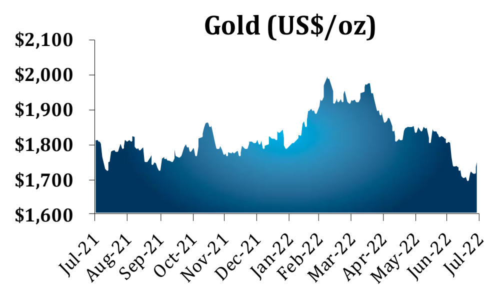
The European Central Bank (ECB) raised its deposit rate to 0.50% from 0% in July; marking the first time in 11 years it has raised rates. With inflation running well above target and rising, it was widely expected that they would increase the deposit rate, though the size of the hike was larger than consensus expectations. Unlike the Fed, the ECB does not have a dual mandate. The ECB's mandate is to maintain price stability (2% inflation target over the medium term). ECB President Lagarde commented that future deposit rate decisions would be taken on a "meeting-by-meeting" approach. Also, the ECB announced the launch of the "Transmission Protection Instrument" (TPI). The TPI is an antifragmentation tool to be used if, through the course of monetary tightening, some countries borrowing costs rise materially higher than others. For example, Italy's borrowing costs relative to Germany's. The ECB was purposely vague on the details of when the facility could be used, only citing fiscal and macroeconomic generalities. The ECB wants the market to know that they can act to keep borrowing costs for the more vulnerable/weaker countries from rising too quickly… and because of this ability, borrowing costs shouldn't spiral for the more vulnerable countries. The ECB is tightening monetary conditions in a slowing European economy hurt by surging energy prices. We may get a chance to see how the ECB's theory holds up.

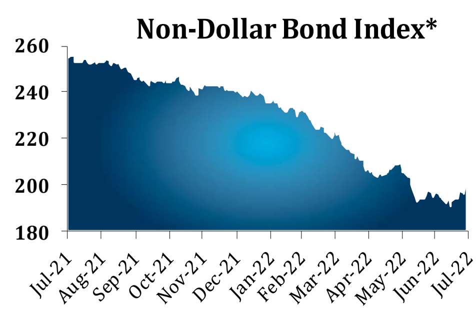
In late July, the Federal Open Market Committee (FOMC) raised the fed fund rate (range) by 0.75% to 2.50%. This was the second 0.75% increase in a row and brings the fed funds rate in line with the Fed's estimation of the "neutral rate" – the rate at which there's full employment and price stability. Given that the neutral rate can only be observed in retrospect, it's a bit of a wonky central banker idea/term. Nonetheless, now that the Fed has reached a neutral monetary policy, Powell commented they would also move to a "meeting-by-meeting" approach (like the ECB) for future fed funds hikes. They want to be "nimble" as they progress through the hiking cycle. After all, the Fed doesn't want to overtighten and cause a recession. Leading indicators for growth have turned down meaningfully as per PMI indices, consumer sentiment surveys, and housing data. Meanwhile, reported inflation is well over the Fed's 2% target. The June Consumer Price Index (CPI) reading was +9.05% YoY (released in July), while the Fed's preferred inflation measure, the core Personal Consumption Expenditure (PCE) deflator, rose +4.8% YoY. Summing it up, we have leading indicators for growth quickly deteriorating, while inflation (lagging indicator) is uncomfortably above target..

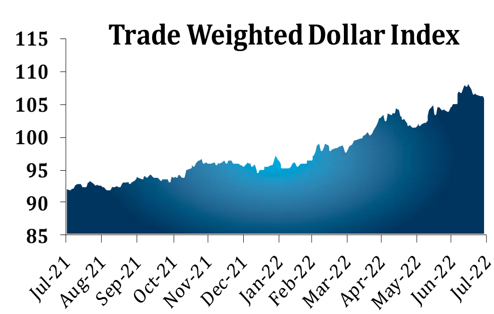
This dichotomy led some market participants to expect the Fed to pivot away from its sole focus on inflation to a more balanced approach where the economic slowdown was outrightly acknowledged. In the FOMC press conference, Powell did note that "spending and production have softened." He also reiterated the need to bring down inflation, saying, "this process is likely to entail below economic trend growth and some softening in labor market conditions." Not exactly an encouraging statement. Nonetheless, stock and credit markets rallied on the news, interpreting Powell's comments as less hawkish than in previous meetings. Interest rates also declined, continuing the trend that started in June. The 10-year treasury fell 0.37% to 2.64% in July, handily outpacing the decline in the 2-year treasury. As such, the yield curve is inverted with the 2-year treasury yield almost 30 basis points higher than the 10-year yield. The dollar also declined off the back of Powell's press conference as proxied by the DXY index. Fewer hikes would lessen the USD's interest rate differential advantage over other developed market currencies. Time will tell if this was, in fact, a policy pivot by the Fed…











*Merrill Lynch Global Broad Market, Ex US Dollar Index

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