

Things That Matter

Cerity Partners Investment Committee

October 3, 202

Another difficult week in the markets ended a tough month and the third consecutive down quarter as the summer advance turned out to be merely a bear market rally when the Fed became even more aggressive in both its rhetoric and actual tightening stance to fight the sticky published inflation numbers.

Europe Struggles Greatly & the UK is Playing with Fire

The concern that the monetary authorities will tighten "until something breaks" became a little too real last week and into this week. The UK gilt market pushed back strongly on the new government's tax cutting initiatives as they will cause burgeoning budget deficits if not accompanied by spending cuts. Along the same lines, the pound sterling also sold off sharply until the Bank of England intervened mid-week and announced they will purchase long-dated gilts to stabilize the market. It also said it would delay bond sales in their balance sheet reduction plan.

- This effective resumption of Quantitative Easing worked (at least for now) in stopping the bleeding, but at a big hit to the UK's credibility. Standard & Poor's put UK government debt on credit watch Friday evening, and the government this morning was forced to backtrack on one of the proposed tax cuts...and may even have to scrap the plan as the "bond vigilantes" have returned to the global fixed income markets as the central banks slowly remove themselves.
- Europe has a worse inflation problem than we have in the US as sharply higher energy prices caused September inflation to accelerate to 10.0% year-over-year, from 9.1% in August as energy was up 40.8%(!) and food was +11.8%. Core inflation also rose to 4.8% year-over-year from 4.3% in August. This should embolden the ECB to increase the magnitude of its rate increases at upcoming meetings.
- In what is being described as Europe's potential "Lehman Moment", Credit Suisse saw a spike in its credit default swap yields and a record low in its stock price, on concerns about its financial strength. While capital appears ample at an over 13% Tier I ratio, confidence in the ability to provide liquidity – and ultimately solvency – is so important to the bank's ability to operate effectively in the capital markets.
- Oil prices spiked higher this morning as OPEC + Russia are reportedly set to cut output by as much as 1.5 million barrels per day at this week's meeting. This is an apparent reaction to prices breaking below levels seen prior to the Russian invasion of Ukraine. The effectiveness of production cuts in meaningfully increasing prices remains to be seen, but it should at least stop the declines in oil and gasoline prices that were brought on by slower global economic growth.



- > US economic statistics reported last week confirm an economy that grew in the third quarter, but at a rather slow rate with inflation showing signs of declining, but not yet fast enough for the Fed to take its foot off the monetary brakes.
 - There is little doubt that the housing sector is in recession, but any downturn should not be nearly as deep as seen during the financial crisis, as inventories are not nearly as bloated. August new home sales saw a big surprise to the upside and were up 29% month-over-month, likely due to the mid-summer dip in mortgage rates. Pending home sales declined 2.0% on the month to the lowest level since 2011, and importantly, home prices appeared to have begun their inevitable decline this summer as the July Case Shiller home price index was down 0.8% while the FHFA index was down 0.6% month-over-month. It will take some time for these price declines to translate into the shelter inflation statistics.
 - Business spending is holding up rather well, as reflected in the August durable goods report. While the headline number was down 0.2% and in line with estimates, core (non-defense, ex-aircraft) orders were up 1.3%, well over the estimate of no growth, and there was a nice upward revision to July. Inventory replenishment continues at perhaps too high a rate, which should remove some inflationary pressures.
 - Consumer sentiment and spending is also defying calls for a collapse, as the summer decline in gasoline prices plus continued jobs and wage growth helped both the Conference Board and U. of Michigan surveys to improve month-overmonth in September. Inflation expectations in these surveys saw declines, although this could be largely due to recency bias from lower gasoline prices. August personal income was +0.3% and in line with estimates while consumer spending was +0.4%, double the +0.2% estimate as consumers reached further into their savings to make purchases. Within this report is the closely followed PCE inflation, which like the August CPI reports earlier this month, showed only scant improvement.



Inflation, Employment...and Earnings

As we anxiously await the third quarter earnings season, there were some pre-announcements of note, that were reflective of mid-year macroeconomic trends. Nike reduced their gross margin guidance by 200 bps to reflect markdowns needed to clear excess inventory. While the company maintains that demand remains strong, this is a trend seen in several goods producing companies where very strong 2021 demand was extrapolated into this year, as consumers shifted their purchase preferences away from goods toward services. Along the same lines, Apple scrapped their plans to increase iPhone 14 production and Micron guided down on weakening end market consumer demand for semiconductors.

Thoughtful Investing in Turbulent Times

With everything going on in the world – Inflation, Ukraine, Earnings, The Fed, etc. – it can be easy to get caught up in the moment. It is important at times like this to remember that timing the markets is often a fool's errand. The history of investing has continually had terrible events occur. It is better to focus on time in the market as opposed to timing the markets.



The Tightening Continues

Rising rates and the dollar continue to tighten financial conditions



Source: YCharts



The Pressure from the Fed Is Hitting Asset Markets

Will the 3rd stool of monetary policy, financial stability, start to matter?



Source: Datastream, @MacroAlf; @carlquintanilla, Bespoke Investments



Inflation Persists

The buoyancy of inflation has boxed in the Fed





Source: FRED, Fidelity @TimmerFidekity



Not As Bad as 2008

A 60/40 portfolio has struggled in 2022





Source: YCharts



Time in the Markets vs. Timing The Markets

January 1, 1995 – September 29, 2022



Source: Strategas



Dow Jones Industrial Average

122 years of (mostly) bad news

		High: 36799.65 High Date: 1/4/2022 Low:	: 41.22 Low Date: 7/8/1932 Last Date: 9/29/2022	
 DJ 30 Industrials Average 	e - Price (Right) Recess	ion Periods - United States		- 6 - 5
			2018	- 4
900 Gold standard	1931 USA wide bank closings		correction	- 3
901 McKinley shot	1932 RFC provided state aid & loans	1956 Suez Canal	Correction and 4	
02 Panama Canal	1933 New Deal & FDIC	1957 Sputnik USSR wins	year recovery	
03 Wright brothers up & away	1934 SEC established	1958 US launches satellite	vear recovery	- 2
05 Russo-Japanese War	1935 Social Security enacted	1959 St Lawrence Seaway	,	
06 San Francisco earthquake	1936 Dust Bowl	1960 First Japanese cars in US; U2 shot down		
07 Financial Panic	1937 Massive strikes	1961 Berlin Wall; Bay of Pigs		
08 Model T Ford	1938 Fair Labor Standards Act 1939 War in Europe, Strikes in US	1962 Cuban Missile crisis		$-\frac{1}{9}$
09 Peary reaches N. Pole 10 Democrats in house 1st time in 16 ye		1963 JFK assassinated 1964 Vietnam War; Gulf of Tonkin		- 8
10 Democrats in house 1st time in 16 ye 11 Standard Oil Trust busted	1941 Pearl Harbor	1964 Vietnam War; Gulf of Tonkin 1965 Great Inflation starts		- 7
11 Standard Oil Trust busted 12 RMS Titanic	1942 Price Controls	1966 Medicare: US hombs N Vietnam		- 6
13 Welcome Income Tax!	1943 Withholding Tax introduced	1967 Six Day War	on and	- 5
14 WW1 & Federal Reserve	1944 D-Day	1968 Tet Offensive; RFK & MLK assassinated 3 ye	2ar 1985 Gramm Rudman, US becomes debtor nation	- 4
15 Lusitania sunk	1945 War ends; Cold War starts	1969 Apollo 11 reco		- 4
16 New taxes and Estate Tax	1946 Stock crash	1970 US invades Cambodia; Kent State	1987 Market crash	- 3
17 US declares War on Germany	1947 Taft-Hartley Act and Marshall Plan		1988 World Trade 1; Lockerble	
18 Armistice and Daylight savings	1948 Truman beats Dewey		1989 Berlin Wall down, Panama 1990 First Gulf War	
19 Prohibition Ratified	1949 Currencies devalued		1991 Gulf War cont'd; Soviet Union collapses	2
20 Women's Suffrage	1950 Korean War begins	Correction and 6	1992 Bosnia Civil War	
21 Immigration restricted	1951 Color TV	Correction and year recovery	1993 Russia Turmoil, World Trade Ctr 1	
22 War on Drugs 1	1952 Steel workers strike	3 year recovery	1994 Orange County bankrupt; NAFTA 1995 Oklahoma City bombing	
23 First Transcontinental Flight; Japan	1953 Korean War ends		1996 "Irrational Exuberance" speech	1 9 8
rthquake	1954 St Lawrence Seaway Bill		1997 Asian Currency and stock crisis	_ 9
24 Ford 10 millionth auto	1955 Eisenhower suffers heart attack		1998 Yen supported; Kenya embassy 1999 NATO bombs Serbia; Columbine	- 7
	Correction and 25 year		2000 Election crisis, USS Cole	- 6
26 Decrease in income tax 27 First non-stop US flight	recovery		2001 World Trade Ctr; Enron	- 5
28 Amelia Earhart Flies Atlantic		1971 Wage & Price controls	2002 Afghanistan invaded; corporate scandals	
29 Stock Crash		1972 Watergate Break in	2003 Iraq War 2004 War on Terror	- 4
30 Smoot Hawley tariffs	Correction and 10	1973 Oil embargo	2005 Oil at \$140	- 3
	year recovery	1974 Nixon resigns; ERISA signed	2006 Housing decline starts	- 3
		1975 Saigon falls, May Day commissions	2007 Full blown financial crisis	
orrection and 3 year		1976 Lockheed Scandal	2008 Financial Failures: Credit Suisse, Lehman, Bear Sterns 2009 War on terror, financial stimulus, Fed interventions	- 2
recovery		1977 Panama Canal to Panama	2010 EU Crisis; Greece	
		1978 Humphrey Hawkins on Fed Full Employment Bill	2011 Debt celling nonsense; US credit downgraded	
	6 1 7 W1WL5	1979 3 Mile Island Iran Hostage	2012 EU debt and US Fiscal Cliff	
		1980 Iraq invades Iran War, Silver market	2013 Boston Bomb; US Gov't shutdown 2014 ISIS; Police protests	_ 1
		1981 Tax cut; Reagan shot	2015 EU terror attacks; China Slowdown	9
		1982 Penn Square Bank, Falklands War	2016 Brexit; US election surprise	- 8
		1983 Terrorism on US forces	2017 N. Korea, trade disputes	- 6
		1984 Continental Bank	2018 Trade, Brexit, Italy, Fed independence 2019 Trade, China, Iran	-
7			2019 Hade, Cima, Han 2020 Covid-19	- 5
		-Major Conflicts	2021 Capitol storm	- 4
			2022 Ukraine	

9/29/2022

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Source: FactSet



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(10/22)

