Third Quarter
REVIEW & COMMENTARY

PETER W. TUZ, CFA, CFP®
PRESIDENT & PORTFOLIO MANAGER

CHASE INVESTMENT COUNSEL CORPORATION

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Peter W. Tuz, CFA, CFP®
President & Portfolio Manager

Cruel September

Forget April, September has again proved itself to be the cruelest month of the year for investors. In the one just ended; the S&P 500 Index ('S&P 500') fell 9.2%. Other major indices acted in like manner: the Dow Jones Industrial Average fell 8.8%, and global indices such as the iShares MSCI EAFE ETF (EFA) fell 9.2% while the iShares MSCI Emerging Market ETF (EEM) fell 11.2%. Year to date, the S&P 500 is down 23.9%, its worst performance since 2008's financial crisis when it fell 36.6%.

Bonds have not been any help to portfolios this year. The iShares Core U.S. Aggregate Bond ETF (AGG) fell 5.3% in the quarter and is now down 16% year to date. The 10 year U.S. Treasury yield on September 30th was 3.83% versus 1.51% on December 31st. Cash has become a much better investment alternative than it has been in several years with two-year T-notes now yielding nearly 4%, although this is still a negative "real" return when inflation is running at 8% plus, it is far better than the 1% levels a year ago and a reasonable place to invest in until markets regain positive momentum.

It is helpful to put this year's market action in perspective. In 2019, 2020 and 2021, the S&P 500 grew by about 99%, so a down year, even a big one, should not be that unexpected.

The main culprits of the third quarter's weakness remain the well-discussed topics of inflation and interest rates, plus a large dose of international turmoil. As the accompanying charts show, inflation might be down a tad from its June 2022 rate, but it is still above 8% while Fed Funds Rates have now gone up five times in 2022 to the 3.00% to 3.25% range with one or two rate hikes likely to push rates to 4.25% - 4.75% by year-end.

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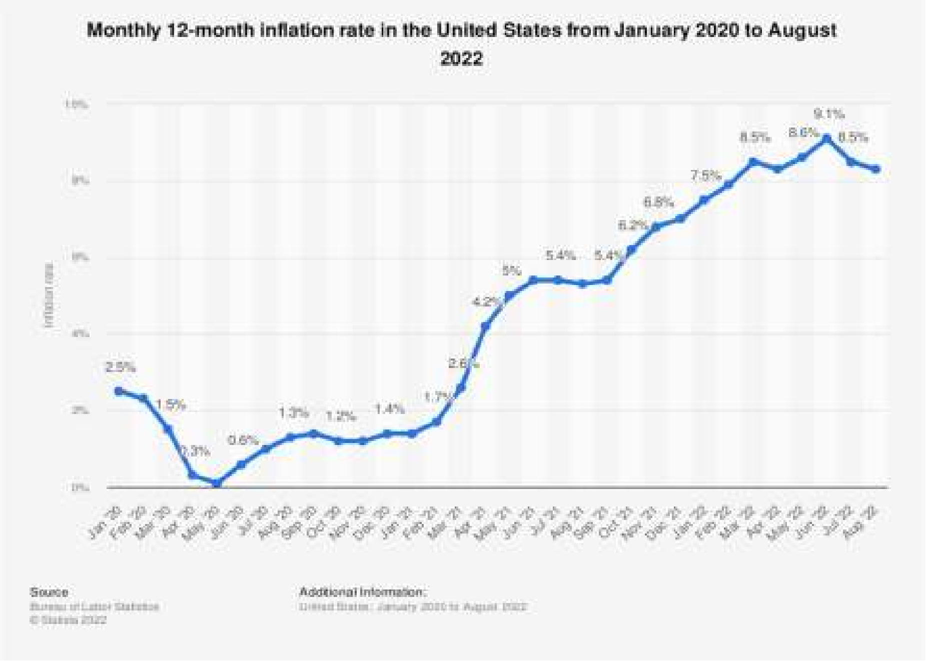

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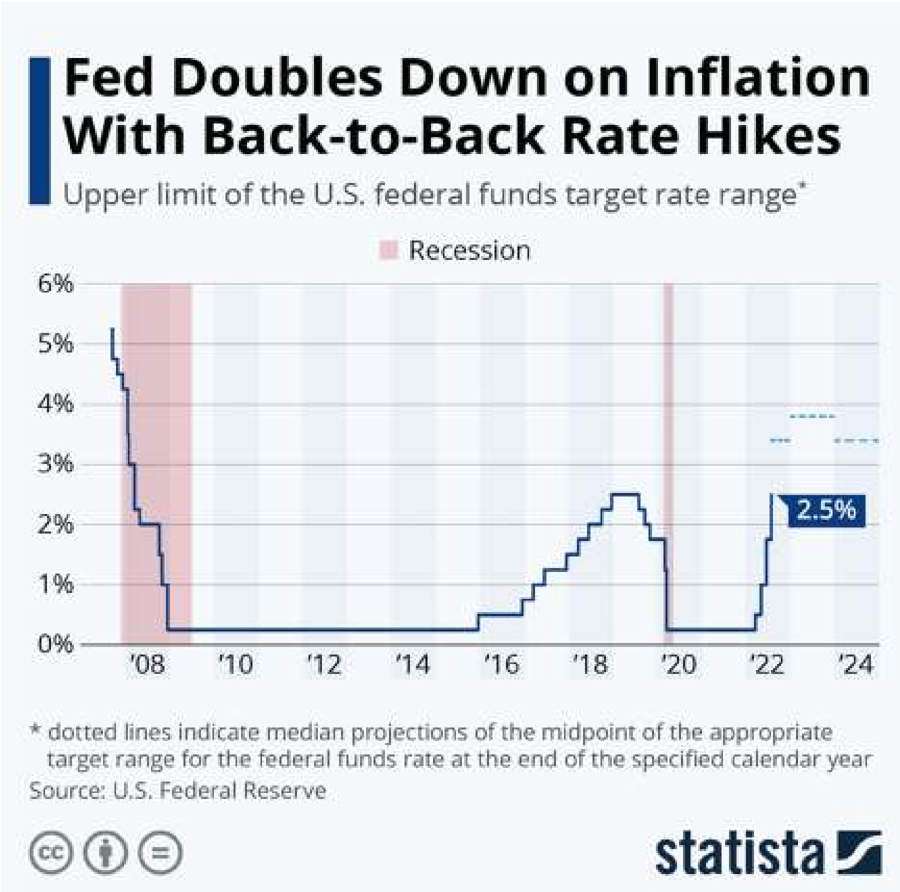

There are many signs of a slowing U.S. economy. There are some, but fewer, signs of a pending recession. Historically "inverted" yield curves (a condition where short-term interest rates are higher than long-term rates), have predicted recessions, sometimes falsely. Surging oil prices as we had in the early and late 1970s predicted others. But other signs of a declining economy are more muted.

Driven by higher mortgage rates, housing sales in the U.S. are now 20% below last year's levels. Commodity prices in general are now near pre-pandemic levels with copper, lumber and steel down 31%, 70% and 33% from their peaks. Unemployment rates in the United States have started to creep up although still low by historic standards. The stock market, is itself a leading market indicator and, as noted it is down about 24.0% from its January 3, 2022 high.

The S&P 500 is now selling for 16.7 times expected 2022 earnings and 15.8 times expected 2023 earnings. These multiples are not out of line with historical averages. A reasonable question to ask, however, is how accurate the estimates are, especially going forward. Next year's consensus S&P 500 estimate of $239.13 is 6% higher than the current 2022 consensus of $226.41. With consumer spending at many retailers looking dubious, a strong U.S. dollar affecting many large U.S. exporting companies and energy companies unlikely to have as strong year in 2023 as in 2022, those estimates are likely to drop, something we will start to see when third-quarter earnings begin coming out in coming weeks.

We all wonder what will happen next – continued pressure or a resumption of gains going forward.

As always, there are positive and negative things to consider going forward:

The positives include:

- Markets are at near-record levels of pessimism according to the AAII sentiment indicator.
- Investors holdings of cash is also at near-record levels. This money could go into stocks.
- In addition, valuations of the S&P 500 are now hovering near long-term averages.
- Both the strong seasonal part of the year and positive election year cycle are drawing close.
- October is often known as the "bear killer," the month many bear markets have ended.

There are also multiple negatives:

- Inflation continues to run at about the 8.0% level, and "core" inflation at about 5%.
- Interest rates are likely to be raised two or three times more at least.
- Many parts of the economy are slowing, especially housing.
- Higher interest rates will only add to an already large U.S. budget deficit.
- Corporate earnings and guidance for Q3 and beyond may be weak.
- Global turmoil shows few signs of abating any time soon.

Historically, markets go up a lot more than they go down. Over the past 96 years, the S&P 500 has gone up 69 times and down 27 times or put simply up 72% of the time and down 28% of the time. Importantly, bear markets that last more than one year are rarer still. In the

19 down markets since 1928, 15, or 79% have lasted one year, one has lasted two years, two have lasted three years and one has lasted four years. Simply put, odds favor “up” years.

As most of us know, markets tend to reflect the “known” items such as the ones above in their valuations very quickly. As former Defense Secretary Don Rumsfeld once said, “there are things we don’t know we don’t know.” And those are the things that can upset markets. The biggest one would probably be either an escalation of the Russia-Ukraine conflict, real action between China-Taiwan or some sort of major negative event in the global financial system.

We have long believed that a good defense is as important as a good offense in maintaining and building wealth. As always, we welcome questions and discussions on what is important to you.