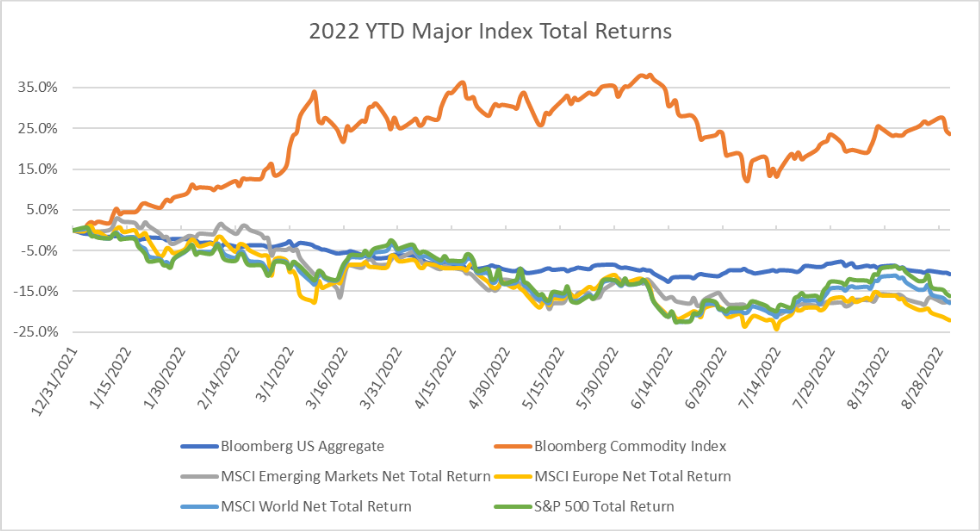
ENCORE INVESTMENT ADVISORS

AUGUST 2022 MARKET REVIEW

Market Recap: After an extremely strong eight-week period during which equities and bonds both rallied off of their mid-June lows, a nine-minute speech from Fed Chairman Powell sent markets hurtling lower. In the month of August, global developed-market equities fell 4.2%, while US bonds fell 2.8%. On a year-to-date basis, global equities have fallen 17.8% while US bonds have fallen 10.8%; an extremely difficult year for most multi-asset portfolios given the lack of diversification benefits between stocks and bonds. In his prepared remarks at the Jackson Hole Economic Symposium, Powell reiterated the Federal Open Market Committee's (FOMC) pledge to use its tools to combat inflation and acknowledged its actions will negatively impact economic and employment levels in the US. The FOMC believes that the risk of stopping its fight against inflation at this point is far greater than the risk of pushing the economy towards a recession. On the day of Powell's speech, the S&P 500 fell over 3%, one of the worst days of the year, a sign that equity investors disagree with the central bank's stance.

Powell's objective is to use three of his most important monetary policy tools: the Fed Funds Rate, open market operations (buying/selling securities with the Fed's balance sheet), and forward guidance to further tighten financial conditions such that demand driven inflation falls. However, the Fed does not have effective policy measures to impact the supply side of the economy. Financial conditions have tightened substantially since the beginning of the year, in large part due to the Fed's policy, which can be observed in the rapid increase in interest rates and mortgage rates, as well as in the volatility within equity markets and the strengthening US dollar. Heading into Powell's speech in Jackson Hole, many market participants were calling for a slowdown in Fed tightening after several larger than normal interest rate hikes. Powell's hawkish tone and "anti-pivot" messaging caught equity investors off guard and are to blame for the market selloff coinciding with his speech. Typically, there is a meaningful time lag (6-18 months) between monetary policy actions and the impact of policy changes appearing in the economic data. Our worry is that if the Fed keeps its foot on the pedal for too long as inflation readings have yet to sharply inflect downward, it could inadvertently induce a recession in the US.

How does this impact our perspective? Many central banks around the world are attempting to harness inflation, while allowing their respective economies to continue recovering from the pandemic slowdown; this is typically referred to as a "soft landing". We place the odds of a successful "soft landing" higher in the US than in Europe or the UK, where the reliance on Russian energy is exacerbating the economic situation. Still, markets do not react in the same manner in all recessions, and there is typically some form of excess that exists and is hardest hit; an example of which is leverage in the housing market leading up to the Global Financial Crisis in 2008. Corporate and personal balance sheets are quite healthy at the moment, and apart from a handful of meme stocks, speculative technology stocks, or the crypto market, it is difficult to identify meaningful areas of excess today. Asset allocation is rarely cut and dry – the risk is balanced in equities, and therefore, we continue to recommend a neutral stance. Small adjustments have been made to fixed income portfolios, while maintaining our underweight stance, as interest rates have recently spiked again. Long-dated treasuries have been added to portfolios, increasing portfolio duration, and acting as a hedge against equity market selloffs.



Data Source: Y Charts

Encore Investment Advisors, LLC is a Registered Investment Advisor