

KEY TAKEAWAYS

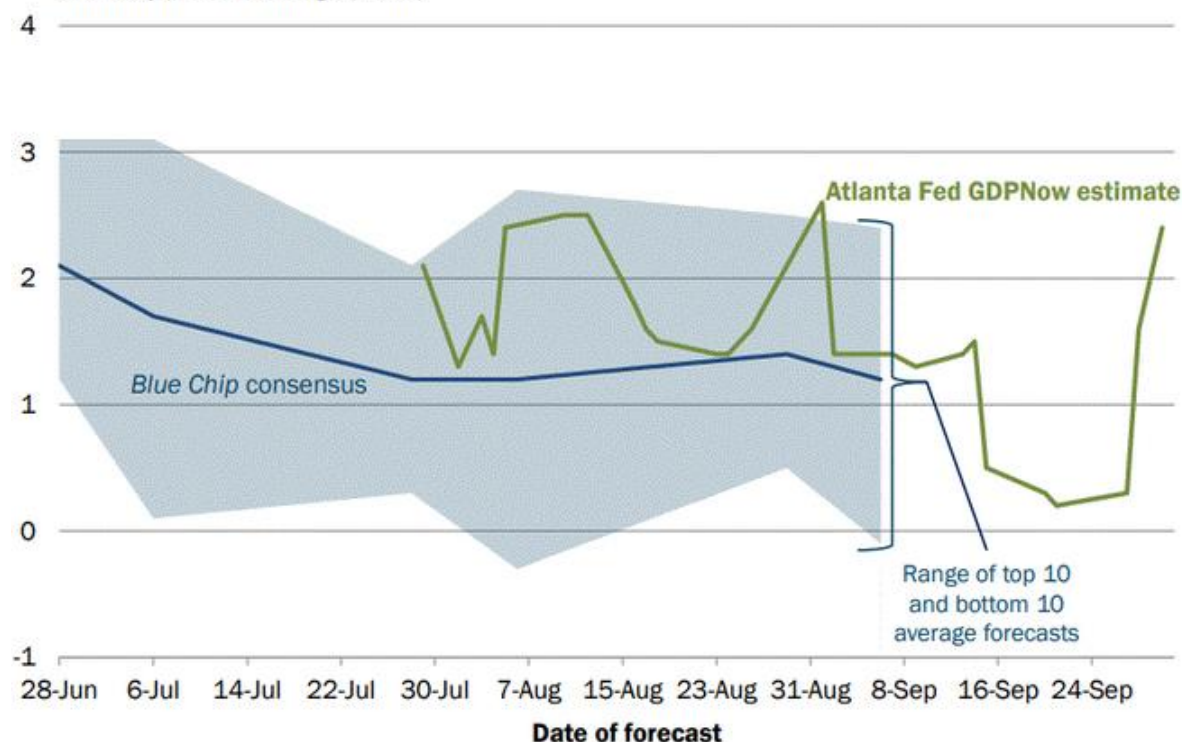
- The post Labor Day week, saw a big rally into the following Monday, but that gave way to basically unrelenting selling into month end. Not even a “BoE (Bank of England) pivot” could halt the selling for more than 1 day.
- Interest rates spent the month steadily moving higher until just before the “BoE Pivot” when rates started jumping, making it to 4% on the 10-year Treasury, before backing off into month-end on the “BoE Pivot”.
- Oil continued wide swings in price to the downside, with the prospects of OPEC+ cutting supplies along with the “end” of SPR releases.

The U.S. Economy

The final look at 2nd quarter GDP stayed the same at -0.6%. The 3rd quarter estimate from the Blue-Chip consensus is still around +1%, though a late surge in economic data popped the GDPNow estimate to over 2%, literally a last day pop of over 2%. The volatile nature of the data is evident in the divergence. We will find out later this month what the government has to say about 3rd GDP. A “strong” GDP print likely continues the Fed to further increase interest rates.

Evolution of Atlanta Fed GDPNow real GDP estimate for 2022: Q3

Quarterly percent change (SAAR)



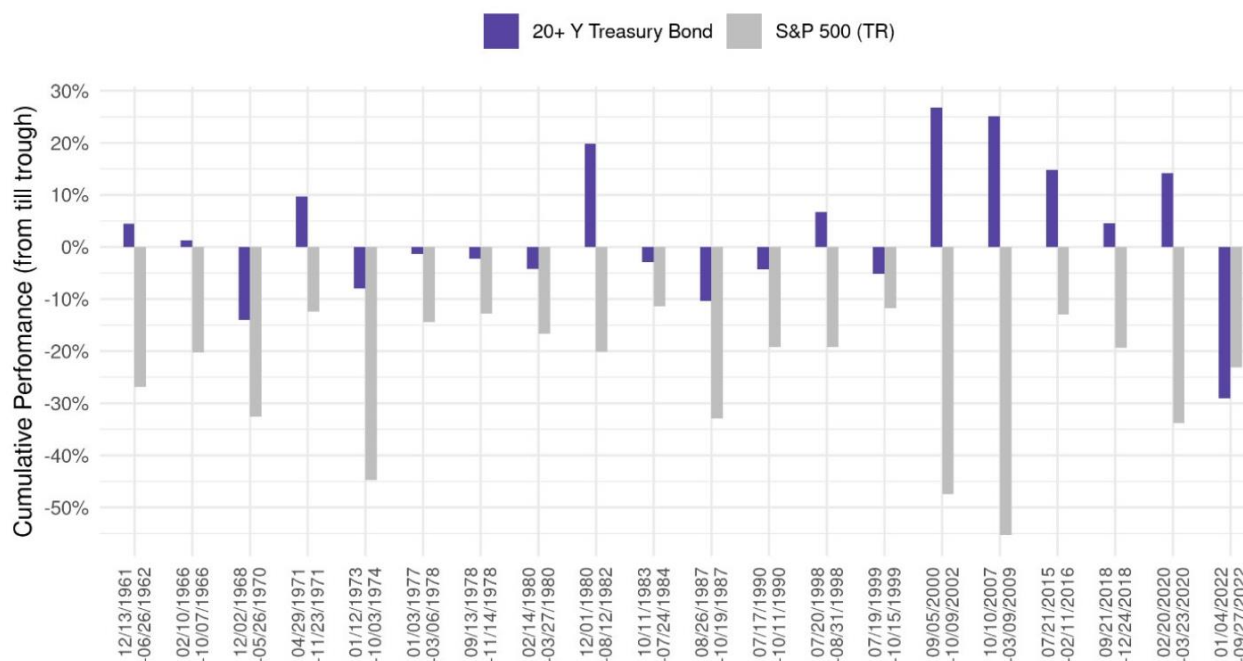
Sources: Blue Chip Economic Indicators and Blue Chip Financial Forecasts

Note: The top (bottom) 10 average forecast is an average of the highest (lowest) 10 forecasts in the Blue Chip survey.

Source: <https://www.frbatlanta.org/cqer/research/gdpnow>

Stocks and Bonds

Interest rates continued to march higher as economic data and especially inflationary data continue to remain higher than expected. The first real signs of credit distress reared-up late in the month when the new British PM proposed a massive unfunded stimulus plan. The British Gilt, US Treasury equivalent, took the news quite poorly and aggressively priced in much higher inflation, which sent Gilt yields soaring. The yields rose so fast in just a few days that the BoE launched emergency Quantitative Easing to calm the markets. The measures, at least temporarily, calmed the fixed income markets and yields fell into month end. The Fed continues talking about inflation concerns and the data continues to show their reason for concern. September was the inflation, higher yield, bets beating out the recession is coming. Next month may be a different story, but at some point, it seems with the attempts to tighten monetary policy, that we will see the long talked about recession occur, which normal drives down bond yields. The chart below, as referenced in the 3Q Asset Allocation Outlook, shows how the flight to Treasuries has been MIA so far during this equity drawdown. The run up in yields, along with increasing credit spreads, created an even stronger headwind for High Quality fixed income, which as measured by the iShares US Aggregate Bond ETF, lost -4.31% for the month. The U.S. 10-year Treasury bond yield ended the month at 3.80% closing off the 4% high yields of the month, but still up significantly from August's close of 3.13%.



Source: <https://twitter.com/leadlagreport/status/1574884450311217184>

The Dow Jones Industrial Average dropped -8.84%, the S&P 500 sank -9.34%, and the small cap Russell 2000 plunged -9.73%. The international markets traded in a similar fashion to the U.S. The MSCI EAFE iShares Core International Developed Markets ETF Index crashed -9.65%, and the MSCI Emerging Markets iShares Core ETF Index collapsed -11.29%.

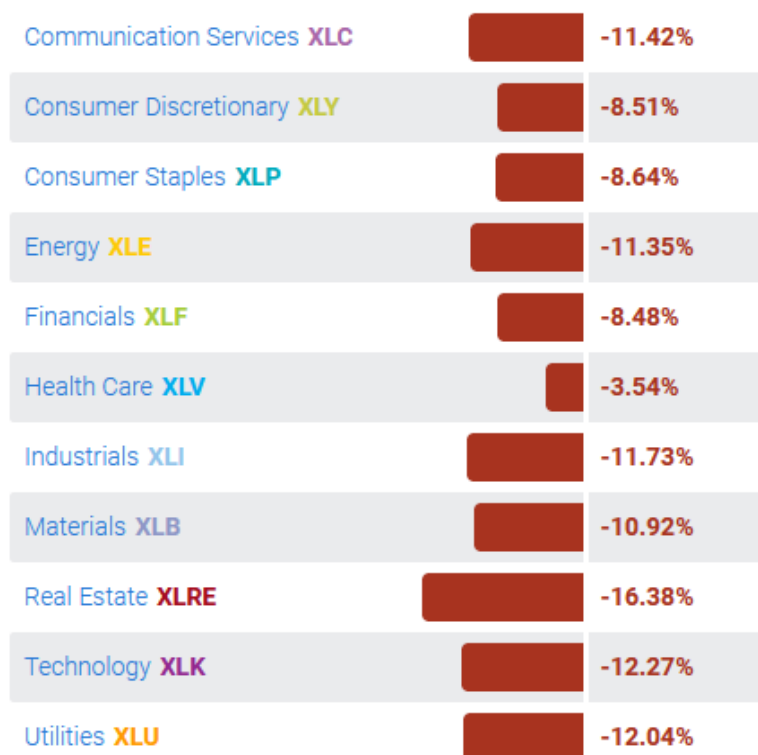
September was ugly, and the sector performance confirms that reality.

The least bad performer was...

- Healthcare: -3.54%

The worst performers were...

- Real Estate: -16.38%
- Technology: -12.27%
- Utilities: -12.04%



Source: <https://www.sectorspdr.com/sectorspdr/tools/sector-tracker>

Oil Report

The oil market continued to fall on concerns of a looming recession, though some support is starting to come from chatter that OPEC+ is going to reduce supplies. The reduction in supplies would be an effort to prevent a glut of oil supply if in fact a global recession occurs. The remaining narratives, no progress in the Ukraine/Russia conflict or Iran continues to drive occasional headline price movement. The current NYMEX WTI Crude Oil futures settled at \$79.74 and posted a loss of almost 11% from the prior month close of \$89.55 a barrel. The weakness in oil barely spilled over to RBOB gasoline, which eased just over 2% vs August's close. Prices are still significantly off June's high but seem to have found a bottom and prices at the pump are starting to move up again. Hurricane season, which had one of its' latest starts in years, has begun in earnest. However, the oil and gas rigs of the Gulf of Mexico have been spared, the same certainly cannot be said of many parts of Florida and along the East Coast, which were pummeled by Hurricane Ian. Additional potential hurricanes merit watching as the supply/demand dynamics of the oil market play out.

The Rest of the Data

The August ISM Manufacturing Index remained unchanged from July's reading of 52.8. On the other hand, the ISM Services Index increased modestly to 56.9 in August from July's print of 56.7. The prices paid component for Manufacturing dropped again and is now near "normal", but for Services, prices remained at high and elevated levels. Any reading above 50 generally indicates improving conditions. Consumer confidence increased to 108.0 in September, which compares to an upwardly revised figure of 103.6 in August. The unemployment rate rose to 3.7%, as 800,000 people reentered the work force, and the economy added a solid 315,000 jobs in August, which edged expectations of 298,000 jobs. The Consumer Price Index for All Urban Consumers (CPI-U) increased at +0.1% in August, on a seasonally adjusted basis. Over the last 12 months, the All-Items Index eased again, now to +8.3% on a non-seasonally adjusted basis. The CPI ex Food and Energy, rose to 6.3% over the last year. This data continues to show that the inflation genie has not been put back in the bottle. The above data continues to indicate the economy is generally on good footing, despite the rhetoric to the contrary. The Fed continues to raise rates faster than any time in the last 40 years and continues to be firm in the stance that interest rates will be higher for longer and indifferent if a recession occurs. So, diametrically opposite of the last 10+ years of policy, hence why we continue to see occasion when the equity market tries to call the Fed's bluff, but so far, the Fed is not backing down. The equity markets continue to probe lower to see if they can find the "Fed put", i.e., panic button. We will continue to monitor economic activity in concert with inflation reports and how that may impact Fed policy.

Summary

The equity markets lost this round of the battle against the Fed caving into lower prices. The question remains, who will win the war, or will we all be losers in the end? The fixed income market, especially the Treasury market, seem to be getting at yields that could approximate fair value. Although as U.S. Large Cap Value showed us for years, cheap can keep getting cheaper. Will the Fed stick to their guns and continue hiking rates until they "break" something as they have a history of doing? Or will they look at dislocations in other markets, the sharp drop in the Japanese Yen or the collapse of the British Pound and the spike in yields of the British Gilts and go on pause to give the rate hikes time to work through the system? Only time will tell and honestly, the Fed probably doesn't know yet either.

As always, the markets can be emotional, so we retain our focus on what we can control, which is the amount of equity risk that is taken in a clients' portfolio in concert with the clients' risk tolerance and long-term goals. The markets will always face different "worries", today it is inflation/war vs. waning growth expectations, tomorrow it will be something else. We have built our asset allocation models with dynamic features and quarterly rebalancing, both in fixed income and equities. If the markets continue to decline, we will reallocate the overweight that occurs in Fixed Income back into equities. The decline in equity markets has triggered the rules-based defense mechanisms to reduce the risk of the portfolio via the dynamic investment vehicles that have been deployed. Additionally, the recent strategic asset allocation changes, have insulated some of the fixed income allocation from continued Fed rate hikes. Further, if the equity markets get too extended on the downside, some of the vehicles will reallocate some capital back into their respective equity exposures.

These dynamic tools have been engaged, a couple of times during the increase in volatility. At month end a portion of equity has shifted to Treasury Bills for U.S. Large and Mid Cap, as well as Developed

International. For a Balanced, 50% Equity/50% Fixed Income portfolio, the current allocation is approximately 26% cash and cash equivalents (i.e., Treasury Bills and floating rate Treasuries), 41% general fixed income and 33% Equity. So, if something drastic, unexpected, happens and the equity market quickly starts a new bull market cycle, we still have some exposure to equities. If on the other hand, the markets continue to decline, we have meaningfully reduced risk exposure vs a static 50% Equity/50% Fixed income allocation.

If you have specific questions about your portfolio or financial situation, we are here to help. Long-term financial planning is designed to deal with uncertainty like those we discussed above. Our portfolio management process is to design a prudent allocation across many asset classes. Equities are for long-term growth and several vehicles that we utilize offer defensive mechanisms to mitigate equity market declines.



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