Chris Hyzy: This is Chris Hyzy, Chief Investment Officer for the October Viewpoint titled The Great Debate Continues. With the draw down in September canvassing equity and debt markets on the back of sharply rising yields, higher than expected oil prices, and the previous concerns over a government shutdown, not to mention the strikes, the great debate continues surrounding the direction of the US and global economies, and therefore, the overall trend in future corporate profits. The broader equity markets in the US alone have fallen some 8% plus from their peaks in late July, with a 5% pullback in September.

In a nontraditional way, the weaker sectors have been the more defensive areas of utilities and healthcare overall. In fact, the utilities sector continues to hit 52-week lows and is now down one of its sharpest performance numbers versus the overall S&P on a year-to-date basis ever. As growth would come down, we expected these areas to attract investment flows not to be the source of investment flows. With technical factors and higher yields weighing on these sectors, we’ve decided to lower utilities one notch to neutral, and upgrade energy further by one notch.

The utility sector has been unable to simply restore momentum, and we don’t expect this to change anytime soon. The 10-year yield climbed some 50 basis points in the past few weeks in one of the sharper moves experienced in the last year. The higher rates for longer timeframe understanding is now gathering momentum, which is pushing global yields higher across the board, and supporting the strong dollar. Better than expected economic data for now, which is likely fueled mostly by the growing deficit, and at times, a still healthy consumer has also caused the Federal reserve to keeping November Federal Open Market Committee live for potential additional rate hike of 25 basis points. However, we are
noticing some signs of a growth slowdown and some consumer data is now being revised lower. This will likely be picked up in the coming months in employment data and potentially filter the earnings revision early next year. In other words, revisions to the downside in the economy could be the catalyst to a peak overall in yields if yields begin to crest and then fall as they price in slower growth, we would expect equity markets to rally to close this year. Of course, markets will have to look past any future government shutdown if it should occur.

As yields have sharply risen across fixed income, we’ve also adjusted our CIO portfolios in this regard. We’ve become slightly more defensive, therefore, we have increased our exposure to agency mortgage-backed securities, also known as MBS, in a now slightly positive on the asset class as nominal spreads looks very attractive. We’ve also increased our exposure to investment grade tax exempt, also known as municipals, and are now neutral on the asset class. Muni treasury ratios have finally normalized from the excessively expensive levels in earlier this year. Fundamentals remains generally solid, and we savor municipals as a higher quality defensive fixed income asset class with less credit risk.

We have decreased our exposure to investment grade corporates and announced slightly negative on the asset class. Credit spreads remain near post-pandemic lows and are not appropriately pricing in any deterioration in credit fundamentals as the economy may weaken in our opinion. Moreover, in addition to the backup in yields, the steady increase in oil prices have also been a wedge in the capital markets throughout the month of September and to start October. We expect oil prices to maintain their current prices and potentially rise further given the supply issues. Therefore, we expect the fourth quarter rally in equities in our opinion to be also lead, again, by the energy sector.
In environments that continue to remain cloudy or overcast with many
cross currents and two big wedges which are rising yields and oil prices
still in the way, we expect a choppy type of rally in the fourth quarter
overall. Our strategy is to remain balanced across all asset classes,
maintain a high level of diversification, use excess cash, add to higher
quality areas that have drifted below strategic asset allocation targets in
both equities and fixed income. We were leveraging alternatives where
appropriate to help mitigate risks in/at to potentially turns and be more
active in the rebalancing strategy early next year, as more economic data
confirms that a slower growth path is indeed unfolding. Once we move to
the first half of next year, we expect a new profit cycle to begin to build
once again, and establish a more sustainable long-term bull equity market.
Until then, we use the next nine plus months to reposition portfolios
towards a balanced manner in case a harder slowdown develops than is
expected, or if it is indeed different this time and the Fed can definitely, in
our opinion, try at least to engineer the much discussed soft landing.

The jury is still out, the great debate continues, stay balanced, stay active,
be prepared for either scenario to unfold. That will do it for today, thanks
for listening.

Operator: Please see important information provided in this report.

END