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INVESTMENT MANAGEMENT

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Equity Market Commentary

SOLUTIONS & MULTI-ASSET | APPLIED EQUITY ADVISORS TEAM | SLIMMON'S TAKE | OCTOBER 2022

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A). I continue to expect a late Q4 rally will lift equities through year end. Three reasons:

1) Improving inflation trends (finally).

2) Q3 earnings not as horrible as widely expected (again).

3) Anticipation that in 2023, Fed's hawkish appetite will become increasingly untenable into a weakening economy. (easier to talk tough with commodity inflation, but harder with rising unemployment).

B). Longer-term, S&P 500 cap-weighted does not look particularly attractive.

1) Top 10 largest stocks comprise 26% of index and are expensive on absolute and relative basis.[1]

2) Other 490 stocks are far cheaper…. excellent investment opportunities.[2]

C). Recession or no recession?

1) With so many stocks down 40% - 50% or greater, many reflect recession outcome already. (AEA adding from this group.)

2) Not necessarily true for S&P 500 cap-weighted, given top ten as discussed above.

D). Price targets on upside/downside provide healthy metrics for strategists/analysts.

1) However, emotionally, investors' recency biases preclude shifting their views on a dime.

2) "Why sell that, it's doing great" and "why buy that, it's doing terribly" ….classic recency bias, setting up for suboptimal results.

E). In my opinion, dollar-cost averaging* into declines has a higher probability of repeatable success versus trying to call lows. As recently witnessed, historically, 20%-25% bear markets in indices:

1) Can lead to further declines near-term.[3]

* **Dollar Cost Averaging** is a program of regular investment that cannot assure a profit or protect against a loss in a declining market. Since such a program involves continuous investments regardless of fluctuating share values, investors should consider their financial ability to continue the program though all market cycles.

    2) Have produced roughly double the average longer-term returns in equities even if further decline occurs first.[3]

F). Personally have deployed this strategy:

    1) Contacted my FA and added to my funds in June once S&P 500 was down 20%, and again this past weekend when down 25%.
    2) At SPX 3,345 (down 30%) will be calling again.
    3) Same methodology enacted in Q1 2020, with the same level of queasiness now as I did back then!

G). In my opinion, the only consistency to equity investing is fear → greed → fear roller coaster. Styles, sectors, and regions of investing get too popular, then too hated.

    1) AEA believes in unconstrained, core strategies. Flexibility allows us to *buy* fear and *sell* greed wherever opportunity presents. (Let the market dictate.)
    2) Seek to buy great companies when thrown overboard and fund from companies currently on pedestal.

H). So where are fear and greed currently? As per B #1 above, top ten are still on a pedestal. Additionally:

    1) Consumer sentiment hit all-time low in July.[4] Lots of fear. A host of high-quality consumer discretionary stock prices reflect this.
    2) Crude oil futures have gone from below $0 a barrel (high fear) in 2020 to $90 today. Energy stocks are up on the pedestal as well.

And finally:

This bear market is painful.

So is being a Chicago sports fan:

Bears, Cubs, White Sox.

OMG.

Chicago, and investors, need the Bulls.

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[1] Bloomberg.
[2] Factset.
[3] 360 Capital. S&P 500 since 1950.
[4] University of Michigan Consumer Sentiment.