MONTHLY MARKET UPDATE

August 2022

OPAL WEALTH ADVISORS

Key market narratives in August included continued deceleration in economic growth, the completion of a strong second quarter earnings season, and a Jackson Hole symposium where central bankers pledged to maintain their hawkish course to tame inflation.

The month was a tale of two halves across global equities with a strong rally in the first two weeks and a sharp reversal in the last two weeks as the Fed made clear its commitment to bringing inflation back down to target levels. This was the third time this year the S&P 500 was both up and down 4% in the same month. Growth underperformed value and defensives (consumer staples/utilities) and energy were relative winners. For the month, U.S. markets finished down 4% and non-U.S. developed markets were down 4.7% but emerging markets managed to post a 0.4% gain driven by the BRICs (ex-Russia which isn't really trading). Europe (-6.4%) underperformed as Russia stepped up pressure on energy deliveries. Commodity markets were relatively flat for the month with oil (-7.8%), gasoline (-25.3%), and metals (-2.7%) losing ground but natural gas (+11%) and grains (+3.57%) rising. The USD was strong against all major currencies, trading near parity with the Euro by month end.

Unfortunately, stocks received no cover from the bond market as U.S. interest rates moved persistently higher through the month pressuring equity markets and foreign currencies. The Barclays Aggregate (-2.8%), High Yield (-2.3%), and Global (-4.3%) all lost substantial ground resulting in the worst bond market return through August on record. Two-year UST yields surged 60bps during the month, bringing the YTD total to nearly +300bps (a magnitude seen only three times since 1977).

Overall economic activity in August continued to slow with PMIs falling into contractionary territory and a sharp deceleration in the housing market, but the robust U.S. labor market and healthy consumer spending made for a pretty mixed picture. Several inflation data points highlighted the potential beginning of a slowing trend including the July CPI report, falling commodity prices, and multiple survey-based metrics. That said, the odds of a Goldilocks outcome for the US economy seemed to take a hit with FOMC and ECB indicating they are willing to induce some 'pain', to tame inflation.

Geopolitical risks including Russian/Ukraine, China/Taiwan, and a tenuous Iranian nuclear deal remained with no clear-cut inflection points yet visible.

Market Anecdotes

- Fundamentals surrounding earnings and profit margins reinforce a note of caution with respect to the forward outlook and trends respectively.
- A look at global central bank policy rates illustrates how synchronized the world is (tightening) but also how deeply negative central bank rates still are considering inflation (real policy rates).
- Slowing global growth and the policy response to inflation have investors on edge. Percolating evidence of supply side and pandemic related disinflation may offer some glimmers of hope.
- The dismal year of the 60/40 portfolio continues to deliver with both stock and bond markets both sitting over 10% in the red YTD and very little company from a misery loves company perspective.
- A look at narrow market leadership and average correlations among stocks within the S&P 500 illustrate some of the primary headwinds for active managers in place since the GFC and era of central bank intervention policies.
- The pain of rising interest rates is clear and translates to rising mortgage rates (30yr (5.66%), 15yr (4.98%), and 5/1 adjustable (4.51%)) exerting pressure on the housing market. Rates are also pressuring P/E multiples which sit near the midpoint of the range over the last ten years.
- Softness in the housing market from exuberant levels of late 2021 to early 2022 is apparent. Bianco Research examined several alternative measures also illustrative of both pricing trends and the technical backdrop.

- With midterms approaching, political analysts are stepping up their forecasts with projections of a divided Congress and a plethora of Trump 2.0 storylines. Key takeaways are limited legislative pathways translating to ample executive agency and debt limit/shutdown debates.
- The EU energy crisis with December and February sanctions looming has EU bound Russian gas being flared, the EU buying gas at any price, and a G7 agreement of a price cap on Russian oil.
- Housing market dynamics, weak domestic demand, a contraction in exports, and persistent zero Covid public health policies are seemingly limiting the modest stimulus measures undertaken in China, leaving strategists with an underwhelming outlook for Chinese equity markets.

Economic Release Highlights

- PCE Inflation MoM of headline (-0.1% vs 0.1%) and core (0.1% vs 0.3%) and YoY headline (6.3% vs 6.3%) and core (4.6% vs 4.7%) both came in slightly below estimates.
- Personal Income (0.2% vs 0.6%) and Personal Consumption Expenditures (0.1% vs 0.4%) both came in softer than expected.
- Retail Sales (0.0% vs 0.1%) were flat but the ex/vehicles (0.4% vs -0.1%) and ex/vehicles & gas (0.7% vs 0.3%) both handily exceeded expectations.
- The August jobs report revealed 315,000 new jobs, just beyond the consensus forecast of 293,000 but the unemployment rate ticked 0.02% higher to 3.7%. The labor market participation also increased 0.02% to 62.4%.
- The JOLT survey showed 11.239mm job openings, well more than the consensus 10.4mm and above the high end of the range.
- Consumer Confidence in August climbed to 103.2, ahead of the consensus estimate of 97.4 and above the high end of the range.
- UofM Consumer Sentiment for August beat consensus expectations, registering 55.1 versus forecasts for 52.2.
- NFIB Small Business Optimism Index came in just above consensus at 89.9 versus forecast of 89.2 and up slightly over the prior month.
- ISM Manufacturing Index for August stayed at 52.8, just above the spot consensus forecast of 52.0.
- August ISM Services Index came in at 56.9 versus consensus forecast of 55.4, toward the higher end of consensus range of 53.5 to 57.0.
- U.S. PMIs (C, M, S) continued to contract in August with readings of 45.0, 51.3, 44.1, all missing and coming in at or below the lowest end of consensus range.
- Eurozone PMIs (C, M, S) of 49.2, 49.7, 50.2 all came in slightly higher than consensus while Japan's readings of 48.9, 51.0, 49.2 moved slightly lower versus the prior month.
- The Global Manufacturing PMI declined further in August, falling to a 26-month low of 50.3, down from 51.1 in July.
- The Case-Shiller Home Price Index rose 0.4%, less than the 1.1% consensus forecast.
- New Home Sales (511k) came in under consensus of 575k and below the low end of the range of forecasts. Pending Home Sales of -1% was slightly better than -2.5% forecasted.
- Existing Home Sales of 4.81mm was below the 4.85mm forecast and growth rates of -5.9% MoM and -20.2% YoY both declined notably versus prior month levels.
- August Housing Market Index collapsed in July to 49, far below the spot forecast of 55 and predicted range (53-58) for the month.

Positioning

August gave back over half of July's rebound, and we still expect persistent uncertainty over the next 9-12 months. As inflation dynamics shift from supply side sources to wage, shelter, and healthcare sources, the FOMC is left in a difficult place in terms of engineering the proverbial 'soft landing' and likely need to maintain more persistent hawkishness than what the market is currently discounting, particularly out into 2023.

Risks of a U.S. recession over the coming year remain elevated if headline inflation doesn't fall back toward 4% and instead prompt the Fed to tighten to recession-inducing levels (Fed Funds near 5% and 10yr UST yield over 4%). Risks in a non-recession

scenario are also clear and present based on our belief that market priced expectations for Fed funds rate over the coming year are too low—whether due to persistently high inflation or falling inflation and corresponding rising real wages providing the Fed renewed motivation to remain hawkish. Both warrant a neutral position toward equities and a modestly short duration stance with periodic tactical rebalancing into pockets of strength and buying into extreme weakness.

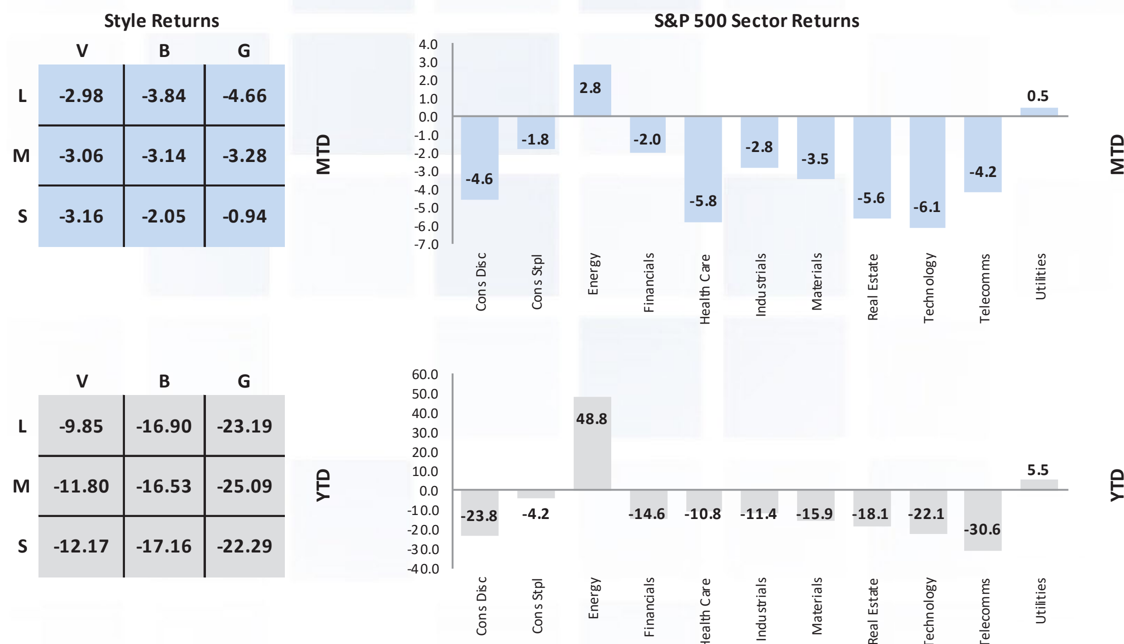
Accordingly, we recommend maintaining a neutral position in equities as we monitor whether the market takes out the June lows. From a geography perspective, although valuations are dramatically cheaper overseas, persistent strength in the USD, high geopolitical tensions and a strong likelihood of recession in Europe have us tempering our short-term outlook for developed non-U.S. markets. Fixed income investors should maintain a short duration bias and remain overweight credit sectors—especially within floating rate issues.

Equity	Level	1 Mo	3 Mo	YTD	1 Yr	3 Yr
Dow Jones	31510	(3.72)	(3.90)	(12.01)	(9.07)	8.33
NASDAQ	11816	(4.53)	(1.99)	(24.07)	(21.99)	14.98
S&P 500	3955	(4.08)	(3.88)	(16.14)	(11.23)	12.39
Russell 1000 Growth		(4.66)	(1.67)	(23.19)	(19.06)	14.51
Russell 1000 Value		(2.98)	(5.58)	(9.85)	(6.23)	8.87
Russell 2000		(2.05)	(0.72)	(17.16)	(17.88)	8.59
Russell 3000		(3.73)	(3.51)	(16.92)	(13.28)	11.90
MSCI EAFE		(4.74)	(9.24)	(19.24)	(19.37)	2.87
MSCI Emg Mkts		0.45	(6.29)	(17.23)	(21.48)	3.10
Fixed Income	**Δ Yield**	**1 Mo**	**3 Mo**	**YTD**	**1 Yr**	**3 Yr**
US Aggregate	2.03	0.10	0.13	0.26	0.19	(0.63)
High Yield	5.26	0.32	0.53	0.99	0.79	(0.35)
Municipal	1.80	0.05	0.02	0.08	(0.01)	(0.34)

Commodities	8/31/22	6/30/22	3/31/22	12/31/21
Oil (WTI)	88.18	107.76	100.53	75.33
Gold	1715.90	1817.00	1942.20	1805.90

Currencies	8/31/22	6/30/22	3/31/22	12/31/21
USD/Euro ($/€)	1.00	1.04	1.11	1.13
USD/GBP ($/£)	1.16	1.22	1.32	1.35
Yen/USD (¥/$)	138.69	135.69	121.44	115.17

Treasury Rates	8/31/22	6/30/22	3/31/22	12/31/21
3 Month	2.96	1.72	0.52	0.05
2 Year	3.45	2.92	2.28	0.73
5 Year	3.30	3.01	2.42	1.26
10 Year	3.15	2.98	2.32	1.52
30 Year	3.27	3.14	2.44	1.90



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Opal Wealth Advisors / 2 Jericho Plaza / Suite 208 / Jericho, NY 11753 / t. 516.388.7980 / f. 516.388.7968 / **opalwealthadvisors.com**