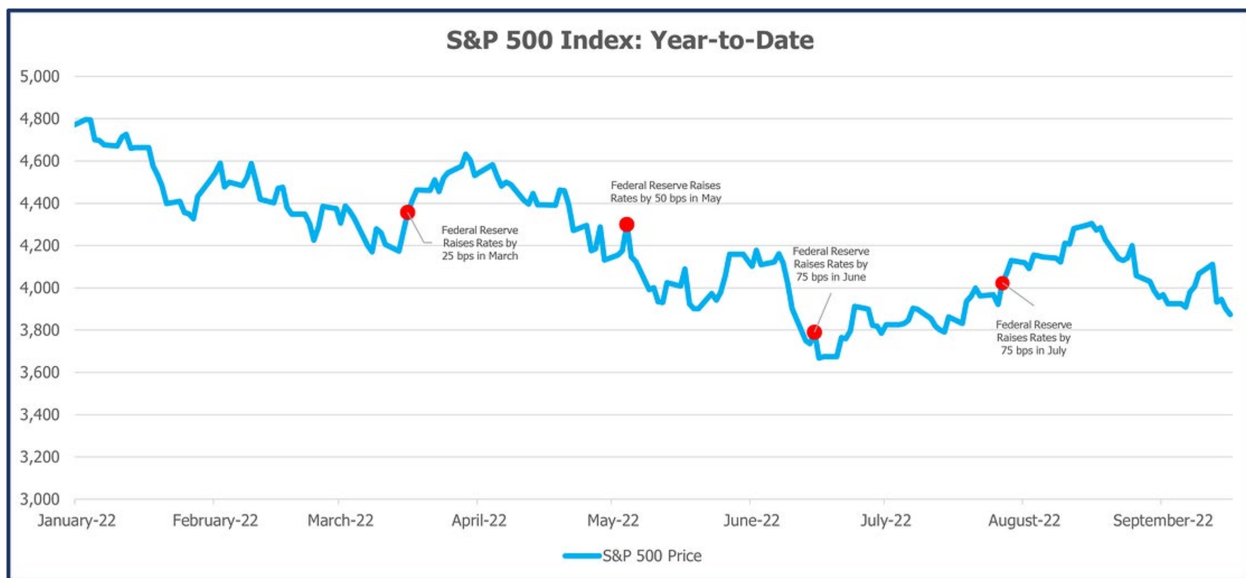
Palisade
CAPITAL MANAGEMENT

The Current Situation

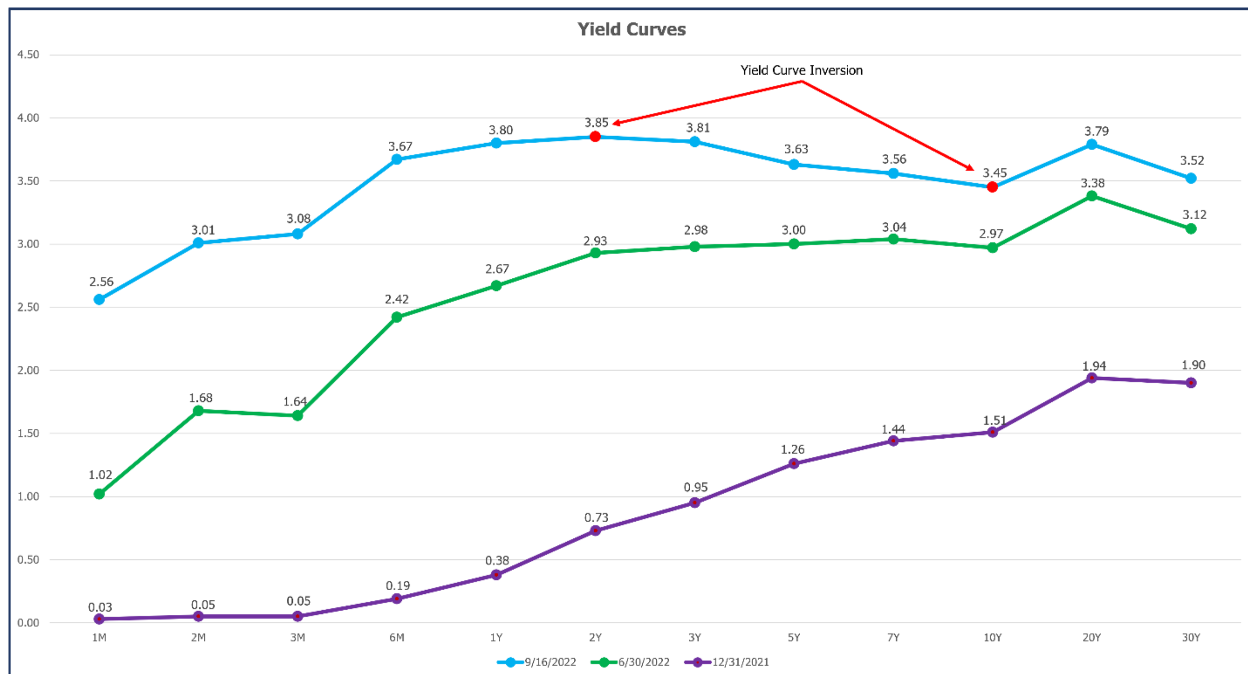
After rallying the previous week, the markets sent a clear message on Tuesday, September 13, 2022, that the roller coaster ride isn't over, as higher-than-expected consumer price increases for August sent stocks into a tailspin. While the markets have settled down somewhat since then, jitters remain ahead of the Fed's next Federal Open Market Committee (FOMC) meeting on September 20-21 and the magnitude and impact of a potential rate hike, with estimates ranging from 75 basis points (0.75%) to the possibility of a full 1.00% increase. Our outlook is for two more 75 bp rate hikes before the Federal Reserve re-evaluates the size and frequency of the increases. Volatility continues, and the markets have been particularly sensitive to economic data.



Source: FactSet Research Systems

U.S. Dollar – Strong and Getting Stronger. The Federal Reserve was the first major central bank to raise interest rates and Europe's ECB only recently followed the U.S. China, in response to weakening economic conditions, is also lowering rates. A strong dollar is a headwind for the profits of companies that export goods abroad, and for the overall stock market in an environment of weakening global economic conditions. Recently, stocks rallied for a brief period in response to the ECB's decision to raise interest rates by 0.75% because the dollar briefly weakened. However, once domestic CPI data was released on September 8 (revealing the Federal Reserve's fight against inflation is not over), the dollar rallied to a new multi-decade high and caused a broad sell-off in equities and bonds.

Higher Rates and Quantitative Tightening: Financial conditions are tightening through higher rates and the shrinking of the Federal Reserve's balance sheet. These two actions increase the possibility of a policy mistake leading to a recession. Short-term interest rates are rising faster than intermediate and long-term treasury bonds, an inversion which could be a forward-looking indicator for slowing economic conditions in the U.S.



Source: FactSet Research Systems

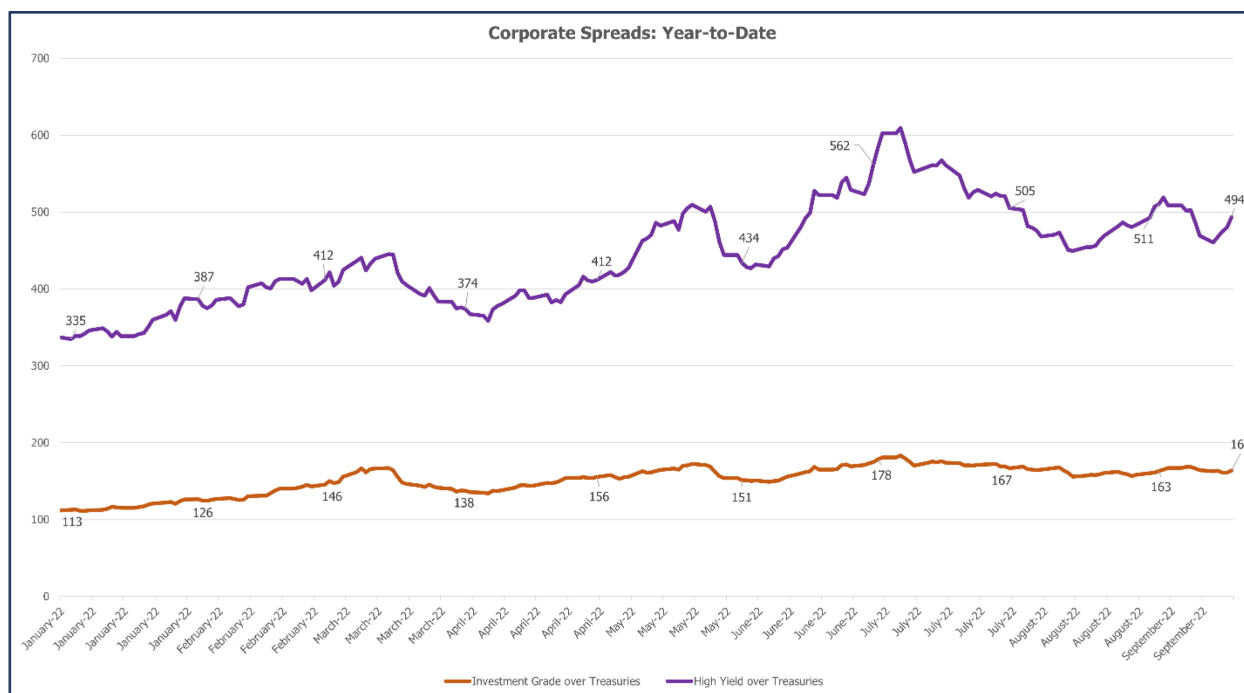
The "Not-so-Known"

The Supply /Demand Imbalance for Labor. There is a significant supply-demand imbalance for labor with widespread labor shortages in key areas of the economy such as air transportation. There are currently more than 11 million job openings but only 6 million unemployed workers as reported in the recent JOLTS survey. Workers can demand higher wages, which puts further upward pressure on inflation. Adding to the problem are continued post-COVID heath issues that affect the pool of available labor. According to a report published by the Brookings Institute, "long COVID" is estimated to have resulted in 15% of the labor shortage.

Geopolitical risk. More than six months have now passed since Russia's invasion of Ukraine, and the conflict shows no sign of ending. The war has had a significant impact on a broad array of commodities such as oil and wheat, but has also contributed to global supply chain disruption. The Ukraine has become a key component manufacturer and the war has resulted in shortfalls for a variety of manufactured products such as autos.

Corporate Earnings – Slowing but no Collapse. Corporate earnings have been strong thus far this year, but we are keeping a close eye for any potential signs of weakness. As previously discussed, we were not concerned with second quarter earnings, but the third

quarter might be different. We are closely monitoring the health of the corporate bond market for signs of stress. The spread over treasuries has widened since the beginning of the year but has not worsened since the equity market low in June. Quarterly earnings reports are always important, but this reporting cycle seems a bit more important as a key indicator of the economy's direction. We believe any degradation of corporate earnings is likely to be seen in the third quarter as another sign we may be approaching or experiencing a slowdown.



Source: Bloomberg L.P.

Mid-term elections.

Mid-term elections are usually a referendum on the person occupying the White House, but this November's races are a bit more complicated to analyze. The President's approval rating has been consistently low (though improving) indicating the potential for significant Democratic losses in the House and possibly the Senate. This election might be a bit different, however, as social issues such as the overturn of Roe v. Wade have energized Democrats. At the same time, the investigation of the previous president and the way it has been conducted has energized many Republicans. Whatever the outcome, the mid-terms have been a positive turning point for stocks since World War II.

Our Outlook

Given the level of uncertainty around the midterms and global geopolitical risk, we believe the markets could go lower at a measured pace until we reach a turning point around or after the November elections, after which we could potentially see more stability.
We remain patient investors, focused on the long-term and not trying to time the markets. Asset allocation remains one of the primary determinants of how your portfolio performs. We invest with conviction, looking for companies and investments with strong fundamentals

we believe are more likely to deliver strong returns over time. We take a disciplined approach and avoid making moves based on short-term temporary market dislocations. We do, however, take advantage of portfolio liquidity to look for buying opportunities in attractively valued equities to capture the potential for upside return when the markets recover.

We are here for you

Palisade has managed assets through a wide range of market cycles, and we understand this can be a stressful time. We are here to help you navigate the current environment and continue to invest for the long term. We welcome the opportunity to provide customized feedback about your investment portfolio. Please feel free to contact us anytime with questions.

The S&P 500® Index is an unmanaged index that is widely recognized as an indicator of general market performance, based on the market capitalizations of 500 large companies having common stocks listed on the NYSE or NASDAQ. The S&P 500® Index does not have a defined investment objective, nor does it charge fees and expenses.

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