

Frayed at the edges

The abrasive dichotomy that defines the marketplace is causing havoc with investor expectations. On the one hand, everything is retreating backwards while on the other everything is going up, including the blood pressure of market participants who wonder just how the split between high inflation versus lowering valuations eventually will resolve. To be sure, there is always something in which to invest. But there appears to be more of a manic divestiture *away from* financial assets than a stampede towards them. Chaos can kill a good market rally.

Markets

To the astute Wall Street observer things don't look so bad. There had been two years of post-pandemic recovery...both in healthcare and portfolio valuation...which looks even better when measured against the damage the virus inflicted at inception. But the virus was an aberration that wreaked historically uneven consequences upon the population. Nevertheless, as we surged out of the carnage the Federal Reserve and other global central bankers felt the need to tamp down our enthusiasm by raising interest rates to quell spending. In this case, the Fed won, the markets lost. Higher interest rates soaked up investor's short term cash as Treasury Bills and CD's made a huge comeback by providing temporary relief from limited returns in savings accounts. And then, boom...stock prices plummeted along with enthusiasm for taking risk. It might be the case that cheaper equity prices will entice speculators back into the market this quarter, or next, but stock luster looks just a bit duller than during the boom last year. So, are we going up or going down? There is no one size fits all answer....

Some might argue that low interest rates, low inflation, and easy money create a stable environment for economic success. Still, others instruct that low interest rates and profligate spending allows corporations to borrow money simply to buy back their own shares rather than to invest in infrastructure and the future; that the individual investor is running up greater (unaffordable) debt; that savings rates are kept artificially low; that unemployment figures don't accurately reflect the gap in demographics of today's world: the well-educated upper class versus the undereducated lower strata with extremely poor chances of competing in today's marketplace. In short, there are no scarcities of fiscal capital gains to be had on Wall Street, while at the same time an equal measure of political and capital moral depreciation on Main Street is running rampant and eroding the buying power and political leverage of the average citizen. As of now, even as monetary measures are being implemented, household indebtedness represents a significant percentage of household expenses. No wonder our social priorities are out of whack. For many, these developments portend a no-win scenario. Rising rates have created a cost too high for discretionary....or for many, necessary....purchasing while falling stock prices put a psychological strain on investor's confidence. There needs to be a fundamental and technical reboot for the markets to stabilize.

Meanwhile, economic and military conflagration in Ukraine create similar global uncertainty. European nations are caught in the middle of a social and political dilemma of absorbing the costs of a war they didn't want while migrating multitudes of refugees must be cared for out of a pool of diminishing resources. Does one really believe that European politicians want to get in the middle of the Russia/Ukraine conflict...or internal strife in France, or Italy, Greece or anywhere else? "European (economic) Union" is a lofty goal but fraught with pitfalls when individual interests are at stake.

We might add that gunfire and political conflict is not limited to central Europe. The emerging economies of Latin America, Asia, and Africa are in flux owing to regional conflicts, a currency unable to find equilibrium or traction, and hostile gang-based violence resulting in death, population migration, and insufficient natural and capital resources required to sustain economic prosperity. Given the infrastructure, political, and cultural obstacles facing those regions we are not yet ready fully to commit client capital to the emerging markets at this time. Many of the developing economies of the world have empty larders in part because of politics or climate. The painstaking process of building social institutions that work for all of their citizens is something that must be addressed.

As with most anything in the capital markets, the issue often boils down to profitability and/or matters of social conscience. Farmers know how to splice genes and ward off crop infestation. Health care workers understand immunization and preventative care. Businesses are adroit when it comes to managing the bottom line. More so, however, the solutions to these and other issues is having the will to lessen the plight of the poor by replenishing supply chains, building infrastructure, and caring for basic human needs (food, water, shelter, security) of their citizens.

Climate change is a defining factor in shifting the rhetoric and action of political leaders. In a warming world, increased famine and population dislocation have become, unfortunately, a new normal. Rising temperatures actually raise the rate of crop growth, but the demand for potable water and fertile land is also increasing as the population soars. Science postulates that as temperatures rise the net output per square foot of farm acreage will drop because of insufficient water capabilities. In dry areas of the globe, with fresh water for irrigation becoming more scarce

or being siphoned off to nourish other crops, staple farming must either learn to adapt or perish. Curiously, wet parts of the world are over saturated; drought-ridden countries are suffering even more.

Strategy

Wall Street must embrace the concept of using innovation in science to “do good” as well as creating profits for stakeholders. It is possible to do both....to enlarge the size of your portfolio while doing so responsibly and consistent with values-based earnings. A company that feeds the poor using better science, or which creates clean energy, can also have rising share prices. Good stewardship of our planet, fair compliance and governance, and profitability from innovation and strong demand are themes that don't have exorbitant “costs” except commitment and empathy. We would argue that *not* to do these things dramatically limits one's exposure to capital gains and cutting edge science.

We will be reducing our exposure to stocks this quarter. However, we are mightily satisfied about allocation decisions made many months ago to reduce risk while, more recently, deploying cash reserves into short term higher-yielding bonds which generate an income “reward” for staying patient during the Fed's machinations and the market's uncertainties. A slowing economy is not conducive to increased earnings or rising P/E levels. There might be additional volatility in the financial markets ahead. The S&P, which is experiencing a 20% correction from last year's “recovery high” is still teetering from the effects of interest rate hikes, earnings patterns dissipating, business disruptions, and sector shifts. We project a fourth quarter base-building around the 3900 level which, unfortunately, remains a staging area for the near term. Understand, we are not suggesting another capitulation below that level but neither are we confident it might not happen if exogenous circumstances arise. In other words, there is very little on the horizon to create exuberance and excitement. Low unemployment, inflation reduction, modest GDP growth are not enough to ignite the next cyclical wave to the upside....merely sufficient to protect against a collapse of epic proportions.

Markets and the economy have arrived at a pivot point: growth is decelerating as actions taken by global central banks to rein in inflation gain traction. An overweighting in commodities and commodities-related assets provides protection from geopolitical and economic risks. Defensive allocations have most always outperformed traditional benchmarks during fractious times. Food insecurity due to scarcities and price increases leave agriculture industries poised for extraordinary gains derived from new demands and technological efficiencies that produce higher crop yields. Similarly, the energy complex must find ways to adapt to changing needs, environmental concerns, and resource shortages. Please note that my 40-plus years of work in building silo-specific portfolios in water, energy, agriculture, and health sciences has been ahead of its time and highly profitable in its returns. More is expected in the months ahead.

Conclusion

We have not yet seen any indication that current market turbulence is abating. However, we are not seeing evidence of a recession or a bear market. There may, in fact, be a vibrant recovery in the needs-based businesses we discussed in this tome and, more broadly, a promising rejuvenation in the cycle of returns in the broader averages by next year. Our investment advice for the final quarter of 2022 is simple: be invested, but be cautious. Identify market momentum indices. Notice the benefit in short term time deposits as rates continue to rise and weigh your risk tolerances for fixed income versus stock trading. Invest for the long term in demographic trends we have discussed this year, and prior: healthcare, biosciences, alternative energy, agriculture, water, technology, and infrastructure. Above all, lessen some of the impatience that is innate from a “must have it now” culture.

Understanding cyclicity requires an appreciation of how *time* plays a role in all criteria of evaluation. Time is the denominator to all calculus for return. Seeking instant gratification, over a week, a month, or a quarter, is not money management....it is gambling. We know that everyone wants the elusive magic bullet. If you don't know it by now.....

Suggested balanced account asset allocation, Q4, 2022

Equity: 45%
Fixed Income: 40%
Cash: 15%

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