September Market Update

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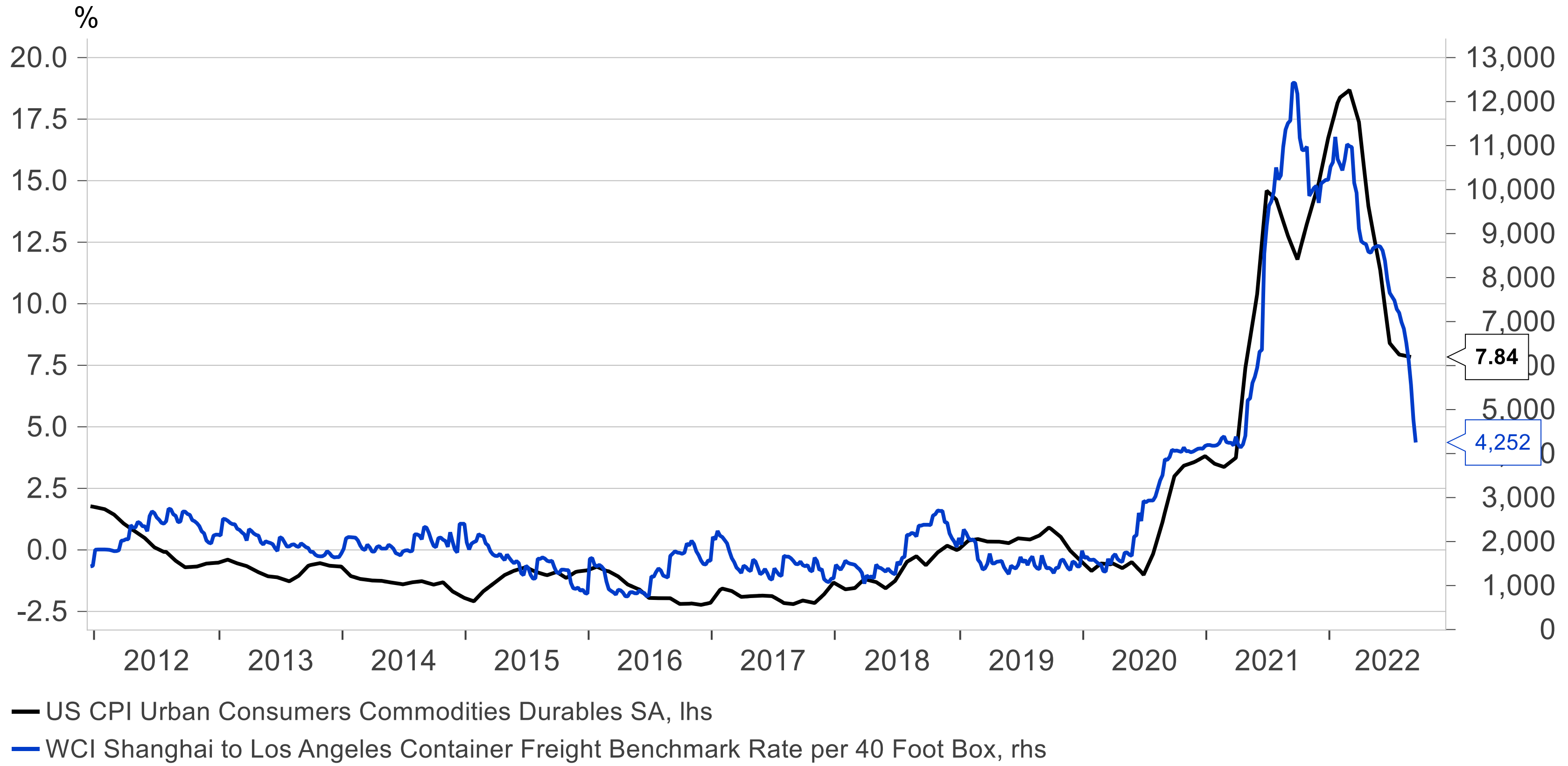
CAMERON DAWSON, CFA®
CHIEF INVESTMENT OFFICER

Passing the Buck:

From goods & supply chains driving inflation to services & labor

Goods Inflation has Peaked as Supply Chains have Eased

Durable Goods CPI Inflation and Shipping Costs from Shanghai to Los Angeles



Source: NewEdge Wealth, Macrobond, Bloomberg

As of: 9/19/22

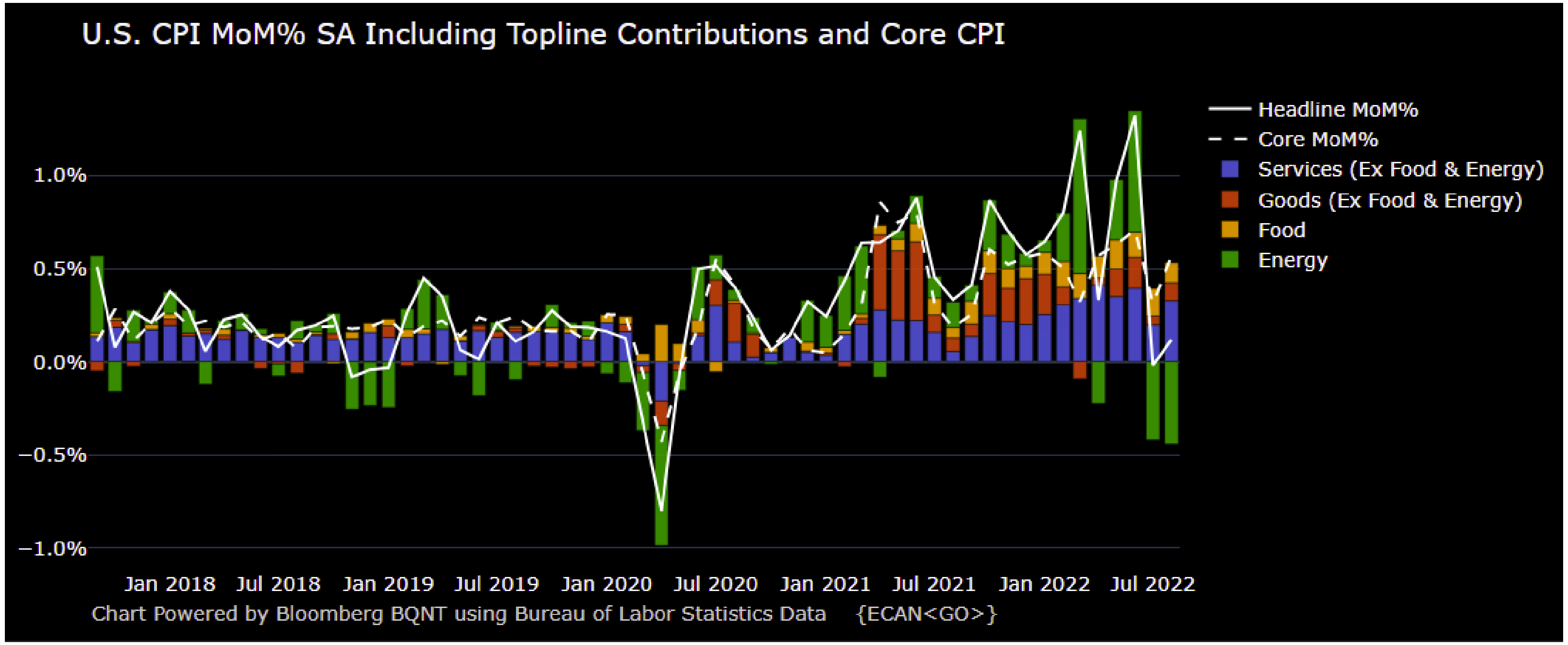
The early days of inflation were driven by a surge in goods prices, specifically durable goods (large purchases like cars, furniture, electronics).

This was due to a surge in pandemic lock-down demand and disruptions to supply chains.

As demand has normalized and supply chain stress has eased (seen here in blue with lower shipping costs), durable goods inflation has slowed from nearly +20% at the start of 2022 to just +8% today.

It wouldn't be surprising to see durable goods *deflation* in 2023.

But August's Inflation Report Showed a Passing of the Buck to Services Inflation



As of: 9/19/22

August's upside inflation surprise of +0.6% MoM for Core Inflation (ex food & energy, dotted line) compared to the +0.3% expected was driven by an uptick in Services inflation.

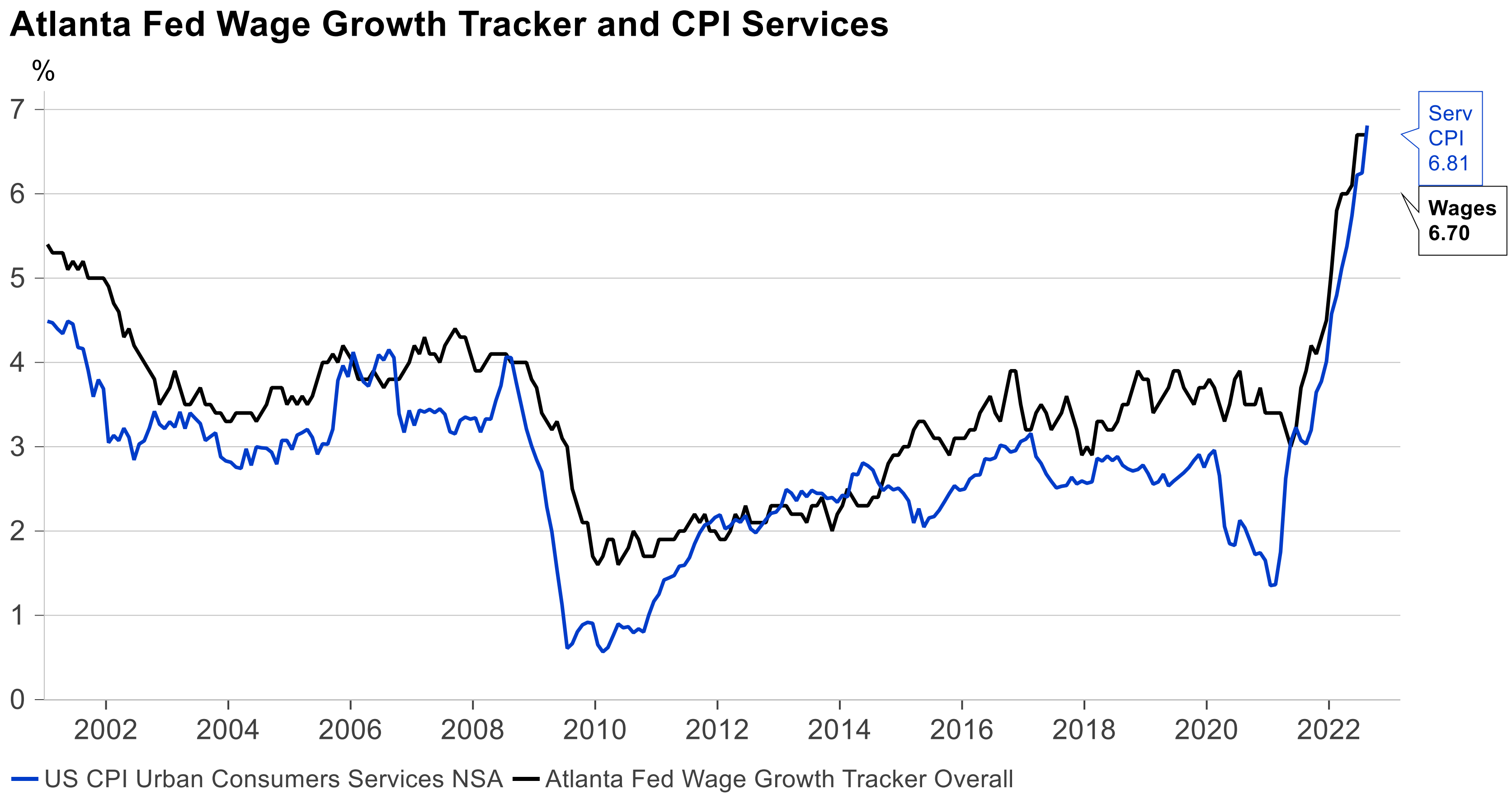
Goods inflation is passing the buck to Services inflation.

Services inflation (purple bar) accelerated to +0.33% in August vs. +0.2% in July.

Services is 57% of the CPI index and tends to be "stickier", meaning that it is not as volatile, so when it goes high, it stays high.

NewEdge WEALTH

Services Inflation Tracks Wage Increases: Both are Sticky



Source: NewEdge Wealth, Macrobond, Bloomberg
As of: 9/19/22

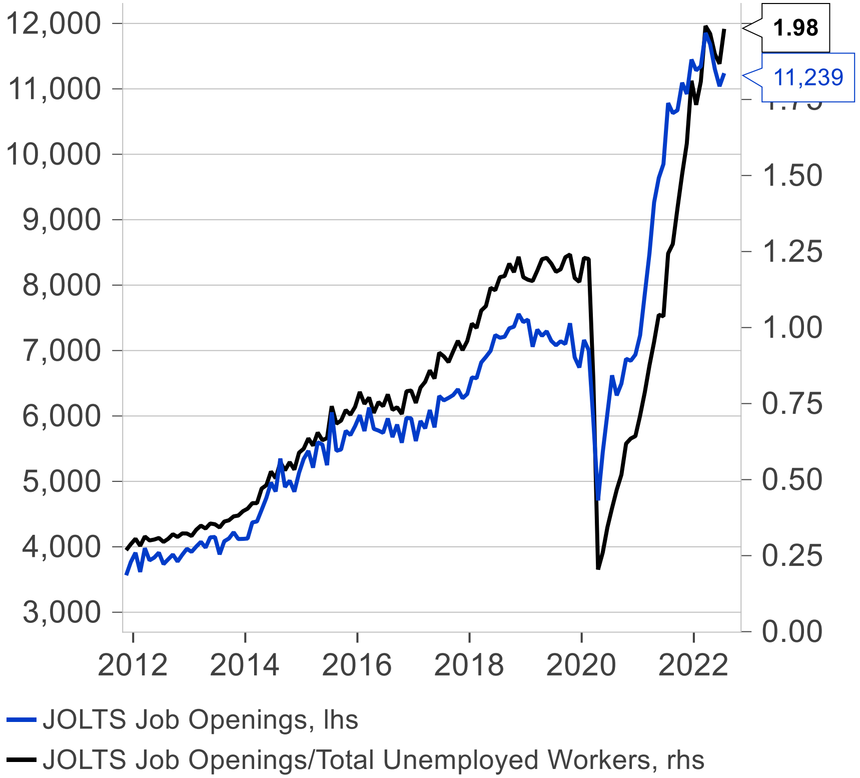
Wages are sticky. Companies are slow to raise wages, but they are also very slow to cut wages once they have raised them.

Wages drive Services inflation, which tends to be centered on more labor-intensive industries (compared to Goods, which can be driven by non-labor factors like commodity prices).

We think the driver of inflation, and thus the focus of the Fed in its fight against inflation, has shifted from goods & supply chains to services & labor markets.

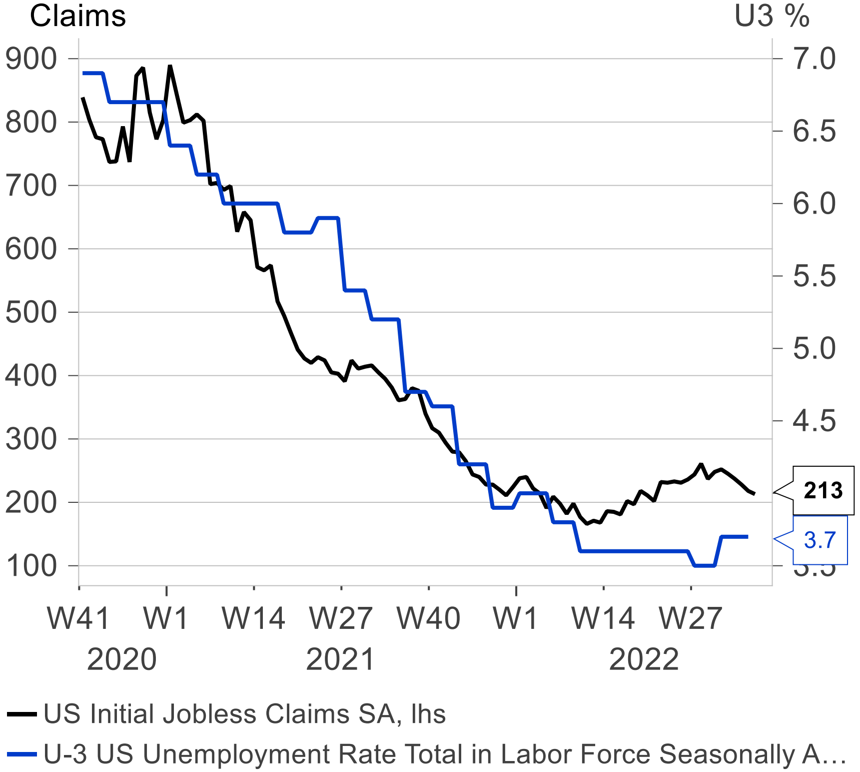
The Labor Market Remains Very Tight, Despite Fears of a Slower Economy

Job Openings and Job Openings Per Unemployed Worker



Source: NewEdge Wealth, Macrobond, Bloomberg

US Initial Jobless Claims and Unemployment Rate



Source: NewEdge Wealth, Macrobond, Bloomberg
As of: 9/19/22

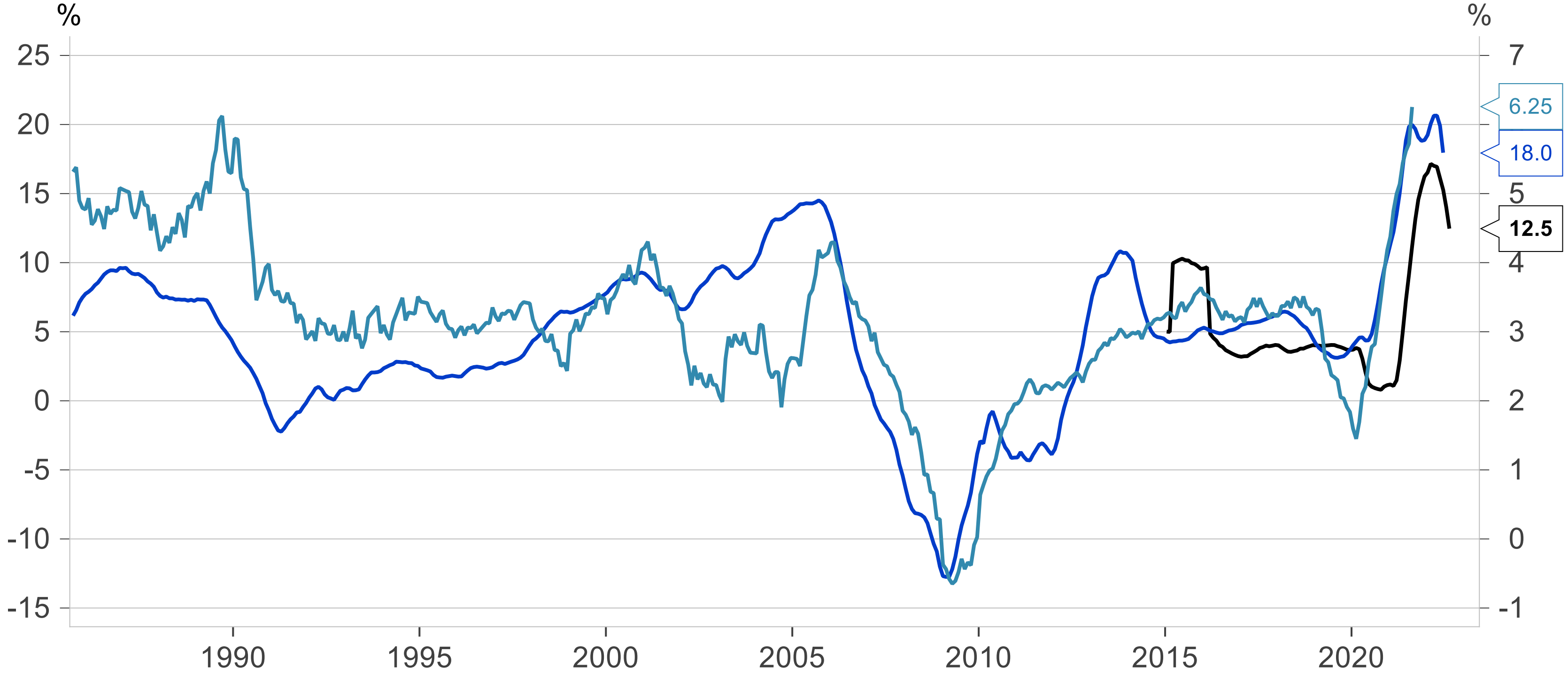
Though Job Openings have come off their peak, there are still nearly 2 jobs open for every unemployed person in the US.

Despite fears of a slowing economy, along with high profile announcements of layoffs, initial jobless claims have been trending lower in recent weeks.

But there remains little slack in the labor market, creating an environment that supports higher wages and thus higher Services inflation. The Fed will tolerate higher unemployment and will likely focus on labor markets, a lagging indicator, to determine when it has gone "too far".

Housing Also Driving Services Inflation

Zillow Rent Index YoY, US Shiller Home Prices YoY, and Housing Components of CPI (4 quarter lead)



Source: NewEdge Wealth, Macrobond, Bloomberg Zillow, S&P Global, U.S. Bureau of Labor Statistics (BLS)
As of: 9/19/22

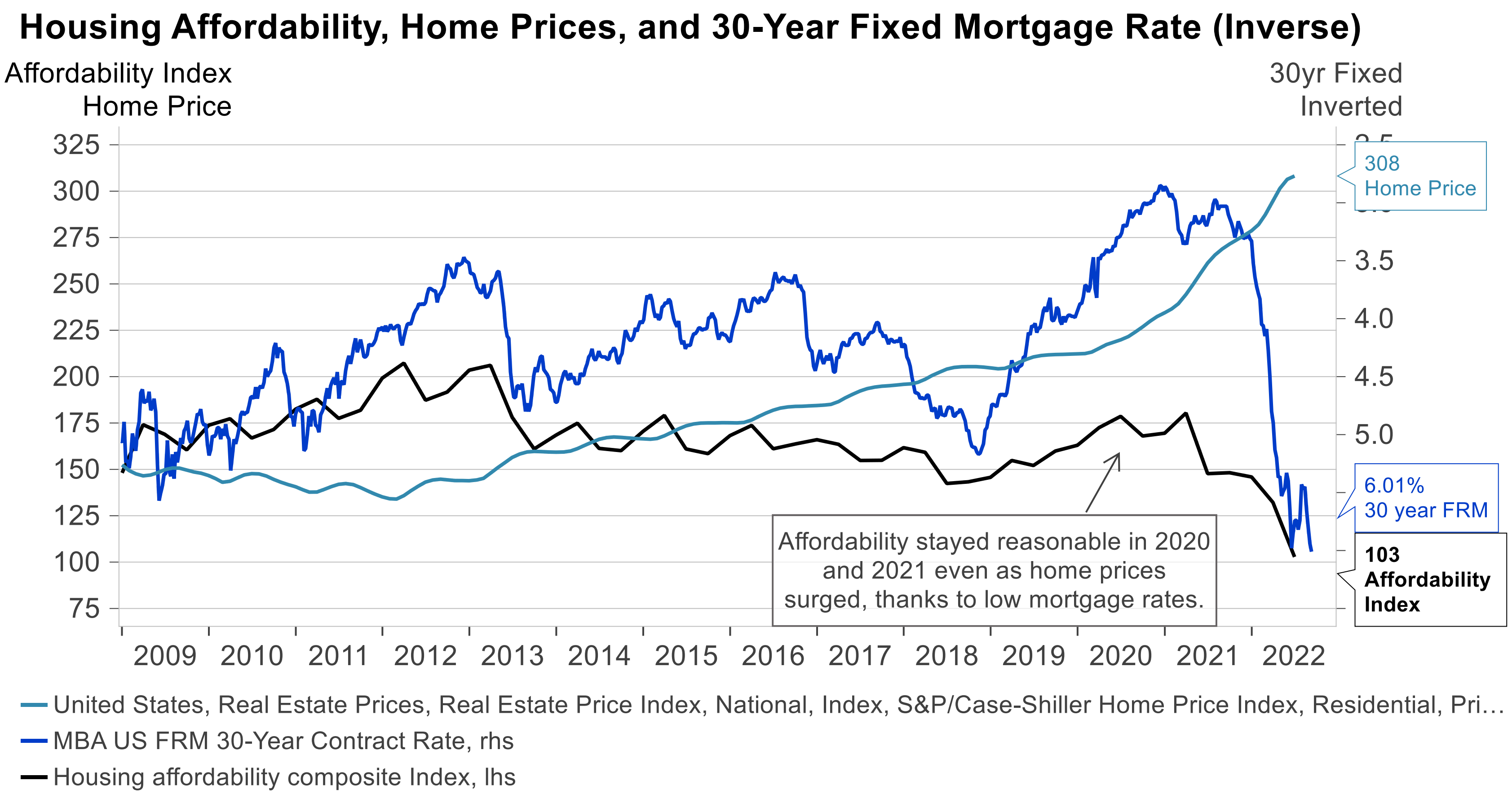
Shelter components make up 32% of the CPI and are now running at ~6.25% YoY.

Importantly Shelter CPI lags home prices (Case-Shiller) and rent (Zillow) by about ~4 quarters.

This means that the slowing in housing activity and prices will take time to be reflected in lower inflation prints.

The Fed may acknowledge this and “look through” high Shelter inflation in the near-term, but the Fed also acknowledges that its ultra-loose policy contributed to higher home/rent prices, meaning they will be hesitant to ease policy and reignite this source of inflation.

The Fed's Role in Housing Inflation



Source: NewEdge Wealth, Macrobond, Bloomberg S&P Global
As of: 9/19/22

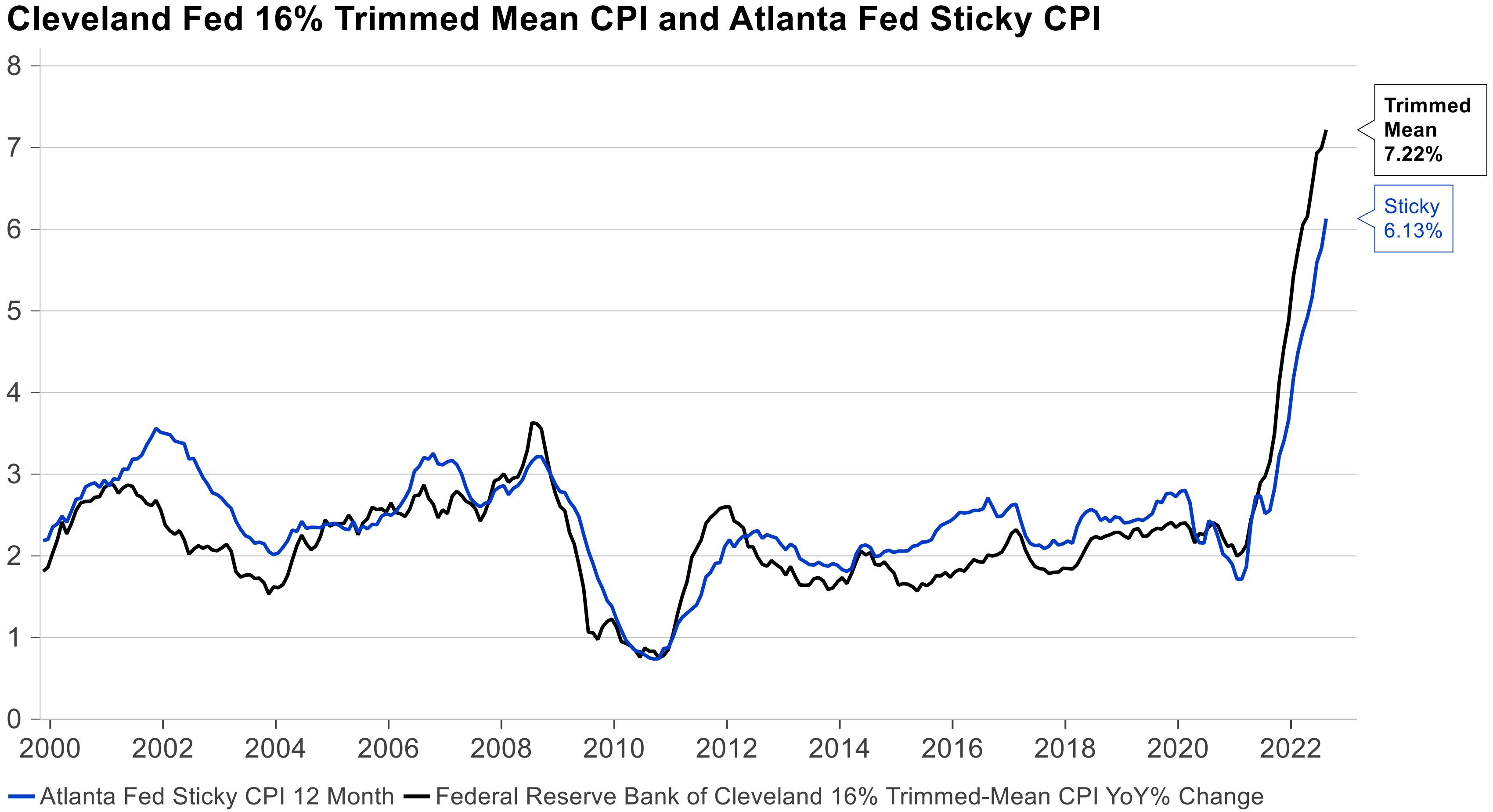
One factor that could keep the Fed from a quick pivot to accommodation is its acknowledgment of its role in today's high housing inflation.

Clearly there are structural issues (low supply given demographics), but by keeping mortgage rates artificially low in 2020 and 2021, the Fed fueled the surge in home prices. This is because even as home prices were rising rapidly, affordability remained stagnant given low and falling mortgage rates.

Now affordability is collapsing as mortgage rates surge (inverted in this chart).

If the Fed cuts rates and mortgage rates fall, will housing inflation take off again?

Other Preventions of Pivots: Sticky and Broad Inflation Still Haven't Peaked



Source: NewEdge Wealth, Macrobond, Bloomberg
As of: 9/19/22

No peak in sight for Sticky measures of inflation (those factors that move more slowly and are thought to reflect a greater signal about future inflation expectations) and inflation Breadth.

Inflation breadth is measured by the trimmed mean CPI, which shows that even as some factors, like Energy prices, are pulling headline CPI lower, the majority of inflation components remain elevated and well above the Fed's target.

Hard to see a pivot before these measures show distinct moderation.

Sugar, We're Going Down?:

Valuation and EPS estimate headwinds, technicals put June lows in play

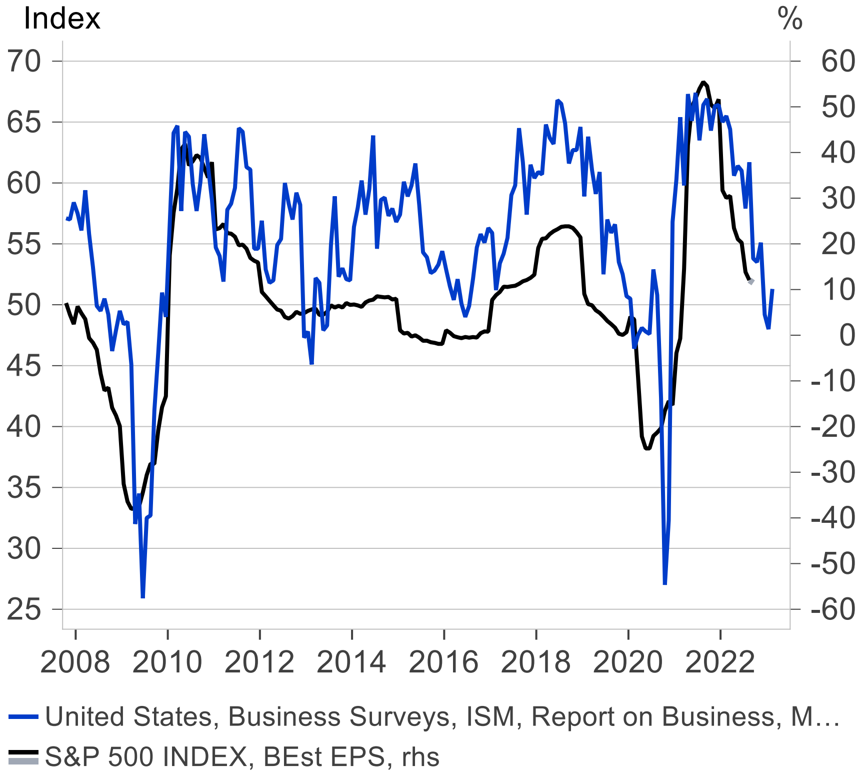
Liquidity Drives Valuations, Growth Drives Earnings

Continued Liquidity Tightening Does Not Support Current Valuations

S&P 500 Current PE Ratio and M2 Money Supply Growth

Source: NewEdge Wealth, Macrobond, Bloomberg

S&P 500 EPS YoY and PMI New Orders-Inventories (9 month lag)



Source: NewEdge Wealth, Macrobond, Bloomberg Institute for Supp

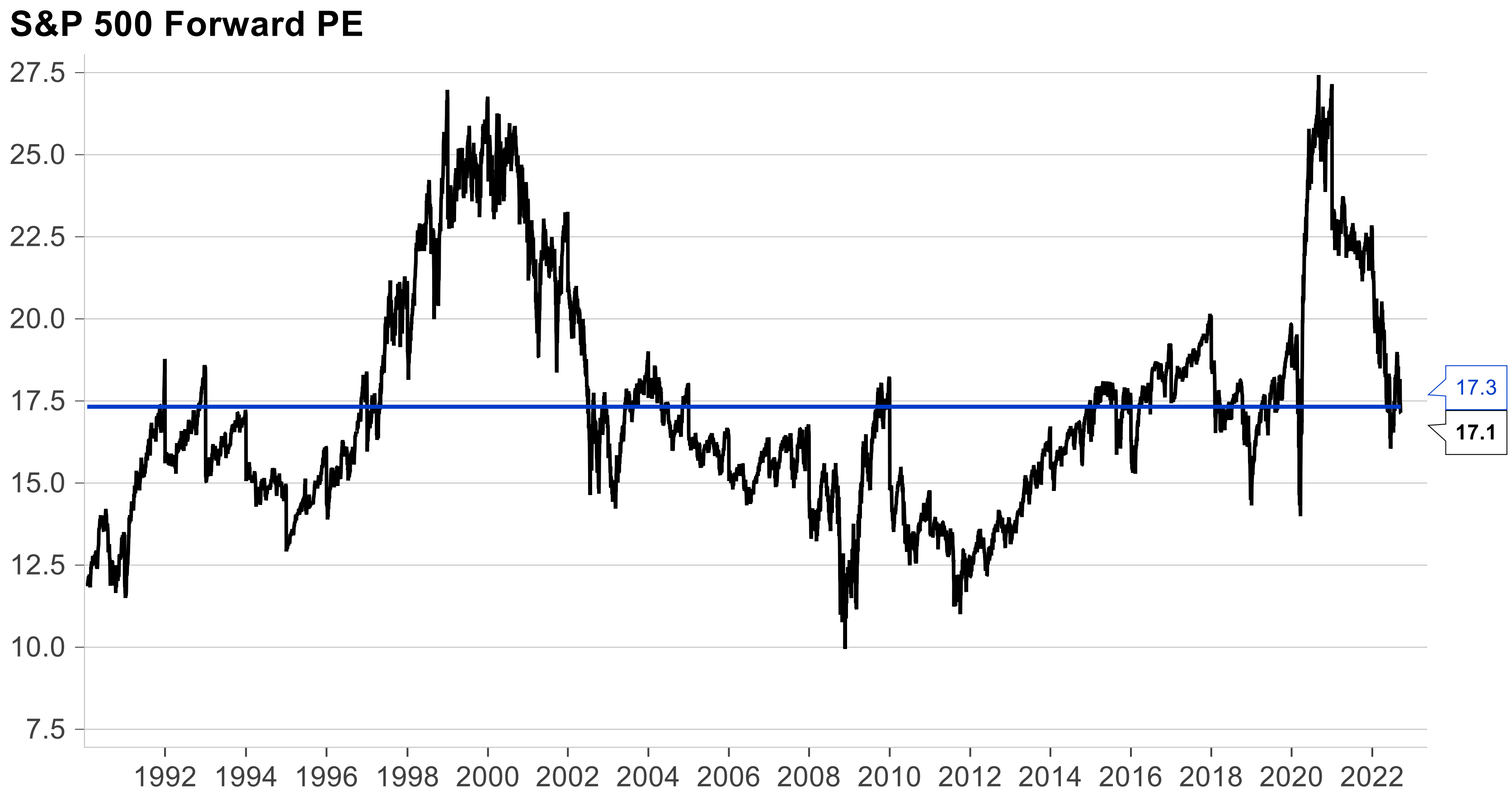
As of: 9/19/22

Liquidity conditions (captured broadly here by M2 Money Supply Growth) drive PE valuations.

Growth (captured here with leading PMI components) drive EPS growth.

The slowing pace of money supply growth puts a lid on multiple expansion, while the slowing in leading growth indicators points to lower EPS growth going forward.

The Bubble is Over, but Equities Are Not "Cheap", Just Average



Source: NewEdge Wealth, Macrobond, Bloomberg
As of: 9/19/22

Valuations have fallen materially since their late-2020 stimulus-fueled peak.

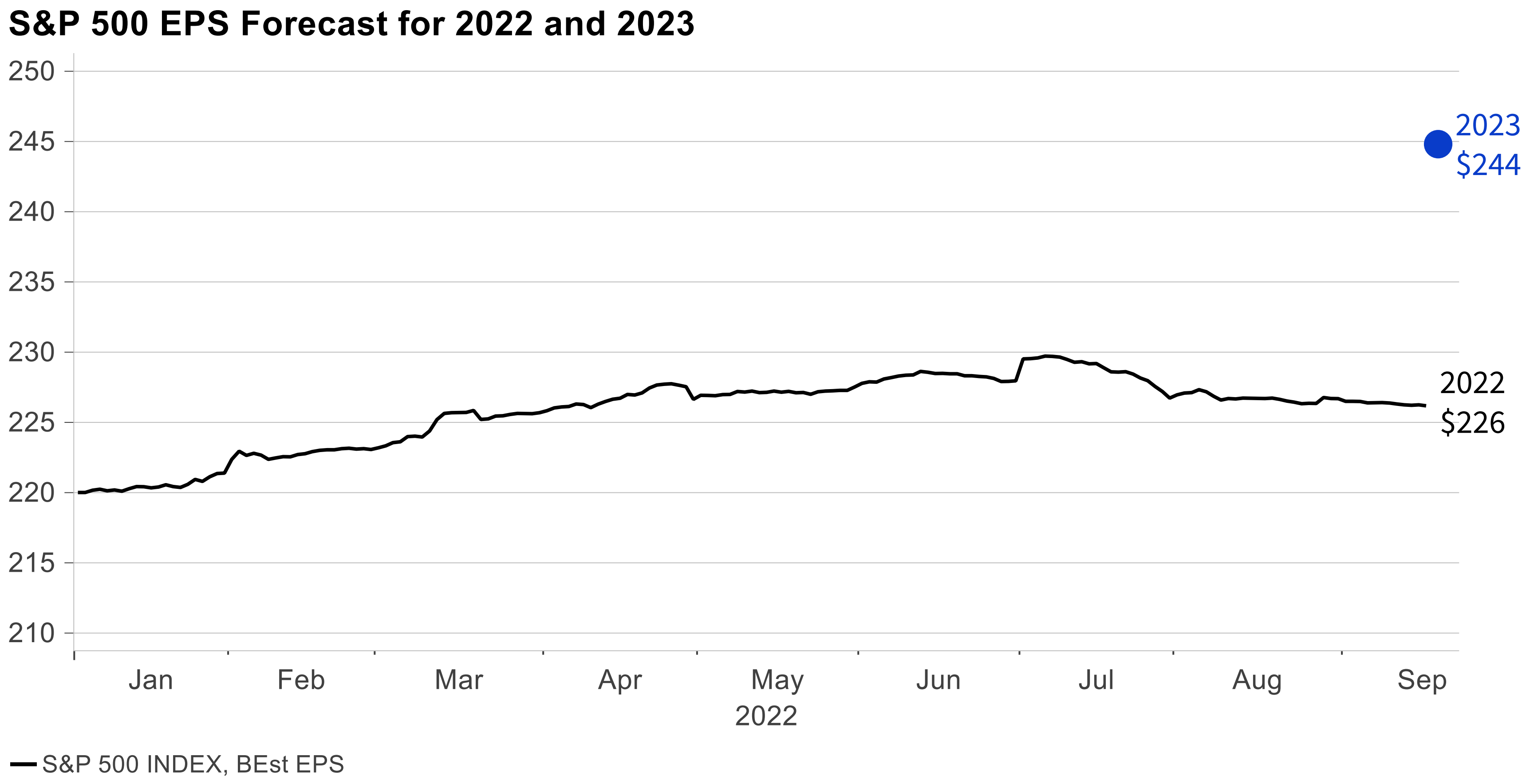
But at 17.4x forward, valuations are not cheap, they are just average.

Typically, in tightening cycles and/or recessions, valuations go well below average.

We think valuations place a near term ceiling on markets. Stock valuations peaked in early 2018 and early 2019 at ~19x. Unless we go back into a bubble/ultra-easing cycle, valuations cannot be sustained higher.

This puts the onus on earnings to deliver upside to stock prices.

While EPS Estimates Remain Elevated



Source: NewEdge Wealth, Macrobond, Bloomberg
As of: 9/19/22

Despite fears of slowing growth EPS estimates for 2022 (+11%) and 2023 (+8%) remain elevated.

This is partially because 2Q22 EPS came in better than expected and did not spark big estimate cuts.

We see risks that 2023 numbers are too high due to the strong USD, slowing economic growth, tough growth comparisons, and being in a tightening cycle. This backdrop is more consistent with EPS growth in the low-single-digits.

The Wedge: The Break Below 3,900 Puts a Retest of June Lows in Play

S&P 500 Index
With 50 (pink), 100 (green), and 200 (purple) Day Moving Averages and Trend Lines Drawn (Red)

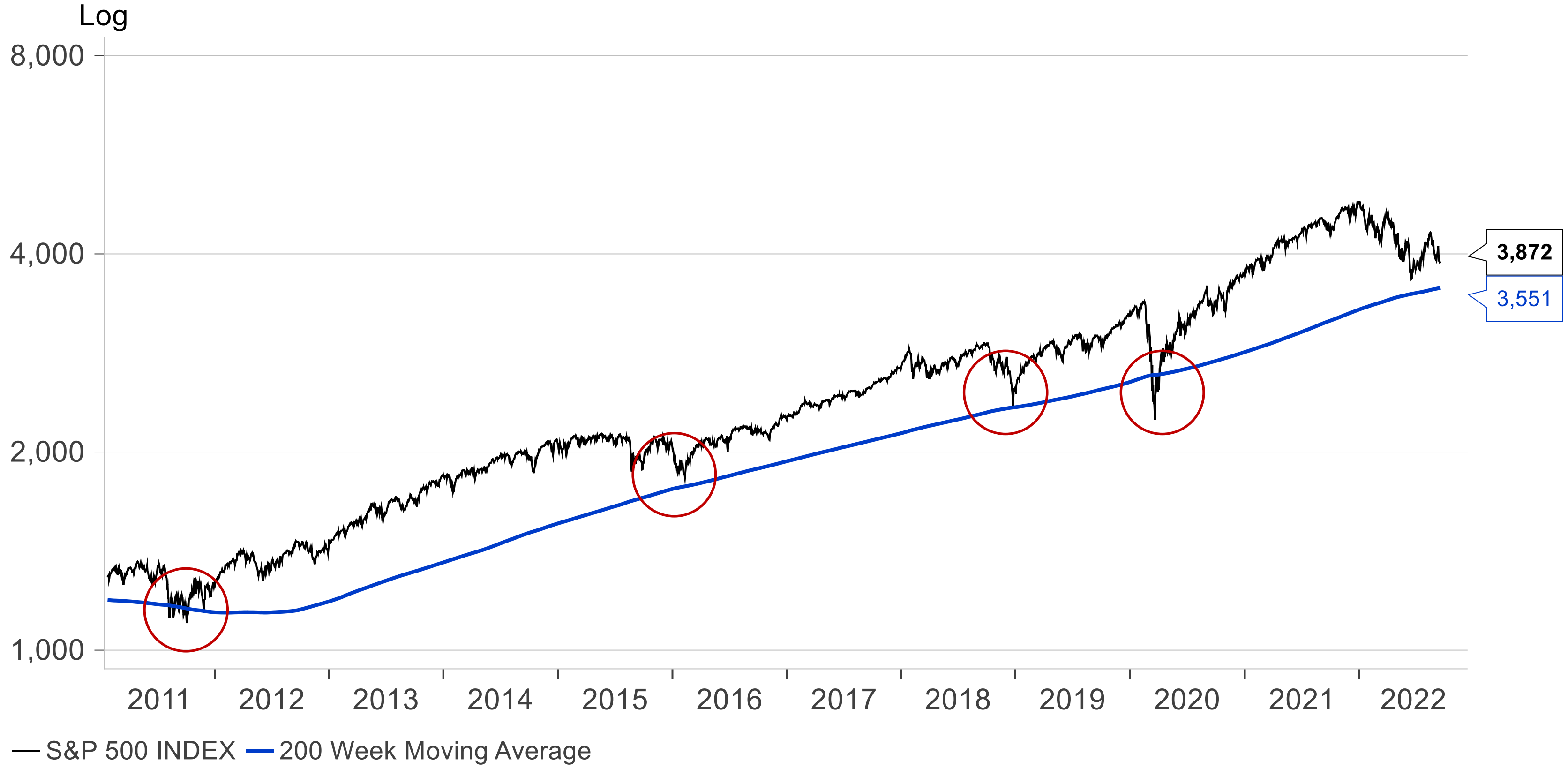
Friday's break below 3,900 puts a retest of the June lows in play.

There is considerable upside resistance ~4,200 (downtrend and downward sloping 200-DMA).

We still do not want to chase rallies in this market, given the downtrend.

Important Support to Hold at 200 Week Moving Average

S&P 500 with 200 Week Moving Average



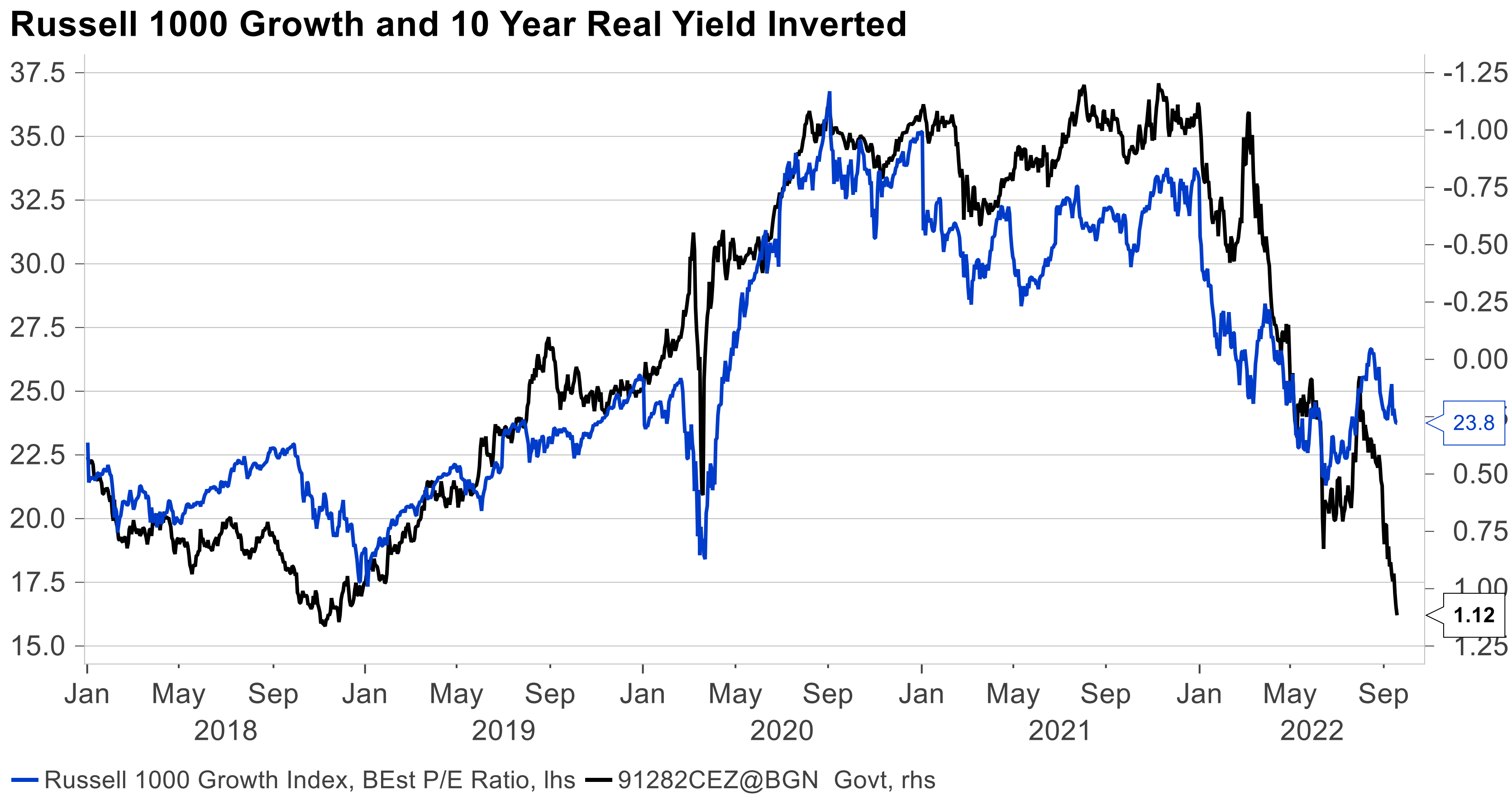
Source: NewEdge Wealth, Macrobond, Bloomberg
As of: 9/19/22

Since the GFC lows, the secular bull market has found support at/near its 200-week moving average.

We think this is both an important support level to hold and a point where the risk/reward for long-term investors begins to look more attractive looking out 12-24 months.

This is not to say that the 200-week will be the ultimate low (we could have a liquidity event or a deeper earnings recession that drives markets lower), *and* the macro/policy backdrop that supported markets since the GFC is different (market helped by easy Fed that was willing and able to support markets because of benign inflation).

Growth PE Multiples are Particularly High Given Rates Backdrop



Source: NewEdge Wealth, Macrobond, Bloomberg
As of: 9/19/22

Growth PE's and real interest rates are inversely correlated: higher real interest rates typically drive lower Growth valuations.

Today, Growth valuations have been resilient compared to the level of real rates.

We see risk for further downside for Growth PE's given the tighter liquidity and higher real interest rate backdrop.

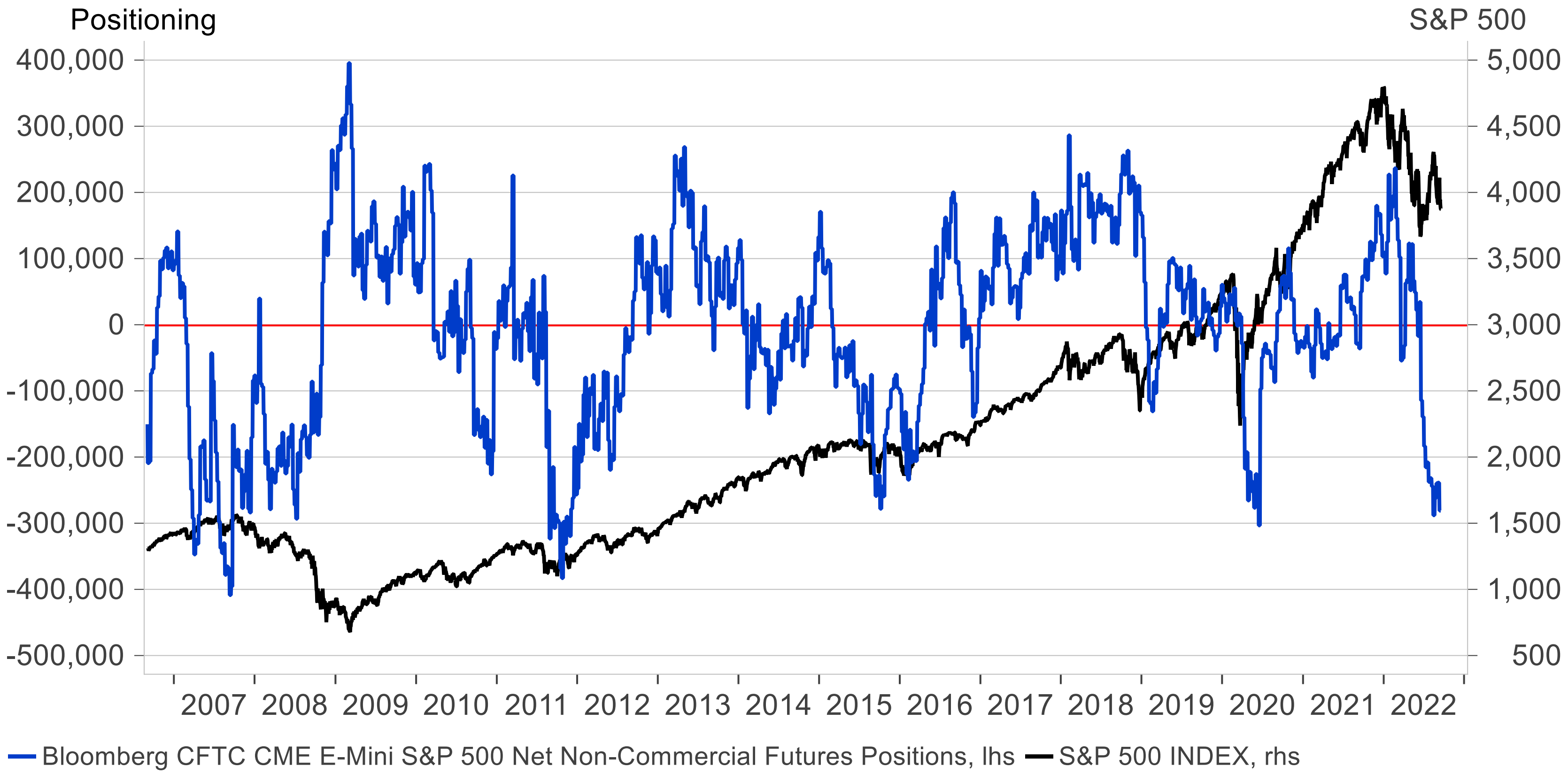
Further, at 24.3x, Growth PE's are at their pre-pandemic peak. Without a return to aggressive pandemic era stimulus/bubble, we think Growth PE's hit a ceiling near these levels (limiting upside for stocks in the near term).

I'm Not Okay (I Promise):

Sentiment and Positioning Check

Futures Positioning Remains Very Short S&P 500

CFTC S&P 500 Futures Positioning and S&P 500



Source: NewEdge Wealth, Macrobond, Bloomberg
As of: 9/19/22

Remember, this futures data only shows one aspect of positioning.

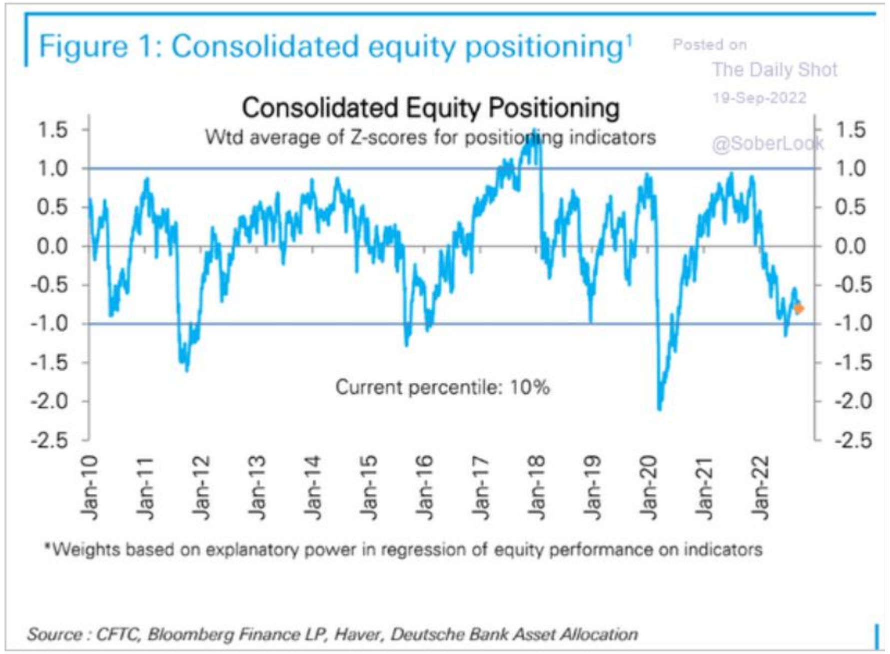
However, the degree of short/bearish positioning is notable and could be tailwind for markets (meaning if “everyone” is already positioned short, how much more selling pressure can be realized).

The thing to remember with positioning is that in longer term bear markets, the timing signal of positioning is not useful.

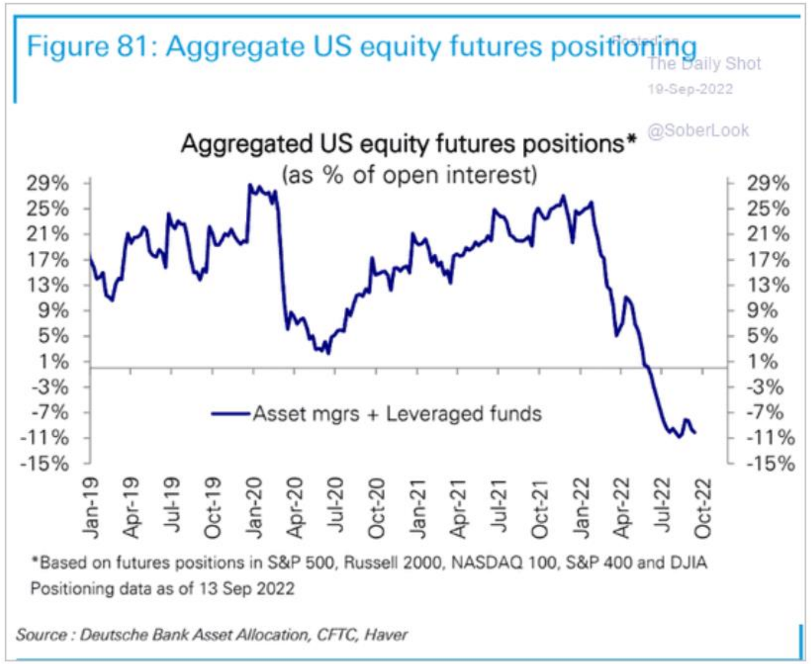
Look at the GFC bear, with max short positioning in 2007, long before the lows.

Again, this is only one aspect of positioning.

Institutional Positioning Remains Light for Equities



Source: Deutsche Bank Research



Source: Deutsche Bank Research

Charts via: The Daily Shot

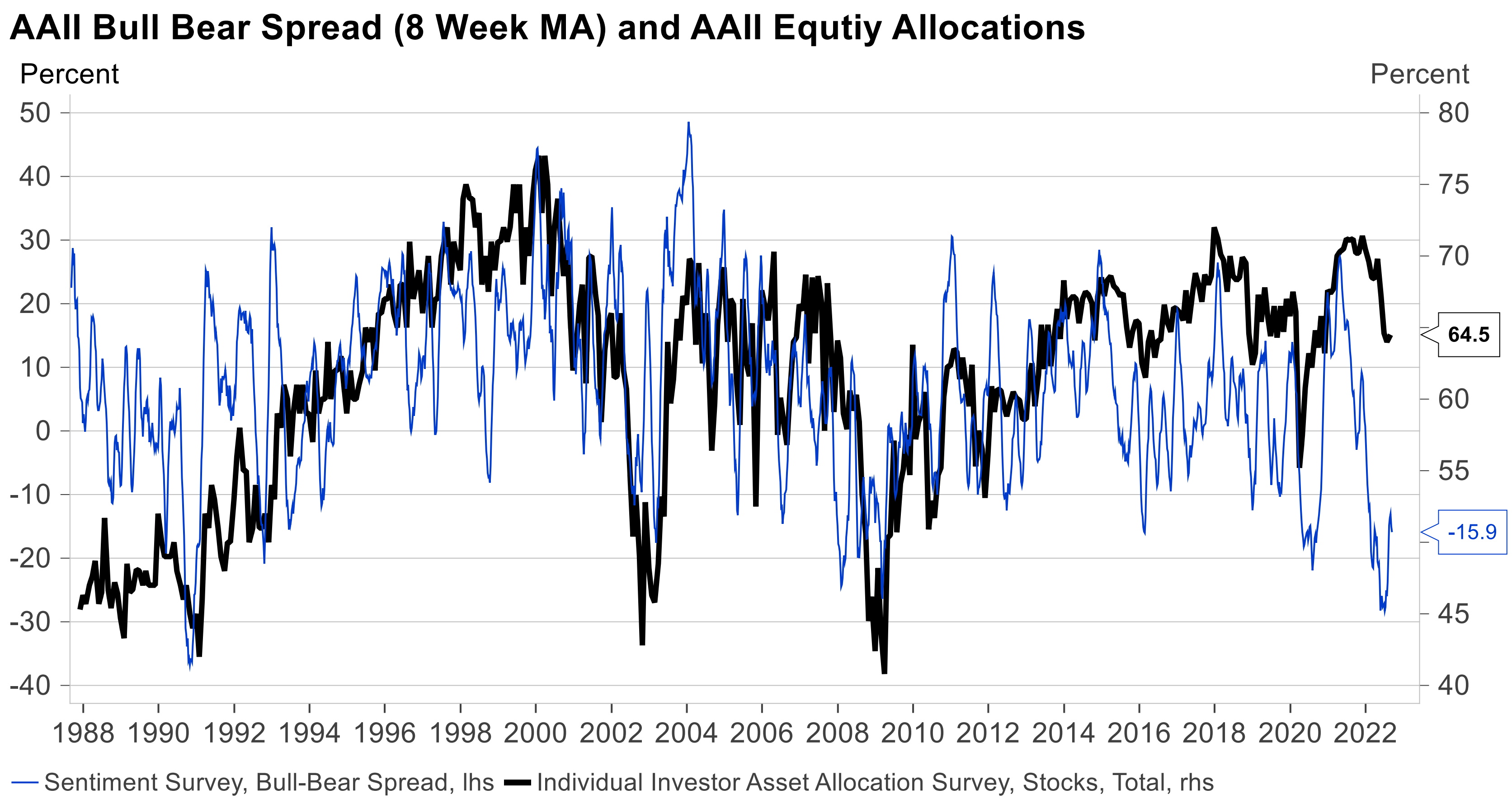
As of: 9/19/22

Institutions (asset managers, hedge funds, etc.) have reduced their exposure to equities, expressing more caution about the outlook.

Again, positioning lows don't have to coincide with market lows. Sometimes positioning is late (i.e., peak short positioning in 2020 came *after* the March bottom as asset managers stayed too bearish) and sometimes positioning is early (i.e., peak bearish positioning during the GFC hit in October 2008 but the market didn't bottom until March 2009 and another ~30% lower).

Positioning being light is net bullish for the market.

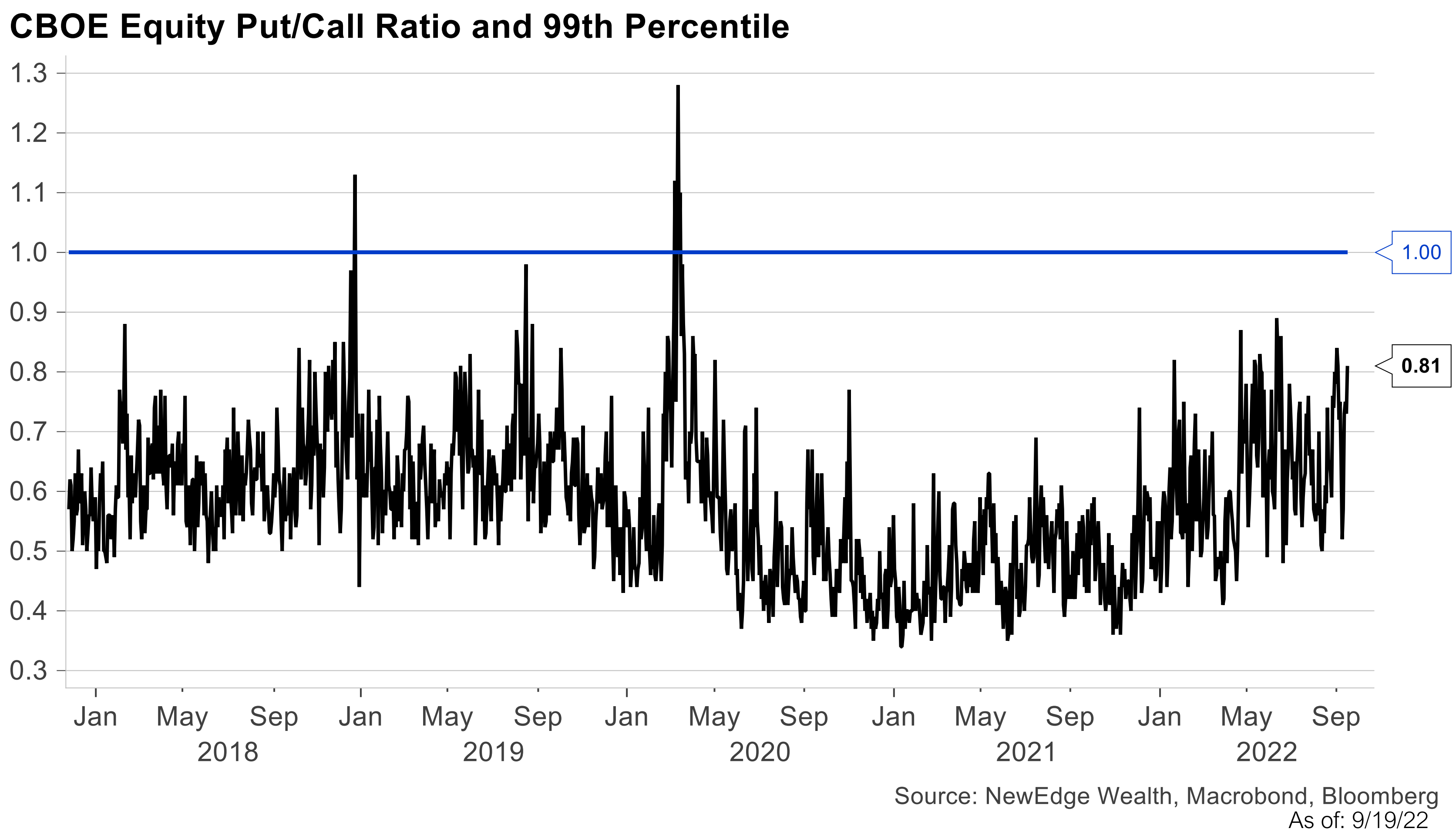
While Individual Investors Have Not Thrown in the Towel



Source: NewEdge Wealth, Macrobond, Bloomberg American Association of Individual Investors (AAII)
As of: 9/19/22

Individual/retail investors remain resolute in their equity positioning, with exposure to equities remaining elevated (~65%) given the degree of the bear market drawdown and the extreme bearish sentiment seen earlier this year.

Put/Call Remains Elevated but Not Extreme



The equity Put/Call ratio captures how much investors are willing to pay for downside protection with puts vs. upside optionality with calls. The higher the ratio, the more investors are clamoring for downside protection.

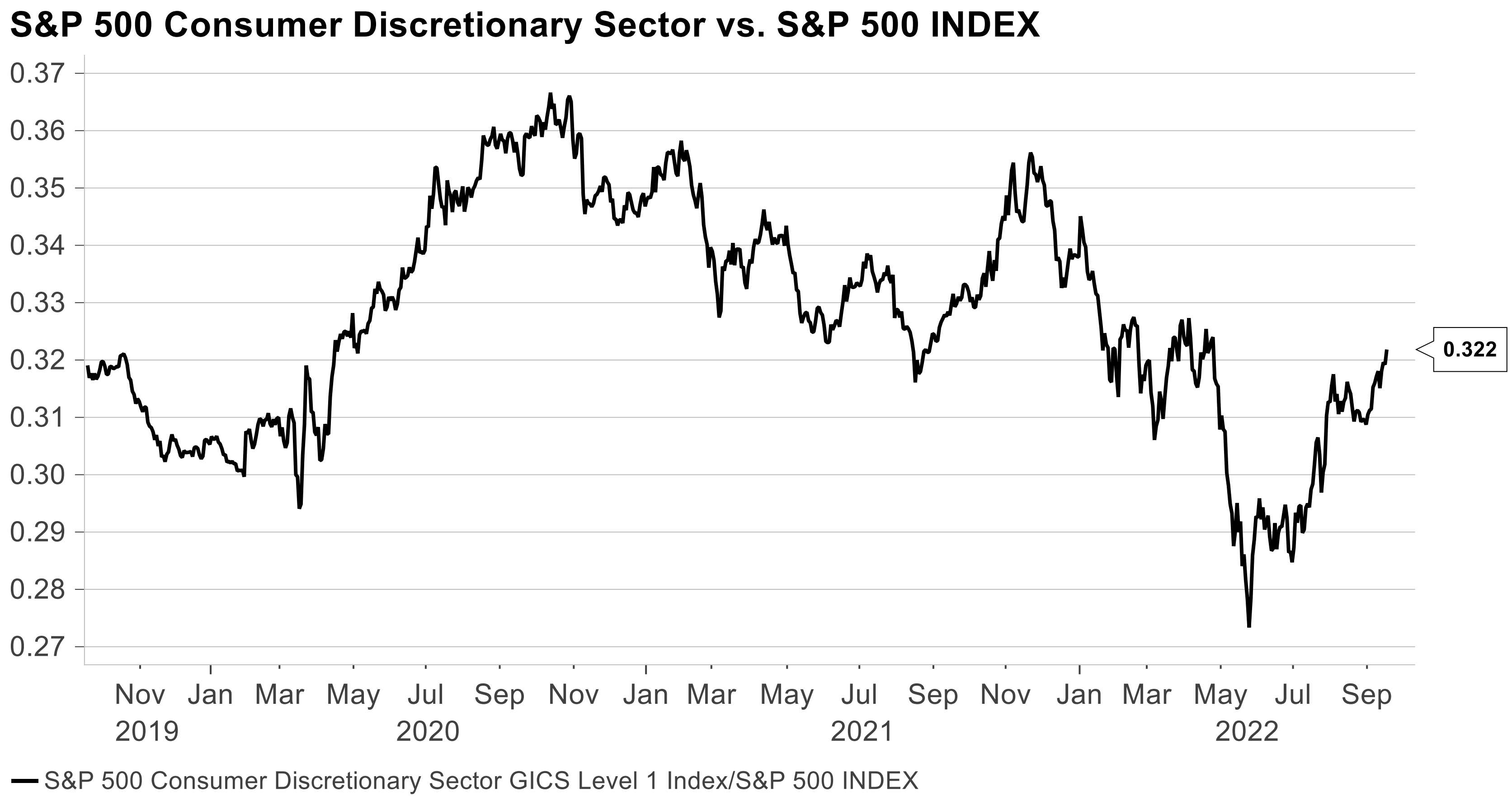
Put/Calls typically spike during market flushes as investors get scared and look to insulate portfolios.

All of 2022, put/call has been elevated but not extreme.

Looking For Signs of Life:

Appetite for cyclicals and risk under the surface is bullish

Surprising Relative Strength Out of Cyclical Sectors



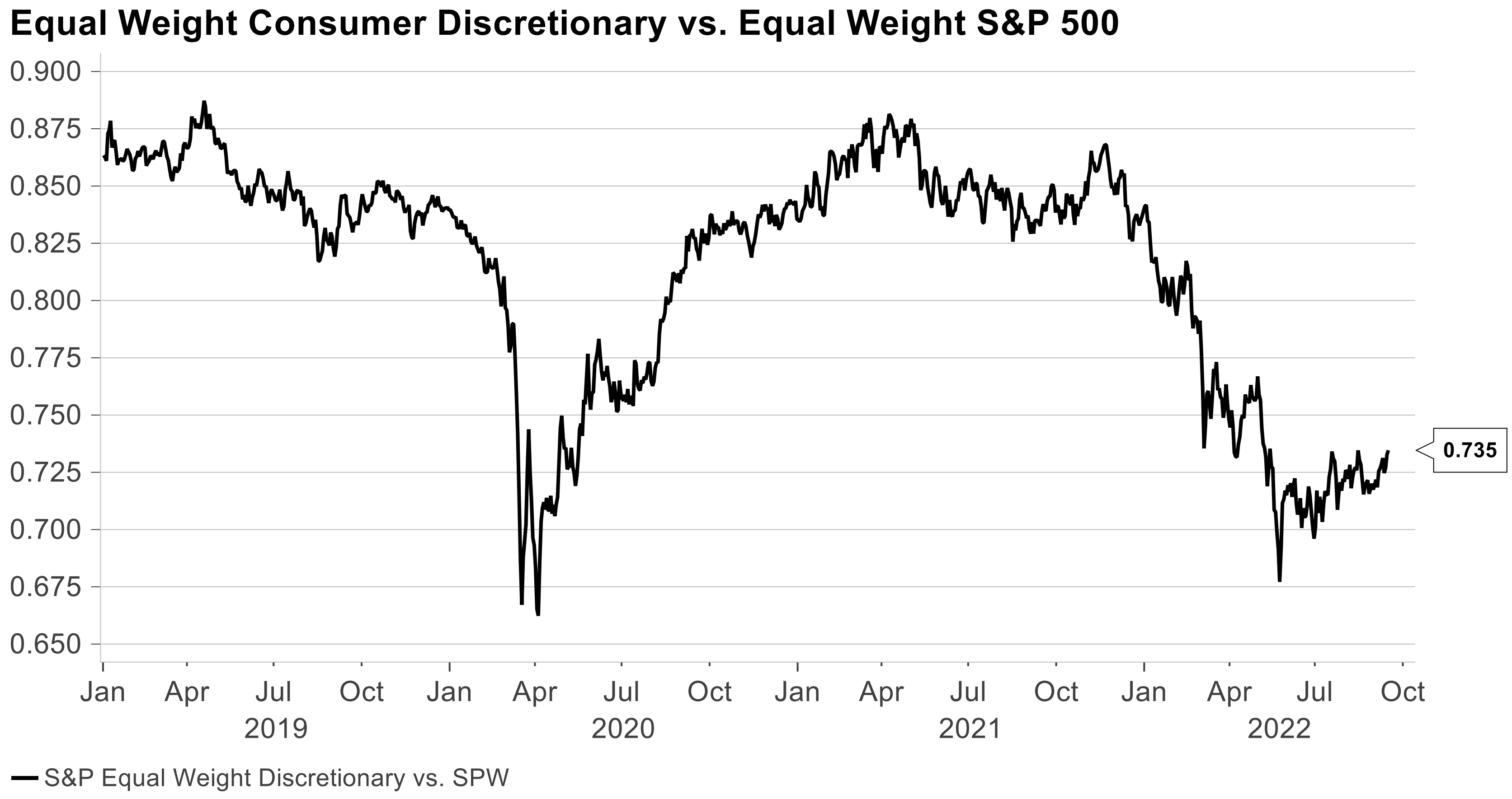
Source: NewEdge Wealth, Macrobond, Bloomberg
As of: 9/19/22

Despite fears about the US consumer given inflation, negative *real* wage growth, poor sentiment, and lack of government support, Consumer Discretionary stocks have been outperforming since late May (they bottomed before the market bottomed in June).

The outperformance of Discretionary vs. the market was a key sign of risk-on, cyclical appetite coming out of the 2020 lows.

Note 44% of this cap weighted index is AMZN and TSLA, which are having outsized influence on the outperformance of the sector.

Equal Weighted Consumer Discretionary Not As Compelling, but Still Better



Source: NewEdge Wealth, Macrobond, Bloomberg
As of: 9/19/22

To remove the impact of AMZN and TSLA, we can look at the equal weight version of both the Consumer Discretionary and S&P 500.

The story is similar, but a little less pronounced: since late May Consumer Discretionary stocks have been showing surprising strength.

Discretionary is contrarian and typically outperforms when the data is the worst (can't get any worse) and underperforms when the data is the best (can't get any better).

This is one of the more bullish signals in today's markets.

NewEdge WEALTH

Quiet Outperformance from Small Caps, But Careful of Head Fakes

Small caps have been quietly outperforming since May.

This is peculiar given the backdrop of tighter liquidity and earnings risk. Small caps tend to struggle more in tightening cycles and recessions, as they have more trouble accessing capital and see greater volatility in their earnings.

This could be a head fake, like what we saw in late 2021 where small caps outperformed briefly only to be clobbered in early 2022.

Or this could be the market sniffing out better risk appetite, liquidity, and growth on the horizon.

We are somewhat dubious given small caps typically only experience sustained outperformance at the beginning of easing cycles.

High Yield Spreads Remain Well Below June Lows

Source: NewEdge Wealth, Macrobond, Bloomberg
As of: 9/19/22

Despite renewed equity market weakness, high yield spreads remain well below the June lows.

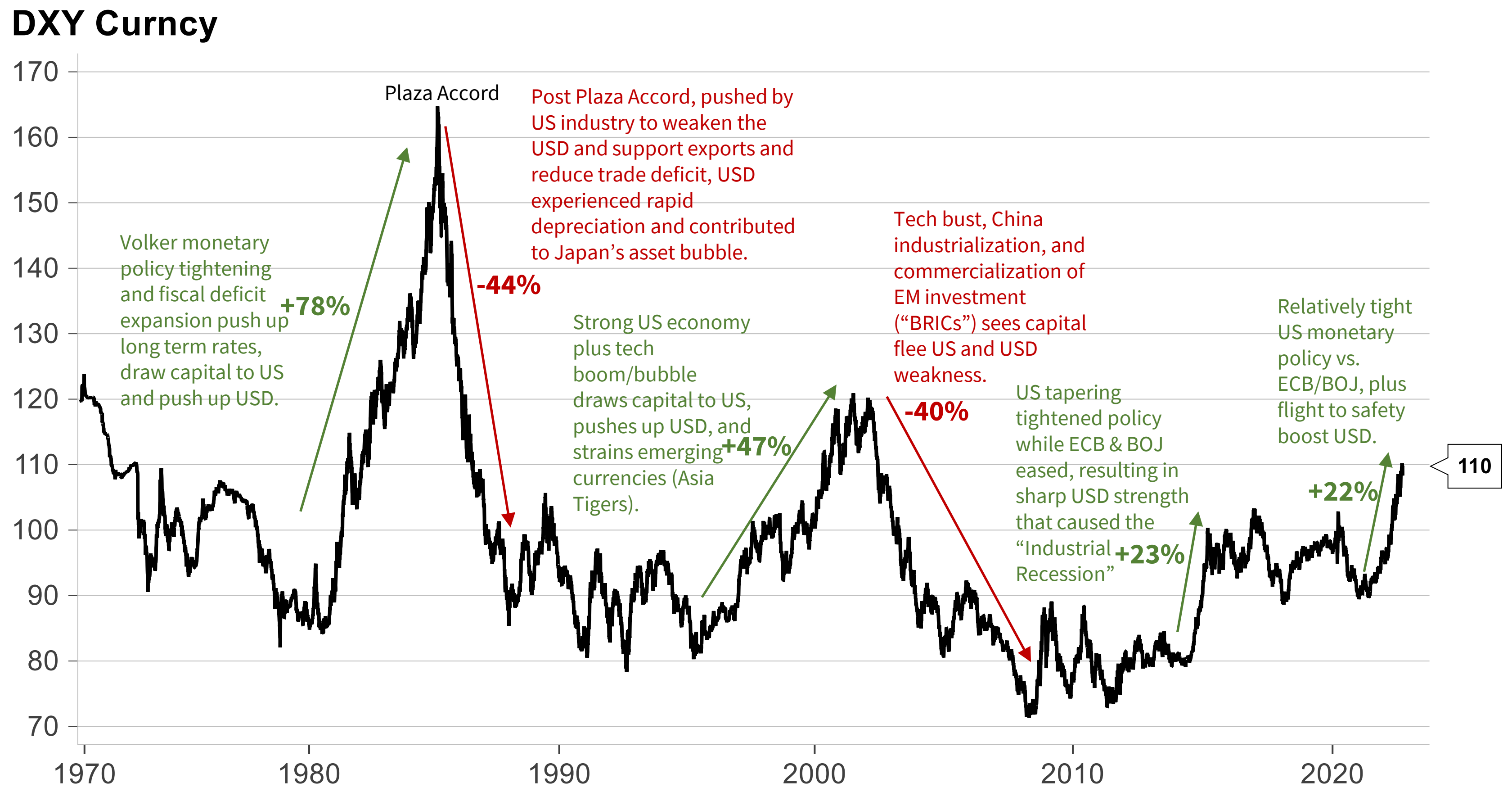
High yield performance has been weak as overall yields have risen, but the extra compensation high yield investors are demanding to hold this riskier paper has not blown out.

This could either be a delayed reaction (more widening to come), or the bond market signaling that a hard landing (with its concomitant business failings and funding market closing) can be averted.

King Dollar:

The Impact and Aftermath of a Strong USD

Big USD Cycles Have Big Implications



Source: NewEdge Wealth, Macrobond, Bloomberg
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The USD has experienced big up and down cycles over the past 50 years driven by capital movement, direct intervention, central bank policy, and more.

For now, the USD is in a distinct uptrend, but a period of sharp USD weakness would have important implications on equity market performance and asset allocations.

The only times in the last 50 years we have had experienced *sustained* and *pronounced* periods of int'l equity market outperformance is when the USD has had a *sustained* and *pronounced* period of weakness (and both ended with an int'l bubble bursting!):

1985-1990 (ended as Japanese bubble burst)

2002-2008 (ended as EM/China bubble burst)

No Signs of Life in Non-US Markets Overall: Distinct Downtrend

MSCI World Excluding United States Index vs. S&P 500

Source: NewEdge Wealth, Macrobond, Bloomberg

As of: 9/19/22

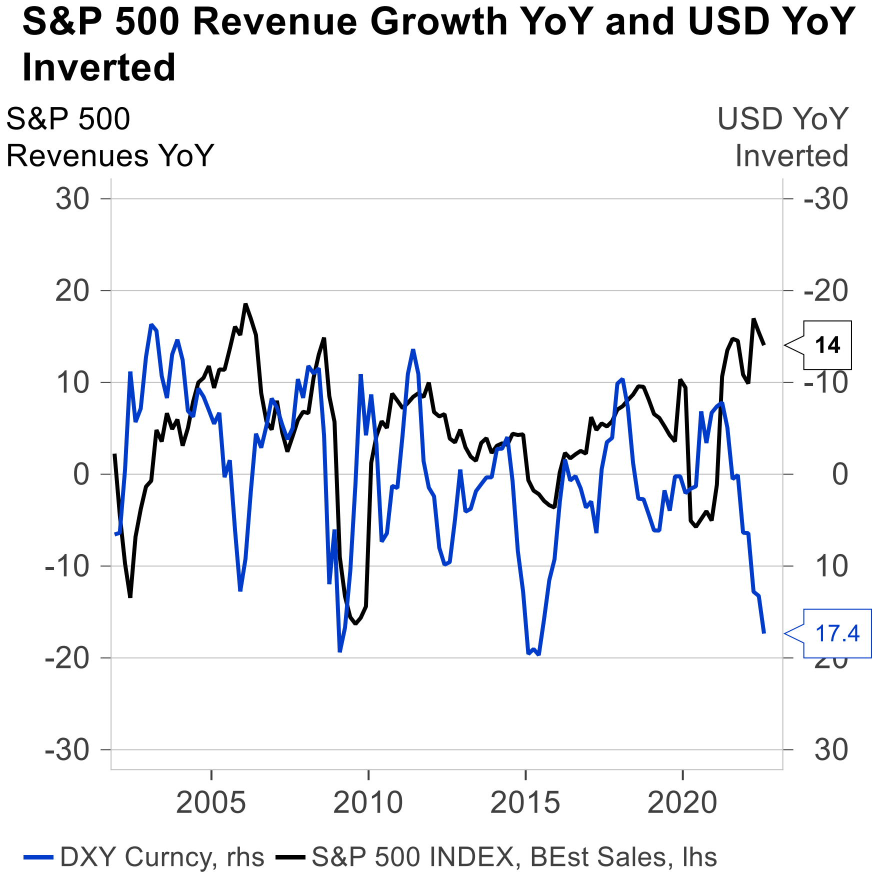
The 14-year bear market in relative performance for non-US markets continues.

Cheap valuations are a trap (we have shown lack of EPS growth for non-US markets over the last 10+ years in prior decks).

Until there is a catalyst to draw capital out of the US (which we think would have to be a major top in the USD) and a driver of relative int'l EPS growth outperformance, we do not think that broad overweight's to non-US markets are warranted.

More Stress if USD Continues to Climb?

Source: NewEdge Wealth, Macrobond, Bloomberg



Source: NewEdge Wealth, Macrobond, Bloomberg

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There is now nearly $12 trillion of foreign debt denominated in USD. As the USD appreciates vs. foreign currencies, it is more expensive for these foreign borrowers to repay the debt (because they need more of their local currency to pay for each USD).

Further, periods of weak revenue growth for US companies have typically coincided with periods of USD strength. This means that today's Revenue growth of +14% is inconsistent with the strength in the USD. There can be exceptions, like 2004-2005, but this was with a boom-like global economic backdrop.

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TIPS: Bloomberg Barclays Global Inflation-Linked: U.S. TIPS Total Return Index Unhedged
Municipals 5-Year: Bloomberg Barclays Municipal Bond 5 Year (4-6) Total Return Index Unhedged USD
Core Bond: Bloomberg Barclays US Agg Total Return Value Unhedged USD
U.S. MBS: Bloomberg Barclays US MBS Index
High Yield Municipals: Bloomberg Barclays Muni High Yield Total Return Index Value Unhedged USD
High Yield: Bloomberg Barclays US Corporate High Yield Total Return Index Value Unhedged USD
Foreign Bond: Bloomberg Barclays Global Aggregate ex-USD Total Return Index Value USD (50/50 blend of hedged and unhedged)
EM Debt (unhedged): J.P. Morgan GBI-EM Global Diversified Composite Unhedged USD
U.S. Large Cap: S&P 500 Total Return Index
U.S. Small Cap : Russell 2000 Total Return Index
International Developed: MSCI EAFE Net Total Return USD Index
Emerging Markets: MSCI Emerging Markets Net Total Return USD Index
World: MSCI ACWI Net Total Return USD Index
U.S. Equity REITs: FTSE Nareit Equity REITs Total Return Index USD
Commodities: Bloomberg Commodity Total Return Index
Midstream Energy: Alerian MLP Total Return Index
Hedge Funds: Hedge Fund Research HFRI Fund of Funds Composite Index
U.S.: MSCI USA Net Total Return USD Index

REITS Diversified: FTSE Nareit Eqty Diversified Total Return Index
REITS Healthcare: FTSE Nareit Eqty Health Care Total Return Index
REITS Industrial: FTSE Nareit Eqty Industrial Total Return Index
REITS Lodging/Resorts: FTSE Nareit Eqty Lodging/Resorts Total Return Index
REITS Office: FTSE Nareit Eqty Office Total Return Index
REITS Residential: FTSE Nareit Eqty Residential Total Return Index
REITS Retail: FTSE Nareit Eqty Retail Total Return Index
REITS Self Storage: FTSE Nareit Eqty Self Storage Total Return Index
REITS Data Centers: FTSE Nareit Equity Data Centers Total Return Index
REITS Specialty: FTSE Nareit Equity Specialty Total Return Index
Real Assets Agriculture: Bloomberg Sub Agriculture Total Return Index
Real Assets Industrial Metals: Bloomberg Sub Industrial Metals Total Return Index
Real Assets Precious Metals: Bloomberg Sub Precious Metals Total Return Index
Real Assets Energy: Bloomberg Sub Energy Total Return Index

Any questions?

Contact:

2200 Atlantic Street, Suite 200 • Stamford, CT

855.949.5855

cdawson@newedgecg.com