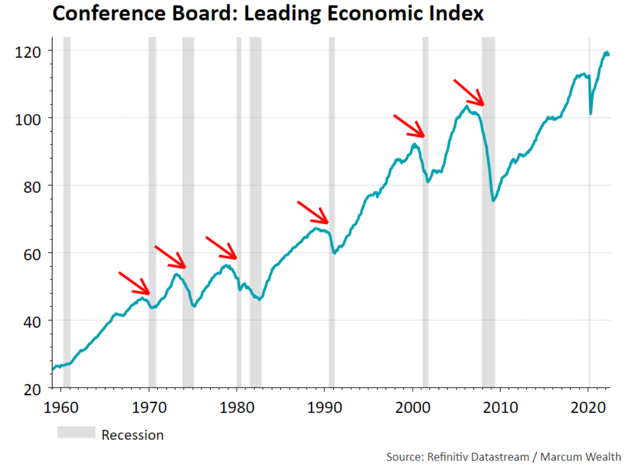
Strategy Newsletter – 3rd Quarter 2022

- Leading economic indicators are slowing while inflation remains hot.
- International equities along with small caps have historically low valuations.
- The bond market disagrees with the Fed's interest rate hiking plans.
- The winners and losers in commercial real estate separate with pricing power.

Economy

The first quarter of 2022 showed a 1.6% decline in GDP. Many estimate the second quarter will be negative as well, which would traditionally signal a recession. Yet the committee responsible for officially calling a recession, the National Bureau of Economic Research (NBER), says this may not be the case. In a Wall Street Journal article, the committee said, "A recession is a significant decline in economic activity spread across the economy."

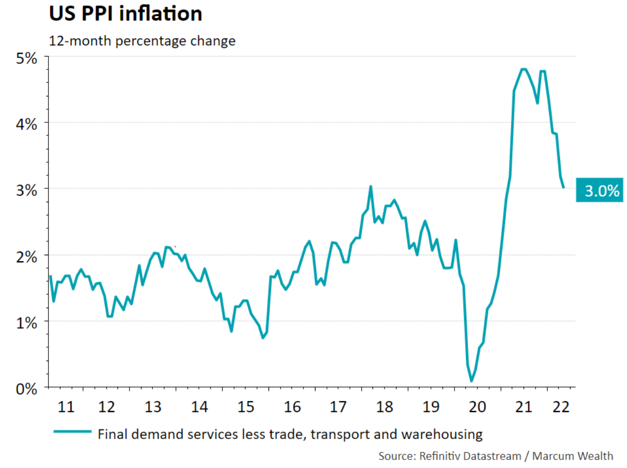
There is a variety of data to follow in calling and anticipating changes in economic activity. Broadly, these fall into three categories of indicators: lagging, coincident, and leading. The chart below shows the Leading Economic Index, which a combination of ten data points. Prior to past recessions, this index began to roll over. Currently its pace of increase has stalled.



Employment gains continue at a strong pace, adding 372,000 jobs in June. This would hardly indicate a recession, yet employment is a lagging indicator in the cycle.

It seems unlikely the economy is in a recession today, yet the risks of recession increased for the year ahead. Inflation-adjusted retail sales are down, while the Federal Reserve continues to increase interest rates to control inflation. Controlling prices is the main concern, which may come at the expense of economic growth.

Getting the most attention today is the inflation data, which came in at a year-over-year change of 9.1%. Yet there are beginning to be signs of less pressure on prices. Used car prices are down from the start of the year. The Producers Price Index (PPI), which measures the average change in selling prices by domestic producers increased at 3% rate, its lowest annual change since early 2021.



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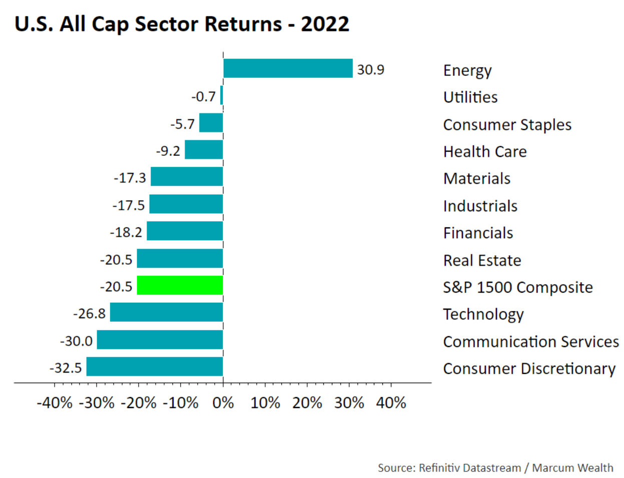
Equity

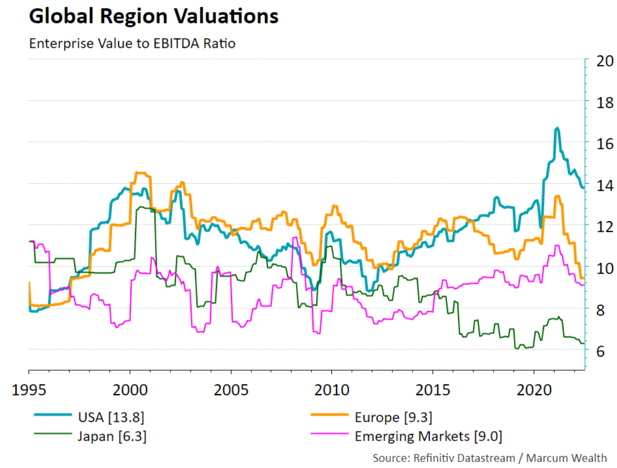
The selloff within equities occurred across markets during the quarter. Value outperformed growth, while small caps slightly edged out large caps.

U.S. Equity	2Q 2022
Large Cap Stock	
S&P 500	-16.1%
Small & Mid Cap Stock	
S&P 400 Mid Cap	-15.2%
S&P 600 Small Cap	-14.1%
All Cap Style Indices	
S&P 1500 Value	-11.4%
S&P 1500 Growth	-20.5%
International Equity	**2Q 2022**
MSCI EAFE	-14.3%
MSCI EAFE Value	-12.1%
MSCI EAFE Growth	-16.7%
MSCI Emerging Markets (EM)	-11.3%
MSCI EM Value	-10.7%
MSCI EM Growth	-12.0%

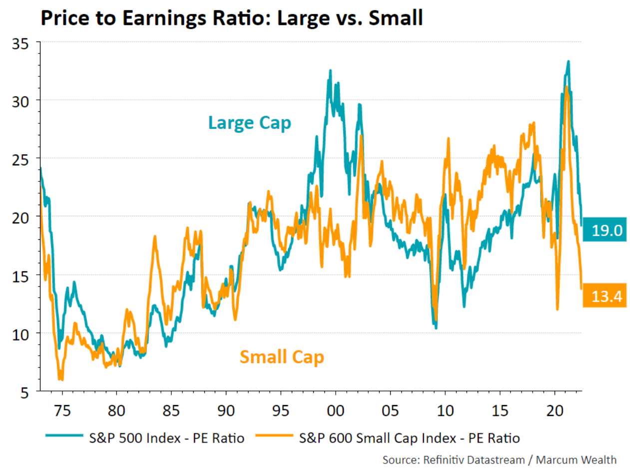
In the first six months of the year, the energy sector was the only positive performer thanks to higher commodity prices. Technology, communication, and consumer discretionary stocks underperformed the broad U.S. market.



Global equity valuations have come down in the first six months of the year. Today, Europe and Japan trade near the lowest multiples seen over the last 24 years. This cheaper valuation compared to the U.S. likely owes to the lower overall economic growth and declining demographics for both. Emerging markets are trading slightly above the long-term average multiple.



The gap between large caps and small caps for the trailing price-to-earnings multiple has only been wider a few times in history. This occurred in the mid-1970s, the early 2000s, and briefly in 2020. Small caps are trading at 13 times trailing earnings. This level was only lower in 2008 and 2020 over the past two decades.



We think it is important to be aware of any sector or style biases within equity portfolios. Many became overweight both growth and technology due to the outperformance in these areas the prior decade. A neutral weighting to these factors lowers the risk versus benchmark indices.

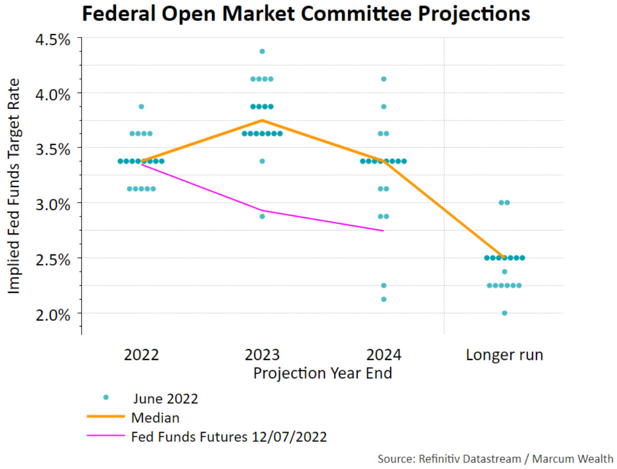
Fixed Income

The 10-year Treasury yield began the quarter at 2.3%, climbed to 3.5%, and fell to end the quarter just under 3.0%.

Fixed Income	2Q 2022
Bloomberg U.S. Aggregate Bond	-4.9%
Bloomberg Corporate Inv. Grade	-7.5%
Bloomberg High Yield Bond	-11.3%
Bloomberg Global ex. U.S. Treas.	-14.0%
Bloomberg Municipal Bond	-3.2%
Bloomberg TIPS	-8.4%

The Fed raised interest rates by 0.5% in June and surprised with a 0.75% hike in June. The tone from the Fed has shifted to more aggressive interest rate hikes for the remainder of 2022. The chart below shows that the Open Market Committee plans to continue hiking in 2023. The magenta line is below the orange line, indicating the market disagrees. It forecasts interest rate cuts in 2023.

Federal Open Market Committee Projections

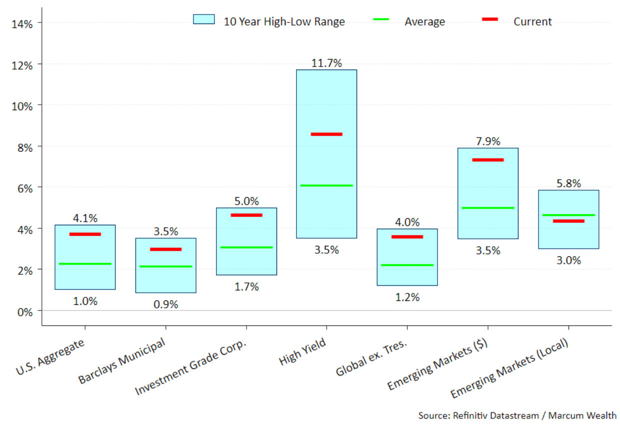


Cutting interest rates sounds impossible given the high inflation today. Yet on average in past cycles, the Fed has begun cutting interest rates within six to nine months of the final interest rate.

Credit spreads widened across the corporate sector, which put downward pressure on interest rates. Spreads also sold off in global bond markets. This has pushed the yield higher and near the highest levels of the past decade for bonds. While this selloff in bonds was the worst in 40 years, the forward looking yields look much stronger for investors.

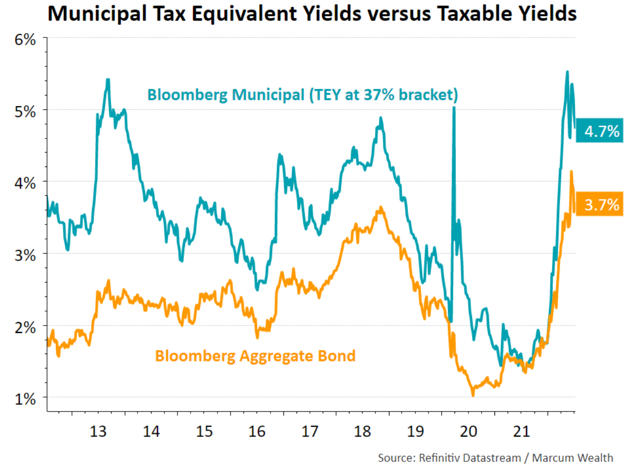
Bond Index Yield-to-Worst

Last 10 Years



Since municipal bonds are exempt from federal income taxes, we must adjust the expected yield to reflect this. In 2021, the tax-equivalent yield was under 2% for municipal bonds. The tax-equivalent yield climbed above 5% during the second quarter of 2022 for municipal bonds. It has reached this level only two other times in the past decade: once after the “taper tantrum” in 2013 when interest rates spiked higher and then again in March 2020.

Municipal Tax Equivalent Yields versus Taxable Yields



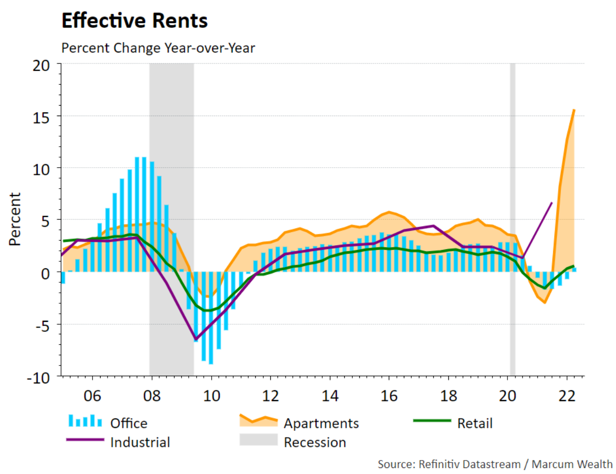
The Marcum Wealth Asset Allocation Frameworks maintains the target exposure to fixed income.

Real Estate

Prices for REITs came under pressure during the second quarter as interest rates increased and the growth outlook slowed.

Real Estate	2Q 2022
Wilshire U.S. REIT	-18.5%
Wilshire Int'l REIT	-19.0%

The four major food groups of the real estate sector can be split into winners and losers. Apartments and industrial real estate enjoyed an increase in effective rental rates. The shortage of housing and strong consumer balance sheet allowed landlords of apartments to increase rents. In addition, industrial benefited from more companies like Amazon seeking to be closer to cities for last-mile delivery.

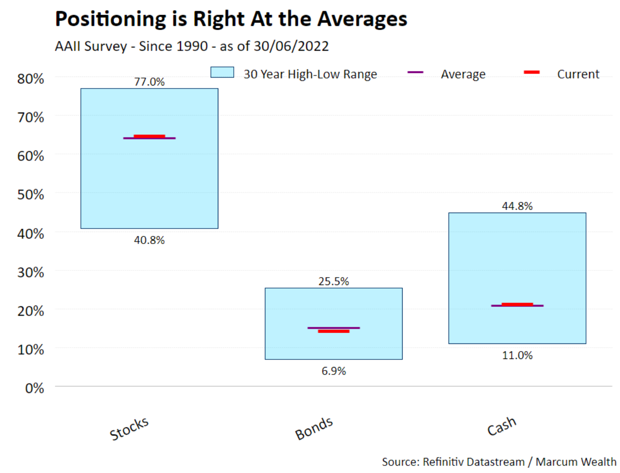


The retail real estate sector has been in a secular decline due to e-commerce. The work-from-home trend has hurt the office sector and seems likely to weigh on it moving forward. Most corporations that can operate remotely believe they will need less office space in the years ahead.

The Marcum Wealth Asset Allocation Frameworks continues to maintain equal weight exposure to REITs.

Summary

The foggy outlook in the economy and the sell-off in equities made investors nervous about the outlook. Most surveys show negative sentiment for retail and professional investors alike. In aggregate, this pushed equity holdings from near the high end of the range over the past 33 years to the average for equities. Cash and bonds also remain near the long-term average allocation. As we enter a seasonally weaker period in the fall, attention will likely turn towards mid-term elections. Historically, getting past mid-terms was a positive catalyst for equity prices.



Marcum Wealth Asset Allocation Frameworks

	Income	Conservative	Balanced	Moderate	Growth
Asset Class	Strategic	Strategic	Strategic	Strategic	Strategic
Equity	**20%**	**35%**	**50%**	**65%**	**80%**
U.S. Equity	12%	21%	30%	39%	48%
International Equity	6%	11%	15%	20%	24%
Emerging Markets Equity	2%	4%	5%	7%	8%
Fixed Income	**77%**	**62%**	**47%**	**32%**	**17%**
US Fixed Income	69%	56%	42%	29%	15%
Global Bonds	8%	6%	5%	3%	2%
Real Estate / REITs	**3%**	**3%**	**3%**	**3%**	**3%**

The risk designations are relative only to the five Strategic Allocation targets and do not represent comparisons with any other investment or risk of the overall strategies.

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