October 18, 2022
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Todd Asset Management

Moving Fast and Breaking Things

Todd Asset Management Q3 2022 US Market Review and Outlook

	3Q 2022	YTD	1 Year	3 Year*	5 Year*	7 Year*	10 Year*
S&P 500	-4.9%	-23.9%	-15.5%	8.2%	9.2%	11.4%	11.7%
Russell 1000 Value	-5.6%	-17.8%	-11.4%	4.4%	5.3%	8.2%	9.2%

* *Annualized Total Returns.*

Battling inflation, the Federal Reserve seems to have adopted Mark Zuckerberg's motto, "move fast and break things." Rates have increased faster than at any time since 1979-1981, when they ranged from 10% to 20% and back again twice in the space of a year. This Fed has learned from that experience and promises to continue raising rates through early next year and hold rates higher until they get inflation back to 2%. Things have broken as a result, like Crypto, growth stocks, SPACS, and the British Pension System among others. US and International stocks are factoring in a moderate recession in our view. ***A recession might occur in 2023, but markets already reflect that.*** No recession is in sight yet for the US. The Fed has created a very durable recovery as we predicted in our Q1 2021 article "Aiming to Overshoot", but inflation has been a by-product. They can ultimately get the economy and inflation to slow, but they risk a recession. Until we get clarity, a rangebound market is what we view as the most likely outcome, between the recent lows (3500) and the recent highs (4300) as the market balances economic growth fluctuations, earnings changes, and higher rates. In our experience, ***when nothing looks good you should buy the best-looking trend out there. Currently, that's the Value rotation.*** Value stocks are probably leaders for the next several years.

US Value Beats Growth by 21% over the past 2 years

The new regime is favoring banks, energy , commodity and other value-oriented stocks. We believe this new cycle is durable and should last.

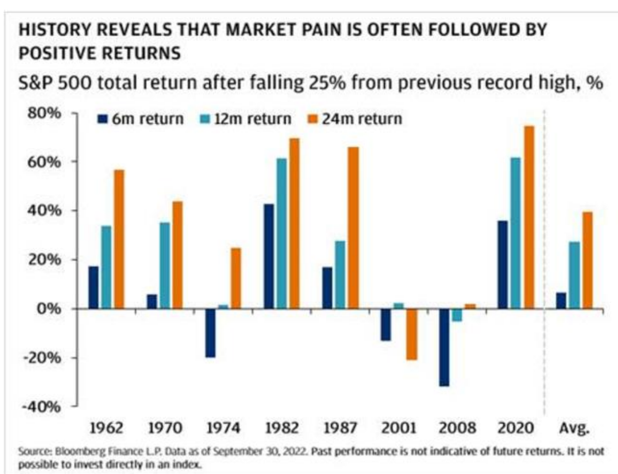
Source: Todd Asset Management, Bloomberg as of 10-7-22

The major points we note from the past quarter are:

- US stocks declined for the third quarter in a row, discounting a moderate recession with a 25% cumulative drawdown. When markets pass a 25% drawdown, forward returns are usually good.
- The trigger for recent weakness was Fed Chair Powell reiterating that the Fed has a target of 2% on inflation and will do what is necessary to achieve that. The Fed has raised rates quickly (and broken things). The dollar surged to multi-year highs as well. Markets are concerned that policy works with lags, and as much as they overshot the stimulus portion of the cycle, they may overshoot the tightening.
- Inflation remains stubbornly high and has not retreated much from multi-decade highs. We believe some relief is coming, but it cannot come fast enough for the Central Banks.
- The underlying economy remains strong, generating jobs and profits. Strategists worry that profits will weaken with the Q3 reports.

A lot of bad news is priced into markets, and markets have a good record after 25% drawdowns. We are at what is usually the seasonal bottom in markets. Market commentators suggest nothing will ever go right again, but do not get too bearish. There is the potential for improved inflation readings, earnings to beat reduced expectations, and the Fed to finish up their tightening over the next several months. Nobody knows where markets bottom, but we think a short-term bottom is likely soon, setting the stage for a more durable bottom once the Fed indicates they are willing to wait to see how the economy responds to tighter policy. In the meanwhile, make sure your portfolios have enough value and quality orientation, because that is likely to be the leadership for the next 7-year cycle.

Positive- 25% Drawdowns Historically Recover



Since 1962, average returns following 25% drawdowns were 7% over 6 months, 27% over the next 12 months and 40% over the next 2 years. Don't get too bearish.

Source: JP Morgan October 5, 2022

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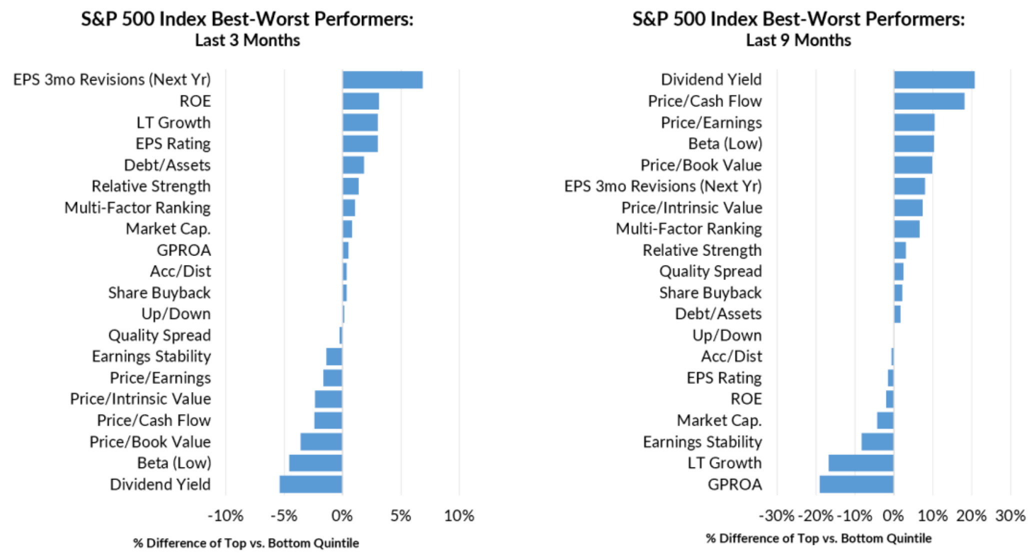
Charts we are sharing with our clients

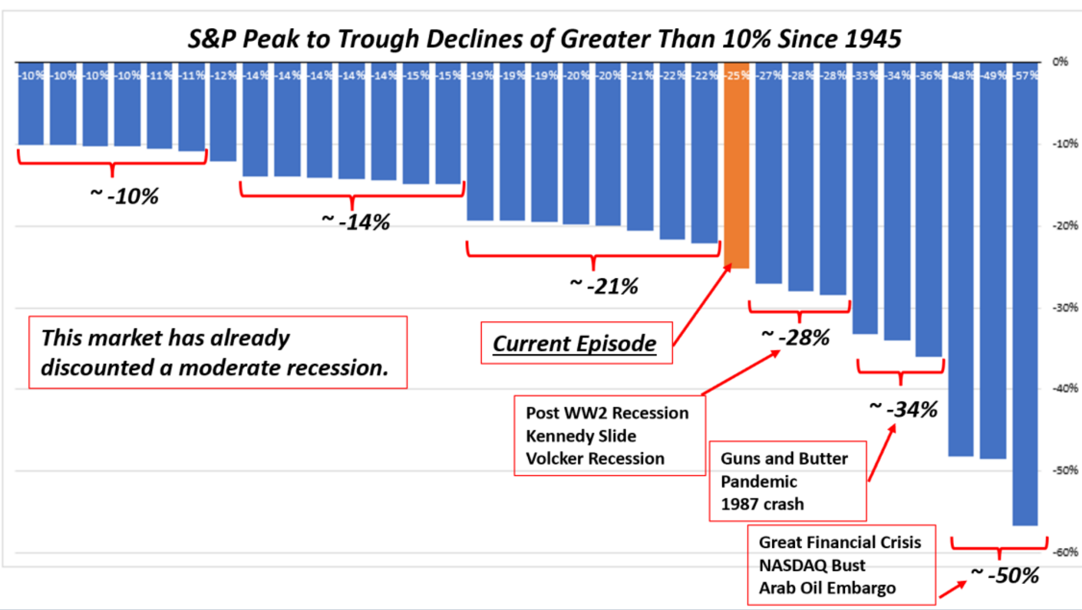
Factors- Value leading YTD

As of 9/30/2022



Data Source: Bloomberg, William O'Neill & Co. and TAM. The noted index is unmanaged, and not available for direct investment; it includes reinvestment of dividends; it does not reflect management fees or transaction costs. The volatility of the index and a client account will not be the same.

Current Bear Market Discounts Recession



Source: Todd Asset Management, Bloomberg as of September 30, 2022
The noted index is unmanaged, and not available for direct investment; it includes reinvestment of dividends; it does not reflect management fees or transaction costs.
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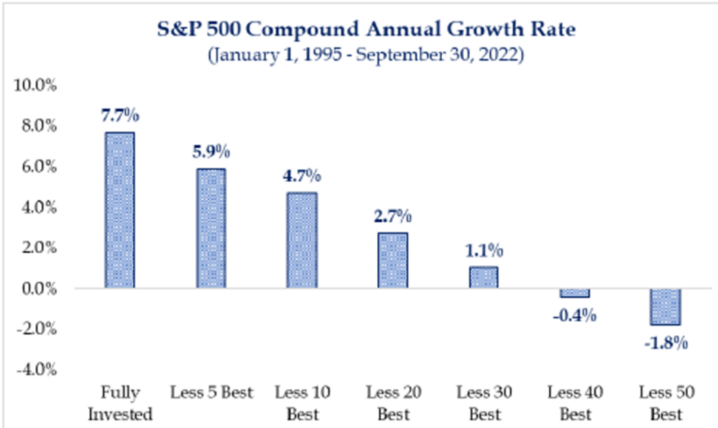
Don't Get Bearish At The Bottom



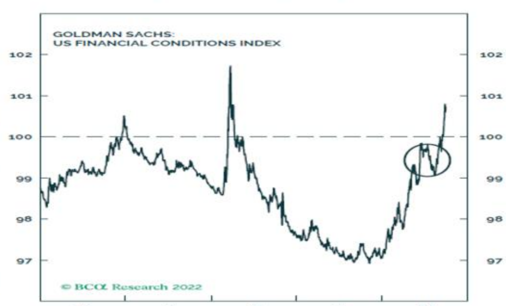
Stay invested, because market timing is hard. Investors generally do not buy back in on time. *Missing the bottom can meaningfully detract from returns.*

Source: Strategas Research Partners October 3, 2022

Headwind- The Fed is Aiming for 4.5%

Fed Funds Futures Estimate of December 2022 Rate

Financial Conditions Index
Higher Reading = Tighter



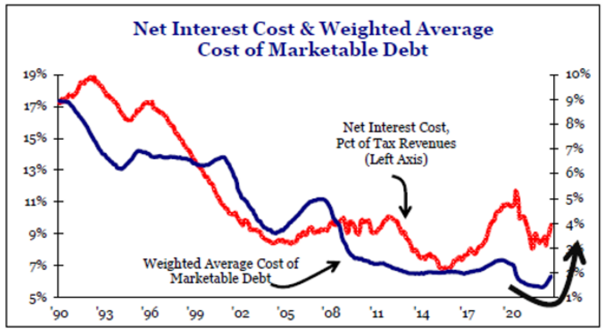
Source : Bloomberg Finance LP, Deutsche Bank

- Markets have misjudged the Fed all year. The Fed is intent on raising rates through December (chart left). Financial Conditions are getting tighter (chart right).
- Economic results are not weak enough to warrant a Fed pivot yet, but conditions are tight enough that investors worry about something big breaking.

Source: Deutsche Bank October 3, 2022, BCA Research and Goldman Sachs

Concern- Rising Rates and Lame Duck Impact on Deficit

- The average interest rate on government debt is under 2% and represents 9% of tax revenue. Market rates are nearly double that. *A painful reset is coming.* (Top chart)
- The lame duck session (post midterms) looks like it has some expensive items on the agenda. Fiscal stimulus may not be over. (bottom table)



Items That Could Be Considered In Lame Duck	Items That Could Be Pushed To 2023
✓ FY23 Appropriations	✓ Supply Chain/China Legislation
✓ FY23 National Defense Authorization Act	✓ Taiwan Free Trade Agreement
✓ R&D Tax Credit - Delay Amortization	✓ Privacy Legislation
✓ Child Tax Credit Extension	✓ Stablecoin Regulation
✓ Tax Extenders	✓ Energy Legislation
✓ Retirement Legislation	
✓ Health Care Legislation	
✓ Trade Provisions	
✓ Electoral Count Act Reform	
✓ Energy Permitting Reform	
✓ Debt Ceiling	
✓ SAFE Banking Act?	

Source: Strategas Research Partners October 4, 2022

New Regime- US 10-Yr Yields Just Broke a 40 Year Downtrend

US Government 10 Year Bond Yields

The bond bubble has burst. This does not mean rates have to move higher immediately, but market forces are pressuring them that way.

Source: Todd Asset Management, Bloomberg
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The volatility of the index and a client account will not be the same.

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US and Global Inflation: Pressures Easing, Just Not Fast Enough

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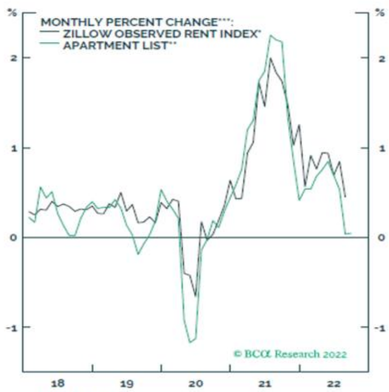
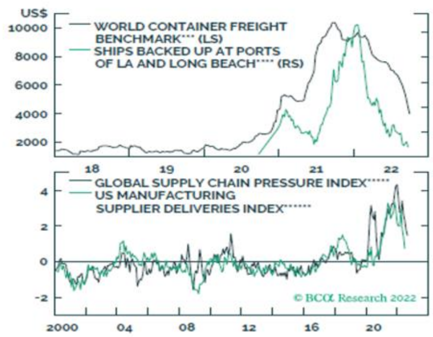
Rents are Easing



* SOURCE: ZILLOW.
** SOURCE: APARTMENT LIST.
*** SEASONALLY ADJUSTED.

Freight Rates and Supply Chains are Easing



*** SOURCE: DREWRY SHIPPING CONSULTANTS; SHOWN IN US$ PER FORTY FOOT CONTAINER.
**** SOURCE: MARINE EXCHANGE SOUTHERN CALIFORNIA. INCLUDES SHIPS AT ANCHOR IN PORTS AS WELL AS THOSE WAITING BEYOND THE PORTS SAFETY AND AIR QUALITY AREA FOLLOWING NEW QUEUING REGULATIONS IMPLEMENTED ON NOV. 16, 2021.
***** SOURCE: FEDERAL RESERVE BANK OF NEW YORK.
****** BASED ON THE ISM AND REGIONAL FED SUPPLIER DELIVERIES. HIGHER VALUES IMPLY SLOWER DELIVERY TIMES.

Some pandemic inflation pressures are easing. These have not worked their way into statistics the Central Banks are monitoring yet.

Source: BCA Research

Positive- Markets Historically Rally Post Midterms

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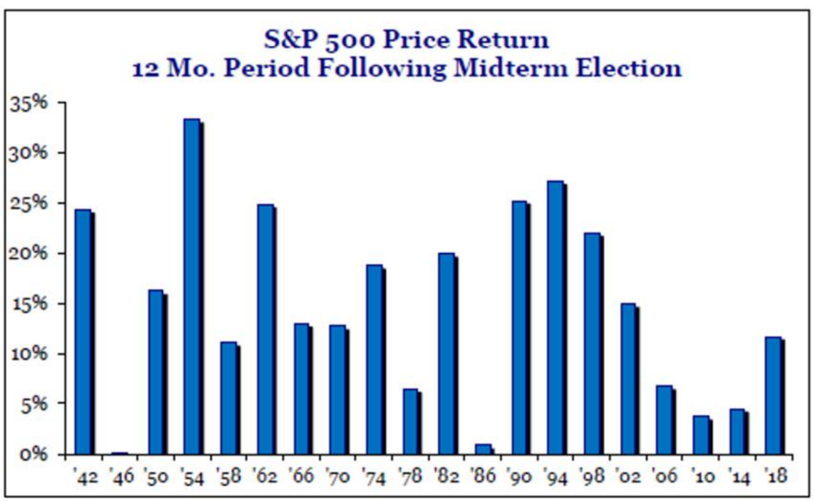
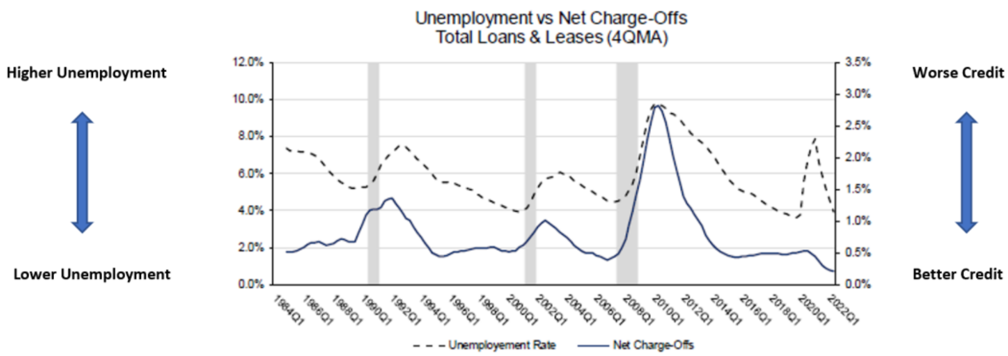


Since 1942, the S&P has never declined in the 12 months following a midterm election. Don't get too bearish.

Source: Strategas Research Partners October 3, 2022

Theme- Financials Have Strong Credit Quality

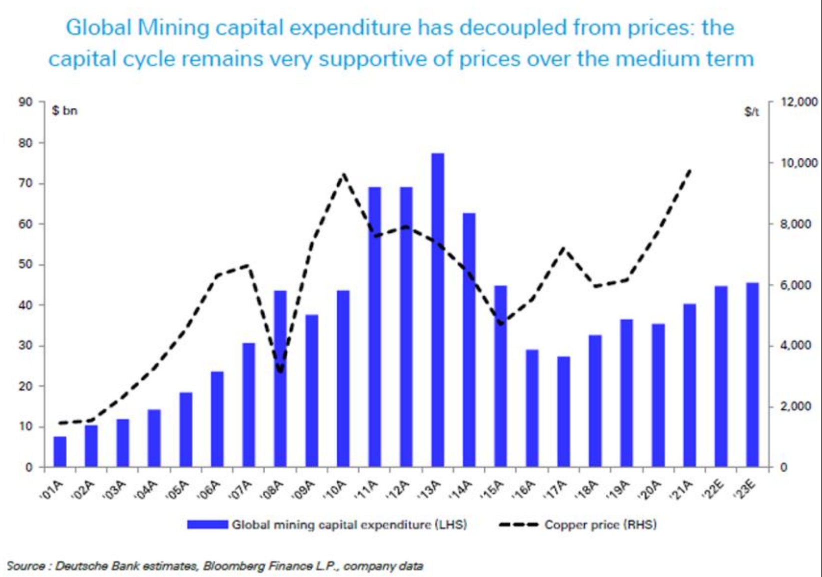


- Bank Net Charge-Offs (NCO's, solid line- right scale) are in excellent shape. Unemployment (dashed line- left scale) also remains low. There are concerns that higher unemployment will lead to higher NCOs.
- NCOs probably increase with unemployment. We believe post- GFC central bank supervision, de-risking of bank balance sheets, and probability of a milder unemployment increase this time leaves the Banks in better shape than generally recognized.

Source: Oppenheimer October 5, 2022

Theme: Industrial Metals- Low Supply Meets High Demand

- Capex has been low for industrial metals despite high prices.
- Demand has risen for de-carbonization projects.
- Ex a recession, there is no quick fix for this imbalance. *Prices probably rise.*



Source: Deutsche Bank Metals and Mining Outlook October 4, 2022

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Theme: Manufacturing Capital Spending is Picking Up

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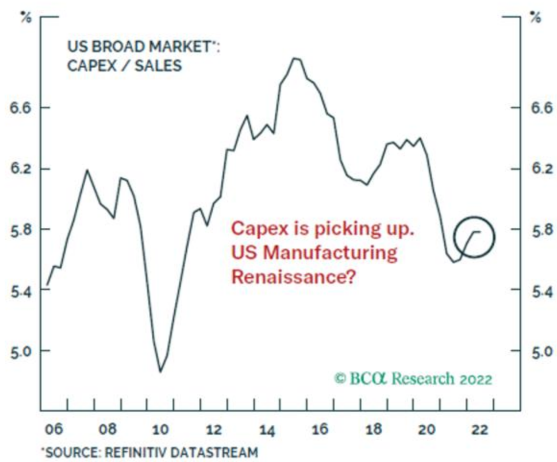
Capital Expenditures (Capex) to Sales



The Supply Chain Snafus of the Pandemic show that current manufacturing sites are too far from home markets. Expect a re-building to help Capex.

Source: BCA Research

Energy- Underinvestment Suggests Higher Prices

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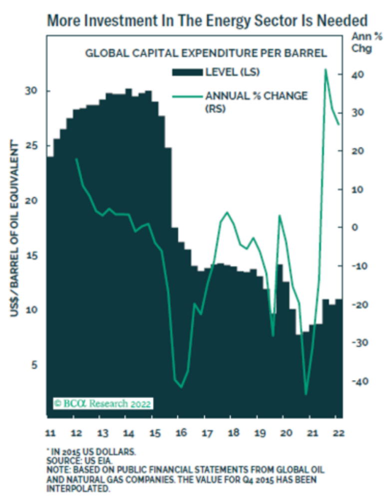

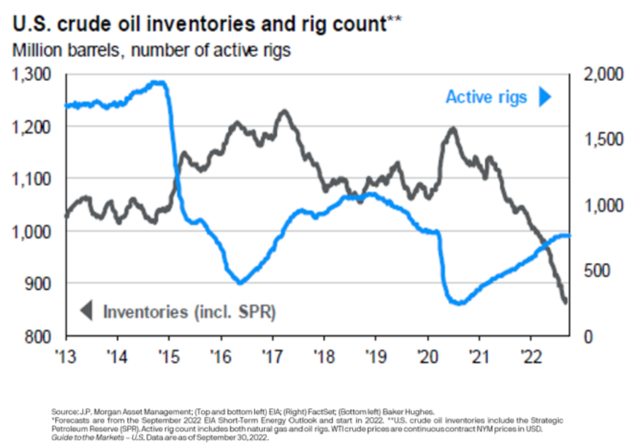

Investment per barrel of oil and US Rig Count have each declined by 2/3 since 2014 (charts above). US inventories are down significantly as well. More investment is needed, and higher prices probably prompt that.

Source: BCA Research, JP Morgan

It's Autumn and investors are nervous. Markets have been volatile, and inflation has remained high. Markets have discounted a recession, but we have not seen one yet as employment and consumption remain good. We think that means the market is in a show me mode, and the focus is on high quality value stocks. Fortunately, that is what we emphasize. What advice would we offer investors? Don't get too bearish! Much of the bad news is already discounted in the markets. Can more unforeseen threats emerge? Sure, but if we already have a nuclear threat on the table, it will need to be something on the order of intergalactic warfare to beat that. In the meanwhile, some measures of inflation are easing, and according to central banks, their tightening should be paused over the next six months as they assess their impact. That should give markets a reason to lift as we move through what historically is the best season to invest in.

As always, if you need any additional information, please feel free to contact any of us.

Curt Scott, CFA
Jack White, CFA
Jack Holden CFA
Shaun Siers, CFA

10/18/22
S&P 500 – 3720
Russell 1000 Value – 1407

Refer to the following page for more information on the commentary presented. This is pertinent to this letter and should not be reproduced or duplicated without this disclosure.

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S&P 500 Index is a widely recognized index of market activity based on the aggregate performance of a selected portfolio of publicly traded common stocks. The performance data was supplied by Standard & Poor's. It is included to indicate the effect of general market conditions.

Russell 1000 Value Index is a widely recognized index of market activity based on the aggregate performance of common stocks from the Russell 1000 Index, with lower price-to-book ratios and lower forecasted growth values. The performance data was supplied by Frank Russell Trust Company.