Advisory Blog

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EV Forward: Core Equity

By: EV Forward | August 12, 2022

New York - This is still a battle royale between the Fed and corporate fundamentals, yet earnings estimates today are *higher* than they were at the beginning of 2022 — in other words, the "E" in the Price/Earnings ratio is not collapsing.

What we are seeing

We intend to remain cautious through the summer, primarily because the Fed continues to tighten... a lot. While we think inflation has peaked, we are a *long* way from getting to the level the Fed is targeting, making it much too early to call when policymakers will stop raising rates.

What we are doing

As of June 2022, the University of Michigan Consumer Sentiment Indicator was at a 44-year low — and this can be a good thing. Consumers have been hammered by a rise in gas and food prices to the point where stocks in the consumer discretionary sector have been washed out. To us, however, this represents a "fat pitch" buying opportunity. To increase our holdings in consumer discretionary stocks, we are paring our energy and defensive positions, which have had a good run for us, but that we expect to revert to the mean.

We continue to like China. When the pandemic hit, the U.S. and Europe addressed the problem with boatloads of money. China instead went into lockdown mode, with no monetary relief and consequently no inflation problem. In fact, China is the only major equity market that is up over the past 12 weeks.

We are reducing our underweight to a portion of our growth position. We believe valuations for the top 50 growth stocks are still too elevated for a rising interest rate environment. However, the broader growth group is close enough to average valuation to begin to reduce the underweight by seeking out quality growth names.

What we are watching

Remember, the Fed is not your friend. While we believe inflation has peaked, the Fed has a long way to go to get to its target. We will keep an eye on corporate fundamentals, but just do not expect to see an earnings collapse, as predicted by many.

We believe too much time is spent on recession talk, and not enough on return metrics. Since World War II — from September 1945 to June 2022 — market returns for the S&P 500 Index after a 20% market drop have averaged +21.5% for the following 6 months and +31.3% over the next 12 months.

The second year of a presidential term has historically been the weakest for equities, with the second quarter of that year usually the worst, while the fourth quarter is typically the best. As the incumbent party in power traditionally loses, the market has historically rallied on a switch to centrist policies.

We expect this year to be no exception. Therefore, I think the second half of 2022 should be much better for the market than the first.

Andrew Slimmon
Head of Applied Equity Advisors

[1] University of Michigan, Surveys of Consumers, Preliminary Results for June 2022.

S&P 500® Index is an unmanaged index of large cap stocks commonly used as a measure of U.S. stock market performance.

Past performance is no guarantee of future results. The returns referred to in the commentary are those of representative indexes and are not meant to depict the performance of a specific investment.

Risk Considerations: *The value of equity securities can fluctuate in response to activities specific to a company. Stocks of small-and medium-capitalization companies entail special risks, such as limited product lines, markets and financial resources, and greater market volatility than securities of larger, more established companies. Investments in foreign markets entail special risks such as currency, political, economic, market and liquidity risks. Illiquid securities may be more difficult to sell and value than publicly traded securities (liquidity risk). Non-diversified portfolios often invest in a more limited number of issuers. As such, changes in the financial condition or market value of a single issuer may cause greater volatility.*

Active management attempts to outperform a passive benchmark through proactive security selection and assumes considerable risk should managers incorrectly anticipate changing conditions.

EV Forward

> We believe times like these underscore the value of active management — carefully assessing the fluctuations driven by all kinds of disruptions, and taking dynamic actions that best serve the long-term interests of our clients.