STOKES CAPITAL ADVISORS, LLC

Market Commentary
September 30, 2022

Quarterly Market Review

Global equity markets continued their decline during the quarter as Central Banks around the globe tighten financial conditions and fears of a global recession rise.

Most of the U.S. equity market has re-entered a bear market, defined as a 20% decline or more, with Energy being the only sector posting a gain year to date. The mid-summer rally was quickly defeated by a bad inflation print and a hawkish Fed Chair Powel speech at Jackson Hole.

Rising interest rates are acting as a discounting mechanism and forcing valuations lower. The technology names have been particularly hard hit as valuations for the sector have been above historical trend for years. The tech heavy NASDAQ Composite is down 32% year to date.

Small cap stocks, which tend to more sensitive to macro-economic trends have now underperformed large cap stocks on a trailing 10 year basis, a very rare event. Small companies tend to suffer more during a recession, have less pricing power and underperform in late stages of the business cycle.

Turning to foreign equity markets, developed markets have outperformed U.S. markets on a local currency basis year to date but a very different picture emerges when translated into U.S. dollars. The U.S. dollar Index is trading at a 20 year high. The Federal Reserve aggressively raising short term interest rates and the risk off market backdrop creating a greater demand for U.S. dollars are essentially twin tailwinds pushing the greenback higher.

The last three quarters have been something of a nightmare for bond investors with the U.S. Aggregate Bond Index recording a year-to-date decline of -14.7%, the worst performance on record. Rising interest rates, concerns over a hard inflationary landing for the U.S. economy and a possible monetary policy error all continued to weigh on fixed income securities for the quarter.

Commodity markets were on the move during the quarter as well with energy markets recording sharp declines for the quarter but remained firmly in positive territory for the year. Brent crude oil declined -23.4% for the quarter but is up 13% for the year closing at $85 per barrel. Globally, both oil and natural gas inventories remain tight and OPEC+ pulling 2 million barrels off the market will likely provide support into 2023.

Precious metals are all decline for the year and have not served as an inflation hedge like some investors had hoped given the massive amounts of money printing (QE) and deficit spending. A hawkish Fed, rising interest rates and a subsequent strong U.S. dollar has taken the shine out of the yellow metal which historically has served as a store of value.

Investment Strategy & Outlook

Last year we noted the trillions of negative yielding sovereign debt across the globe and that a bubble was likely forming in the bond market. Tragically, this fear turned into a reality this year with the Barclays Aggregate Bond Index recoding an eye watering -14.7% decline. The 2 Year Treasury yield has now rallied from a low of 0.15% to 4.20% in the last year as the Federal Reserve has signaled their intention of bringing inflation back to their 2% target.

In my opinion, this move (bond prices down, yields up) has created an excellent opportunity for investors seeking income and preservation of capital. For the first time in almost a decade, bonds are now competing for capital and the era of "free" money is over……at least for now.

Another observation worth noting over the last 3 years has been the meteoric rise in the "FAANGS" or growth stocks, many of which don't pay a dividend and trade at historically high valuations. The rise in interest rates has punished these stocks essentially serving as a discounting mechanism and pulling valuations back down to earth. Furthermore, since these stocks produce very little to no income, investors must figure out the right time to monetize their paper gain into real cash triggering the difficult "When do I sell" task.

If there is one truth in capital markets lore, "rising interest rates will kill the market…..every time". This quote is from

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my finance professor, Dr. Oliver G. Wood at the University of South Carolina in 1987. There are very absolutes in finance but that is clearly one. This can be a painful lesson to learn indeed. Investors unfortunately expected the Federal Reserve to hold rates negative forever and nothing lasts forever. In our opinion you are going to need an investment that can increase your income every year at a rate faster the rate of inflation, invest in businesses needed to operate the global economy, have low levels of debt, have pricing power, maintain healthy margins and are leaders in their respective industries. This is the definition of a dividend growth stock portfolio.

Capital Markets Scorecard

Benchmark Description	Q3	YTD	1 Year
U.S. Treasury 3 Month T-Bill	0.46%	0.61%	0.62%
Barclays Aggregate Bond Index	-4.75%	-14.61%	-14.60%
Bloomberg US High Yield Bond	-0.65%	-14.74%	-14.14%
S&P 500 Index Total Return	-4.88%	-23.87%	-15.47%
NASDAQ Composite TR	-3.91%	-32.00%	-26.25%
NASDAQ Dividend Achievers TR	-5.35%	-20.21%	-10.39%
Russell 2000 Index TR	-2.19%	-25.10%	-23.50%
Alerian MLP Index TR	8.05%	18.9%	19.56%
MSCI Emerging Markets Index	-8.02%	-20.46%	-21.13%
China SCI 300 Index LC	-14.30%	-21.4%	-20.14%
U.K. FTSE 100 Index LC	-2.72%	-3.66%	0.90%
Japan Nikkei 225 Index LC	-0.83%	-8.07%	-9.98%