The third quarter of 2022 has been a continuation of the prior two, with elevated volatility, souring sentiment and losses across all asset classes dominating global markets. These headwinds have made for extremely challenging investing conditions, with prices indiscriminately moving lower, irrespective of fundamentals, a real 'baby with the bathwater' scenario. While the catalyst for market moves in the first half of the year was undoubtedly inflation, the narrative has switched to being almost singularly focused on the Fed's policy response and the implications of said policy on risk assets and economic growth.

When we last wrote, the Fed's outlook for year-end interest rates was 3.25-3.5%; that has now increased by a full percentage point. The Fed has always operated under a dual mandate: maximum employment and stable prices. It has become increasingly clear that these two conditions cannot exist concurrently in the present environment. The Fed has made it abundantly clear that their number one goal is to crush inflation, thus the dramatic repricing of financial assets. While hope for a 'soft landing' was very much a possibility three months ago, that scenario appears to be more problematic, currently.

Somewhat perversely, this has led to a "good news is bad news" situation, where continuing labor strength and solid consumer spending numbers have translated into a negative sentiment for the markets. The thinking is: so long as the economy remains resilient, inflation will persist and thus the Fed will continue with their restrictive monetary policy. Essentially, the Fed will carry on tightening until they begin to see cracks in the economy, whether via rising unemployment, sluggish demand, corporate earnings erosion, or outright recession and until those cracks appear, the markets will remain volatile, uncertain, and generally bearish.

The effects of central banks' efforts to rein in inflation have been felt globally. Risk assets worldwide have repriced, and the US Dollar has surged, creating currency headwinds for multi-national corporations, and triggering interventions by multiple central banks to keep their currencies from depreciating too much versus the greenback. Europe looks especially vulnerable, as they combat a war on their doorstep, an energy shortage, inflation, and a weakened Euro, all while growth is slowing across the eurozone. Similarly, since leaving the EU, England is facing a stark devaluation of the Pound and policy missteps by the incoming government have almost led to an outright meltdown in their government bond market.

While a seemingly gloomy backdrop, our comments from the prior quarter still stand:

"Nevertheless, with equities down 20% on the year and the S&P 500 now trading at its historical 10-year average, valuations are much more compelling. Volatility will undoubtedly persist and the market could see another leg down, yet we believe the fundamentals are much healthier now, given the repricing that we've seen. Our strategy of owning high-quality companies, with good

Prepared by Flagship Capital Management, Inc.
400 W State Street | Suite 3 | Media, PA 19063
T 610.565.9580 | flagshipcap.com

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cash generation, low debt and above-average growth prospects remains intact. The market will normalize, but trying the guess the bottom, or time entry points is foolhardy."

As corporate earnings appear set to slow in the coming quarters, this sentiment is even more relevant, as our selection of high quality, less economically sensitive companies should serve to differentiate in a tough earnings environment.

With rates rising across the yield curve in Q3, we have taken the opportunity to allocate capital into corporate bonds in the 2–4-year maturity range, at yields of 5-7%. This level of income has been unattainable over the prior ten years, and we are extremely constructive on the prospect of further adding to this strategy. Similarly, with the Fed showing little sign of slowing their tightening, the government bond and mortgage-backed security sectors are also looking quite attractive. While rising rates have been a detriment to risk markets thus far, we are viewing the new landscape as an opportunity to reallocate and refocus going forward, always through the lens of achieving our long-term goals.

Looking ahead, we see the biggest risk to the markets being a Fed that goes too far, too fast, as monetary policy impacts the economy with a lag. Stabilization in the markets will require evidence of a peak/decline in inflation, a peak in policy hawkishness and a peak in yields. Until then, things will likely remain choppy. We may look to opportunistically tax-loss harvest and buy back those holdings that we are constructive on at a lower cost-basis or hold cash as dry powder to put to work when the markets find their footing. Locking in yields at 6+% should also serve to support the overall portfolio yield and provide a ballast to equity volatility.

As always, don't hesitate to check in with us if you have questions or would like to review. We have settled in nicely to our new offices in Media and would love to have you in for a visit. Please take care and rest assured that we are here to help you navigate these challenging times.

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