Rockefeller Global Family Office
45 Rockefeller Plaza, Floor 5
New York, NY 10111

# The CIO Monthly Perspective

## November 1, 2022

**Jimmy C. Chang, CFA**

Chief Investment Officer
Rockefeller Global Family Office
(212) 549-5218 | jchang@rockco.com

## GAME OF THRONES

### Political fratricides & the weaponization of oil

Last month's market action was all about second derivatives, or the expected rates of change. The S&P 500 Index hit a cycle low of 3,491 shortly after the release of worse than expected inflation data on October 13. However, the Index then made a quick reversal when traders once again pushed the "peak-inflation-is-behind-us" narrative. Next came the pre-election gift from the doves at the Fed. On the morning of Friday, October 21, Wall Street Journal reporter Nick Timiroas, a known Fed conduit to the Street, reported that the Fed intends on slowing the pace of rate hikes beyond the planned 75-bps increase at the November 2nd FOMC meeting. This "step-down" thesis conveniently marked the interim peaks for the U.S. Dollar Index and the 2- and 10-year U.S. Treasury yields at 4.63% and 4.34%, respectively. The S&P 500 Index went on a tear despite lackluster earnings results and substantial declines among erstwhile Big Tech darlings. The bear market rally was so powerful that it turned the S&P 500 Index's initial 3% intra-month decline into an 8% gain for October.

Fundamentally, U.S. private demand continued to decelerate into what I believe will be an unavoidable recession. Despite the 2.6% annualized growth in the advance estimate of 3Q22 GDP, real final sales to private domestic purchasers were merely 0.1% annualized. Overall economic growth was driven by net exports, thanks to Europe's natural gas demand and weapons for Ukraine, which contributed 2.8% of the 2.6% growth in real GDP. Similarly, 3Q22 earnings were weaker than usual – with 53% of S&P 500 companies having reported earnings as of October 28th, aggregate earnings per share (EPS) growth for the quarter was revised *lower* from 4.5% at the start of October to 4.1%. Historically, at this point of the earnings reporting period, growth estimates for the quarter would be lifted as most companies tend to beat the expectations they set for the Street. Despite the strong rally of late and the prospect for further gains in the typically stronger year-end period, I still advise investors to remain patient, selective, and defensive. Since 1929, all except one recession-induced bear market had bottomed *during*, not before the onset of the recession. The one exception was the 2001 recession in which the market bottomed about a year after the recession was over.

Rockefeller Global Family Office
45 Rockefeller Plaza, Floor 5
New York, NY 10111

## THE SUEZ CRISIS

It was a Halloween full of tricks and no treats as President Eisenhower's re-election campaign was hit with the worst kind of October surprise just a few days before the 1956 general election. The crises were an interplay among three historic forces: waning empires versus their rebelling colonies, a young nation's existential struggle against hostile neighbors in the Holy Land, and a Cold War with rising risk of nuclear annihilation. 66 years later, remnants from the crises are still affecting the world.

It all started with a daring move by a young Arab nationalist firebrand – 38-year-old Egyptian President Gamal Abdel Nasser – who was bent on erasing centuries of national humiliation by standing up against erstwhile colonial powers while playing superpowers against each other. Nasser was the leader of the 1952 coup that ousted the Egyptian monarchy and established a republic; he was fast becoming the symbol of Arab nationalism and pride. The U.S. was quick to support Nasser on the hope that he would become a bulwark against the spread of communism and Soviet influence in the Middle East. Nasser, however, chose to be a tactical neutralist and purchased offensive weapons from the Soviet Union. In 1956, Secretary of State John Foster Dulles decided to renege on a $270 million loan to Egypt for the construction of the Aswan Dam after Nasser thumbed his nose at America's policy of containment of communism by establishing a diplomatic relationship with Communist China. Undeterred, Nasser shocked the West in July 1956 by announcing the nationalization of the Suez Canal to generate revenues to help fund the dam's construction.

A canal connecting the Red Sea and the Mediterranean had been envisioned for centuries, but the project did not commence until the mid-1800s due to concerns over the alleged difference in sea levels at each end. In 1830, British General Francis Chesney's survey work showed there was no difference in sea levels and that such a project was feasible. However, it was a former French diplomat, Ferdinand de Lesseps, who championed the financing and construction of the Suez Canal as a more efficient trade route between Europe and South Asia. The British government was opposed to the project as it would degrade Britain's commercial and maritime supremacy in the Cape Route, a much longer shipping route from the Atlantic Ocean to the Indian Ocean via the Capes of Good Hope and Agulhas at the southern tip of Africa.

| Equity Market Indices[1] | 9/30/22 Price | 10/31/22 Price | MTD Change | YTD Change |
|---|---|---|---|---|
| MSCI All Country World | 553 | 586 | 6.0% | -22.3% |
| S&P 500 | 3586 | 3872 | 8.0% | -18.8% |
| MSCI EAFE | 1661 | 1750 | 5.3% | -25.1% |
| Russell 2000®[2] | 1665 | 1847 | 10.9% | -17.7% |
| NASDAQ | 10576 | 10988 | 3.9% | -29.8% |
| TOPIX | 1836 | 1929 | 5.1% | -3.2% |
| KOSPI | 2155 | 2294 | 6.4% | -23.0% |
| Emerging Markets | 876 | 848 | -3.2% | -31.2% |
| **Fixed Income** | | | | |
| 2-Year US Treasury Note | 4.28% | 4.49% | 20 | 375 |
| 10-Year US Treasury Note | 3.83% | 4.05% | 22 | 254 |
| BBG US Agg Corp Spread | 1.59% | 1.58% | -1 | 66 |
| BBG U.S. HY Corp Spread | 5.52% | 4.64% | -88 | 181 |
| **Currencies** | | | | |
| Chinese Renminbi (CNY/$) | 7.12 | 7.31 | 2.7% | 14.9% |
| Brazilian Real (Real) | 5.42 | 5.18 | -4.4% | -7.1% |
| British Pound ($/GBP) | 1.12 | 1.15 | -2.6% | 18.0% |
| Euro ($/Euro) | 0.98 | 0.99 | -0.8% | 15.1% |
| Japanese Yen (Yen/$) | 144.74 | 148.71 | 2.7% | 29.2% |
| Korean Won (KRW/$) | 1431.15 | 1424.65 | -0.5% | 19.8% |
| U.S. Dollar Index (DXY) | 112.12 | 111.53 | -0.5% | 16.6% |
| **Commodities** | | | | |
| Gold | 1661 | 1634 | -1.6% | -10.7% |
| Oil | 79.5 | 86.5 | 8.9% | 12.4% |
| Natural Gas, Henry Hub | 6.77 | 6.36 | -6.1% | 70.4% |
| Copper (cents/lb) | 341 | 338 | -1.1% | -24.4% |
| CRB Index | 268 | 274 | 2.2% | 18.0% |
| Baltic Dry Index | 1760 | 1463 | -16.9% | -34.0% |

Source: Bloomberg

In 1858, de Lesseps' perseverance paid off with the formation of the Suez Canal Company, a joint venture between French investors and Egypt's ruling family. The construction of the canal took ten years, involved 1.5 million people, and cost more than double the initial projections. In November 1869, the canal opened for business under French control and soon became the most vital trade route in the world. The British belatedly felt the impact as concerns over the declining Cape Route triggered the Panic of 1873, a financial crisis in Europe and North America. However, as the world's then superpower, the U.K. made itself relevant again by buying out the Egyptian ruling family's 44% stake in the Suez Canal Company in 1875. In 1882, under the guise of protecting European interests and the Egyptian monarchy against a nationalist revolt, Britain colonized Egypt and took control of the canal. 72 years later, in October 1954, Nasser succeeded in pressuring the U.K.

Rockefeller Global Family Office
45 Rockefeller Plaza, Floor 5
New York, NY 10111

to agree to completely pull its troops out of Egypt, and the last British military unit left the Suez Canal in March 1956.

Sir Anthony Eden, who became U.K. Prime Minister following Churchill's retirement in April 1955, was furious at the nationalization maneuver and intended to resolve the issue by force. The French government, already upset at Nasser's support of anti-colonial guerilla attacks against French interests in Algeria, was also ready to take military action. The Suez Canal was of vital strategic and economic importance to Western Europe – two-thirds of its oil supplies passed through it. Indeed, at a U.S. National Security Council meeting in August, Secretary of State John Foster Dulles warned that Nasser's seizure of the canal was an integral part of a long-term strategy to build up Arab power as stated in Nasser's 1952 book, *Revolution*. Nasser had made it clear in the book that Arab nations possessed great powers with the control of important transportation lines and oil resources – Western Europe would grind to a stop without Middle Eastern oil. President Eisenhower, however, refused to support any British and French military operations as he believed that the U.S. should be a champion of decolonization. He instructed Dulles to recognize Egyptian sovereignty over the canal while developing an international body to operate and maintain it.

In October 1956, Eden secretly agreed to France's plan to bring Israel into the fold to launch a military operation to recapture the Suez Canal. Israel was a willing participant as Nasser had cut off Israel's access to the Red Sea by closing the Suez Canal and the Straits of Tiran to Israeli shipping. The plan called for Israel to invade the Sinai Peninsula, which would give Britain and France the excuse to seize the canal under the pretext of ensuring the waterway's freedom of passage.

On October 29th, Israel initiated lightning strikes on Egyptian positions across the Sinai. The following day, Britain and France issued an ultimatum demanding "freedom of passage." On October 31st, the Royal Air Force started bombing Egyptian airfields to initiate the Anglo-French invasion, prompting Nasser to close the Suez Canal and sink all stranded ships.

President Eisenhower was livid that the U.S. was kept in the dark about the tripartite invasion. He was already pre-occupied with the fast-evolving situation in Hungary, where a popular uprising against the Soviet-backed puppet regime had led to street battles. The U.S. could not call on the USSR to respect the will of the Hungarians while condoning the invasion of Egypt. On Halloween night, six days before the 1956 general election, Eisenhower outlined his positions in a nationally televised speech – the U.S. would offer economic assistance to nations seeking to break free of Soviet control, and the U.K., France, and Israel should pull their troops out of Egypt and have the United Nations settle the disputes.

The ensuing days were some of the most chaotic and surreal periods of the Cold War. The Soviet Union threatened to send troops to Egypt to fight Britain and France, and to rain nuclear missiles on the West. The U.S. realized that the presence of Soviet troops in Egypt would lead to WWIII because of America's obligations under NATO to defend our allies. The U.N. Security Council, at the behest of the U.S., called an emergency special session of the General Assembly for the first time and established the peacekeeping UN Emergency Force. With Eden stubbornly ignoring Eisenhower's call for an immediate ceasefire, the U.S. went for the U.K.'s jugular. For the first time in history, the U.S. launched a financial war against an ally. Eisenhower not only blocked the International Monetary Fund (IMF) and the U.S. Export-Import Bank from extending urgently needed credit to Britain, but also threatened to sell the U.S. government's holdings of sterling bonds to tank the value of the pound-sterling. Upon realizing that these moves would bankrupt the British government, Eden finally relented and unilaterally announced a ceasefire on November 6th without even informing France and Israel. Meanwhile, the Soviet military seized on the world's fixation on the Suez Crisis to march into Budapest and brutally crushed the popular rising and the interim government.

By the end of 1956, the UN peacekeeping force had moved into the Sinai while Britain and France had pulled their troops out of Egypt. The Suez Crisis was a big blow to the prestige of these two erstwhile colonial powers and hastened the decolonization process across Africa. Eden never recovered from the humiliation and was forced out of 10 Downing Street in January 1957. The Soviet Union's standing was boosted across the Middle East and the Third World as some were led to believe that the USSR was willing to wage nuclear war against the hegemonic West to defend Egypt. The rising influence of the USSR prompted President Eisenhower, who had won his 1956 re-election by a landslide, to deliver a seminal speech in January 1957 to outline the so-called Eisenhower Doctrine – the U.S. would offer economic

Rockefeller Global Family Office
45 Rockefeller Plaza, Floor 5
New York, NY 10111

and military aid, and if necessary, direct military intervention to stop the spread of communism in the Middle East. The U.S. had, in essence, replaced Britain and France as the major external powerbroker in the complex sphere of Middle Eastern politics.

Israel finally pulled its troops out of the Sinai in March 1957, after the UN peacekeeping force created a security buffer and lifted Egypt's blockade of the Straits of Tiran. Despite Egypt's poor military performance, Nasser was lionized as the hero who prevailed over Western powers. He became increasingly dictatorial, self-aggrandizing, and anti-American. Nasser's hubris and machinations in regional politics eventually led to Egypt's humiliating defeat at the hands of Israel during the Six Day War in 1967. He died of a heart attack at age of 52 in 1970 but remains a legend among many Arabs, having had inspired a cadre of brutal strongmen including Saddam Hussein and Muammar Gaddafi.

## LOSING TRUSS

In his 1960 memoirs, *Full Circle*, Sir Anthony Eden blamed John Foster Dulles for America's betrayal – the threat to push up gilt yields and trigger a run on the pound in order to force Britain to cease its successful military operation. This interference earned Eden the distinction as the shortest serving British prime minister at the time (not including George Canning who died after just 119 days as PM in 1827). Eden lasted one year and 279 days on the job despite having won a huge electoral victory in May 1955 and overseeing the lowest unemployment rate – 1% in July 1955 – in U.K. history.

65 years later, Liz Truss set a new record as the shortest serving British prime minister in history – she announced her resignation after just 45 days into her premiership. Ironically, her undoing was triggered by what Eden had feared in 1956 – surging gilt yields and a run on the pound. However, the financial crisis that doomed her premiership was self-inflicted.

Truss came into power without an electoral mandate – she won the Conservative Party leadership election with 81,326 party members' votes. However, she quickly introduced the most aggressive fiscal package, dubbed her "Growth Plan," without having the non-partisan Office for Budget Responsibility (or OBR, which is similar to our Congressional Budget Office) assess the impact on public finances. Her plan included the biggest tax cuts in five decades as well as a massive bailout package to subsidize energy bills for households and businesses. While tax cuts are usually favored by financial markets – it seemed reasonable to reduce the income tax rate for earnings of more than £150,000 a year from 45% to 40% – pairing it with new spending initiatives at a time of double-digit inflation was widely viewed as fiscally irresponsible. The market reaction was swift and severe: 30-year U.K. gilt yield surged from 3.78% to an intraday high of 5.14% in four trading sessions while the pound collapsed 9% from 1.126 per U.S. dollar to an intraday low of 1.035 over two trading sessions. On September 28th, the Bank of England (BOE) realized that a "doom loop" had started as surging gilt yields triggered margin calls on many British pension funds, which begot more gilt selling to push yields even higher. The BOE was forced to delay its planned gilt sales, part of its tightening policy, and instead initiated purchases of long-dated gilts to forcefully bring down gilt yields.

With financial markets pushing back hard against the Growth Plan, then Chancellor of the Exchequer Kwasi Kwarteng sought to placate detractors with a promise to release details of the revised fiscal plan and the OBR's in-depth assessment on October 31st. However, BOE Governor Andrew Bailey pulled the rug out from under by insisting that the emergency purchase of gilts would not be extended beyond October 14th. Bailey's line in the sand sent yields surging again, and Kwarteng quickly became the shortest-serving Chancellor in British history (not including Iain Macleod who died of a heart attack one month into his job in 1970). Unfortunately for Truss, scapegoating Kwarteng was too little, too late to salvage her premiership.

## HIDDEN LEVERAGE & RISKS

While gilt yields and the pound have largely settled down from DEFCON 1 levels, the crisis did highlight the return of bond vigilantes and hidden leverage and risks. For most of the last decade, bond vigilantes had become an endangered species as central banks were able to run roughshod over them with a variety of easing tools – verbal intervention, rate cuts, quantitative easing, yield curve control, and even negative interest rates. Now, however, with monetary easing tools being shelved in the face of multi-decade high inflation, bond vigilantes have returned without fearing retribution from central banks. The result is that fiscal profligacy and so-called Modern Monetary Theory (MMT) may no longer be viable with bond vigilantes enforcing market discipline. With Uncle Sam projected to run up annual fiscal deficits from roughly $1 trillion in the next few years to over $2

Rockefeller Global Family Office
45 Rockefeller Plaza, Floor 5
New York, NY 10111

trillion by the end of this decade, U.S. Treasury yields are at risk of trending higher over time. U.S. policymakers may eventually be forced to increase financial repression (i.e., forcing financial institutions to hold more government securities via regulatory means) and even consider yield curve control. Similarly, the European Central Bank (ECB) may find it difficult to suppress the spread between Italian and German sovereign bonds.

On the issue of hidden leverage and risks, the U.K. pension funds' margin call crisis may be the proverbial canary in the coal mine. In the good old days when fixed income securities offered sufficient yields, pension funds would purchase them to match their future liabilities, or payout schedules. However, more than a decade of artificially suppressed interest rates, courtesy of central banks' aggressive easing policies to dampen volatility and to stoke inflation, has pushed U.K. pension funds with defined benefit schemes to pursue a newfangled investment strategy called Liability Driven Investment (LDI). This strategy uses swaps and derivatives to free up money to invest in growth assets. However, when gilt yields suddenly surged at a pace not seen in decades, which was not included in LDI's risk models, these derivatives triggered big margin calls that would have imploded some pension funds without the BOE's intervention. One can't help but wonder if there are other highly levered strategies elsewhere that could be detonated by rapidly rising interest rates. After more than a decade of low interest rate policies, and even negative interest rates in some regions, it's no surprise that investors have levered up and taken on more risk in search of yields. The question now is whether these positions and possible losses can be managed without triggering another round of financial contagion.

## XI'S CORONATION

While the U.K. was embroiled in its parliamentary system's chaotic selection of a new prime minister, which Rishi Sunak eventually won, the Chinese Communist Party (CCP) was holding its 20th Party Congress to rubber stamp a new cadre of senior leaders for the next five years. The Party Congress turned out to be a total victory for Chairman Xi Jinping as he has, in essence, dismantled the post-Mao governing principles created by Deng Xiaoping: a collective senior leadership with checks and balances, term limits, reforms and opening up, and the philosophy of "hide your strength and bide your time." To the surprise of most political observers, Xi managed to pack the Politburo and the seven-member Standing Committee with his loyalists, banish reformers, and publicly humiliate his predecessor, the aging and feeble Hu Jintao, to a chilling warning to his detractors in the final session of the Party Congress.

The coronation of Xi as China's absolute leader will accelerate and broaden the CCP's micromanagement in all aspects of the Chinese society and economy to effectuate a high-tech surveillance state. As a case in point on how omnipresent the CCP's interference is, Chinese regulators have reportedly banned movie and TV personalities who have had plastic surgery or foreign-sounding stage names. It's part of a campaign to promote the "correct aesthetic" and reduce Western influence – Big Brother wants to control not only political correctness, but also what defines pulchritude. Interestingly, while Chinese women are discouraged from having plastic surgery, Politburo members still have pitch dark hair despite their age. The CCP's highly visible hand in every aspect of Chinese lives will likely impede the country's growth prospects in the foreseeable future.

On the geopolitical front, the Cold War between China and the U.S. will likely escalate further. Xi will need to craft a response to the White House's tough new sanctions aimed at curbing China's access to key semiconductor technologies. Xi may make China more insular in the name of boosting self-sufficiency and preparing for potential conflicts with the West, especially over his "unstoppable mission" to retake Taiwan. The regional arms race among China, Taiwan, Japan, Australia, and the U.S. will likely kick into higher gear. It will be interesting to see if Xi softens his wolf-warrior diplomacy in order to pursue a divide and conquer strategy to weaken America's policy of containment. Spoiler alert: Germany may be one of the first to cave.

Given these elevated risks, I believe China remains un-investable except for short-term focused investors who can trade on policy initiatives and economic cycles, e.g., the timing of the eventual lifting of the zero-COVID tolerance policy. These risks also extend to China proxies, such as Hong Kong-based companies, as well as Western businesses with substantial exposure to China. In short, the era of rapid Chinese economic growth is now a thing of the past. What awaits the Chinese people may be a new Cultural Revolution led by income redistribution and the purge of "decadent" Western influences. Here in the West, every corporate board should question its management on what its China contingency plan is.

Rockefeller Global Family Office
45 Rockefeller Plaza, Floor 5
New York, NY 10111

## TO DRILL OR NOT TO DRILL

Speaking of China's zero-COVID tolerance, it has been a gift from Chairman Xi to President Biden as the policy's drag on China's economy has temporarily reduced the country's crude oil demand and helped lower commodity prices. In an effort to contain runaway crude oil and gasoline prices after Russia's invasion of Ukraine, the Biden Administration has been selling crude oil from the nation's Strategic Petroleum Reserve (SPR) at a pace of nearly one million barrels a day, and it has recently upsized the original sales target of 180 million barrels by 15 million more barrels, even though crude oil prices have fallen back to preinvasion levels and the expected loss of Russian crude never materialized. President Biden has worked tirelessly to get foreign oil producers to increase production. Back in July, he reluctantly traveled to Jeddah to meet with Saudi Crown Prince Mohammed bin Salman (MBS) in order to get OPEC to increase oil output. MBS reciprocated with what some considered a slap in the face – a token increase of 100,000 barrels per day starting in September. In recent months, the Administration has reportedly mulled easing sanctions on geopolitical foes such as Venezuela and Iran to allow them to sell more crude oil.

In early October, Biden learned firsthand, as President Eisenhower and all his successors had, just how treacherous politics in the Middle East can be. Saudi's MBS stabbed him in the back a month before the U.S. midterm elections by convincing OPEC+ to reduce crude oil production by 2 million barrels per day due to weakening global demand. President Biden called the decision "shortsighted" while Congressional Democrats threatened retaliation such as freezing weapons sales. Unfortunately, despite all the blustering, there is much danger in downgrading our relationship with Saudi Arabia simply because it has plenty of what the world needs – crude oil – and it can deal us a blow by pricing the commodity in another currency, say the renminbi. Indeed, the recently held Future Investment Initiative in the Kingdom, or "Davos in the Desert," had more than 80 Chinese CEOs in attendance. The U.S. business community has largely ignored the bad blood between Biden and MBS as hundreds of corporate chieftains, led by Jamie Dimon (JPMorgan Chase), David Solomon (Goldman Sachs), Ray Dalio (Bridgewater), and Stephen Schwartzman (Blackstone), also made the pilgrimage.

Some may argue that perhaps the most shortsighted entity is the U.S. government, which still lacks a coherent energy policy. Instead of tinkering with band-aids like selling oil from the SPR or threatening the energy industry with export bans, we should, according to Jamie Dimon, "Stop going hat in hand to Venezuela and Saudi and start pumping more oil and gas in the U.S.A." After all, he opined, it is the only way the U.S. can maintain its standing and use energy security to ensure Western unity.

Dimon's "just pump more oil" comment may trigger some activists who have long complained that JPMorgan Chase is the biggest U.S. lender to the fossil fuel industry (because it happens to be the biggest U.S. bank). To the chagrin of climate activists, the energy crisis that started in the summer of 2021 has posed an "existential threat" to many countries' sustainability goals as the world's consumption of coal has risen to record levels. It has also tarnished the image of activists who have successfully pressured many private and public entities to move off fossil fuels. Remember how the 16-year-old Greta Thunberg, TIME's 2019 Person of the Year, angrily denounced the audience at the U.N. General Assembly? "How dare you," chided the teenager, "You have stolen my dreams and my childhood with your empty words." Today, the tables have turned as some are blaming "do-gooder kids on a committee" (again quoting Jamie Dimon) for having driven politicians to pursue half-baked energy transition with no contingency plans.

The fact is that both renewable energy and fossil fuels are important to our national security and economic wellbeing. Well-intentioned climate activists should acknowledge that there are limits to renewable energy – e.g., solar or wind energy alone cannot power a semiconductor fab, and there are physical limits to how fast they can be developed (e.g., access to copper, lithium mines). Having signed into law the awkwardly named Inflation Reduction Act that will invest $391 billion in provisions related to energy security and climate change, Biden can make an astute political and pragmatic pivot by facilitating more domestic energy production – nuclear, oil, and natural gas. Ramping up American energy production – both renewable and traditional – is one of the most effective geopolitical levers in dealing with our friends and foes, not to mention the socioeconomic benefits at home. Ironically, a failure to incentivize domestic fossil fuel development would make these assets more attractive to investors, as scarcity will result in potentially higher commodity prices and more return of cash to shareholders. In short, I remain positive on energy and its related ecosystem.

Rockefeller Global Family Office
45 Rockefeller Plaza, Floor 5
New York, NY 10111

## MORE PAIN AHEAD

During the last week of October, the sharp selloffs in erstwhile market darlings – Microsoft, Alphabet, Meta, and Amazon (MAMA?) – and the rally among once shunned energy stocks – Exxon Mobile and Chevron – seemingly marked a symbolic end of an investment era dominated by the FAANG club and its roadies. However, as investors dumped MAMA stocks, they piled into Apple, the last of the FAANG club that has managed to outperform the market. It reflects many fund managers' short-term focus on getting across the finish line to 2023 by hiding in stocks showing relative strength. However, as great a company as Apple is, it may not be immune to the impact of recession. By the time investors capitulate on this widely held stock, if it happens at all, it may mark the trough for the bear market.

For now, market bulls are arguing that the imminent peak in inflation, Fed hawkishness, interest rates, the U.S. dollar, combined with the expiry of share buyback blackout periods would usher in a joyous holiday season and even the end of the bear market. They have been emboldened by the recent dovish tilt among the Reserve Bank of Australia, the Bank of Canada, and the ECB, which they believe will set the tone for the Fed. The bulls may turn out to be right in the short run, but their thesis has not been battle tested by a recession. I also find it interesting that investors would spin a potential 50-bps rate hike in December as something incrementally more bullish when the Fed has already signaled it with its 4.4% year-end 2022 Fed funds rate forecast released in September. This parlor game of trading on the timing of the Fed's eventual pivot is akin to wagering on which song the band on the tilting deck of the Titanic would play next when the course is already set. That is, a recession looks inevitable due to the long and variable lags of the Fed's aggressive rate hikes, and this downturn may be global in scope.

At this point, I am more positively disposed to U.S. Treasuries than equities. The shorter-end of the yield curve offers more than 4% in yield to park dry powder, while the unusually high volatility in the Treasury market offers opportunities to accumulate longer-dated bonds. As recession becomes more apparent, I expect long-dated bond yields to come down materially. On the equity side, the next shoe to drop is likely to be more aggressive cuts to the consensus 2023 EPS estimate, which still has an optimistic 6% growth expectation. Over the last six decades, aggregate corporate earnings have declined in *every* recession, including those in the 1970s when high inflation buoyed nominal growth. As Chair Powell has warned, there will be some pain for households and businesses, and I am afraid it is still ahead of us in this economic and market cycle.



1 Index pricing information does not reflect dividend income, withholding taxes, commissions, or fees that would be incurred by an investor pursuing the index return.

2 Russell Investment Group is the source and owner of the trademarks, service marks and copyrights related to the Russell Indexes. Russell® is a trademark of Russell Investment Group.