ASTORIA PortfolioAdvisors

# Astoria's Q3 Investment Outlook:

## It's time to start nibbling on stocks/credit.

Q3 2022

# Astoria's Current & Prospective Economic Outlook

# The risk reward for stocks/credit is attractive. Start to nibble.

Thus far 2022 has proven to be the exact opposite of 2021. Whereas last year was characterized by easy money, peak economic growth, and peak corporate profits, 2022 has seen a tightening of financial conditions, lower economic growth, and slower corporate profits. This combination has led to very difficult returns from a variety of asset classes thus far in 2022.

According to Morgan Stanley research, this is the worst first half return for the S&P 500 (-20%) since 1962, US High Yield bonds (-10.2%) since 1989, Japanese Yen (-15.2%) since 1989 and US 10Y (-10.8%) since the 1970s. We wrote in our last quarterly commentary that we thought Q1 weakness in the equity and bond market was attributed to a growth scare and not a full-blown pending recession. At the time of our Q1 outlook, our base case was that this extreme weakness would not spread more broadly to all US equity sectors. However, inflation sensitive assets were not able to avoid the acute weakness in all other asset classes and underperformed in Q2.

# At Astoria, we think there is more potential for upside than downside, so we are starting to increase our risk levels in our multi-asset portfolios.

Our view is that markets are experiencing a vicious negative feedback loop. Higher inflation stemming from supply chain shocks lingering from post Covid, excessive stimulus, plus tight labor markets has forced the Fed to be draconian in their rate hikes. Higher rate hikes have pressured longer duration assets. Significant downturns in growth, speculative technology, and cryptocurrency has caused investors to degross their books. The biggest year to date winners are being sold to bring risk levels down. In recent weeks, this has led to a significant downturn in commodity and inflation sensitive assets. There are no places to hide anymore. Our view is that Fed has been too late and too aggressive with rate hikes creating this negative feedback loop.

With all this said, investing is about assigning probabilities and we think now is an attractive opportunity to buy stocks and credit. You can never be sure the worst is behind us, hence, why one must assign probabilities. The title of our outlook is 'It's time to start nibbling' which is what we at Astoria are beginning to do.

# We view bear markets/recessions as opportunities.

We wrote the following in our Q1 outlook: “Admittedly, inflation sensitive assets have seen strong returns over the past 12-18 months. That does not imply that the upside is limited, but we acknowledge that the rate of change could slow in the future.” This has proven to be case in Q2.

Inflation will need to come down in order for the Fed to take its foot off the gas pedal. Market participants will focus on the next CPI and PPI announcements which are scheduled for July 13th and 14th, respectively. The next FOMC Meeting is scheduled for July 26-27th.

In summary, we believe there are three notable risks that the economy faces:

1) the Fed continues to be behind the curve and is stepping hard on the gas pedal

2) the Fed is looking to unwind its balance sheet at the same time it’s hiking interest rates

3) inflation has not peaked.

# While most commentaries are presenting a doom and gloom scenario, we are taking advantage of these opportunities.

Will the broader economy be able to withstand these risks without going into a recession? The stock market has already discounted the recession in our view. There are a number of high quality growth stocks are down 30-35%year to date. Crypto assets are down as much as 75% and unprofitable technology stocks are down as much as 75% from their all-time highs.

Historically buying stocks in a recession has proven to be a good risk/reward as your margin of safety is usually wider. It seems sensible for us to start nibbling if you are a long-term strategic investor. These opportunities won't last too long.

We wrote in our last commentary that broadly owning a portfolio of diversified sets of asset classes, as well as owning multiple factors, inflation hedges, and alternatives will be paramount in 2022. We continue to advocate these disciplines. After all, they are Astoria's True North.

# Astoria's Macro Insights

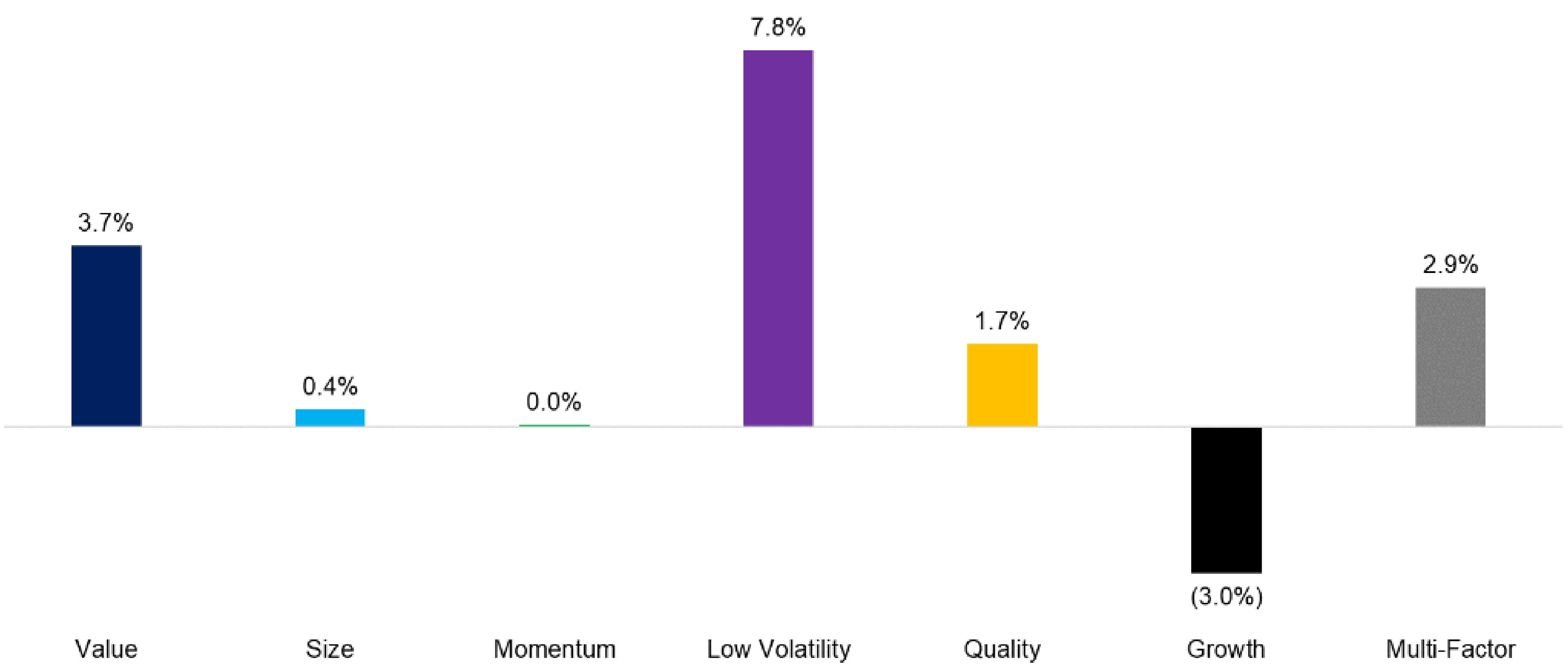
# Two Inflation sensitive assets (Commodities and MLPs) were amongst the best performing asset classes in H1 of 2022.

## 2022 YTD %


Source: Topdown Charts, Refinitiv Datastream

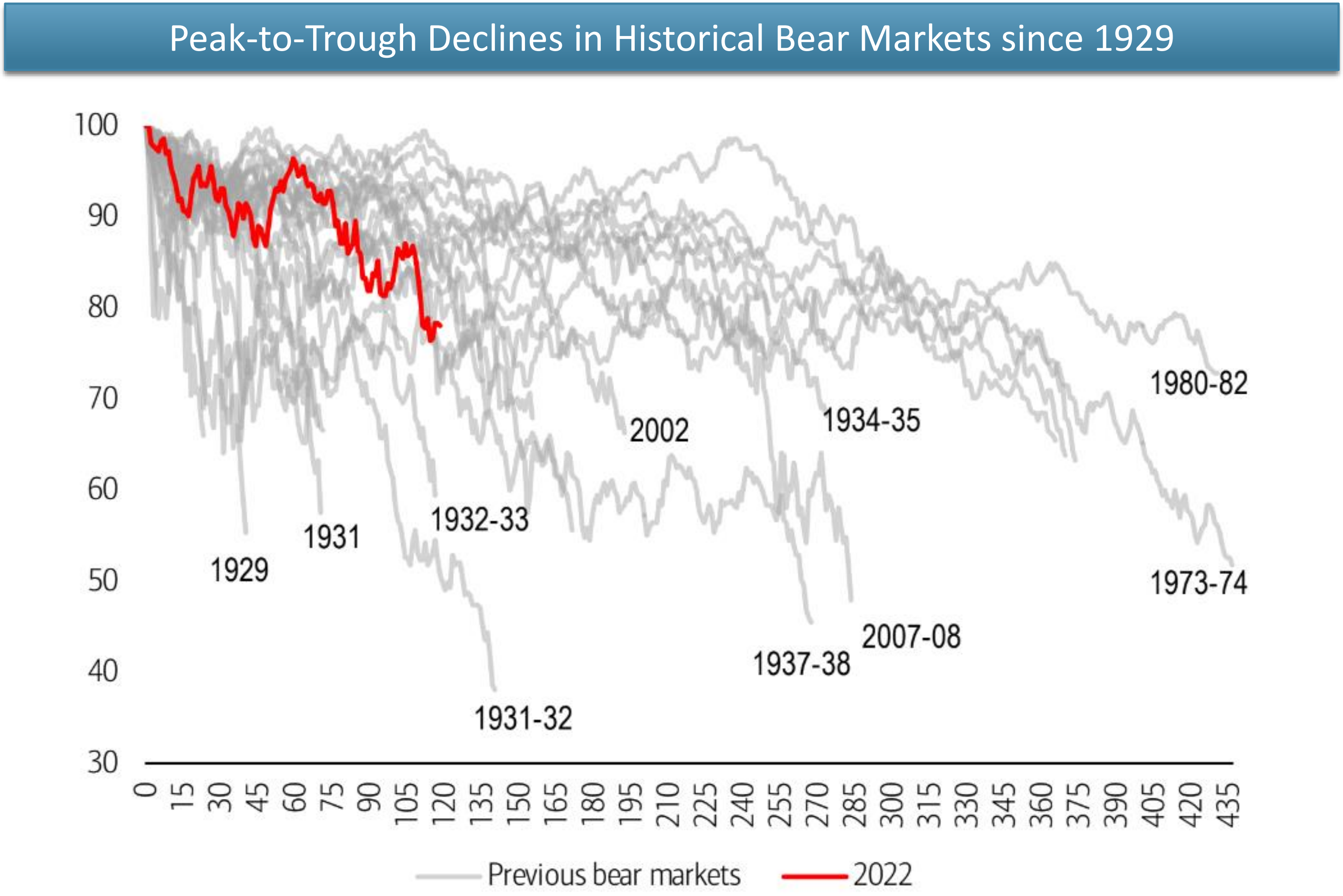
# Astoria has gone into great lengths to explain why we harvest multiple factors in portfolios. The YTD performance of factors is a good example why we like to mix factors.

Excess Returns from US Smart Beta ETFs: Year to Date 2022




Source: FactorResearch

# The S&P 500 officially entered a bear market.




Source: BofA Global Research

# According to BAML Research, the S&P 500 fell 32% from peak to trough on average during prior recessions.

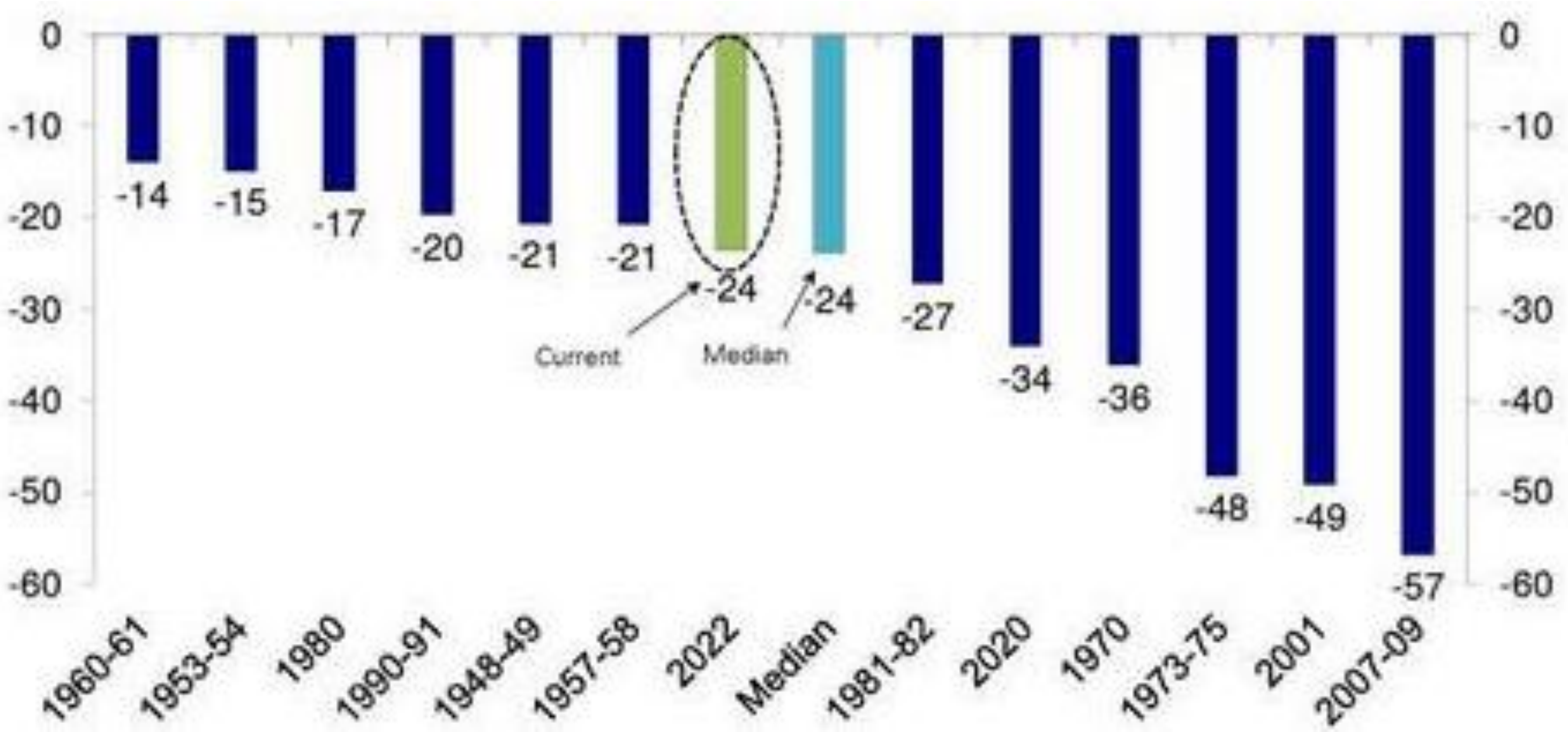
## Historical Recession Stats since 1950

| | S&P 500 | | Price peak-to-trough | | Trailing P/E | | | ERP (trailing EY - Rf) | | | Fwd P/E | | | GDP | EPS |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Recession | Peak date | Trough date | % return | # of months | Peak | Trough | % chg. | Trough | Peak | Chg. (bps) | Peak | Trough | % chg. | % chg. | Peak-to-trough |
| 3Q53-2Q54 | 1/5/53 | 9/14/53 | (14.8%) | 8 | 11.1 | 9.6 | (13.1%) | 8.2% | 9.4% | 1.2% | | | | (2.5%) | (17.6%) |
| 4Q57-2Q58 | 8/2/56 | 10/22/57 | (21.6%) | 15 | 13.0 | 12.2 | (6.3%) | 4.9% | 7.0% | 2.1% | | | | (3.6%) | (22.0%) |
| 3Q60-1Q61 | 12/12/61 | 6/26/62 | (28.0%) | 7 | 22.4 | 17.2 | (23.1%) | 3.5% | 5.2% | 1.7% | | | | (1.3%) | (11.7%) |
| 1Q70-4Q70 | 11/29/68 | 5/26/70 | (36.1%) | 18 | 18.0 | 14.8 | (17.7%) | 5.8% | 7.8% | 2.0% | | | | (0.7%) | (12.9%) |
| 1Q74-1Q75 | 1/11/73 | 10/3/74 | (48.2%) | 21 | 18.4 | 7.0 | (62.1%) | 8.1% | 14.0% | 5.8% | | | | (3.1%) | (14.8%) |
| 2Q80-3Q80 | 2/13/80 | 3/27/80 | (17.1%) | 1 | 7.5 | 7.4 | (0.4%) | 5.7% | 8.1% | 2.4% | | | | (2.2%) | (5.2%) |
| 4Q81-4Q82 | 11/28/80 | 8/12/82 | (27.1%) | 21 | 8.6 | 7.9 | (9.0%) | 0.9% | 3.3% | 2.4% | | | | (2.6%) | (17.0%) |
| 4Q90-1Q91 | 7/16/90 | 10/11/90 | (19.9%) | 3 | 15.5 | 13.0 | (16.1%) | 0.7% | 1.6% | 1.0% | 12.2 | 10.4 | (14.3%) | (1.3%) | (27.6%) |
| 2Q01-4Q01 | 3/24/00 | 10/9/02 | (49.1%) | 31 | 28.1 | 18.1 | (35.5%) | (1.0%) | 1.9% | 3.0% | 22.7 | 14.7 | (35.5%) | (0.3%) | (23.0%) |
| 1Q08-2Q09 | 10/9/07 | 3/9/09 | (56.8%) | 17 | 17.0 | 10.2 | (40.1%) | 3.2% | 7.8% | 4.6% | 14.7 | 11.1 | (24.5%) | (3.8%) | (44.8%) |
| 1Q20-2Q20 | 12/27/19 | 3/23/20 | (30.9%) | 3 | 19.1 | 18.0 | (5.6%) | 5.0% | 6.6% | 1.6% | 17.8 | 16.5 | (6.9%) | (10.1%) | (13.9%) |
| | | **Median** | **(28.0%)** | **15** | **16.2** | **12.3** | **(16.1%)** | **4.1%** | **6.6%** | **2.1%** | **16.8** | **13.2** | **(19.4%)** | **(2.5%)** | **(17.0%)** |
| | | **Avg.** | **(31.8%)** | **13** | **16.7** | **12.6** | **(20.8%)** | **3.7%** | **6.4%** | **2.5%** | **16.8** | **13.2** | **(20.3%)** | **(2.9%)** | **(19.1%)** |
| Today | 1/3/22 | 6/16/22 | (23.6%) | 5 | 26.0 | 17.5 | (32.8%) | 4.2% | 5.0% | 0.8% | 21.4 | 15.2 | (20.1%) | ? | ? |

Source: BofA US Equity & Quant Strategy, Haver Analytics, Bloomberg, FactSet

According to Deutsche Bank, the S&P 500 has recently moved in line with the median post WWII recession correction level, down 24% from its all time high. This also marks the fourth worst non-recession correction within the period.

S&P 500 Returns in Post-War Recessions (%)




Source: Shiller Data, Haver, DB Asset Allocation, Deutsche Bank

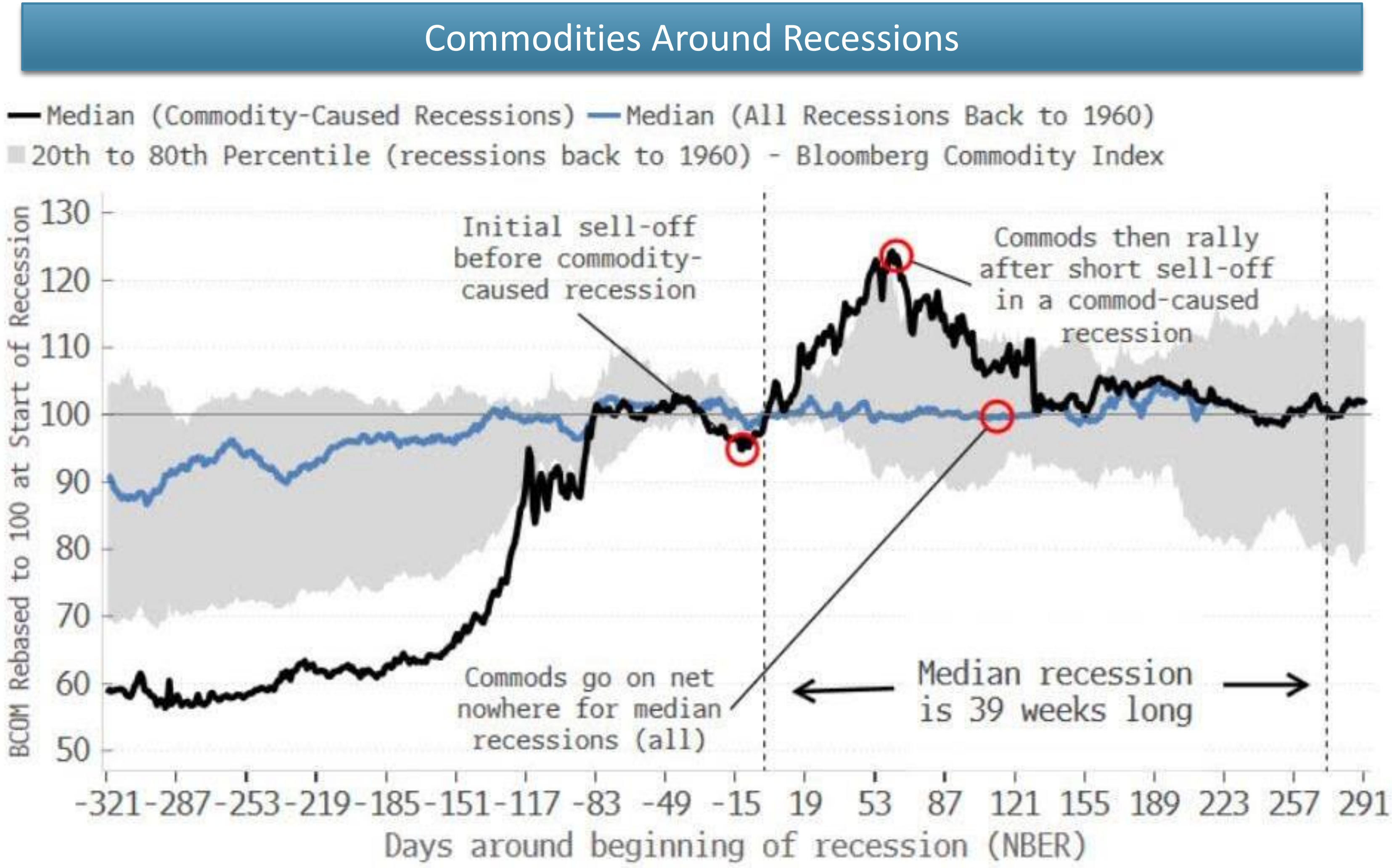
# While the market downturn has felt draconian thus far, some sectors are still far off their average recession max drawdowns. We view this as an opportunity!

## Max Drawdown in Recessions vs. Drawdown in 22' by Sector & Industry

| | | 1990<br>Max Drawdown | 2000<br>Max Drawdown | 2008<br>Max Drawdown | 2020<br>Max Drawdown | Recession Average<br>Max Drawdown | Today<br>2022 Max Drawdown |
|---|---|---|---|---|---|---|---|
| **Discretionary** | **Discretionary** | -32% | -45% | -61% | -33% | -43% | -36% |
| | Autos & Components | -39% | -62% | -86% | -56% | -61% | -47% |
| | Consumer Durables & Apparel | -30% | -34% | -70% | -47% | -45% | -37% |
| | Consumer Services | -39% | -46% | -45% | -49% | -44% | -28% |
| | Retailing | -36% | -37% | -60% | -28% | -40% | -34% |
| **Energy** | **Energy** | -12% | -33% | -54% | -61% | -40% | -20% |
| **Financials** | **Financials** | -39% | -37% | -84% | -43% | -51% | -26% |
| | Banks | -47% | -25% | -88% | -50% | -52% | -33% |
| | Diversified Financials | -40% | -50% | -84% | -39% | -53% | -26% |
| | Insurance | -32% | -41% | -82% | -44% | -50% | -17% |
| **Health Care** | **Health Care** | -16% | -37% | -41% | -29% | -31% | -16% |
| | HC Equipment & Services | -17% | -14% | -50% | -35% | -29% | -21% |
| | Pharma, Biotech, & Life Sciences | -16% | -44% | -38% | -23% | -30% | -14% |
| **Industrials** | **Industrials** | -28% | -43% | -65% | -43% | -45% | -21% |
| | Capital Goods | -28% | -49% | -69% | -45% | -48% | -21% |
| | Commercial & Professional Services | -31% | -25% | -61% | -37% | -38% | -22% |
| | Transportation | -28% | -22% | -56% | -38% | -36% | -22% |
| **Materials** | **Materials** | -25% | -39% | -62% | -37% | -41% | -18% |
| **Real Estate** | **Real Estate** | - | - | -79% | -39% | -59% | -25% |
| **Staples** | **Staples** | -17% | -17% | -35% | -25% | -23% | -16% |
| | Food & Staples Retailing | -21% | -36% | -34% | -16% | -27% | -26% |
| | Food Beverage & Tobacco | -17% | -11% | -36% | -31% | -24% | -11% |
| | Household & Personal Products | -20% | -38% | -40% | -23% | -30% | -21% |
| **Tech** | **Tech** | -31% | -83% | -55% | -31% | -50% | -30% |
| | Semis & Semi Equip | -42% | -84% | -62% | -35% | -56% | -37% |
| | Software & Services | -46% | -73% | -55% | -31% | -51% | -28% |
| | Tech Hardware & Equipment | -31% | -86% | -54% | -32% | -51% | -29% |
| **Utilities** | **Utilities** | -12% | -63% | -49% | -37% | -40% | -16% |
| **Comm** | **Comm Services** | -23% | -77% | -51% | -29% | -45% | -33% |
| | Media & Entertainment | -28% | -64% | -66% | -30% | -47% | -36% |
| | Telecom | -23% | -77% | -51% | -24% | -44% | -11% |

Source: Bloomberg, Morgan Stanley Research

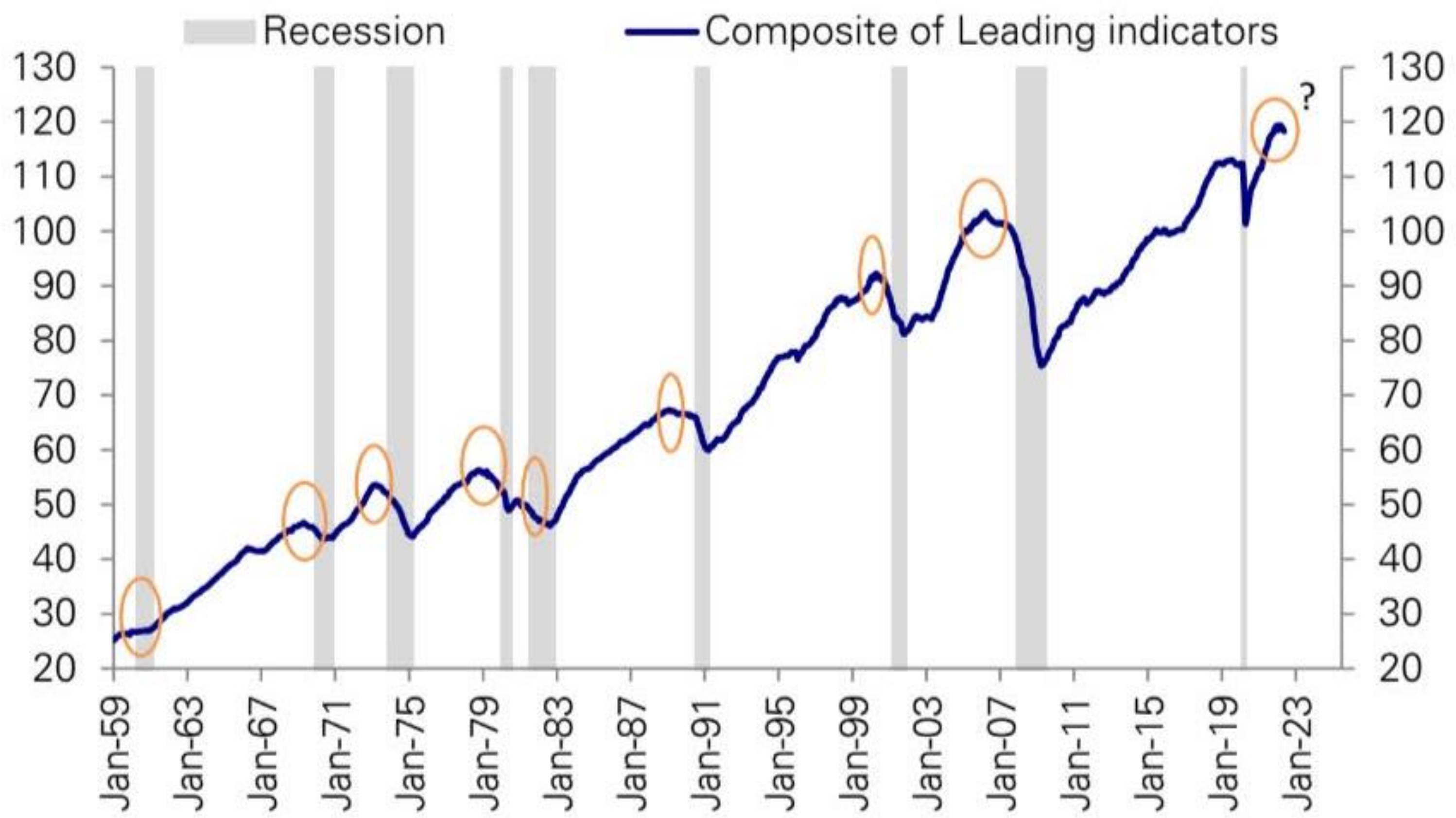
# Commodities usually rally into a recession. This time was no different.




Source: Bloomberg

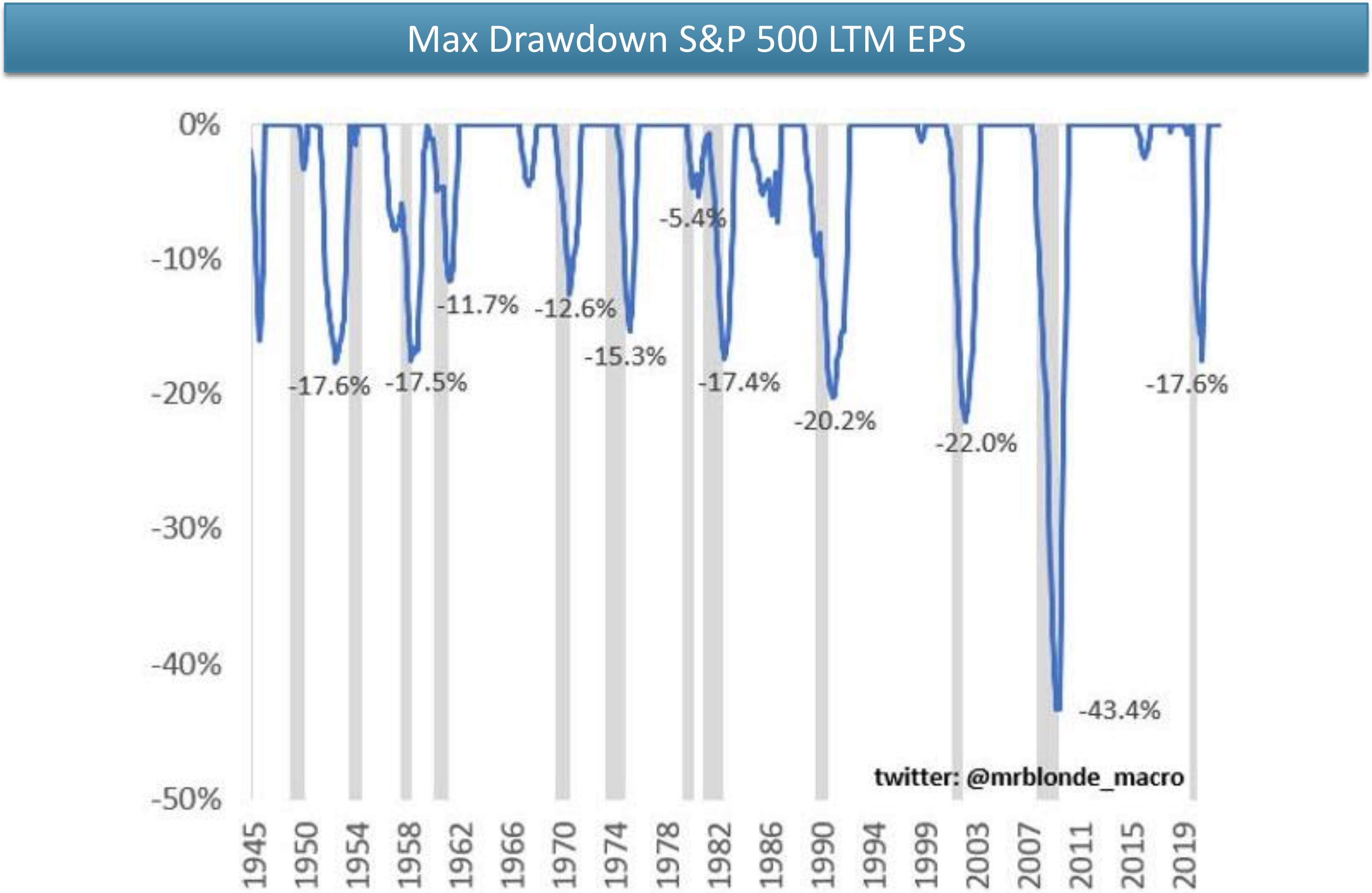
# The Composite Index of Leading Economic Indicators has weakened.

## Composite Index of Leading Economic Indicators




Source: The Conference Board, Haver, Deutsche Bank Asset Allocation, Twitter @WallStJesus

# Analysts estimates remain high and will likely decline as reporting season kicks into high gear.




Source: Twitter @MrBlonde_Macro

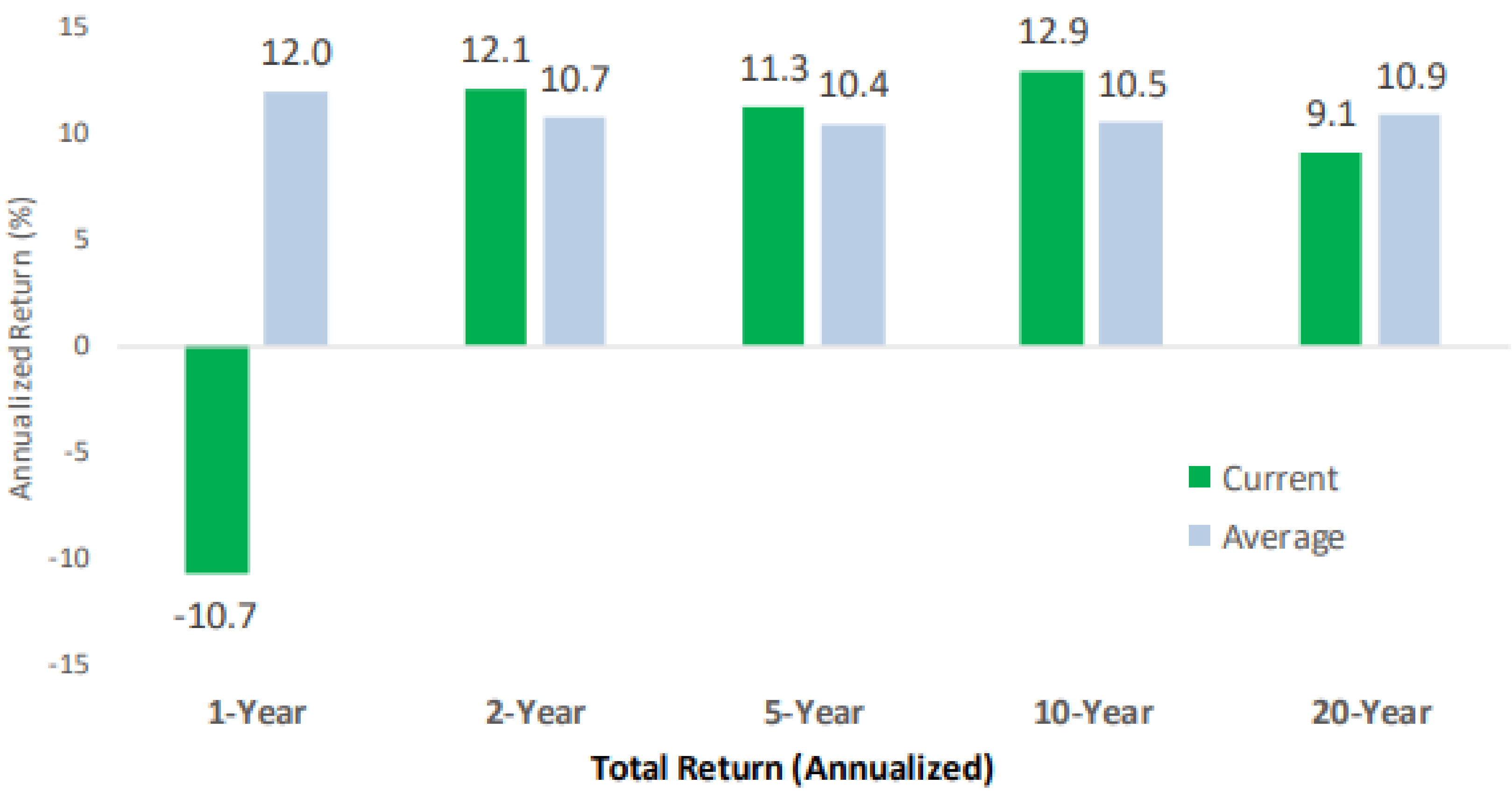
Five-year breakevens are pricing the lowest level of inflation this year. Regardless of whether or not we have reached peak inflation, Astoria's vantage point is that inflation will stay structurally higher for years to come.  Moreover, inflation sensitive assets are cheap to carry in a diversified portfolio.

## US Breakeven 5YR and US 5YR 5YR Forward Breakeven


Source: Bloomberg Finance L.P.

On a percentile basis, the one-year return of -10.7% for the S&P ranks in only the 12 percentile, the 20-year is in the 35th percentile, while the two, five, and ten-year returns are all between the 50th and 60th percentile.

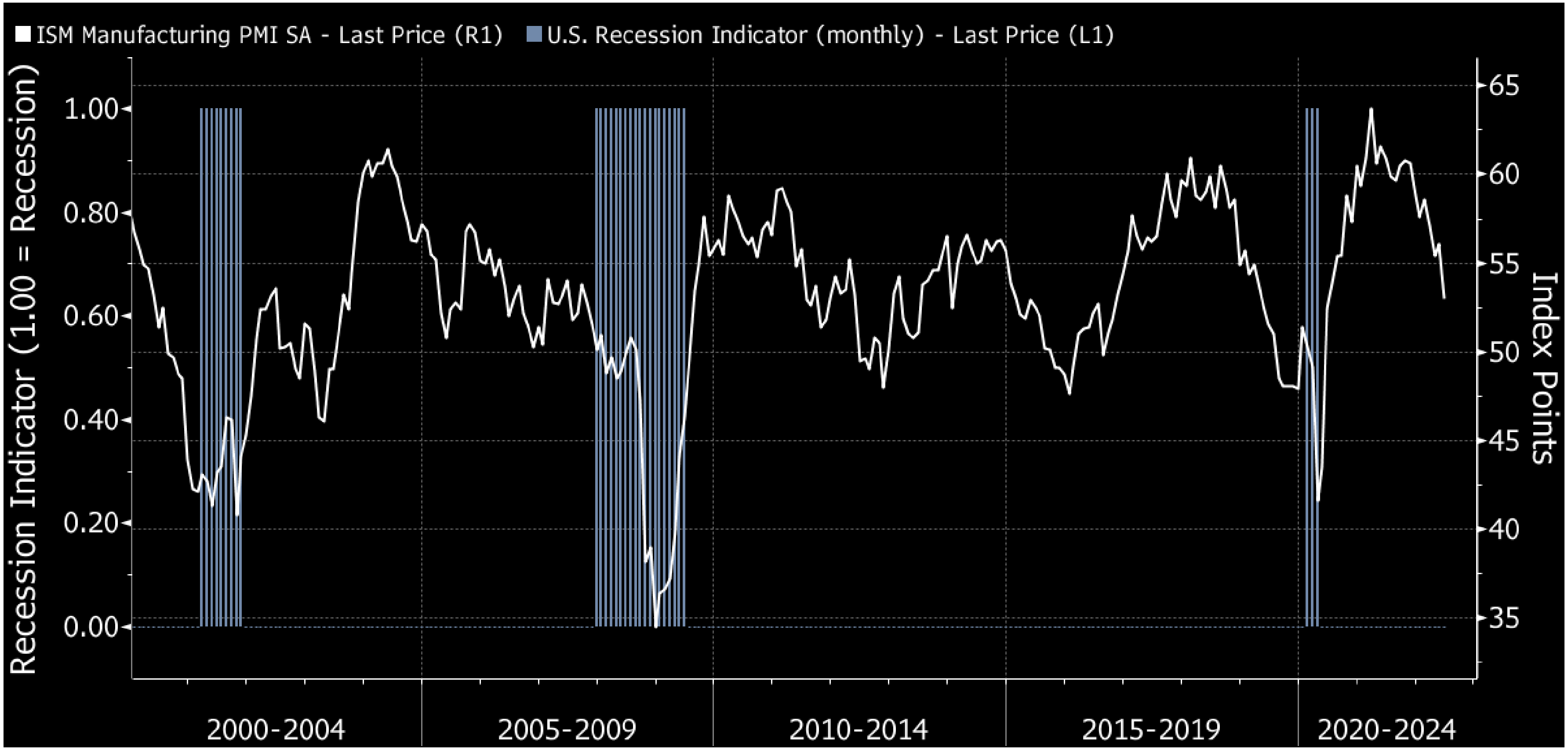
S&P 500 Current vs. Average Total Returns: 1928-2022




Source: Bespoke Investment Group

# US manufacturing has declined significantly. But then again, stocks have already discounted the weakening fundamentals.  Again, we view this as an opportunity!

## ISM Manufacturing PMI




Source: Bloomberg

Spreads in both investment grade and high yield have widened to reflect the risk of recession. Balance sheets are strong in most industries and debt service costs are low in relation to cash flow. Our risk managed strategies are starting to purchase credit.  This is a notable change for us.

## Investment Grade and High Yield Credit Spreads



Source: Bloomberg Finance L.P., GarthFriesen.com

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