CAPITAL INVESTMENT
SERVICES, LLC

Looking Forward – Managing through Noisy Markets
Q4 Quarterly Commentary

Let me start off by saying that this has been a challenging year and I understand that client portfolios have been negatively impacted near term. However, the team at Capital Investment Services has been and will continue to be in the fight for you every day. It is in challenging times that we strive to do our best work positioning your portfolio for an effective recovery. We thank you for your continued confidence and know that our data-driven phased approach that we have used in 2008-2009, 2013, 2018 and 2022 is being used as our basis and we are objectively looking for opportunities to provide potential returns back into your portfolio.

Third Quarter Recap

Global markets declined again in the third quarter as inflation remained near multi-decade highs, geopolitical tensions escalated further, and the Federal Reserve continued to aggressively hike interest rates signaling future rate increases will be larger than previously expected.

Key Market Impact Points

1. Solid performance by corporate America as indicated by Q2 earnings reports are expected to slow as Q3 earnings reports begin in October.
2. Global macroeconomic challenges continue to shift led by monetary policy tightening shifting the currency markets considerably led by a very strong US Dollar.
3. In July and September, the Federal Reserve raised interest rates by a total of 150 basis points landing Fed Funds Rate at 3.25% with an estimated terminal rate in this rising cycle of 4.5%.
4. The August CPI report (released in September) showed a slight increase in prices, implying that while inflation pressures had potentially peaked. However, the September CPI Report (released in October) showed a continued increases in inflation bolstering the Federal Reserves case to raise rates further.
5. Global currency and bond markets saw a dramatic increase in volatility, as the government of the United Kingdom announced a spending package designed to stimulate the economy.

The combination of sticky inflation and expectations of numerous future Fed rate hikes present significant obstacles for the economy in Q4 2022. As we start the fourth quarter markets remain in search of concrete positive catalysts that signal declining inflation pressures and a less-aggressive Federal Reserve.

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Third Quarter Performance Review

US Equity Indexes	Q3 Return	YTD
S&P 500	-4.88%	-23.87%
DJ Industrial Average	-6.17%	-19.72%
NASDAQ 100	-4.42%	-32.35%
S&P MidCap 400	-2.46%	-21.52%
Russell 2000	-2.19%	-25.10%

Source: YCharts

International Equity Indexes	Q3 Return	YTD
MSCI EAFE TR USD (Foreign Developed)	-9.29%	-26.76%
MSCI EM TR USD (Emerging Markets)	-11.42%	-26.89%
MSCI ACWI Ex USA TR USD (Foreign Dev & EM)	-9.80%	-26.18%

Source: YCharts

Commodity Indexes	Q3 Return	YTD
S&P GSCI (Broad-Based Commodities)	-10.31%	21.80%
WTI Crude Oil	-24.73%	6.31%
Gold Price	-8.62%	-9.19%

Source: YCharts/Koyfin.com

US Bond Indexes	Q3 Return	YTD
BBgBarc US Agg Bond	-4.75%	-14.61%
BBgBarc US T-Bill 1-3 Mon	0.47%	0.63%
ICE US T-Bond 7-10 Year	-5.80%	-15.72%
BBgBarc US MBS (Mortgage-backed)	-5.35%	-13.66%
BBgBarc Municipal	-3.46%	-12.13%
BBgBarc US Corporate Invest Grade	-5.06%	-18.72%
BBgBarc US Corporate High Yield	-0.65%	-14.74%

Source: YCharts

Fourth Quarter Market Outlook

As we start the final quarter of 2022, an honest assessment of the macroeconomic landscape reveals that the markets and the economy are still facing numerous challenges from still-high inflation, ongoing Fed rate hikes, and geopolitical instability. But while the outlook for risk assets remains challenged, that reality must be considered in the context of a market that has declined substantially and, presumably, likely already priced in a lot of “bad news.” Additionally, multiple sentiment indicators have hit or are approaching levels that historically have represented extreme pessimism and bearishness, and they are largely ignoring the reality that there has been some improvement in the macroeconomic outlook over the past several months.

Inflation has likely peaked which will lead to a less-aggressive Fed perhaps as early as the fourth quarter. According to the Fed’s estimates, interest rate increases will begin to slow in the coming months, and the last rate hike for this cycle could occur in March 2023 or sooner. If that turns out to be the case, and the Fed signals to markets that this rate hike cycle is approaching its end, I believe that will likely be a materially positive catalyst for both the stock and bond markets, and that’s evidenced by the July and August rallies that were driven by hopes of a less-aggressive Fed. Amid a difficult macroeconomic backdrop, the U.S. economy and corporate America have proven impressively resilient. Most measures of U.S. economic growth remain in solid shape, while U.S. corporate earnings estimates have stayed largely elevated, and the widespread earnings declines that were feared back in early 2022 simply have not materialized.

This is a difficult market and a complicated moment for the world, but history is clear: Positive surprises can and have occurred even in difficult times such as this, and through periods of similar macroeconomic turmoil, markets have historically eventually recouped the losses and moved to meaningful new highs. There is no reason to think this time will be any different.

Fourth Quarter Strategy Drivers

1. Continue re-evaluating our clients’ international exposure and identifying potential funds that favor large-cap U.S. Market.
2. Identifying individual equity opportunities focusing on a mix on companies that generate free cash flow.
3. Continue re-evaluating our clients’ defensive structure of allocations focusing on higher interest rates on money market funds and short-term treasury funds.
4. Continue evaluating alternative funds within your portfolio for effectiveness to be non-correlative to the volatile components of the market.

In general, I am expecting a bear market rally to begin off the start of Q3 corporate earnings in October with continued fuel through the mid-term elections. With the expectation that the House of Representatives will flip to a Republican majority, this will be the catalyst the markets have been reaching for. Another important component will be the messaging from the November Fed Meeting which will occur during the first week of November. I fully expect another 75-basis point raise in the Fed Funds Rate during the November meeting which will land the Fed Funds Rate at 4%. Without an indication of slowing inflation, the year-end target for the Fed Funds Rate is 4.75% with a terminal rate on this cycle of 5.5%. I expect an S&P500 range of 3500-4400 within the fourth quarter.

Strategic investing is a marathon, not a sprint, and even extended bouts of volatility like we've experienced so far this year are unlikely to alter a diversified approach set up to meet your long-term investment goals. Therefore, it's critical for you to stay invested within your risk profile and remain patient. I understand that the past 10 months in the markets have been a grind lower; however, opportunities have begun to present themselves during the bottoming of the market. Volatility can induce fear with market values testing the lows of the year. It is very important to treat volatility as a friend and not a foe when investing through these challenging markets.

Rest assured that our entire team will remain dedicated to helping you effectively navigate this market environment. At Capital Investment Services, we understand the risks facing both the markets and the economy, and we are committed to helping you effectively navigate this challenging investment environment. Please do not hesitate to contact us with any questions or comments, or to schedule a portfolio review.

Sincerely,

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Financial Advisor, RJFS