Churchill Management Group

Monthly Market Update

October 12, 2021

TACTICAL STRATEGIES

PREMIER WEALTH TACTICAL & PREMIER WEALTH TACTICAL CORE

The market had its biggest decline of the year as September lived up to its penchant for being the historically worst month for stocks. The drawdown of -5.8% in the S&P 500 edged the decline in mid-February where the markets fell -5.7%.

On the surface, the major indices have had it easy this year. A couple of 5% drawdowns, separated by a few 3% to 4% declines, within an entire year is considered calm by historical standards. However, beneath the surface, the sell-off felt much worse in the individual stocks, especially Tech.

The episode in September was very similar to the decline in February, as Tech sold off while interest rates rose. Like last time, investors rotated into Value names in the Financial and Energy sectors.

The 10-year Treasury yield rose sharply to 1.74% in February before falling back to 1.2%. The recent pop has it probing those highs again, returning to 1.6%. In addition, like last time, individual stocks have fared worse than the indices, with 54% of stocks on NYSE below their 50-day moving average. Plus, about half of the S&P 500 is still down over 10%, even after the nice bounce last week.

There was no shortage of reasons for the decline. The mainstream media pivoted away from the previous myopic focus on inflation and stimulus, playing up the debt ceiling. There was also the blow-up in Chinese real estate developer, Evergrande, evoking fears that it could be the Chinese equivalent of Lehman Brothers.

Our view on the debt ceiling debate is a bit more sanguine than the catastrophic picture painted in the press. While the subject has clearly been politicized in an effort to gain political leverage, both parties understand the timing and consequences. No politician wants to be in the history books for creating a self-inflicted disaster. We have already seen a sign of rationality as both parties have already agreed to push the deadline to December.

The issue of Evergrande, while still opaque, appears to be isolated for the most part to China. Being the second largest real estate developer with over $300 billion in debt, the company is likely too big to fail. This is where a central command economy has the upper hand, as the government can dictate a solution by forcing most parties to accept its will. Unlike the U.S., where JPMorgan Chase had to agree to buy Bear Stearns, the Evergrande resolution will be done by government decree.

Our view is that inflation and the withdrawal of stimulus is, and will remain, in the driver's seat. Inflation has been more stubborn than the central banks have predicted. In addition, recently we have seen them feel the need to double down and reiterate their views that inflation is transitory. While central banks have a good case to make that inflation may be transitory, the temporary supply bottlenecks they attribute to the short-term inflation spikes have been slow to be ironed out. The recent resurgence in yields is likely a reflection of some unease that the longer the bottlenecks remain, the higher the odds that it may change longer-term expectations.

There has also been talk that we are in a taper tantrum redux similar to that of 2013 – especially in light of the Federal Reserve explicitly setting the expectations to reduce asset purchases later this year, while tapering down to zero by the middle of 2022. While the “tapering tantrum” was widely publicized, the reality is that it only brought about a 6% correction. We already had that last month.

In our view, tapering is not tightening. The Fed will still be buying significant amounts of assets until the middle of next year. In addition, rate hikes are likely another year away. When the time comes, the Fed will be smarter this time around, unlike in 2018 when they let the balance sheet runoff and hiked rates. We can assume this time will be one or the other, but not both.

Bottom line: A constructive view of the market is likely warranted, with the Fed still very accommodative, and only beginning on a slow march to neutral. The economy is likely in good shape, too, as there is plenty of spending power available with $2.4 trillion in excess savings. Half of those savings came from fiscal transfer payments, the other half from savings on decreased spending on services during the pandemic. That amount constitutes a significant 15% of annual consumption.

Of course, one could also argue that this could be the driver for inflation. The prospect of higher inflation and a persistent, but shallow breadth divergence on the NYSE did encourage us to take a small step in reducing some exposure in Growth – an area that tends to underperform with rising rates and higher inflation.

TACTICAL OPPORTUNITY

We raised a small level of cash as the market hit some bumps. Despite the volatility, few sell signals were triggered. There were not many buy signals either. For now, the 'ride-the-middle' theme rings true.

FULLY INVESTED

ETF SECTOR ROTATION

The rotation continues, with the latest shift back to Value. Energy surged, jumping 19% since the start of September. That came as nine of the 11 sectors fell during the same period. Financials was the only other positive sector, up around 2%. Leaders from the summer lagged, primarily Real Estate, which shed 8%.

We remain overweight Energy and Financials, with holdings in Tech, Healthcare, Industrials, Materials, and Consumer Discretionary. A neutral 'watch-and-see' approach is likely to continue.

For the broad markets, Value held up better than Growth. However, across the board, all were down. Internationals – both in Europe and Emerging Markets – all lagged slightly.

EQUITY GROWTH OPPORTUNITY

Despite the pickup in volatility and the selling within the technology sector due to the rise in rates, the portfolio remained relatively quiet. We continue to have a slant towards Growth and Technology and have not had sell signals trigger out of that space. We plan to watch the ongoing rotation closely and will rejigger the allocation if need be. At this point, this is normal volatility in the market and we have not had a breach below key levels.

EQUITY GROWTH AND VALUE

FAANG-type stocks tapped the brakes. Since the start of September, Apple (-6%), Amazon (-5%), and Google parent Alphabet (-4%) all fell. Mitigating those losses were good months from Energy and Financials, such as Wells Fargo (+10%) and JPMorgan Chase (+7%). Given the rotation, consistent leadership has been hard to find, so broad holdings remain the theme.

EQUITY DIVIDEND INCOME

Despite the 10-Year Treasury rising, Dividend Stocks fared better than the market, boosted by strength in Energy and Financials. Energy stocks, such as Exxon and Chevron, soared over 13%. Financials like KeyCorp also had a great month. Activity continues to be light.

RISK BLENDED STRATEGIES

Our Risk Blended Strategies are a combination of both Premier Wealth Tactical Core and ETF Sector Rotation. Please see the above commentary for more information on each strategy.

- **Churchill Moderate:** 70% Premier Wealth Tactical Core / 30% ETF Sector Rotation
- **Churchill Moderately Aggressive**: 50% Premier Wealth Tactical Core / 50% ETF Sector Rotation
- **Churchill Aggressive:** 30% Premier Wealth Tactical Core / 70% ETF Sector Rotation

For a full description of each strategy, please click here.

Best regards,

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