Churchill Management Group

Monthly Market Update

August 11, 2022

TACTICAL STRATEGIES

PREMIER WEALTH TACTICAL & PREMIER WEALTH TACTICAL CORE

The direction of the market continues to be a function of guessing what the Federal Reserve will do next in its fight against inflation. If investors believe the Fed will remain hawkish and want to continue to raise rates and tighten monetary conditions, then the market sells off. If investors believe that the Fed gets comfortable with the direction of inflation and, thus, can slow down its rate raising campaign, markets bounce.

Wednesday's CPI report apparently gave comfort to those embracing the theory that the worst of inflation is behind us. The CPI measure of inflation came in at 8.5%, which was better than the 8.7% that economists were expecting, and also an improvement from the 9.1% reading from last month. However, even before that, markets had been hopeful. Starting in mid-June, interest rates took a reprieve from their quick rise, the ten-year treasury falling from 3.48% to 2.51%, triggering stocks, especially Growth stocks, into a short term rally off oversold conditions.

The bounce came on the heels of what the market interprets as a potential pivot for the Fed following Jerome Powell's speech announcing the July decision to raise rates by 75 basis points. Powell said, "As the stance of monetary policy tightens further, it likely will become appropriate to slow the pace of increases while we assess how our cumulative policy adjustments are affecting the economy and inflation."

Will the Fed slow as some have come to expect? Maybe, but it is far from certain. Many Fed members are out in public declaring that increases are coming. History says the Fed does not stop raising rates until the fed funds rate is above the inflation rate. Right now, the fed funds rate is at 2.5%, and inflation is at 8.5%. While a decline from last month is good, we are a long way from those two meetings in the middle.

The Fed Has Never Stopped Hiking Before Fed Funds > CPI

Tightening Cycle	Fed Funds Peak	Date	CPI	Real Fed Funds
1973	11.00%	8/30/1973	7.40%	3.60%
1976-1980	20.00%	3/3/1980	14.80%	5.20%
1980	20.00%	12/5/1980	12.50%	7.50%
1983-1984	11.75%	8/24/1984	4.30%	7.45%
1986-1989	9.75%	2/24/1989	4.80%	4.95%
1994-1995	6.00%	2/1/1995	2.90%	3.10%
1999-2000	6.50%	5/16/2000	3.20%	3.30%
2004-2006	5.25%	6/29/2006	4.30%	0.95%
2015-2018	2.50%	12/19/2018	1.90%	0.60%
2022	***2.50%****	***7/27/2022***	***9.10%****	***-6.60%***

* If rate hikes ended today

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The bottom line is that while the Fed may believe rates are within the range of where the neutral rate is, they also have communicated that "we need to get policy to at least a moderately restrictive level." That likely pegs the terminal rate, or the rate at which the Fed anticipates halting at, around its projected 3.25 to 3.5 range. In addition, that would require inflation to start coming down at a much faster rate. Powell and team have been very explicit that they would rather do too much tightening than too little, even if it comes at the expense of an economic slowdown.

The next Fed decision will be on September 21st. There will be a lot of data to assist them in that decision, including one more inflation reading as well as two employment reports. We would expect to see heightened volatility for those releases just as we saw for yesterday's inflation release.

In the meantime, our indicators continue to show a mixed picture, though more positive. While the short-term action can be deemed as technically positive, our fundamental and sentiment indicators are mixed.

Technically, the action since May fits some of the profile of a bottoming formation. On the two indices that have seen the most damage — namely the Nasdaq and the Russell 2000 — we have seen the biggest recoveries. They have also both overtaken the June highs. In addition, breath on the NYSE has made a good recovery.

Fundamentally, we continue to see a mixed bag. Valuations have come down in a big way relative to recent history. However, the market is still not cheap on a historical basis. In addition, bottoms have historically occurred when the Fed either reduces rates or leaves rates flat. While we may not need rates to fall or flatten out today due to the Fed's forward guidance, the Fed continues to indicate that rates will keep rising even going into next year.

In terms of sentiment, we have seen an extreme level of bearishness by advisors. They have yet to reach the extreme levels typically associated with a bottom, but it might be close enough. On the retail side, the fear is definitely not showing up with most investors still heavily invested in equities.

In summary, a case can be made that this could be a bottom. We have taken a step to put our toe in the water to better align ourselves with that possibility.

If markets can sustain the positive action, we will continue to tiptoe our way back in. We remain cognizant that this could also be a countertrend rally that ultimately forces us to reduce exposure again. If that were to be the case and the market rolls over and makes new lows, the market will once again have to form a new bottoming process.

We have seen that happen many times in past bear markets. Markets can make multiple attempts to form bottoms, flashing several failed tries before succeeding. We will continue to keep a close eye on all our indicators.

TACTICAL OPPORTUNITY

Over the last month, the slight increase in the percent invested has resulted from the market rally, although we did not see as many buy signals as might have been expected. Big pops from mainstays Apple and Amazon made them the best performers. Value plays EOG Resources and Pfizer are among the laggards but remain holds.

FULLY INVESTED STRATEGIES

ETF SECTOR ROTATION

As a result of an unexpected drop in interest rates, leadership has flip-flopped since the middle of June. Growth surged behind good runs in Tech and Consumer Discretionary stocks. The tide did raise all ships, as every sector has been up since July 1. Although more defensive sectors, such as Health Care and Consumer Staples, unexpectedly lagged.

We saw no significant changes in the model, as it owns a mixed bag of Growth and Value but does lean more defensive with its holdings.

In the broad markets, Growth has led substantially since July. Large-Cap Growth was up around 13%, compared to Value's 5% rise. Small Caps also enjoyed the rally, rising around 12%.

No change yet in the model's holding, which still leans toward the Value side. While International has also been up since July 1, these holdings lagged the U.S. Our model maintains a preference for U.S. positions over International.

EQUITY GROWTH OPPORTUNITY

We saw good lift from the Growth side of the portfolio on hopes the Federal Reserve may pivot and hold back on rate hikes. We swapped some Value with Technology to capture this rotation but the back and forth volatility on the inflation story may continue for longer. We plan to be patient until we see strong signs of capitulation and a potential market bottom. Until then, the portfolio will be balancing out both the Value and Growth side of the ledger.

EQUITY GROWTH AND VALUE

With Tech and Consumer Discretionary leading, good runs were seen in stocks like Apple, Chipotle Mexican Grill and Nasdaq. Defensive plays, particularly Health Care stocks, like Eli Lilly and Pfizer, lagged. No significant changes since the portfolio is decently balanced for a flip-flopping environment.

EQUITY DIVIDEND INCOME

Dividend stocks have risen, but not as much as Grown stocks for the last month. Still, weakness in areas such as Telecom (e.g., AT&T and Verizon) was more than offset by strength in the likes of Broadcom, Franklin Resources, Extra Space Storage and similar holdings. The plan is to stay the course.

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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