

Encompass Portfolios Quarterly

Third Quarter 2022

Third Quarter 2022 – Market Downtrend Persists

The first-half selloff across both stocks and bonds continued into the third quarter. Market indices vacillated between multi-week periods of euphoric speculation that the US Federal Reserve would tone down its hawkish speak, alternating to despair over economic reports highlighting persistent inflation and a doubling down of Fed rate-hike messaging. In the end, September closed at fresh lows for 2022. While the bear market for stocks has remained relatively well-contained with US Large-caps **-23.9%** to-date (*'SPY' ETF Proxy*), the unusual coincident occurrence of a bond bear left the *Bloomberg Aggregate Bond Index* down **-14.4%** (*'AGG'*). This has been the worst retrace for the asset class in nearly 100 years (*New York Times, "Bonds May Be Having Their Worst Year Yet," 9/30/22*).

There is no shortage of reasons for the pullback. First, stocks and bonds alike entered the year relatively overvalued based on near-zero interest rates and on the heels of tremendous fiscal and monetary stimulus from the Covid-era. Second, ensuing inflation, initially thought to be 'transitory' by the Federal Reserve, has ended up being 'stickier' than anticipated due to on-going labor shortages and supply chain disruptions. Third, the war in eastern Europe and China's Zero-Covid policy have only exacerbated the problem among the energy and production arenas. Consequently, the Federal Reserve has held a stalwart hawkish rate stance throughout the year, quickly raising interbank lending rates. This has translated to the fastest increase in mortgage rates in history, with 30-year rates exceeding 7% (*Zero Hedge, "30-Year Mortgage Rises Above 7% for The First Time Since 2000," 9/27/22*). When rates rise so dramatically, both stocks and bonds are subject to repricing and the economy typically slows – and this is precisely where we are at.

US Stocks (*'VTI'*) retreated **-4.5%** during Q3, while overseas stocks were further set back by the war and a strong US Dollar, down **-10.6%** (*'VEA'*). Making the year difficult for traditional portfolios, fixed income securities added to their annual losses, down another **-4.7%** (*'AGG'*). Commodities also came in **-10.3%** (*'DBC'*), hopefully presaging a decline in inflationary reads.

The outlook for markets remains dour going into year-end, although many indices are 'due' at least a temporary bounce. On one hand, markets will likely require some catalyst to begin a longer-term healing process. On the other, sentiment being as broadly low as it is, often precedes a turnaround. In addition, it is important for investors to recall that markets typically recover from their lows well in advance of the economy should we enter an official recession. Meanwhile, have a wonderful holiday season ahead, and be assured we continue to closely monitor markets during this volatile period.

**Dividend-adjusted ETF data from Commodity Systems, Inc.*

S&P 500 (^GSPC)
 S&P - S&P 500 Real Time Price (Currency in USD)
3,677.95 +94.88 (+2.65%)
 At close: 05:44PM



Market Outlook-at-a-Glance

Economy	● ● ● ● ●
Valuation	● ● ● ● ●
Price Trends	● ● ● ● ●
Choppiness	●

Association Financial Services



Association Financial Services brings together a team of experts to provide portfolio solutions to its clients.

The firm's founder, Roffé Hofmann, feels an important sense of accomplishment in helping his clients achieve their financial goals.

The Encompass Portfolios managed by our sub-advisor are comprised of five diversified, objectives-based core strategies that adapt to changing market conditions to help you achieve your goals. May not apply to all clients.

Discussion

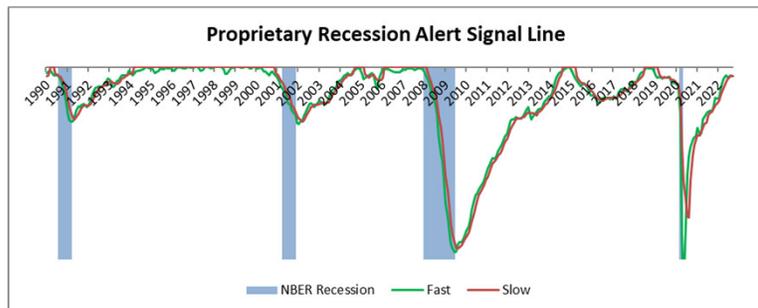
Chart

(Available Data as of 9/30/22)

US Economy ●●●●●

Global growth has stalled under pressure from elevated energy costs, supply chain disruptions, the Russia-Ukraine war, broadening inflation, rising central bank lending rates, and frequent economic stop-starts in China under its Zero-Covid policy. Calling the slowdown “broad-based and sharper than expected,” the International Monetary Fund again cut its 2022 US growth forecast to +1.6% from +2.3%, with world output reduced to +3.2% for 2022 and +2.7% for 2023 (IMF, “World Economic Outlook,” 10/22). The US economy is in technical recession, although the recent nonfarm payrolls report was strong with unemployment near 50-year lows of 3.5% (US Dept. of Labor, “Sept. 2022 Jobs Report...,” 10/7/22). Inflation has remained stubbornly high with the Consumer Price Index (CPI) reported at +8.2% (US Bureau of Labor Statistics, 10/13/22). While CPI has fallen, the pace has been slow, supporting the Federal Reserve’s “higher for longer” rate policy. An elevated US Dollar has resulted, stoking problems overseas, including a Bank of England bond market intervention (CNBC, “Pension Fund Panic...,” 9/29/22).

Period	Non-Farm Payroll	Personal Income	Retail Sales	Industrial Production	Service Activity	Weighted Economic Assessment	
	PAYEMS	PI (Net)	RSAFS	INDPRO	NMFBAI	Overall	Acceleration
Year-over-Year	3.86%	0.56%	0.00%	3.68%	-5.14%	Positive	Minus
Sep-22	0.17%	0.00%	-0.39%	0.00%	-2.96%	Pending	Pending
Aug-22	0.21%	0.07%	0.30%	-0.16%	1.67%	Positive	Minus
Jul-22	0.35%	0.62%	-0.42%	0.52%	6.77%	Positive	Plus
Jun-22	0.19%	-0.39%	-0.29%	-0.01%	2.94%	Flat	Minus
May-22	0.26%	0.06%	-0.62%	-0.07%	-7.78%	Positive	Minus



Source: Federal Reserve Bank of S. Louis; assessments and signal line are proprietary.

Stock Valuation ●●●●●

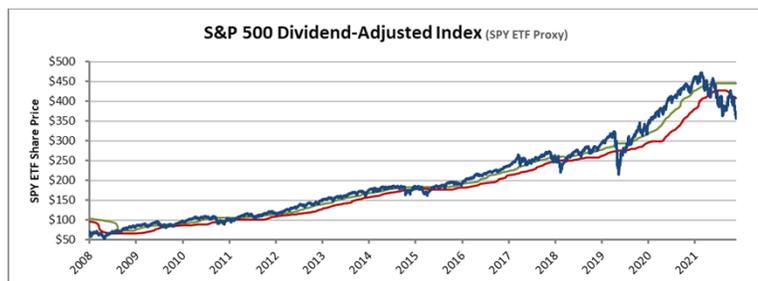
The adjusted stock Price/Earnings (PE) ratio has fallen from a peak of 43.2 to 30.4, a -30% reduction. While healthier, this remains within the 90th percentile of upper valuations within the past 20-year period. Year-over-year Q3 2022 earnings are forecast to grow +1.6% on higher sales despite rising costs (Factset, “S&P 500 Earnings Season Update,” 10/14/22). If the forecast holds, it will be the weakest earnings growth rate reported for the index since Q3 2020.



Source: Professor Robert J. Shiller, Yale University; Price/ Smoothed 10-yr Earnings.

Price Trends ●●●●●

Every single one of our major tracked asset classes finished in the red for Q3 (see Page 3). Until we see a faster decline in inflation, a central bank pivot, or a resolution to the war in Europe, the outlook is likely to remain negative. Typical bear markets last about nine months, which would calendar about here in the fall. However, markets associated with recessions tend to retrace deeper than experienced thus far, and we are technically within one right now (defined as two consecutive quarterly GDP contractions).

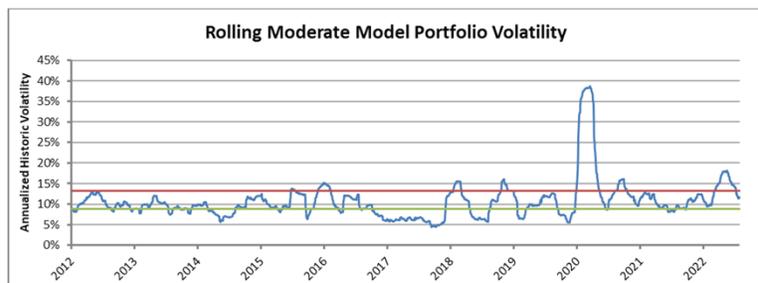


Source: Dividend adjusted data from Commodity Systems, Inc.; technical channels.

Portfolio Choppiness ●●●●●

Last year we stated a belief that volatility may be heightened in 2022 as compared to recent years, and that this may benefit more tactical approaches incorporating effective risk management techniques.

Although the VIX options volatility index is elevated, it has remained relatively contained compared to past bear markets. For the time being, our models hold significant cash until volatility normalizes, which has reduced both losses and day-to-day account swings.



Note: Historic volatility of the Moderate ETF Index portfolio; annualized dispersion from mean calculation.

Asset Class (Representative ETP)	Proprietary Outlook*	Quarterly Performance	Price Chart (As of 9/30/22)**
United States Stocks Vanguard Total Stock Market ETF (VTI)	Negative 	-4.5%	
Overseas Stocks Vanguard FTSE Developed All Cap ex-US ETF (VEA)	Negative 	-10.6%	
Emerging Stocks iShares Core MSCI Emerging Markets ETF (IEMG)	Negative 	-12.4%	
US Aggregate Bonds iShares Core US Aggregate Bond ETF (AGG)	Negative 	-4.7%	
Global Fixed Income Vanguard Total International Bond ETF (BNDX)	Negative 	-3.4%	
Global Real Estate SPDR Dow Jones Global Real Estate ETF (RWO)	Negative 	-11.4%	
Commodities PowerShares DB Commodity Tracking ETF (DBC)	Neutral (Downgraded) 	-10.3%	
Alternatives IQ Hedge Multi-Strategy Tracker ETF (QAI)	Negative 	-3.3%	

* Based on a proprietary indicator, not trading advice; ** Representative ETP index proxies, dividend-adjusted time series from Commodity Systems, Inc.

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