WEEKLY MARKET INSIGHTS

August 29, 2022

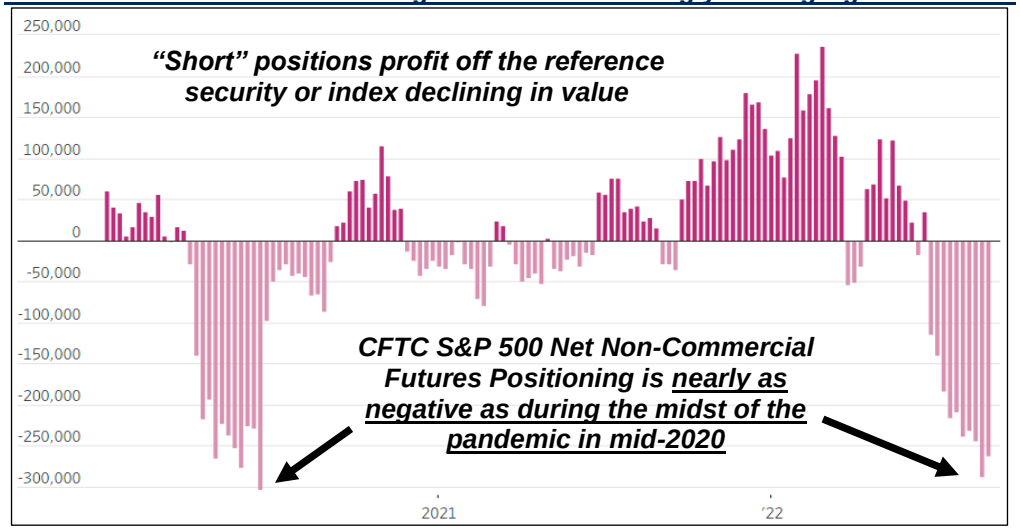
INVESTMENT MANAGEMENT GROUP | ARVEST

"The universe is not required to be in perfect harmony with human ambition" – Carl Sagan, Astronomer

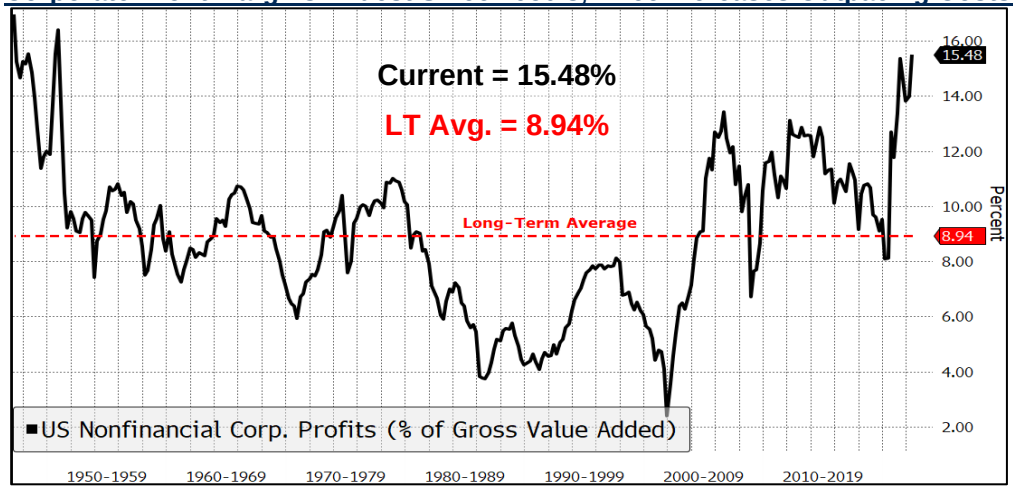
The Federal Reserve's (FED) annual Economic Symposium at Jackson Hole concluded last week. A lot of investors did not like what they heard. The world's top central bankers seemed unified in sending the message that inflation is broad based and will require unwavering action. Where they downplayed inflation risks at first, partly to dampen the negative feedback loop effect of rising inflation ***expectations***, the FED now says inflation will be arrested by force. Equity markets reacted by broadly selling off on Friday, and that sentiment has continued to start the week. Equity investors are now as negatively positioned as they were during the depth of the pandemic in 2020 (see chart, top right). That is to be expected after FED officials made statements that even an economic recession does not mean they will pivot to a more accommodative monetary policy, unless inflation slows meaningfully. What was not expected was the reaction from the bond market. Or, more accurately, a lack of reaction. Treasury yields barely moved higher in response to the hawkish tone of the world's central bankers. Basically, bond investors seem to be calling the FED's bluff. The bond market either believes that inflation has peaked, or that economic growth will slow enough to warrant a pause in the FED's current interest rate policy trajectory. Be mindful that equity investors are often far more emotional (i.e. irrational) than bond investors. Bond investors are higher on the capital food chain and are more narrowly focused on ability to repay debt. Those are easier numbers to crunch than nebulous future growth projections that most equity investors focus on.

Despite the seriousness of the tone surrounding central banker inflation discussions last week, U.S. corporations are still fairly healthy from an earnings standpoint. Corporate profit margins are currently at the highest level since the 1950's (see chart, bottom right), which means they are increasing prices faster than they are seeing their own costs increase. This may lend itself to "price gouging" headlines and rebukes from the Biden Administration looking to limit the damage from inflation on election results, but this is simply the real-world outcome of rising inflation expectations that we have often talked about all year. If a company expects their costs to increase, they will understandably increase prices ***before*** higher costs become a problem. Not after. Those profit margins will inevitably soon return to more reasonable levels, and it is plausible that these margins may have peaked. The coming headlines are likely to be filled with negative profit surprises as corporations adjust to higher interest ***(cont.)***

S&P 500 Futures Market Showing Investors Increasingly Betting Against Market



Corporate Profit Margins Widest Since 1950's, Price Increases Outpacing Costs



Sources: Top – Bloomberg LP; Bottom – Wall Street Journal, FactSet

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Arvest Wealth Management currently manages over $14 billion in client assets by providing a diverse mix of services including brokerage, trust, investment management, retirement plans, IRAs, custodial accounts, estate settlement and insurance. We are people helping people find financial solutions for life. The Investment Management Group is a registered investment advisory within Arvest Wealth Management, founded in 2011, and responsible for managing approximately $750 million in assets.

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rates and input costs combined with slowing demand. Corporations have been able to pass on costs so far, but this does not seem likely to continue at the current rate without further affecting consumer demand.

The financial media's relatively narrow focus on the FED, interest rates, and recessions has overshadowed more exciting news. NASA was planning to launch their new rocket (SLS) and spacecraft (Orion) this morning (see graphic, top right), but the launch has been postponed due to a reported minor hydrogen bleed in one of the four engines. The launch is now expected to take place on Friday morning. Overall, the agency ***initially*** plans to complete three Artemis missions, named for the twin sister of Apollo in Greek mythology. The program will culminate in a manned moon mission in 2025. This first mission (Artemis I) is meant to be an unmanned stress test. A lot has changed since NASA started this project over a decade ago though. No part of the SLS rocket is reusable. Since that time, private companies have now pioneered reusable rockets as cost efficient and reliable space transport. The potential start of a new age of space exploration with lots of room for improvement is something to be optimistic about, but it is far from the only area where human ambition is currently exploring new frontiers.

Morgan Housel is fond of saying that it takes an optimist to get rich but a pessimist to stay rich, and we believe that every investor with a long-time horizon should be an optimist. Sometimes turning off the constant flow of negative headlines can help refocus attention on the long-term potential of economic growth, instead of just the risks. The best time for investors to explore opportunities is when everyone else is too distracted by the negativity.

The markets will be closed on Monday for Labor Day. As such, we will not publish next week and will resume on September 12. Hope you have a peaceful long weekend!

JOIN OUR MONTHLY MARKET CALL

The Arvest Investment Management Group hosts a monthly Market Viewpoint webinar. To join us for our next meeting, please contact Charles Kurtz at ckurtz@arvest.com.

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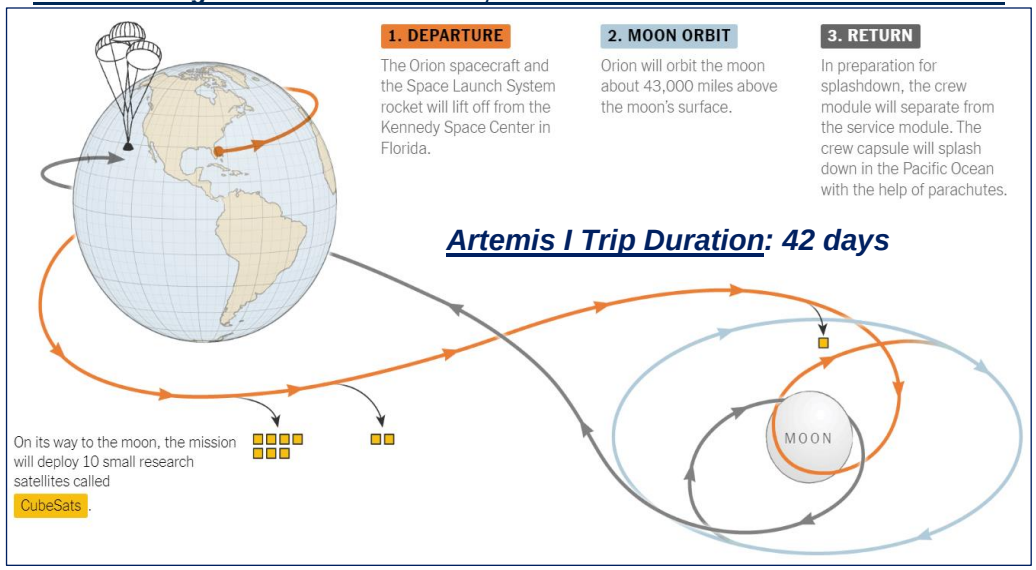
Alex supports the portfolio management team through market research that aids asset allocation decisions and due diligence on third party investment managers. He has a BSBA in finance, as well as a certificate in integrated investment management, and holds the CFA designation as a member of the Chartered Financial Analyst Institute and the Kansas City Society of Chartered Financial Analysts.

NASA To Begin Test of New Rocket, Manned Moon Mission Planned for 2025



Source: The New York Times

CURRENT ASSET CLASS OUTLOOK

Equities	Current
U.S. Equity	Neutral
Int'l Equity	Slightly Favorable
Emer. Mkts	Slightly Favorable

Real Assets	Current
Real Estate	Slightly Unfavorable
Infrastructure	Neutral
Commodities	Neutral

Fixed Income	Current
Invest. Grade Credit	Neutral
Treasury/Agency	Neutral
Mortgage (MBS)	Slightly Unfavorable
Commercial MBS	Slightly Favorable
Asset Backed (ABS)	Favorable
High Yield	Neutral
Emer. Mkts Debt	Slightly Unfavorable
Taxable Muni	Favorable
Tax-Exempt	Neutral
Tips	Neutral

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Market Returns & Rates (as of 8/26/2022)

Asset Class	Sub-Asset Class	Index	YTD	1-Year	3-Year	5-Year	10-Year	2021
Equity	U.S. Large Cap Equities	S&P 500	-14.00%	-7.88%	13.95%	12.64%	13.32%	28.68%
Equity	U.S. Mid Cap Equities	S&P 400	-11.17%	-6.63%	12.18%	9.60%	11.63%	24.73%
Equity	U.S. Small Cap Equities	Russell 2000	-14.71%	-13.17%	10.10%	7.92%	10.34%	14.78%
Equity	Developed ex. U.S. Equities	MSCI ACWI ex U.S.	-16.32%	-16.17%	4.71%	2.64%	5.13%	8.32%
Equity	Emerging Markets Equities	MSCI Emerging Mkts	-16.28%	-17.86%	4.33%	1.24%	3.26%	-2.32%
Fixed Income	Broad Aggregate	BB Aggregate	-10.02%	-10.59%	-1.62%	0.72%	1.47%	-1.54%
Fixed Income	U.S. Treasury	BB U.S. Treasury	-9.43%	-10.05%	-1.94%	0.46%	0.93%	-2.32%
Fixed Income	U.S. Treasury Inflation Prot.	BB U.S. Inflation Linked	-6.72%	-4.72%	3.24%	3.63%	1.92%	6.00%
Fixed Income	U.S. Investment Grade	BB U.S. Invest. Grade	-12.73%	-13.17%	-1.46%	1.42%	2.57%	-1.04%
Fixed Income	U.S. High Yield	BB U.S. High Yield	-9.74%	-8.73%	1.70%	2.97%	4.69%	5.28%
Fixed Income	U.S. Leveraged Loans	CS Leveraged Loan	-1.05%	0.42%	3.07%	3.56%	4.07%	5.40%
Fixed Income	U.S. Municipals	BB Municipal Bond	-8.32%	-8.29%	-0.69%	1.37%	2.29%	1.52%
Fixed Income	Non-U.S. Gov't Bond	FTSE Non-U.S. WGBI	-20.98%	-24.68%	-8.06%	-4.00%	-2.14%	-9.68%
Fixed Income	Emerging Markets Debt	JPMorgan EMBI	-16.05%	-17.24%	-3.66%	-0.72%	1.92%	-1.51%
Real Assets	Real Estate	FTSE NAREIT	-15.75%	-4.96%	4.65%	6.47%	7.80%	43.24%
Real Assets	Energy Infrastructure	Alerian MLP	32.20%	39.19%	9.40%	4.75%	2.01%	39.85%
Real Assets	Broad Commodities	Bloomberg Commodity	25.64%	31.22%	17.72%	8.36%	-1.48%	27.05%
Real Assets	Oil	WTI Crude	23.73%	38.03%	20.16%	14.22%	-0.33%	55.01%
Real Assets	Gold	Gold COMEX	-5.06%	-3.13%	4.39%	6.08%	0.39%	-3.51%

Key Market Interest Rates	Current Rate	1 Month Ago	2 Months Ago	3 Months Ago	4 Months Ago	6 Months Ago	1 Year Ago
Federal Funds Rate	2.33%	1.58%	1.58%	0.83%	0.33%	0.08%	0.09%
Secured Overnight Fin. Rate (SOFR)	2.28%	1.53%	1.50%	0.78%	0.28%	0.05%	0.05%
90-Day Treasury Rate	2.70%	2.34%	1.68%	1.03%	0.78%	0.29%	0.03%
2-Year Treasury Rate	3.40%	3.00%	3.12%	2.48%	2.62%	1.58%	0.24%
5-Year Treasury Rate	3.21%	2.84%	3.25%	2.72%	2.84%	1.86%	0.85%
10-Year Treasury Rate	3.04%	2.78%	3.20%	2.74%	2.82%	1.96%	1.35%
30-Year Treasury Rate	3.19%	3.07%	3.31%	2.96%	2.89%	2.28%	1.95%
3-Mon/10-Yr Treasury Spread	0.34%	0.44%	1.51%	1.71%	2.04%	1.67%	1.32%
2-Yr /10-Yr Treasury Spread	-0.36%	-0.21%	0.08%	0.26%	0.21%	0.38%	1.11%
6-Month CD Rate	0.91%	0.72%	0.43%	0.42%	0.29%	0.14%	0.14%
1-Year CD Rate	1.38%	1.14%	0.85%	0.82%	0.51%	0.28%	0.28%
2-Year CD Rate	1.58%	1.37%	1.02%	1.00%	0.58%	0.32%	0.32%