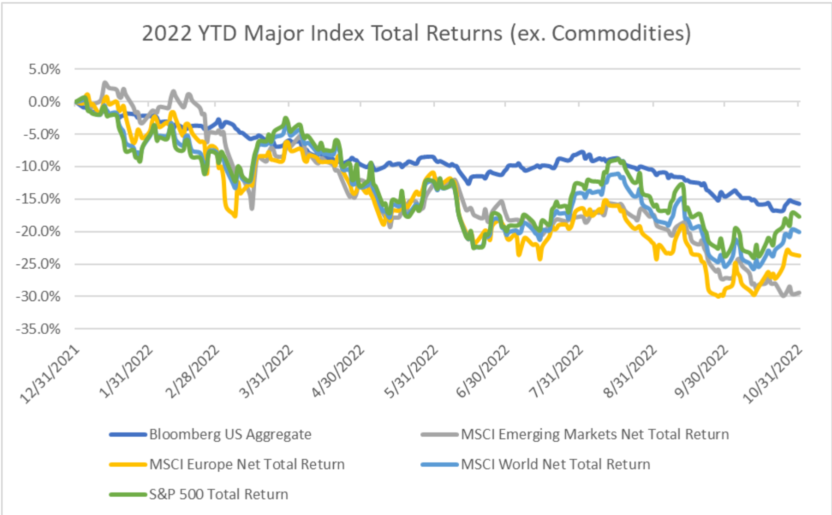
ENCORE INVESTMENT ADVISORS

OCTOBER 2022 MARKET REVIEW

Market Recap: The third bear market rally of 2022 occurred during the month of October. Global equities returned over 7% (the best month of the year thus far), while interest rates pushed higher, pressuring fixed income securities. The best performing components of the equity market were value-oriented sectors, while the laggards tilted towards growth. Global value companies outperformed their growth counterparts by 5% during the month of October and are now outperforming by almost 20% in 2022 to date; a stark contrast to performance since the Global Financial Crisis, as markets have been dominated by large technology companies for over a decade. There were many storylines in October that impacted the movement of asset prices, driving the deviation between the growth and value factors. Turmoil in the UK government continued, global companies released their third quarter earnings reports, and Chinese President Xi Jinping was "reelected" during the 20th National Congress of the Chinese Communist Party. Risk assets shook off uncertainty in China and the UK, as well as mediocre earnings data in the US, as stocks looked for any reason to rally. Equity market fundamentals remain wobbly; however, investor sentiment and positioning are both extremely pessimistic, and are at levels which can spur technically driven relief rallies on news that would not ordinarily move markets. Investors also continued to price in another large interest rate hike in the US, despite clear indications that inflation is moderating.

One of our external research providers describes the global economy as being a three-legged stool propped up by the US, European, and Chinese economies. As we have spent time in prior reviews discussing happenings in the US and European markets, we feel it is an opportune time to discuss China in more depth. In October, the Chinese Communist Party held their 20th National Congress – a large political gathering that occurs every five years; the Congress includes voting to determine the country's president. The elected officials have a state-of-the-union type address, and release their domestic and foreign policy goals. This congress was expected to be more meaningful than previous meetings, given the crossroads China is at with a slowing economy, and strict Covid policies that have remained in place far longer than most other countries. Straying from Chinese political norms, Xi Jinping was elected as the party's General Secretary for a third consecutive term. The members of the communist party also voted for members of Xi's cabinet, known as the Politburo Standing Committee (PSC). The newly elected members tilt the PSC even more in favor of President Xi. In Xi's two hour speech at the congress, he touched on many items that will be addressed over the next five years, but the speech did not produce major policy changes or surprises. There was no pivot on the country's Zero-Covid policies, much to the dismay of investors, and the speech lacked decisiveness on any action relating to Taiwan.

How does this impact our perspective? The outcome of the National Congress led to a massive swath of foreign investors cutting their exposure to China and Hong Kong based companies. The volatility of Chinese equity markets has continued, while shares have rebounded slightly over the past week based on rumors of an amendment to the country's Covid strategy. There are certainly aspects of the Congress that are negatives from an investment perspective, mainly the lack of diversity at the top of the Chinese government and the stacking of the PSC with Xi loyalists. If we needed any reminder, it appears that Xi is in full control of the government. In addition to the composition of the PSC, China's previous leader, Hu Jintao, was forcibly removed from the Congress, akin to Secret Service escorting President Trump out of President Biden's state-of-the-union. There were, however, portions of Xi's speech that can be viewed as positives. Total factor productivity, an economic term measuring the efficiency of an economy, was discussed as well as improving the country's industrial sector and supply chains, which would provide more resiliency to the global economy. Recent economic policy was centered on "common prosperity" and the eradication of excesses in the technology and real estate sectors, so even a small shift in focus to growing the consumer-based economy is a welcomed change. While there are obvious concerns with investing in emerging markets, including China, we believe that it is too early to draw any conclusions from the National Congress. Given the risk, those portfolios that are exposed to China, typically hold a relatively small weighting, and primarily use actively managed strategies, in hopes of adding value through security selection.



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