Quarterly Commentary
September 30, 2022

Dear Valued Client:

BRAKING OR BREAKING, WHAT IS THE FED DOING TO THE U.S. ECONOMY?

After a promising start that began with a relief rally, global markets continued their year-to-date declines during the 3rd quarter as record inflation, geopolitical tensions, lingering effects from the pandemic, and, most importantly, fears that an aggressive Federal Reserve would push the U.S. economy into recession weighed heavily on the broader markets.

Based on the false belief that the economy was moving past the point of peak inflation and the Fed would soon "pivot" to a less aggressive policy stance, the markets rallied over 18% from their June lows during the 1st half of the quarter. Surprisingly, even the bond markets were fooled by the hope of a "Fed pivot." Bond prices rallied along with the major stock averages, pushing the yield on the benchmark 10-Year Treasury, which moves in the opposite direction of bond prices, down nearly 90 bps ("bps"; 100 bps is equivalent to 1%) from its June highs. However, a steady stream of unfavorable inflation data continued to pressure the major averages. And by mid-August, any hope of less aggressive Fed actions was quickly dashed by persistently high inflation data. But it was Fed Chair Powell's commentary at the Economic Symposium in Jackson Hole, WY, in late August, during which he warned the U.S. economy would likely feel some "pain" as a result of the Fed's actions, that set the market's tone for the rest of the quarter. As the implication of Powell's words finally settled into the collective understanding of the markets, the major averages gave back all of their early August gains - and then some, with the S&P 500 closing solidly lower, down 4% by month end. Unfortunately, September was no better for the markets. Another unfavorable August CPI report combined with several earnings pre-announcements and another 75bps rate increase - with the Fed signaling there would be more to come – pushed the major averages to their worst monthly declines since March 2020.

The silver lining, if there is one, is that the market's recent declines will help the Fed in its effort to reduce inflation and eventually return it to a range of 2%, which is the Fed's long-term target. It also shows that, despite a challenging economic and geopolitical backdrop, the U.S. economy remains quite resilient – especially compared to the rest of the world. U.S. employment continues to be strong, and corporate profits are still rising, all be it at a slower rate. And finally, much of the bad news – inflation, rising rates, recession fears, etc. – is already being priced into the markets. Assuming the Fed reaches its targeted Funds rate by the middle of next year, or perhaps even earlier, we expect the markets will anticipate and respond positively to a "real" Fed pivot, even if the economy were to enter a mild recession.

3RD QUARTER OVERVIEW: U.S. EQUITY MARKETS

For the Quarter, it was the first time the S&P 500 and Nasdaq experienced three consecutive quarterly losses since 2009, losing 5.3% and 4.1%, respectively. Not to be left out, the Dow tumbled 6.7% in the third quarter, the first time it faced three straight quarterly losses since 2015. Adding to more market history, it was also the first time in 80 years that the S&P 500 posted a quarterly loss after rising more than 10% during the quarter. For the Dow, the month of September was particularly notable. It was the worst month for the Average since 2002 – even compared to September 2008 during the financial crisis. By the end of the quarter, all the major averages were trading below their prior 52-week lows set in June, increasing the risk for continued downside next quarter.

U.S. Equity Indexes	Q3 Return	YTD
S&P 500	-4.9%	-23.9%
D.J. Industrial Average	-6.2%	-19.7%
NASDAQ 100	-4.4%	-32.4%
S&P MidCap 400	-2.5%	-21.5%
Russell 2000	-2.2%	-25.1%

Source: YCharts.

RECENT MARKET DRIVERS: THE FED STAYS THE COURSE

Over the prior five FOMC meetings between March and September, the Federal Reserve has raised the Fed Funds Rate by a total of 300 bps (again, 100 bps is equivalent to 1%). Based on the most recent inflation data, the markets anticipate the Fed will increase rates by another 125 bps by year-end. If the Fed maintains this course, it will equate to 17 individual 25 bps rate hikes totaling 425 bps, an increase not seen since Paul Volker was Fed Chairman. Along with rate increases, the Fed has been reducing the number of its bond holdings it has acquired over the years – in a process known as Q.T., or "quantitative tightening." Because this is the first time the Fed has attempted to reduce such a large number, perhaps several Trillion dollars worth, of bonds it currently holds on its $8.9 trillion balance sheet, the exact impact on the credit markets is unknown.

Below are the Fed rate increases **announced** and expected by the Fed in 2022:

Month of FOMC Meeting	Increase in bp	New Fed Funds Target
March	+25	0.25% to 0.50%
May	+50	0.75% to 1.00%
June	+75	1.50% to 1.75%
July	+75	2.25% to 2.50%
September	+75	3.00% to 3.25%
November	+75	3.75% to 4.00%
December	+50	4.00% to 4.50%

Source: https://fred.stlouisfed.org/.

COMMODITIES: RECESSION, GEOPOLITICS & THE STRONG DOLLAR

Commodities fell sharply during the third quarter as a combination of the multi-decade strength of the U.S. dollar, growing fears of a global recession, and rising interest rates negatively impacted industrial commodities as well as traditional safe havens like precious metals. Oil prices also fell in the quarter as concerns about future demand offset any risk that geopolitics would impact supplies. However, OPEC's decision to cut production by 2 million barrels per day as the cartel shifts its focus to maintaining price vs. market share could mean that oil's recent declines may be short-lived.

Commodity Indexes	Q3 Return	YTD
S&P GSCI (Broad-Based Commodities)	-10.3%	21.8%
WTI Crude Oil	-24.7%	6.3%
Gold Price	-8.6%	-9.2%

Source: YCharts.

FIXED INCOME: RISING RATES COULD BE ATTRACTIVE

Bond markets appear to be at a significant inflection point heading into Q4. Long rates are coming off their biggest monthly gain in 2022, suggesting further upside in yields. Bond prices, in aggregate, are falling multiples of prior record declines, raising concerns that more volatility could result in a series of unintended consequences for the financial system - similar to what occurred recently in the UK LDI (liability-driven market). However, as interest rates continue to rise, the relative attractiveness of fixed-income investments is also increasing, especially for risk-averse investors. More recently, as the yield on shorter-term U.S. Treasuries has risen above 4.5%, and near where the Fed is expected to finish its rate tightening cycle, there could be more investment opportunity in the U.S. Treasury market than at any time since 2007.

WE ARE UNABLE TO PREDICT MARKET BEHAVIOR, BUT

At DAC, we believe the best way to preserve purchasing power during these uncertain times is to grow your income faster than inflation. We understand the risks facing the global economy and financial markets and are committed to helping you navigate this challenging environment. As we increase the level of due diligence on the companies we invest in, we believe our dividend-focused companies will emerge from this challenging period even stronger than before. Perhaps there is no better recent example than what occurred during the pandemic. Companies with strong cash flows, leading brands, and robust pricing power were also the best positioned to take market share. These are the same companies we invest in on behalf of our clients and the ones that make superior long-term investments based on the power of their future earnings and dividend growth.

BUILDING ON PREDICTABLE INCOME

Dividend Assets Capital ("DAC") was built on a pioneering, 40+ year legacy of dividend growth investing that we call the 3D process… "Double-digit, Dividend Growth for a Decade or More." We believe companies that declare and increase those dividends substantially and consistently, year after year, tend to perform uncommonly well for reasons beyond their dividends alone.

Another hallmark of our dividend growth investing process is that it provides at least two significant benefits for investors. The first is long-term capital appreciation, and the second is a stream of rising portfolio income. Most conversations about portfolio results focus on total return, which is a combination of both of those elements. However, we believe that the growth of portfolio income is an equally important investment outcome, but it is often underappreciated and simply overlooked by even the most knowledgeable investors. Examining the results from the DAC Equity strategy composite over the last decade demonstrates how both outcomes can be achieved from a single investment strategy and how income growth can contribute materially to an investor's financial situation. situation.

Best regards,

Marc Saurborn, CFA®, Director of Research and Investment Strategies

AND... Your DAC Team

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The S&P 500 refers to the Standard and Poor's 500 Index which is a capitalization weighted index of 500 leading companies and covers approximately 80% of available market capitalization. The volatility (beta) of an account may be greater or less than its respective benchmark. It is not possible to invest directly in an index

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