SANCTUARY

Sanctuary
Asset Management
Investment Outlook
February 2023

Active Asset Allocation Views

Overview

2023 has started off on a strong foot for equities and we are seeing more opportunities in international and emerging markets than we did in 2022. Most of that is due to the Dollar falling, which we feel has broken its uptrend and may come under further pressure. Too early for US Megacap growth, but opportunities in value, small cap and EM in the equity market. The question is how soft or hard of an economic landing the Fed can engineer and if the bond markets are correct (pricing in rate cuts in 2023) or if the Fed verbiage is correct saying "*higher for longer.*" We feel this may be a choppy market that investors need to be very selective with. Bonds may be one of the biggest opportunities in 2023 as they rebound from a historically bad year last year. We are closely watching earnings, technical patterns and if the downtrend and resistance levels that have so far held in this bear market continue to hold. Lastly, trajectory of inflation and Fed will certainly drive market performance.

Economy

The Fed is expected to raise rates 0.25% at its Feb. 1st meeting, and it would be a shock to the markets if it was 50bps instead. We feel with inflation trends continuing to cool, the Fed will continue to decelerate and downshift its rate hikes. The markets may push bond rates down due to demand, which we have seen in Jan. Even if the Fed continues to hike, we could see a 150-200bps spread between money market and the 10-year. The Fed wants to be anchored and prepared for higher for longer and may overshoot and stay higher for longer in order to restore their credibility after the whole *transitory* debacle of 2021-2022. The yield curve inversion screams recession, and we feel there is one coming. Core vs. Services on inflation is an area we are watching and if housing finally starts to roll over, we may actually see a rapid deceleration of inflation back to trend. Getting inflation from 5%+ to 2% may be challenging to close that gap with food and healthcare remaining sticky.

Equities

Our view is to underweight equities, and specifically to underweight growth, is still in play. We do feel investors would be remiss not to be looking internationally and at Emerging markets specifically. The US Dollar has broken its uptrend and may be a nice tailwind to international investments as well as valuations are much more moderated and attractive outside the United States. Europe's recession seems imminent but may not be as severe as thought and the much warmer winter has helped offset fears of an energy crisis. Excessive Eurozone pessimism was built into the markets last year. We do feel short term the markets are hitting some significant resistances around 4,100 and do not want to call the end of the bear market until those levels are definitively broken. We are more neutral now to US due to valuation concerns and if the recession is an earnings recession as well. US indexes are also still dominated by Megacap tech, which we feel is still at risk.

Fixed Income

Fixed Income is well on its way to rebounding from a historically bad 2022. We do feel bonds have the potential to outperform equites and be up 15-20% on the year vs. a choppy year for equity markets. Duration and credit have both been accretive to portfolios in January. The 10-year remains stuck in a range, and we do still fear a retest of 4% is possible, though we are now neutral vs. underweight on duration due to the strong rally. 4-4.25% seems to be a cap for the 10-year treasury, and we are watching the 3.44% level, as a sustained break of that could signal to move out further on duration. If the Fed is wrong, and a rate capitulation is coming, the longer you are the better your returns will be. An entry point for adding duration would be after a retest of 4.00% on the 10-year, we feel it is a bit rich at this moment to move out further on the curve.

Alternatives

We have moved more neutral on Alts, though with the sector being extremely bifurcated, we feel there continues to be opportunities in some pockets. With an increase in base rates and a widening of spreads, we are shifting our focus towards PE and credit opportunities in the secondary market. The secondary market currently presents an abundance of supply in comparison to demand, resulting in attractive pricing on secondary deals. However, many buyers in the market for secondaries lack the necessary information to make informed decisions about pricing. A recent report from Jefferies indicates that pricing in the secondary market dropped from 92 cents on the dollar in Q3 to 81 cents on the dollar in Q4. Real assets we are also neutral on due to concerns about enough compensation for risk, and currently with a 4.5% 6-month treasury bill, you are not being compensated enough for the illiquidity premium in the legacy REITs. There is also some pressure on money coming out of Private Funds that may also pressure returns.

Asset Allocation **Views**

			UW	N	OW		
			Conviction			Change	
MAIN ASSET CLASSES		Equities	●			▲	Bear market rally. Until we definitively break 4,100 we will remain unweight equities
		Fixed Income (>1yr)			●	▲	Opportunities in 2023 in Fixed Income due to peak rates and potential economic recession
		Alternatives			●	▼	Selective positioning, ensure you are being compensated enough for illiquidity and other opportunities
		Cash			●		Cash and cash equivalents offer yields higher than the S&P 500 yield
ASSET CLASS	EQUITIES	U.S.		●		▼	High quality, but dominated by Megacap Tech and valuations are high vs. rest of world
		Int'l ex U.S.		●		▲	UK, Europe, and Japan are more reasonably valued and no longer facing US Dollar headwind
		Emerging Markets		●		▲	Lower US Dollar, moderate valuation, faster potential growth make these markets more attractive than 2022
		U.S. Large Cap			●	▲	Valuations still high with mega tech expensive especially in a higher interest rate environment
		U.S. Small/Mid			●		Small caps are more attractively valued and tend to respond better to reopening/growth rallies
		U.S. Growth	●				Concerns on earnings growth trajectory and ability to justify valuations
		U.S. Value			●		Value, dividends and quality tend to weather recessions the best
	FIXED INCOME	Duration		●		▲	Underweight duration at 3-5 years. Be selective to increase duration if you see rates rally
		U.S. Government			●		Yields remain attractive on the short-end, higher than S&P 500 dividend by more than 2x
		Corp IG			●		Attractive yields and decent spread over Treasuries in the belly of the curve
		Corp HY		●		▲	Credit spreads may continue to widen and pressure the sector if there is a recession
		Municipals			●	▲	Attractive for high tax brackets and competitive Tax Equivalent Yields
		Int'l ex U.S.		●		▲	While US Dollar headwinds are easing, we prefer high quality US debt at this time
		Emerging Markets		●			Very cheap valuations, more attractive as US dollar peaks and commodities to remain firm.
	ALTERNATIVE	Hedge Funds		●			Quality long/short managers and managed futures are historically good ways to weather volatility
		Private Credit			●		Higher Yields offset risks of increased default cycle. Attractive discounts on secondaries and traded BDCs
		Private Equity			●		Expertise in secondary markets allows manager to capitalize on IPO dearth and secure attractive deals
		Real Estate		●		▼	Be selective where NOI growth can be driven by increase rents, and understand sources of liquidity/exit
		Crypto		●			Focus on the underlying blockchain technology rather than individual coins. Bitcoin holding supports

Sector Views

EQUITY SECTOR

EQUITIES

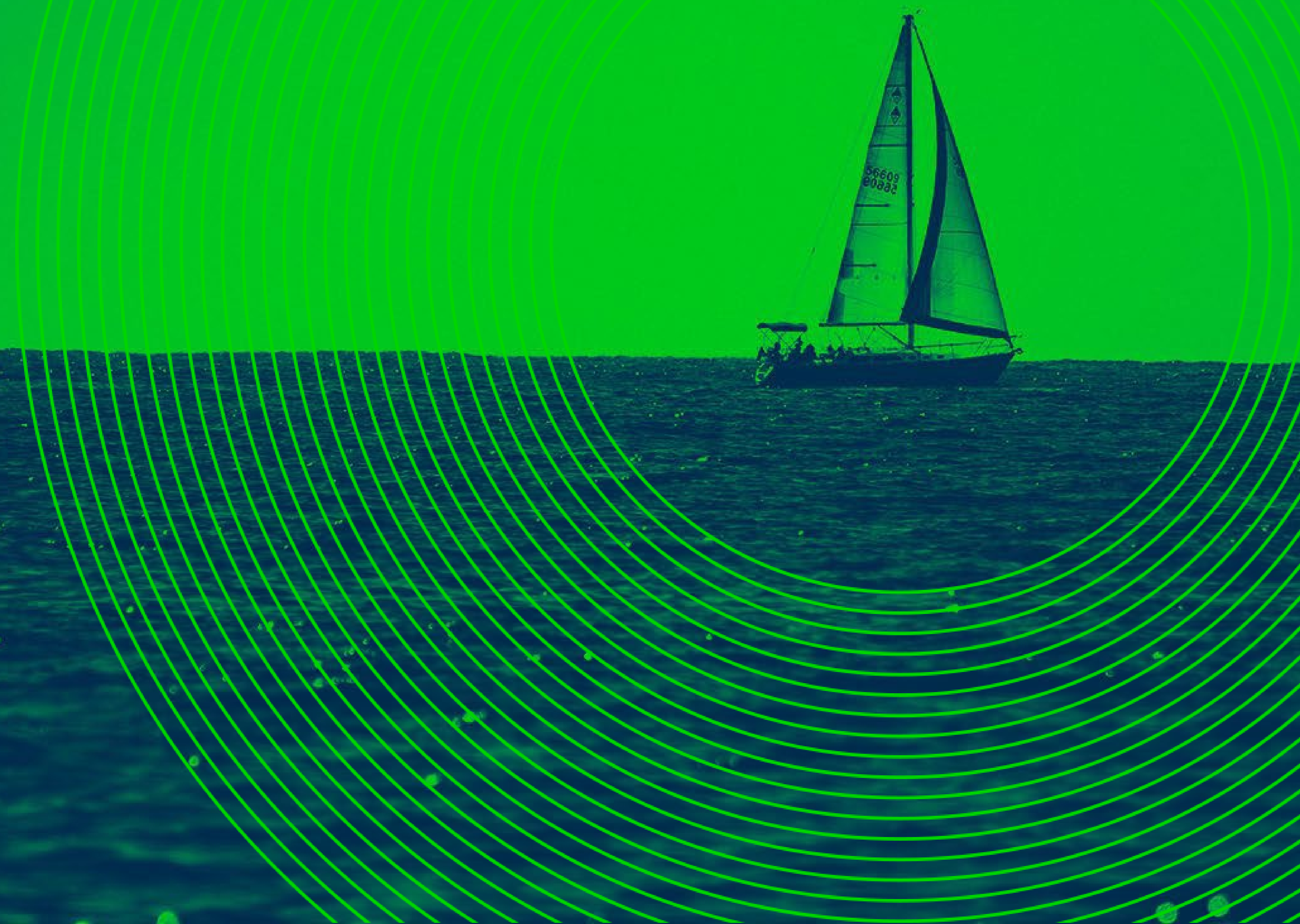
	UW	N	OW		
	Conviction			Change	
Communication Services	●				Weakening fundamentals, increasing streaming competition with regulatory risk on interactive Media. Advertising spend is falling sharply. Traditional telecom attractive on valuations and yield.
Consumer Discretionary	●				Valuations remain high with a pending recession. Higher unemployment puts this sector at high risk.
Consumer Staples		●			Focus on Quality and Dividends. Staples generally perform better during a weakening economy.
Energy			●		Strongest earning and the cheapest sector within the S&P 500. Investors remain underweight the sector. Attractive and growing dividends.
Financials		●			Value with dividends and net interest margins should continue to grow for the banks. Risk is that the banks continue to set aside loan loss reserves. Banks perform better with a steep yield curve.
Health Care			●		High consumer demand and growing with the baby boomers. Still under-owned by long-only funds.. Growth in Biotech but with idiosyncratic risk.
Industrials			●		Value sector and select industries leveraged to energy. Infrastructure beneficiary along with inflation and rates. Under-owned sector.
Information Technology	●				Valuations remain too high with slower growth. Higher rates and slower consumer spending to negatively impact earnings. Deglobalization a risk. Advertising spending is falling sharply.
Materials			●		Leveraged to higher commodity prices and inflation. An inexpensive sector that is under- owned.
Real Estate	●				Rising interest rates are a big negative for the sector and it's the most expensive sector in the S&P 500. Over-owned relative to history.
Utilities		●			High Quality sector with dividends. Demand rising with resilient fundamentals. Higher rates historically a negative due to high leverage.

Sanctuary Asset Management

13501 Galleria Circle
Building W, Suite 230
Austin, TX 78738
(512) 381-6900

For inquiries, please contact:
Laura Anacker - Portfolio Strategist
(609) 613-4093

SAM@sanctuarywealth.com
www.sanctuarywealth.com



SANCTUARY