Lane Asset Management

Stock Market in Focus

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Stock Market in Focus (SMiF) presents my view of equity market conditions and factors that I believe may indicate direction in coming weeks. For the most part, these factors are based on what's called "technical analysis," or TA. Other factors, collectively referred to as "fundamental analysis," or FA, include various economic, political and geopolitical conditions that impact investment markets. Those factors also inform my view of market direction but trading decisions are based entirely on technical analysis.

Technical analysis is the study of different indicators of price movement and trading volume of stocks, funds or indexes that can be suggestive of future price direction. The more these indicators agree with one another, the more reliable the trend interpretation, though there is no guarantee of outcome. Another way to look at TA is that it is essentially an analysis of investor behavior seen through market action which is presumed to indicate, if past is prologue, the direction investors believe a given investment is headed. However, past performance is no guarantee of future results. **Please see the Appendix to this presentation for a brief description of the technical indicators I use in the following pages.**

The fundamental factors affecting markets in 2022 are a unique combination and number of headwinds. They include the wide-ranging effects of COVID, restrictive monetary policy by the U.S. Federal Reserve to combat inflation, the invasion of Ukraine by Russia, climate change, potential recession, Washington politics, relative U.S. dollar strength, a "fiscal cliff" (a reduction in federal spending relative to prior periods) and geopolitical tension with China and in the Middle East, to name some of the more familiar factors.

Owing to the number and uniqueness of these factors, and especially on account of increasingly frequent events that surprise investors, forecasting market direction is more difficult and less reliable. With that caveat, the following pages present my best attempt at understanding evolving market direction.

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A Summary

As shown in the following pages, technical and fundamental analysis shows a resumption of a deteriorating outlook following the two-month recovery that began in mid-June and ended mid-August. In last month's Stock Market in Focus, I said "*Despite the challenge, I'm willing to go back out on a limb with a prediction of another week or two of net loss for the S&P 500 for the period beginning September 1st, as the S&P approaches the next line of support for SPY at $380. What happens after that will depend on investor reaction to the September 13th CPI report by the BLS. My suspicion is that the CPI will show continued relaxation in inflation and investors will move back into the market, hopeful that the Fed will ease up at its November 2nd meeting following the anticipated 75bp move at its September 21st meeting. If investors are disappointed, we may see SPY approach the June and YTD 2022 low at $360.… As of this writing, with a substantial cash allocation, I would "sit on my hands" until a meaningful reversal begins in market performance.*"

As it turned out, the S&P 500 made a 4-day advance at the beginning of September, then moved sharply lower for the balance of the month as the Bureau of Labor Statistics (BLS) surprised investors by reporting an increase in inflation when a decrease had been expected (markets move in the direction of investor expectations and can move suddenly in a new direction when expectations are not met). This opened the door for a larger than hoped for Fed funds rate increase at the FOMC meeting on September 21st and, indeed, that happened with a 75 basis point increase along with hawkish words from Chair Powell that made another 75bp increase more likely at the next meeting on November 2nd (my view). As anticipated, investor disappointment led to SPY approaching, and actually falling through, price support at $360 on last Friday, September 30th. My suggestion to "sit on hands" for September turned out to be the right thing to do.

Again, despite the challenge (and risk) of making forecasts, here is what I see as the potential outcome for October. The trend and momentum of the market is decidedly negative and additional market deterioration appears more likely than not. I believe this reflects an expectation for lowered Q3 corporate earnings along with an expectation for another 75bp increase in the Fed funds rate at the November 2nd meeting. That said, the market is technically oversold and a "bear market rally" should not come as a surprise. Absent information that significantly alters investor expectations, I believe a rally will be short lived, if it happens at all. Long term investors might begin to nibble on the stocks of the best beaten down companies but, otherwise, considering the extent of uncertainty and market volatility, I suggest continuing to "sit on hands" but also considering the addition of short-term CDs, Treasuries or preferred stocks where yields in the neighborhood of 4% are not uncommon.

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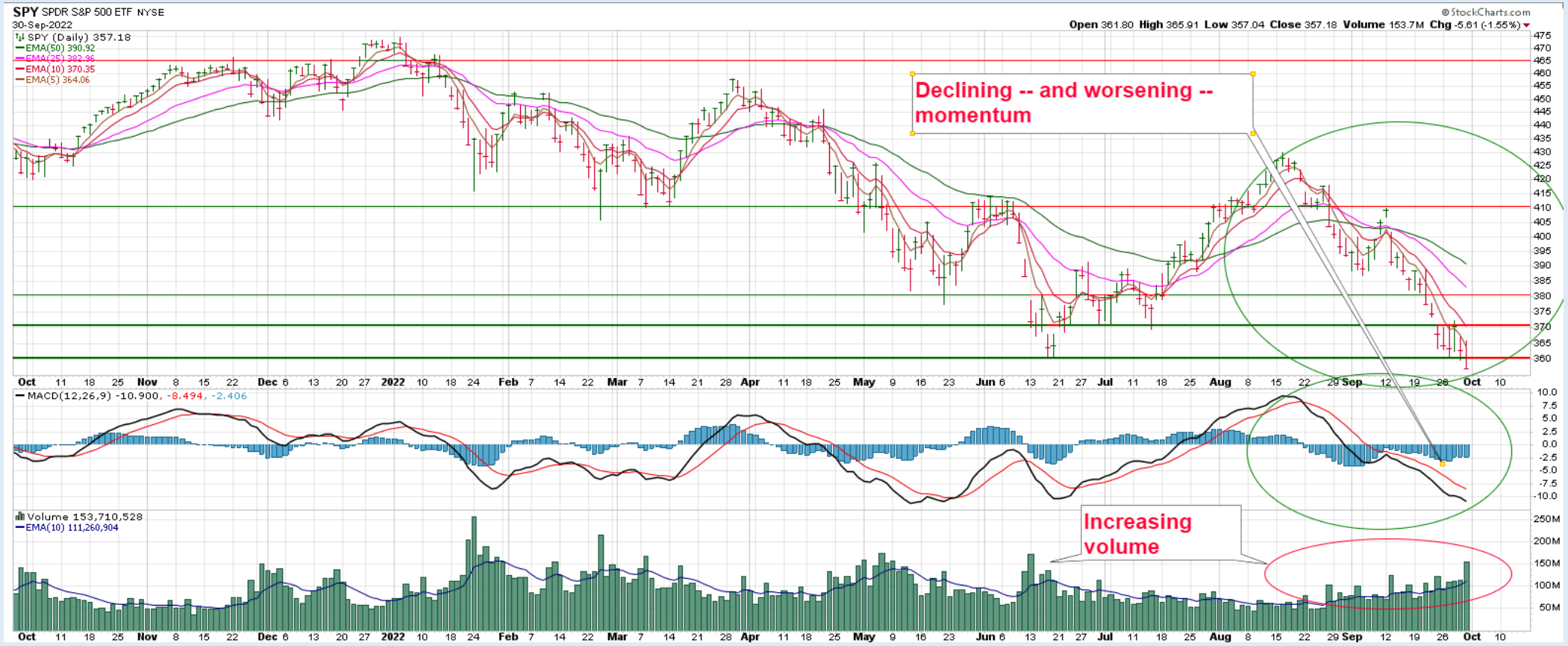
This chart shows daily price movement for the S&P 500 (using the ETF "SPY" as a proxy) along with 5-, 10-, 25-, and 50-day exponential moving averages. This chart also shows lines of support and resistance, the most critical ones at the moment being at $360 and $370. While the picture is strongly negative, the current downturn in prices and the break below $360 may lead to a rally back up the $370 mark. While the chances for a bear market rally seem good, it will take a significant reversal and improvement in investor expectations for the rally to hold.



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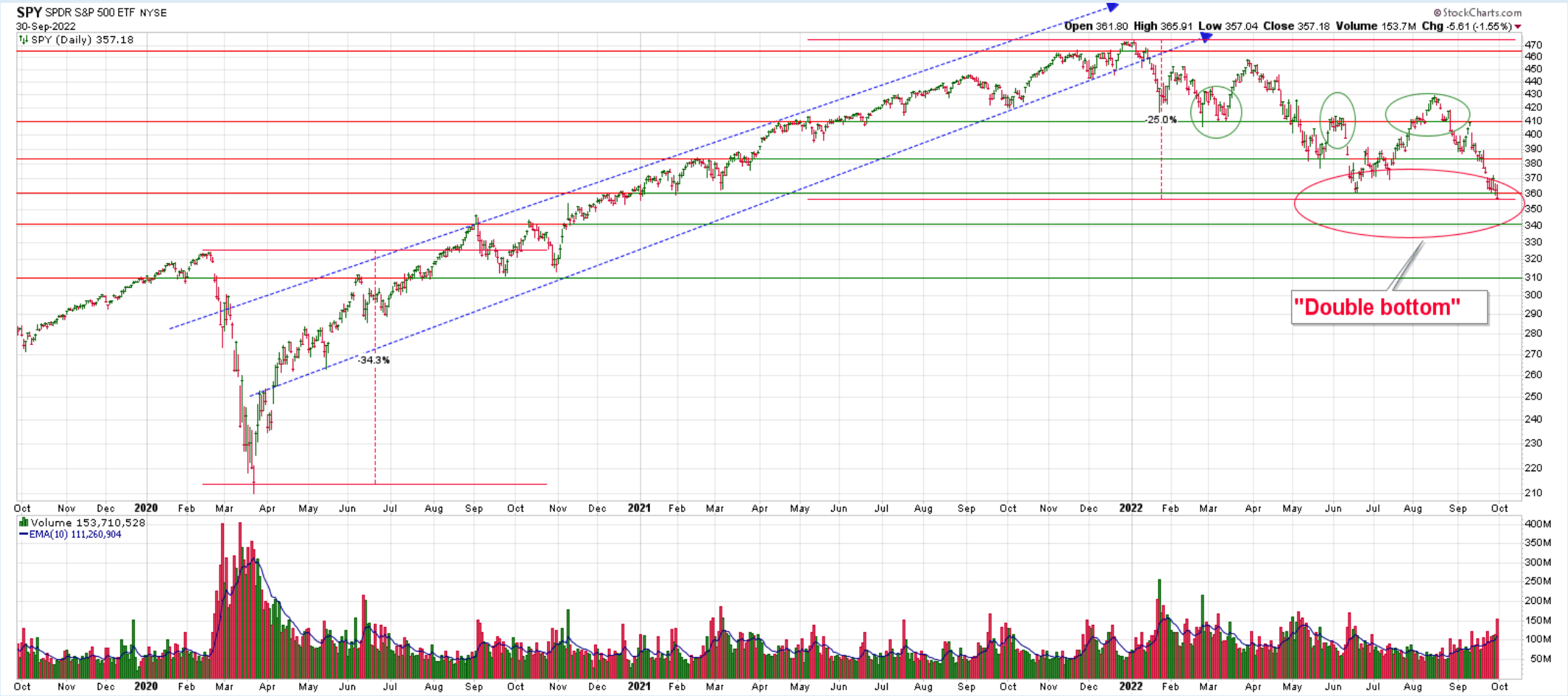
This chart shows the daily movement of the S&P 500 (SPY) for the last 3 years. Note the horizontal lines which indicate areas of support and resistance (S/R lines) for price. Current support is at $360 for the second time in recent months. While a "double bottom" often results in a reversal, I'm not expecting that at this juncture – except for a possible short-term bear market rally. If support does not hold at $360, the next level of support comes in at $340, almost 5% below the current price. If investor expectations worsen during October, SPY price could potentially push toward the next level of support at $310, a 13% drop from the current level, at which point it may be appropriate to add some equity exposure.



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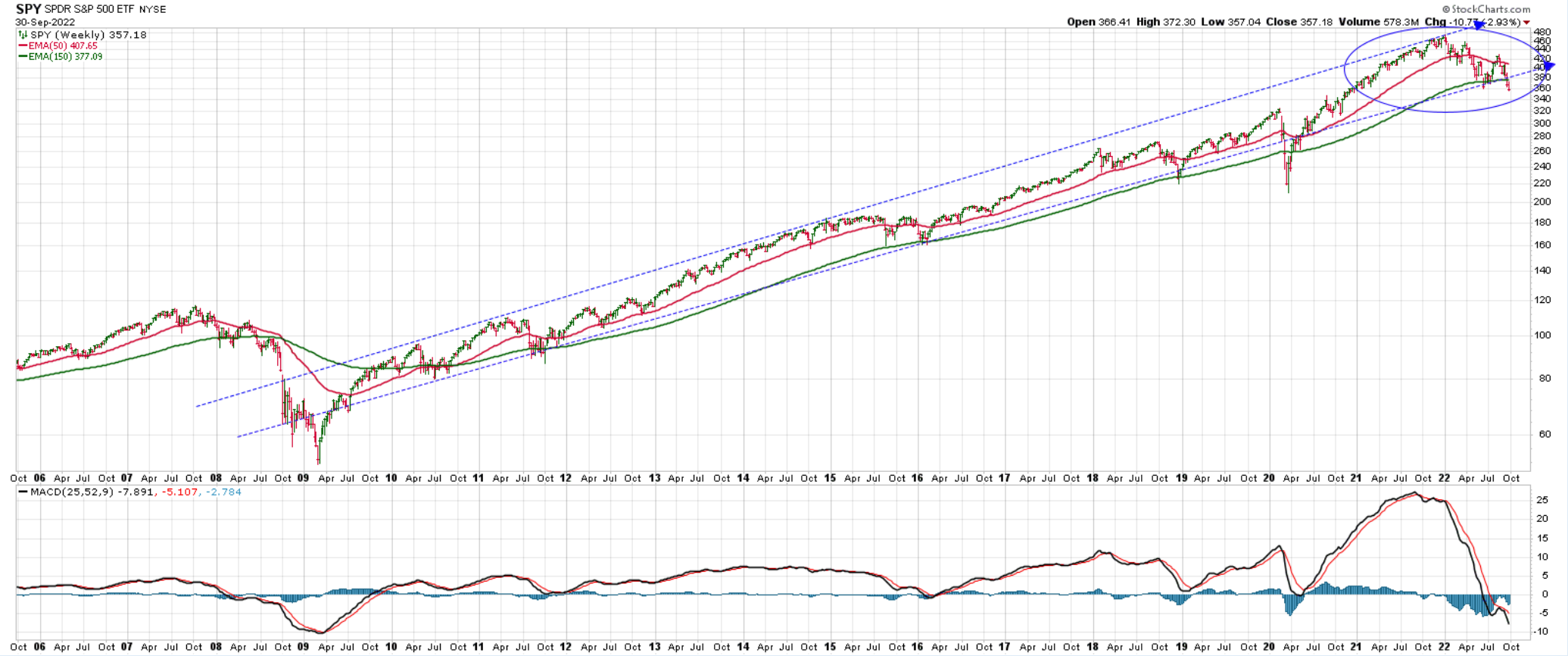
This is a chart of weekly price movement with 50- and 150-week exponential moving averages (red and green, respectively). Longer term charts like this provide insight to longer-term trends and momentum. Several factors are worth noting:

- Both the 50- and 150-week moving average show key areas of support which, now broken, indicate significant price weakness.
- The 150-week EMA held in June and July but failed at the end of September.
- The MACD was showing signs of momentum reversal in August but the subsequent weakness confirmed the downward trend.
- In the longer-term weekly perspective, price will need to get back over the 50-week moving average with confirming MACD before a more optimistic outlook can be achieved.



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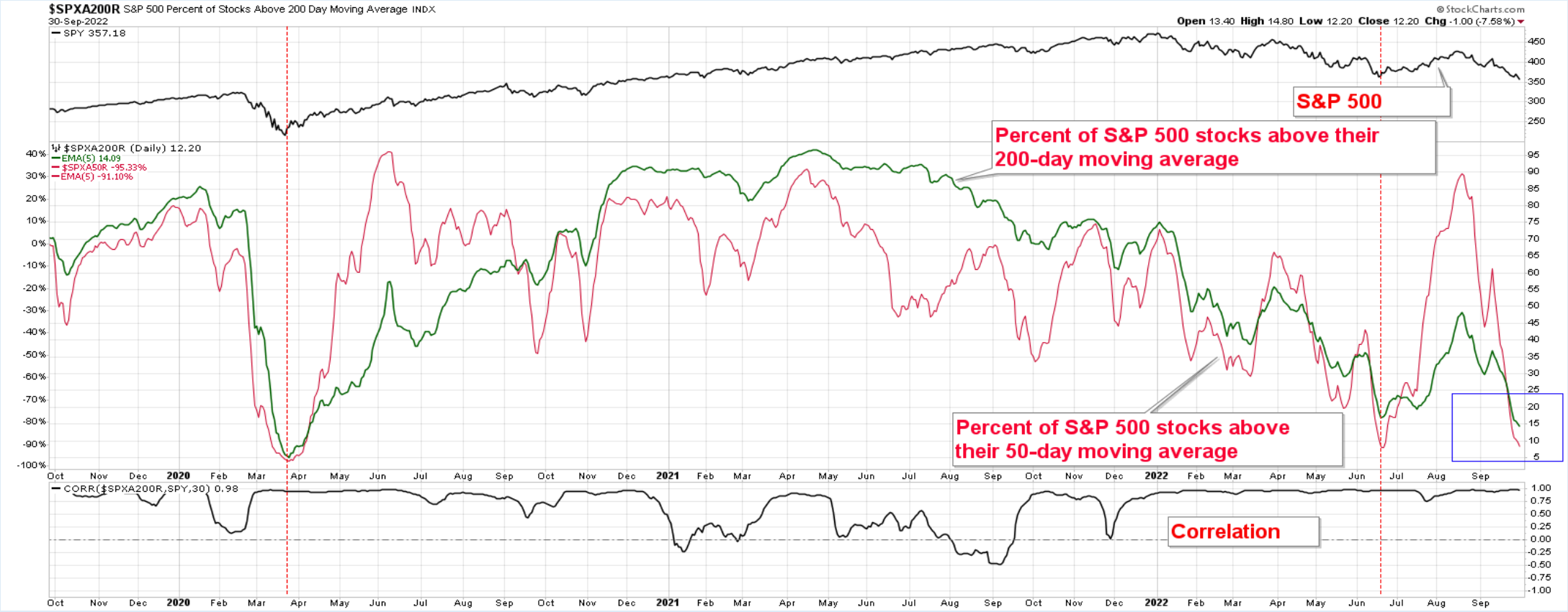
This chart shows the percentage of S&P 500 stocks above their 50-day and 200-day moving averages. The following points are important:

- There is generally a high correlation between the changes in the 200-day percentages and the performance of the S&P 500.
- Low correlation began in middle 2021 as the percentage of stocks above their 200-day moving average stabilized and then began to fall while the S&P 500 continued to rise. The divergence ended with the market correction that began in early 2022.
- When the percentage of stocks below the 200-day moving average falls below 15%, as they did 3 times in the last 20 years, market participants have treated this as an extreme oversold situation and have come back into the market. This may help explain the recovery in prices since mid-June and may again be a source of buying strength in early October.



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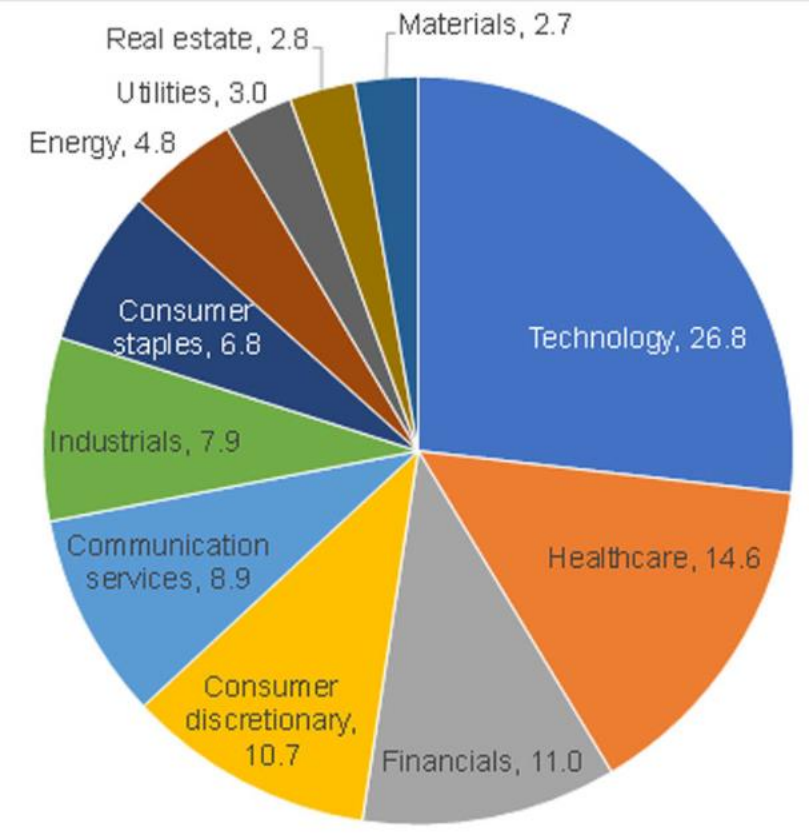
The charts below show the 11 sectors and their weighting that make up the S&P 500. Note that not a single sector had positive performance in September. And only energy had a positive return so far in 2022. Within the S&P 500, 10 companies, mostly technology, make up nearly 27% of the entire index. Generally, as these companies go, so goes the entire S&P 500.



NAME	1D PERF	5D PERF	1M PERF	3M PERF	6M PERF	YTD PERF	1Y PERF
XLV - Health Care Select Sector SPDR Fund	-01.38%	-01.32%	-03.16%	-05.18%	-11.73%	-13.06%	-03.41%
XLF - Financial Select Sector SPDR Fund	-00.91%	-02.22%	-08.35%	-02.96%	-21.77%	-21.12%	-17.53%
XLP - Consumer Staples Select Sector SPDR Fund	-01.74%	-03.82%	-08.70%	-06.95%	-11.05%	-11.85%	-00.58%
XLY - Consumer Discretionary Select Sector SPDR Fund	-01.97%	-02.71%	-09.11%	+03.83%	-24.14%	-29.91%	-20.03%
XLE - Energy Select Sector SPDR Fund	-00.80%	+02.19%	-10.38%	+01.81%	-04.99%	+33.92%	+44.54%
XLB - Materials Select Sector SPDR Fund	-00.26%	-00.61%	-10.42%	-07.07%	-22.92%	-23.71%	-12.18%
XLI - Industrial Select Sector SPDR Fund	-01.31%	-02.25%	-11.19%	-04.70%	-20.07%	-20.73%	-13.94%
XLC - Communication Services Select Sector SPDR Fund	-01.22%	-02.48%	-11.54%	-11.57%	-31.38%	-37.91%	-39.67%
XLU - Utilities Select Sector SPDR Fund	-01.93%	-08.71%	-11.86%	-05.95%	-10.81%	-06.50%	+05.59%
XLK - Technology Select Sector SPDR Fund	-01.92%	-04.01%	-12.82%	-06.33%	-26.00%	-31.21%	-19.75%
XLRE - Real Estate Select Sector SPDR Fund	+01.07%	-03.87%	-13.48%	-11.07%	-25.03%	-28.89%	-16.41%

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While the previous pages focused on the S&P 500, the chart below shows the picture for the technology-heavy NASDAQ 100 index (represented here by the ETF QQQ). Several factors are noteworthy:

- The chart is similar to the S&P 500 with relative weakness in QQQ since the beginning of August.
- As indicated last month, If QQQ fails to hold at $300, the next line of support is 10% lower at $270. That's exactly what happened.
- At the bottom of the chart, the MACD is continuing to show worsening momentum, a poor sign for coming days.

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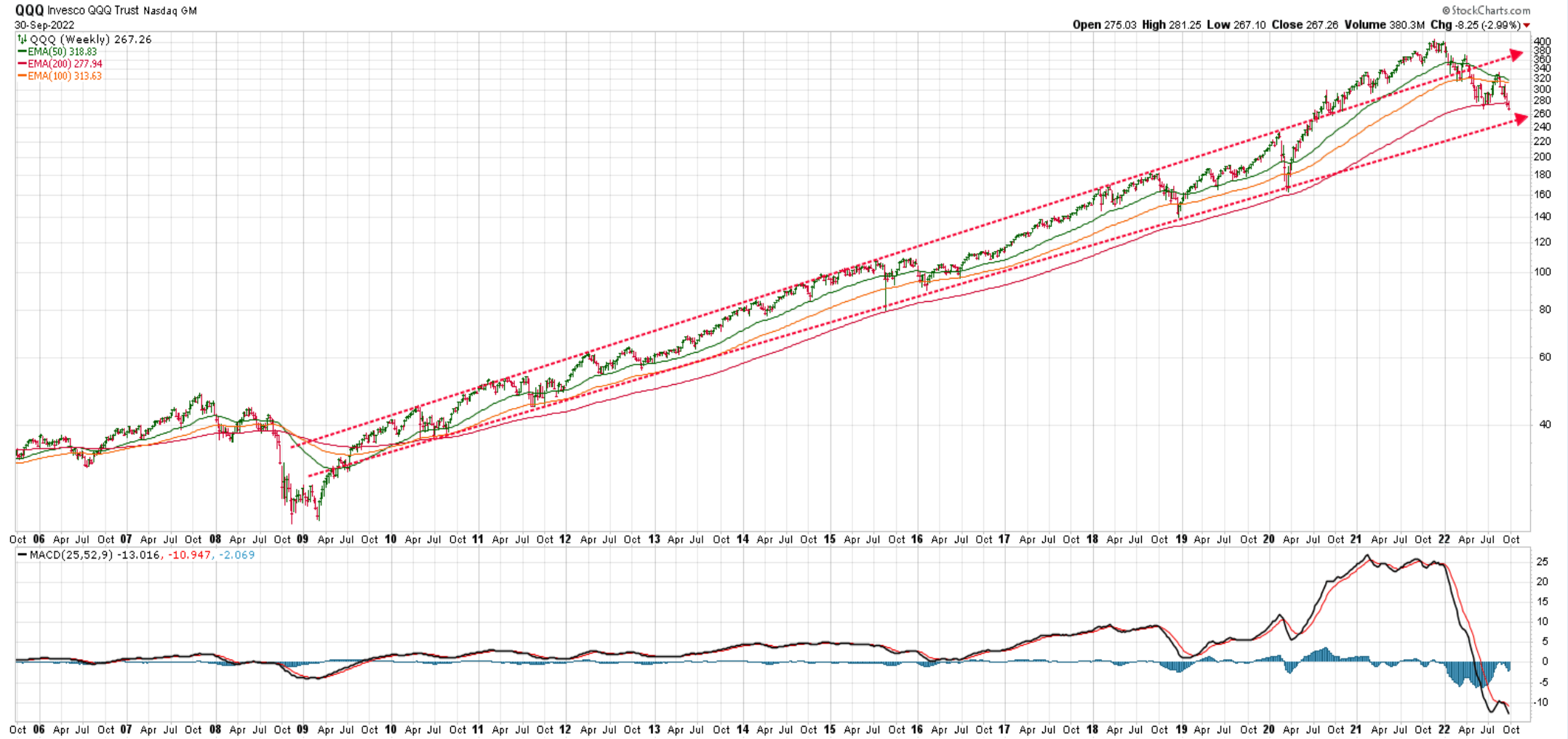
This chart shows the longer-term view of the technology-heavy NASDAQ 100 (using the ETF "QQQ" as a proxy) with a price channel bounded by the dotted red lines and 50, 100, and 200-day moving averages. Following the financial crisis of 2008, QQQ has remained bounded by the long-term channel except for the breakout in late 2020 and 2021. Now that QQQ is back within the channel, another critical support level occurs around $260. The moving averages and the MACD do not look promising that level will hold.



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The chart below shows the performance of the Vanguard All-World (ex-US) ETF with the same TA tools as contained in prior charts. The following is noteworthy:

- Developed (mature) markets in Europe comprise about 30% of the fund, followed by emerging markets in Asia (16%), Japan (15%), and developed markets in Asia (11%).
- International stocks underperformed domestic stocks by about 7% in 2020, an additional 20% in 2021, and an additional 3% so far in 2022.
- VEU has remained significantly below the 100- and 200-day moving averages.
- Support was broken at $46 with the next line of support at $42 (see next page).

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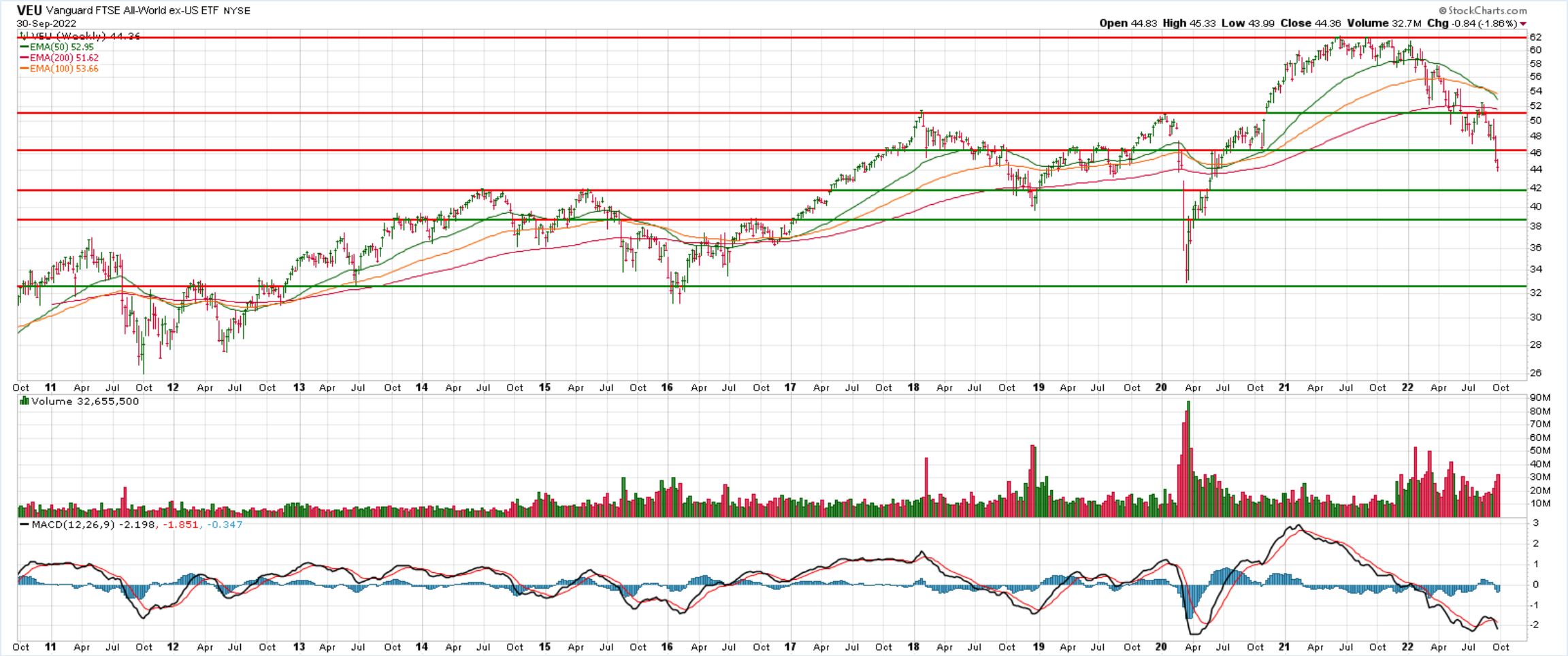
The chart below shows the long-term performance of the Vanguard All-World (ex-US) ETF. As indicated on the prior page, the next line of support is at $42, 5% below the current price. With the crossover of the 50-week moving average over the 100-week average, the trend is strongly negative.



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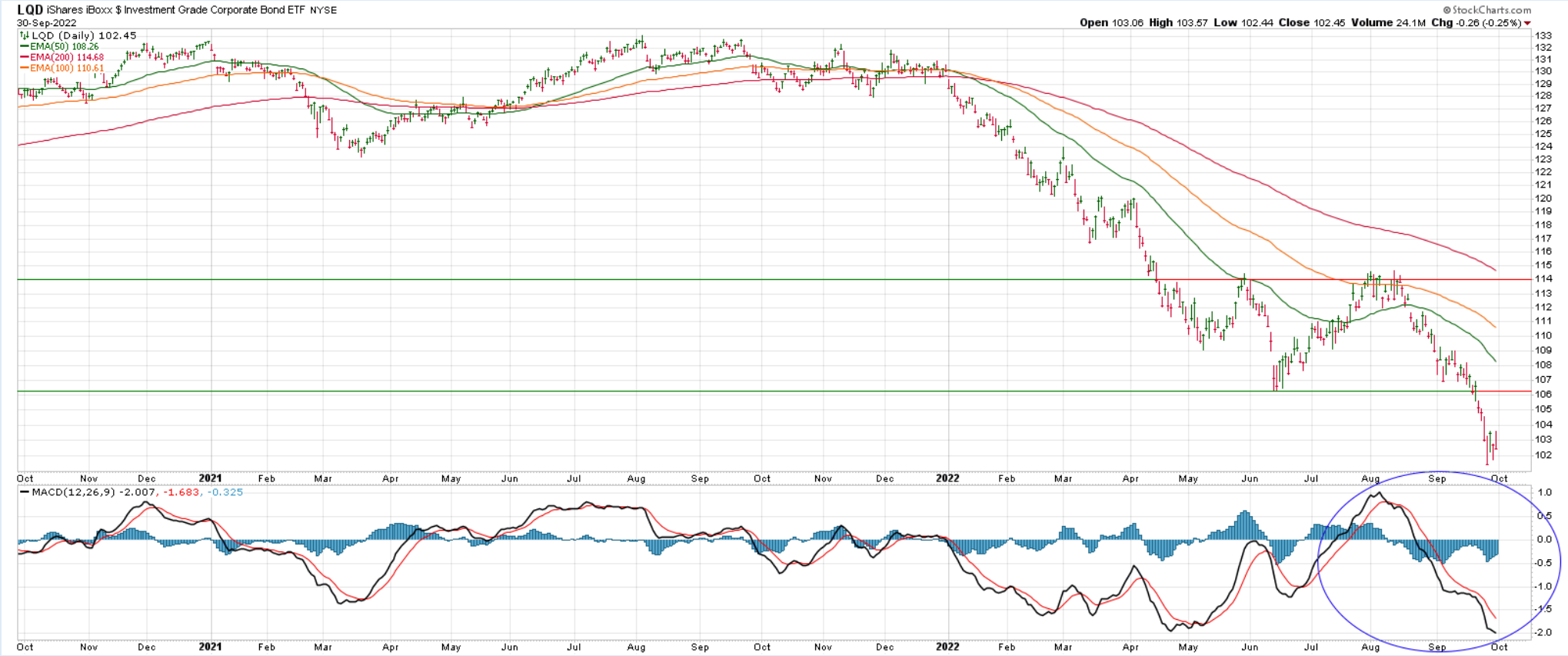
The chart below shows the performance of the Investment Grade Corporate Bond index, using the ETF "LQD" as a proxy. The following points are worth noting:

- Performance characteristics and the technical indicators are remarkably similar to the S&P 500. Through this writing on October 2nd, the cumulative year-to-date returns for LQD and SPY are extremely close with LQD outperforming SPY by under 3 percentage points.
- The recent weakness of LQD reflects the back-up in 10-year bond yields since the beginning of August (currently 3.8%, up from 3.2% last month).
- LQD broke through support at about $106 and is headed for the next line of support at $100 (see next page).



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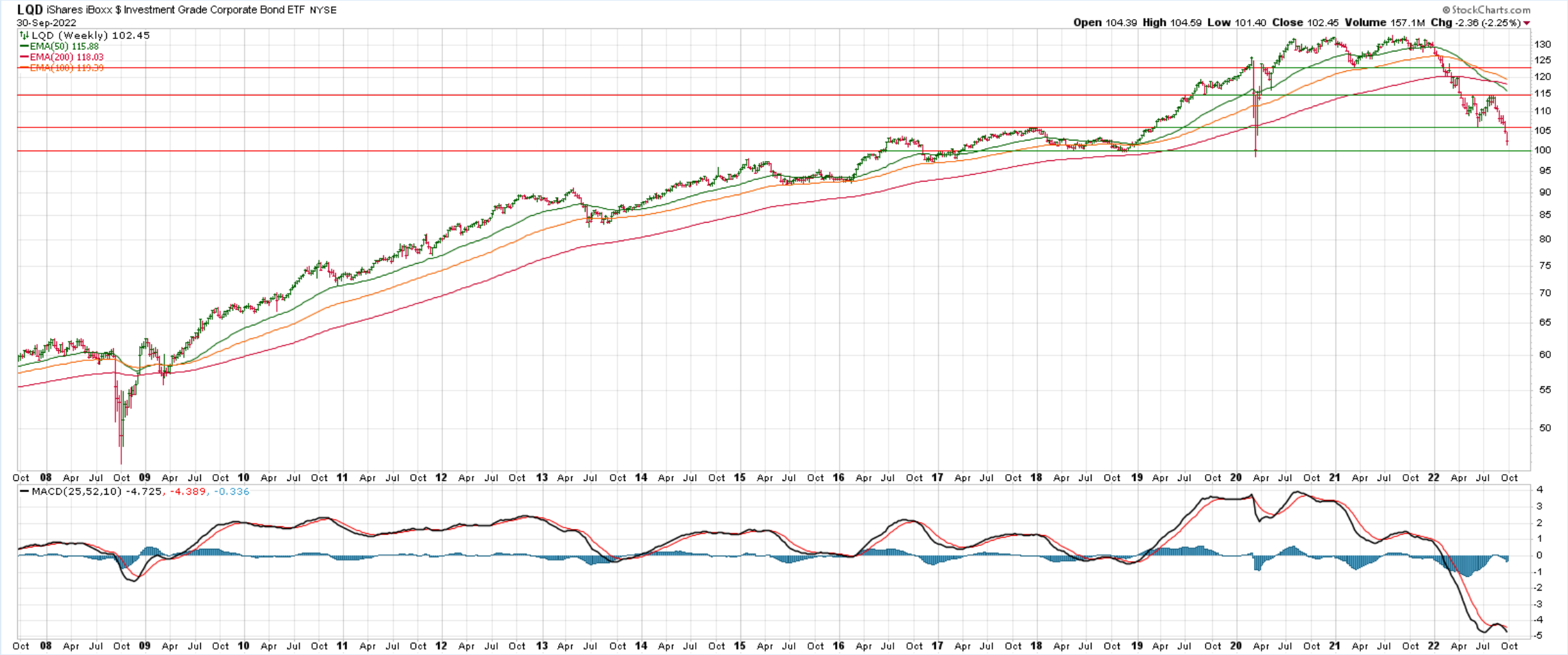
The chart below shows the long-term performance of the Investment Grade Corporate Bond index headed to the next line of support at $100. With the expectation of interest rates continuing to increase, LQD is expected to fall below $100 in October. LQD is highly correlated with the 10-year Treasury bond rate.



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Appendix

There are hundreds of technical analysis indicators and an almost unlimited number of parameters used in them. My analysis focuses on three of them: moving averages, momentum (using the "MACD"), and support/resistance channels, and trading volume. These four are briefly described below.

The daily and weekly price charts show price movement for the indicated exchange-traded funds representing the S&P 500 ("SPY"), international equities (ex-US) ("VEU") and investment grade corporate bonds ("LQD"). Moving averages indicate price trend with steeper moving averages indicating stronger trend. Various moving averages of different lengths are also shown. As faster moving averages cross over slower ones from above, the market is weakening and consideration should be given to reducing position exposure; when faster moving averages cross over slower ones from below, the market is improving and consideration should be given to increasing exposure.

The MACD indicator at the bottom of the charts is another indicator of price momentum. MACD is used to indicate the momentum of price trend and can also be used to indicate a reversal in trend. If different signals are given by the moving averages and the MACD, caution is advised as a reversal in trend may be coming.

Charts also show levels of support and resistance, some of which are horizontal lines and some of which upward or downward sloping. The longer price remains within a channel, the more reliable the channel is for forecasting. When price moves definitively outside of a channel, further movement in the direction of the trend may be expected. When price returns to the channel and then resumes its departure, additional weight can be given to price direction.

Volume indicates the number of shares traded during a period. Increasing volume may indicate conviction of traders. Very high volume, especially within a downtrend in prices, can indicate a reversal.

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Investing involves risk including loss of principal. Investing in international and emerging markets may entail additional risks such as currency fluctuation and political instability. Investing in small-cap stocks includes specific risks such as greater volatility and potentially less liquidity. Small-cap stocks may be subject to higher degree of risk than more established companies' securities. The illiquidity of the small-cap market may adversely affect the value of these investments.

Investors should consider the investment objectives, risks, and charges and expenses of mutual funds and exchange-traded funds carefully for a full background on the possibility that a more suitable securities transaction may exist. A prospectus for all funds is available from Lane Asset Management or your financial advisor and should be read carefully before investing.

Note that indexes cannot be invested in directly and their performance may or may not correspond to securities intended to represent these sectors.

Investors should carefully review their financial situation, making sure their cash flow needs for the next 3-5 years are secure with a margin for error. Beyond that, the degree of risk taken in a portfolio should be commensurate with one's overall risk tolerance and financial objectives.

The charts and comments are only the author's view of market activity and aren't recommendations to buy or sell any security. Market sectors and related exchanged-traded and closed-end funds are selected based on his opinion as to their usefulness in providing the viewer a comprehensive summary of market conditions for the featured period.

Chart annotations aren't predictive of any future market action rather they only demonstrate the author's opinion as to a range of possibilities going forward. All material presented herein is believed to be reliable but its accuracy cannot be guaranteed. The information contained herein (including historical prices or values) has been obtained from sources that Lane Asset Management (LAM) considers to be reliable; however, LAM makes no representation as to, or accepts any responsibility or liability for, the accuracy or completeness of the information contained herein or any decision made or action taken by you or any third party in reliance upon the data. Some results are derived using historical estimations from available data. Investment recommendations may change without notice and readers are urged to check with tax advisors before making any investment decisions. Opinions expressed in these reports may change without prior notice. This memorandum is based on information available to the public.

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