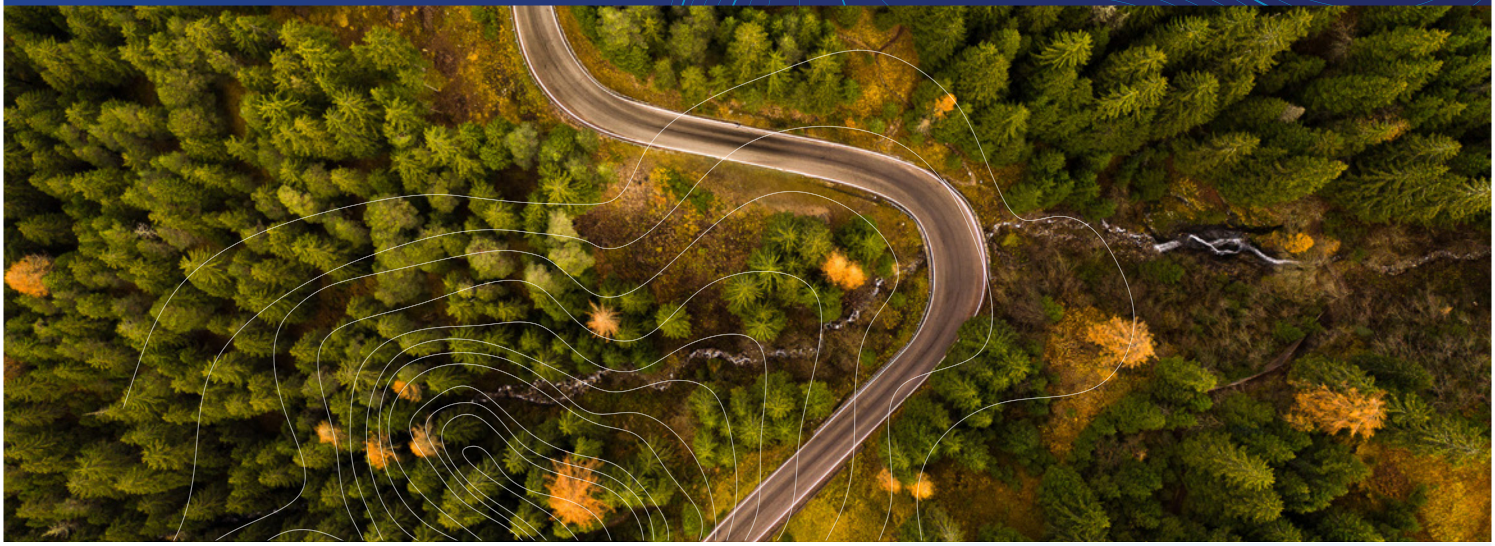

3Q22 Market Overview: Fake Empire

An impressive early-summer rebound in risk markets proved fraudulent, as the weakness that has characterized much of 2022 resumed in the back half of the third quarter and sent many indexes back into bear-market territory.

Hopes for a near-term pivot by the Federal Reserve toward less-aggressive policy proved misplaced. A whipsaw of market sentiment in August turned what had been double-digit intra-quarter gains for indexes like the S&P 500 and MSCI World into losses of 4.9% and 6.2%, respectively. There was little in the way of refuge for investors during the quarter, as fixed income and commodities generally finished in the red as well.[1]

While the challenges of 2022 have been painful, it's possible we've completed the mathematical phase of the adjustment to a financial system in which capital actually has a meaningful cost. Such transitions are rarely uneventful, however, and we are wary of some sort of looming financial accident that may trigger a new, more emotion-driven period of risk aversion in markets. We believe it's important to maintain a level temperment in such an uncertain environment, cautiously taking advantage of opportunities as they emerge while also maintaining defensive optionality.

KEY TAKEAWAYS

- Hopes for a Fed pivot toward a more moderate pace of policy tightening were dashed during the quarter, as central bank rhetoric made it clear that fighting inflation remains its primary focus.
- Market and macroeconomic trends in 2022—while painful— generally reflect a mathematical and relatively orderly transition from an environment marked by a generational-low cost of capital to one in which money has a price.
- The good news is that the mathematical phase of this reckoning may be complete, and asset prices once again appear to offer reasonable risk premia for investors. However, the emotional—and potentially more challenging—phase may still lie ahead.
- While current market valuations support the judicious planting of seeds to hold for the next decade, the potential for nonlinear market behavior compels us to maintain defensive optionality should even more attractive opportunities emerge.

1. Source: FactSet; data as of September 30, 2022.

Supreme Mathematics

In the US, marginally improved inflation data and signs of economic stagnation early in the third quarter sparked hopes that the Federal Reserve may be prepared to moderate its pace of rate hikes, fueling a decline in real interest rate expectations and a rally in risk assets. But those hopes—and the rally—were dashed in late August with Chairman Powell's hawkish speech that underscored the Fed's commitment to fighting inflation. At late August's Jackson Hole Economic Symposium, Chairman Powell noted that the restoration of price stability remained the Fed's primary focus, saying that "pain to households and businesses" were "the unfortunate costs of reducing inflation." His tough talk was followed up by tough action, as the central bank announced another 75 basis point hike to the federal funds rate at its September meeting. The Fed's third consecutive hike of that magnitude—and fifth consecutive overall—brought the benchmark rate to 3.25%, and the "dot plot" of committee member forecasts implies it will comfortably exceed 4% by year-end.[2] While inflation in the US continues to be troublingly high—September core CPI came in at a new 40-year high—anchored long-term inflation expectations suggest the Fed's credibility remains intact.[3]

> Anchored long-term inflation expectations suggest the Fed's credibility remains intact.

We believe 2022's market and macroeconomic trends—while painful—generally reflect a mathematical and relatively orderly transition from an environment marked by a generational-low cost of capital to one in which money has a price.

While equities have been weak across the board, the previously high-flying speculative-growth subsegment of the market has suffered profoundly; for example, the ARK Innovation ETF—a multi-cap vehicle whose theme is "disruptive innovation" and that could be considered a proxy for this group of stocks—is down around 75% since its peak in early 2021.[4] Meaningfully positive real interest rates at the long end of the curve have fueled a selloff in sovereign bonds globally; the Bloomberg US Long Treasury Index was down about 29% year to date, and the yields on the weakest developed markets sovereigns—like Italy and the UK—have risen well above comparable Treasury rates.[5] Spreads on both investment grade and high yield corporate bonds in the US have rebounded to near their long-term averages.[6]

In the real economy, US contraction in the first and second quarters of 2022 had some observers declaring recession. However, the National Bureau of Economic Research, the official arbiter of such matters, considers a broader range of indicators—including continued strong job growth and low unemployment rate—and has yet to declare a peak to the current expansion. That said, a number of cracks have emerged in macroeconomic backdrop in the US and worldwide:

- Manufacturing surveys are approaching contractionary levels in the US and have fallen into contraction globally, a trend that can be attributed largely to falling new orders and rising inventories as demand wanes.[7]
- Covid-era shortages have turned into gluts across a range of industries and supply chains. For just two prominent examples, US retailers are sitting on a record $732 billion of inventory as of July[8] while a number of semiconductor manufacturers have reported cutting production as sales decline.[9]
- China appears likely to fall well short of its 2022 GDP growth bogey of 5.5%. While its zero-Covid policy has hurt, China's economy has been further challenged by a collapse in the real estate market, drought conditions and soft global demand.[10]

2. Source: Federal Reserve; data as of September 30, 2022.
3. Source: Bloomberg; data as of September 30, 2022.
4. Source: Bloomberg; data as of September 30, 2022.
5. Source: Bloomberg; data as of September 30, 2022.
6. Source: FactSet; data as of September 30, 2022.
7. Source: S&P Global; data as of October 3, 2022.
8. Source: US Census Bureau; data as of September 15, 2022.
9. Source: Bloomberg; as of September 30, 2022.
10. Source: Bloomberg; data as of September 14, 2022.

- Euro zone inflation continues to trend higher despite 125 basis points of rate hikes by the European Central Bank during the third quarter; it's expected to reach double digits upon its next report.[11] While second quarter GDP of 3.3% was better than expected, higher-frequency metrics suggest significant deterioration of economic activity over the past few months as consumers and businesses alike face a winter of economy-choking natural gas prices and, in certain countries, costly energy subsidies.
- Erstwhile European Union member the UK remains the only G7 nation that has yet to fully recover from the economic dislocations of the pandemic.[12]

Watchful for What Lies Beneath

The good news is that this mathematical phase of adjustment may be complete, and asset prices once again appear to offer reasonable risk premia for investors. Lest we get too excited, however, it's important to acknowledge that an emotional—and potentially more challenging—phase may still lie ahead and could be sparked by the emergence of any number of unwelcomed events.

In some ways, a Fed tightening cycle is not unlike dynamite fishing. In this much-maligned and widely illegal practice, fishermen toss explosives into the water targeting schools of fish—but also concussing any other marine life in the vicinity of the blast. Accompanying the hundreds of now-stunned or -dead grouper and dorado that rise to the surface via this operation is the occasional whale.

> As the Fed continues to wring liquidity from the system, we are watching closely for a metaphorical whale to emerge.

As the Fed continues to wring liquidity from the system, we are watching closely for a metaphorical whale to emerge. A number of idiosyncratic threats have materialized in recent months—the Bank of England's intervention in the gilt market and all-time highs in the cost of credit-default swaps on Swiss banking giant Credit Suisse are just two examples—but none have served as the detonator for a fear-driven selloff. Looking ahead, we must be cognizant of potential outsized market reactions to a range of more commonplace occurrences. How will markets react if US payrolls begin to decline and the unemployment rate climbs? If corporate profits peak and head lower? If the Fed pivots prematurely and loses its credibility in the process?

We believe that current market valuations support the judicious planting of seeds to hold for the next decade, but we'd resist deploying our last dollar of ballast given the heightened uncertainty. The potential for an unintended consequence of central bank policy to emerge somewhere in the financial system is meaningful, in our view, and such an accident likely would prompt markets to exhibit more emotional, nonlinear behaviors—and potentially present generational buying opportunities in what we view as resilient, high-quality companies. We want to be prepared for this possibility.

The Global Value team takes a note from French playwright Molière: "The trees that are slow to grow bear the best fruit." We are focused on maintaining a level temperament in the face of a particularly uncertain future. We are playing offense selectively, adding to assets we view as undervalued at a measured pace while maintaining defensive optionality in an asset like gold, which—unlike the dollar—is not at a generational high. Moreover, we are avoiding the rear-view mirror; regardless of relative performance trends in recent years, we maintain that diversification is a foundational long-term strategy.

11. Source: Haver/Eurostat; data as of October 19, 2022. Seasonally and working day adjusted, quarter on quarter at an annualized rate.
12. Source: Haver/Office for National Statistics; data as of September 30, 2022. UK's real GDP in June 2022 remains 0.2% below its end-2019 level.

The opinions expressed are not necessarily those of the firm. **These materials are provided for informational purposes only.** These opinions are not intended to be a forecast of future events, a guarantee of future results, or investment advice. Any statistics contained herein have been obtained from sources believed to be reliable, but the accuracy of this information cannot be guaranteed. The views expressed herein may change at any time subsequent to the date of issue hereof. The information provided is not to be construed as a recommendation to buy, hold or sell or the solicitation or an offer to buy or sell any fund or security.

Past performance is not indicative of future results.

Risk Disclosures

A principal risk of investing in value stocks is that the price of the security may not approach its anticipated value or may decline in value. "Value" investments, as a category, or entire industries or sectors associated with such investments, may lose favor with investors as compared to those that are more "growth" oriented.

There are risks associated with investing in foreign investments (including depositary receipts). Foreign investments, which can be denominated in foreign currencies, are susceptible to less politically, economically and socially stable environments, fluctuations in the value of foreign currency and exchange rates, and adverse changes to government regulations.

Investment in gold and gold-related investments present certain risks and returns on gold related investments have traditionally been more volatile than investments in broader equity or debt markets.

Diversification does not guarantee investment returns and does not eliminate the risk of loss.

Bear market refers to a period during which a market experiences a prolonged decline in price.

Volatility is a statistical measure of the degree to which an individual portfolio return tends to vary from the mean, based on the entire population. The greater degree of dispersion, the greater degree of risk

All investments involve the risk of loss of principal.

One cannot invest directly in an index. Indices do not incur management fees or other operating expenses.

S&P 500 Index is a widely recognized unmanaged index including a representative sample of 500 leading companies in leading sectors of the US economy and is not available for purchase. Although the S&P 500 Index focuses on the large-cap segment of the market, with approximately 80% coverage of US equities, it is also considered a proxy for the total market.

MSCI World Index is a widely followed, unmanaged group of stocks from 23 developed markets and is not available for purchase. The index provides total returns in US dollars with net dividends reinvested.

Core Consumer Price Index (CPI) measures the changes in the price of a basket of goods and services, excluding food and energy, purchased by urban consumers.

Bloomberg US Long Treasury Index includes fixed income securities issued by the US Treasury (not including inflation-protected bonds) and US government agencies and instrumentalities, as well as corporate or dollar-denominated foreign debt guaranteed by the US government, with maturities greater than 10 years.

FEF Distributors, LLC (Member SIPC) distributes certain First Eagle products; it does not provide services to investors. As such, when FEF Distributors, LLC presents a strategy or product to an investor, FEF Distributors, LLC does not determine whether the investment is in the best interests of, or is suitable for, the investor. Investors should exercise their own judgment and/or consult with a financial professional prior to investing in any First Eagle strategy or product.

First Eagle Investments is the brand name for First Eagle Investment Management, LLC and its subsidiary investment advisers.

M-TL-GVT-MO22Q3-D-LT