The S&P 500 is down nearly 6% over the past 30 days. This recent sentiment is largely a function of three factors:

- Debt Ceiling – The Stopgap funding or continued resolution passed by Congress last week provides a budget through December 3rd. However, this budget is meaningless if the debt ceiling is exceeded. Secretary of Treasury Janet Yellen predicts the date of exceeding the debt limit to be October 18th.

- Inflation – Escalating prices have most recently leveled off. However, fears are being stirred in Europe and China as governments race to capture oil and natural gas stockpiles in the face of La Nina (a weather pattern that typically results in abnormally cold winters).

- China Evergrande – The Chinese property developer has buckled under the sheer amount of debt and lack of lease income. In addition, the financing of Evergrande largely comes from Chinese banks with all parties effectively being owned by the Chinese Communist Party (CCP).

Despite the recently volatility Titan Investment Management believes this is an attractive entry point into the market for the following reasons:

- Debt Ceiling – The one thing that remains predictable about Capitol Hill is a politician's self-preservation. To achieve self-preservation, votes need to be acquired. A default of the US Treasury would cause significant duress to the US and global economy. Thus, politicians of both parties would suffer, and lifers such as McConnell and Pelosi would be the first on the chopping block.
    - Conclusion – Democrats will most likely use budget reconciliation (only need 50 Senate votes) to pass a debt ceiling increase, separate from the larger stimulus.

- Inflation – The bottlenecks causing prices to rise are largely taking place at US ports. COVID is the unfortunate culprit as port officials have noted the shift cleaning of all equipment, daily health screenings, social distancing, and other COVID measures leading to significant inefficiencies. Fortunately, the number of new cases as well as deaths is on the decline from the Delta variant and sets the stage for these policies to loosen up as the holidays approach.
    - Conclusion – The situation at the ports seems to have stabilized, albeit at an abnormal wait time to unload. This is set to improve as the number of COVID infections is on the decline. Lastly, La Nina may not even come to fruition. The US is a net exporter of oil and natural gas and has the means to meet demand if winter turns out abnormal.

- China Evergrande – It is estimated that Evergrande is indirectly responsible for ~3.8M Chinese jobs. The CCP cannot afford to have this public-private firm go bankrupt and has clearly been working behind the scenes with other Chinese public-private firms to buy up units of the distressed firm.

- Conclusion - The CCP has been “asking” Chinese banks to not halt lending to Evergrande and is issuing overnight financing to quell any sort of real estate panic. Shares of Evergrande and Hopson Development Holdings (another Chinese real estate developer) were halted for trading on Monday as Hopson seems to be buying a large business unit of Evergrande. This not only dilutes the risk of real estate, but also provides much needed cash onto Evergrande’s balance sheet.

The risk of the debt ceiling, inflation, and Evergrande need to be put into context. The risk of inflation and Evergrande is largely confined overseas as the US has little to no exposure to Evergrande and lack of energy supplies. Ironically, this recent indigestion has benefited the “zombie” firms of the US. The highest levered firms in the S&P 500 have outperformed the lowest levered firms by ~6% over the past week. Thus, if one is truly fearful of the debt ceiling being reached, inflation running rampant, and/or Evergrande spilling onto the global economy, these would be the worst firms to own.

Despite the macro headwinds that currently exist for the global economy, the fundamentals of US corporate balance sheets and consumers remain strong:

- S&P 500 profit margins are at an all-time high of 13.6%.
- Earnings growth continues to exceed expectations after lapping COVID.
- Consumer debt service is at an all-time low while net worth is at an all-time high.
- Unemployment continues to fall as the number of job openings is at an all-time high.

The past 30 days have been a volatile, yet a short amount of time. Given that strong fundamentals are being offset by negative sentiment, positive fundamentals will eventually set in. This is why Titan Investment Management views the current environment as an attractive entry point for incremental cash that will not be needed in the short term.

If you have any questions, do not hesitate to ask.

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