MARKET REVIEW & OUTLOOK

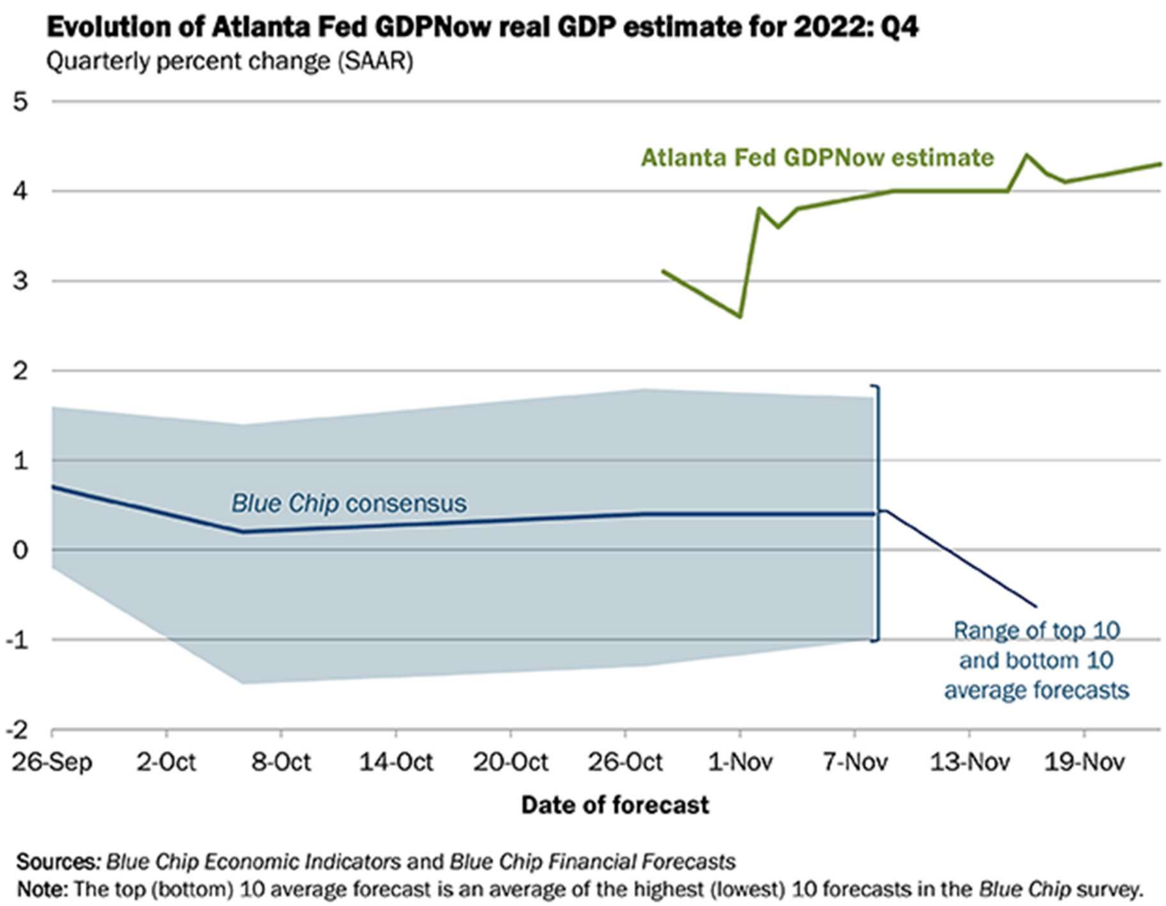
NOVEMBER 2022

KEY TAKEAWAYS

- The equity markets ended with a bang on the presumption that the Fed Pivot is imminent.
- Interest rates abruptly reversed on less hot than expected inflation. And continued to see rates drift lower the balance of the month on expected economic weakness on the back of all the Fed interest rate hikes.
- 3rd quarter GDP was much better than the first half. The 4th quarter, please see below, looks to be even better!

The U.S. Economy

The second look at 3rd quarter GDP was better than expected, coming in a 2.9%, though this is well in the rearview mirror at this point. The 4th quarter estimate from the GDPNow estimate is looking better and better at over 4% expected, though the Blue-Chip consensus is around +0%. Interesting that most of the year, the first half recession was ignored, but the calls for recession in 2023 continue against a strong 2nd half 2022. Does this mean more rate hikes from the Fed or 2023 rate cuts that the market is pricing in?



Source: https://www.frbatlanta.org/cqer/research/gdpnow

Stocks and Bonds

Interest rates rose to start the month, but the lower-than-expected CPI print, provided a boost for bond prices and yields fell. The report was really the first to miss expectations and one of the few prints lower than a previous report, the market assumed one month meant the trend changed. The markets are looking at the glass as half full. Though the 2-year Treasury yield was higher on the month and is widely viewed as the vehicle that projects Fed rate policy, while the longer end of the curve was much lower in yield. The longer end is viewed as the gauge for inflation and economic growth, or lack thereof. Expectations tailed off as the month continued and the market now only sees a 50bps rate hike as likely. The "pivot" has arrived, though the Fed continues to say higher and held longer than expected. The drop in yields served as a major tailwind for High Quality fixed income, which as measured by the iShares US Aggregate Bond ETF gained 3.69% for the month. The U.S. 10-year Treasury bond yield ended the month at 3.70%, basically the lows of the month, closing far below the early month highs' of almost 4.25% and down significantly from October's close of 4.05%.

The Dow Jones Industrial Average rallied +5.67%, the S&P 500 rose +5.38%, and the small cap Russell 2000 climbed +2.15%. The international markets traded significantly stronger relative to the U.S., on the back of the worst month in 13 years for the U.S. Dollar. The MSCI EAFE iShares Core International Developed Markets ETF Index jumped +13.53%, and the MSCI Emerging Markets iShares Core ETF Index soared +15.27%.

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November continued the green sector screen play of October.

The best performers were…

- Materials: +10.70%
- Industrials: +7.50%
- Financials: +6.20%

The “worst” performers were…

- Consumer Discretionary: +0.83%
- Energy: +2.13%
- Technology: +4.92%

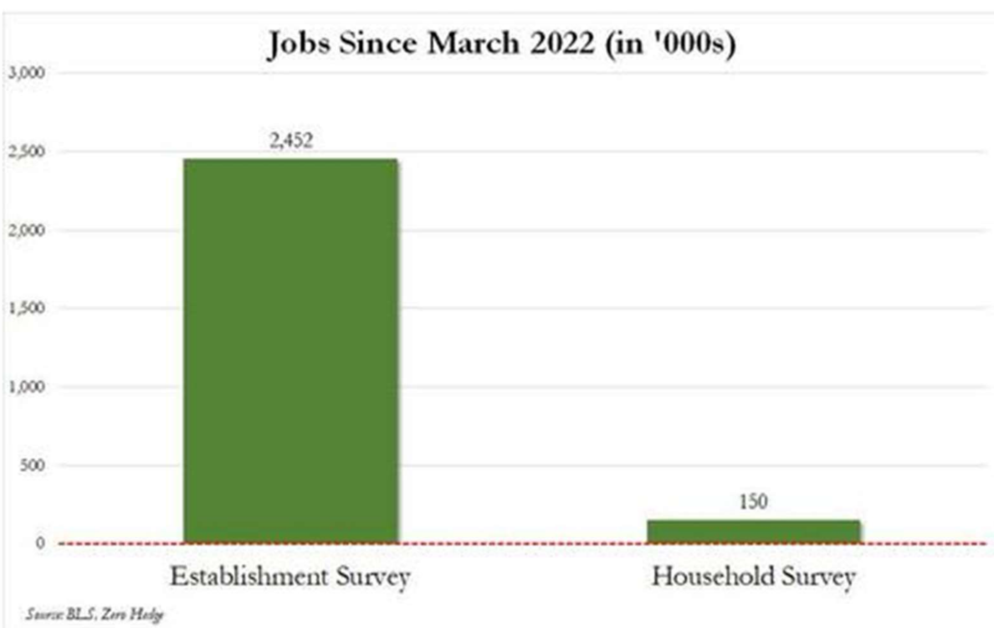
Source: https://www.sectorspdr.com/sectorspdr/tools/sector-tracker

Oil Report

The oil market sold off most of the month on continued demand concerns as China continues with their Zero-Covid policy, which caused additional provinces to be locked down, or is it welded shut… ☹ At the end of the month OPEC+ announced that they would increase supply cuts if demand continued to wane, which produced a small jump in prices. The current NYMEX WTI Crude Oil futures settled at $80.55 and posted a loss of almost 7% from the prior month close of $86.53 a barrel. The weakness in oil spilled over to RBOB gasoline, which lost almost 6% vs October’s close. Gas prices are well off summer highs and seems to have found an equilibrium in price as we have been oscillating in this range for 3 months. Summer driving and hurricane seasons are now behind us, so the focus will shift to economic activity in relation to demand and the supply activity of OPEC+.

The Rest of the Data

The October ISM Manufacturing Index decreased to 50.2 from September's reading of 50.9. Additionally, the ISM Services Index decreased to 54.4 in October from September's print of 56.7. The prices paid component for Services rose modestly and prices remained at high and elevated levels. Any reading above 50 generally indicates improving conditions. Consumer confidence decreased to 100.2 in November, which compares to a downwardly revised figure of 102.2 in October. The unemployment rate rose to 3.7%, and the economy added a solid 261,000 jobs in November, which beat expectations of 195,000 jobs. The Consumer Price Index for All Urban Consumers (CPI-U) again increased at +0.4% in October, on a seasonally adjusted basis. Over the last 12 months, the All-Items Index rate decreased to +7.7% on a non-seasonally adjusted basis, which was well below expectations. The CPI ex Food and Energy, eased to 6.3% over the last year. This release rejuvenated the animal spirits that inflation is being slayed and that the Fed pause is just around the corner, i.e., first signs should be in December. The above data continues to indicate the economy is generally on solid footing, despite rhetoric to the contrary. The data has the Fed continuing to argue for higher interest rates than current and to hold at a higher level once they get to the terminal rate. This point was reiterated by Fed head Powell today, month end, that more work is needed even though the pace may slow from the 75bps cadence of the last few months. Today, the markets read the last part of that statement as Fed Pivot and the equity markets shot for the moon. A question though, is the market getting ahead of itself or is the Fed looking at faulty data. Of note, is the difference between the household survey, which factors into the unemployment rate and the BLS establishment survey. Please see the chart below, which is right? The Fed has been holding to the "strong" labor market and persistent inflation. No question inflation is persistent globally, though in November several countries reported less than expected, though still high inflation. The equity market rally that started last month on the hopes of a Fed pause, took a big leap forward with Powell's speech today. We will continue to monitor economic activity in concert with inflation reports and how that may impact Fed policy.



Source: https://www.zerohedge.com/markets/something-has-snapped-unexplained-23-million-jobs-gap-emerges-broken-payrolls-report

Summary

The markets have stabilized and strengthen in the last 6 weeks though for seemingly different reasons. The equity market seems to have a stake in the ground that first comes reduced pace of hikes, maybe starting in December. That leads to an eventual, hope is shortly, end of rate hikes, which naturally means it's time for rate cuts to bolster equity prices. The short end of the Treasury curve, as measured by the 2-year Treasury, continues to price in more rate hikes, though not to the level the Fed has stated. The long end of the Treasury curve is rallying on expectations that all the rate hikes to come and that have already happened will drive the desired slowing, recession, of the economy. The labor market has been resilient, but how much of that has been driven by the pandemic induced labor shortage, which has companies hesitant to reduce staff. The answer to that seems to be coming sooner than later, as Mega Tech has started announcing layoffs in the last couple of months. The big question does that spread to other industries outside of mortgage, which has already been devastated with the large increase in rates. At some point the rate hikes "normally" curtail economic activity, but we still aren't seeing it in the data. Either way, we let the rules-based mechanisms act accordingly. As the markets have continued to rally, both U.S. Mid Cap and International markets shifted from Treasury Bills to their respective equity exposure during the month.

As always, the markets can be emotional, so we retain our focus on what we can control, which is the amount of equity risk that is taken in a clients' portfolio in concert with the clients' risk tolerance and long-term goals. The markets will always face different "worries", today it is inflation/war vs. waning growth expectations, tomorrow it will be something else. We have built our asset allocation models with dynamic features and quarterly rebalancing, both in fixed income and equities. If the markets continue to decline, we will reallocate the overweight that occurs in Fixed Income back into equities. The decline in equity markets has triggered the rules-based defense mechanisms to reduce the risk of the portfolio via the dynamic investment vehicles that have been deployed. Additionally, the recent strategic asset allocation changes, have insulated some of the fixed income allocation from continued Fed rate hikes. Further, if the equity markets get too extended on the downside, some of the vehicles will reallocate some capital back into their respective equity exposures.

These dynamic tools have been engaged, a couple of times during the increase in volatility. At month end a portion of equity remained shifted to Treasury Bills for U.S. Large, though if the rally continues for a few more days, U.S. Large Cap is likely to shift back to Equity exposure. The tactical allocation remains allocated in Floating Rate Treasuries.

If you have specific questions about your portfolio or financial situation, we are here to help. Long-term financial planning is designed to deal with uncertainty like those we discussed above. Our portfolio management process is to design a prudent allocation across many asset classes. Equities are for long-term growth and several vehicles that we utilize offer defensive mechanisms to mitigate equity market declines.

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