OCTOBER 2022

MARKET UPDATE

The downward momentum across capital markets in the back half of August continued throughout September. Markets reacted sharply in response to a Fed that appears to be setting the stage to take a more hawkish stance for longer as the Fed struggles to contain inflation. The S&P 500 fell by over 9% in the month and the Bloomberg US Aggregate fell by over 4%.

There were effectively no places to hide across capital markets, with every sector within the S&P 500 solidly in the red, as well as every major fixed income sector. The S&P 500 slightly outperformed international developed and emerging markets which were down 9.35% and 11.72% respectively, compared to the -9.22% for the S&P 500. The strength of the dollar has continued to create headwinds in emerging markets.

August's inflation report showed monthly price increases re-accelerated and core CPI, which excludes food and energy, turned back upward. The report put more pressure on the Fed ahead of their September meeting. In response, the Fed hiked rates another 75 basis points in mid-September and looks to be on pace for another 50-75 basis point hike in November. In a similar story to prior months, the yield curve moved upwards across the board, though more sharply at the short end of the spectrum as markets adjusted their expectations (again) on future Fed movements.

Across the economy, the job market continues to remain hot with 315 thousand jobs added in August and initial unemployment claims continuing to remain low. However, the consumer has been showing signs of cooling, although at a very gradual pace. Retail sales grew 0.3% in August, but prior month revisions showed consumers have slowed spending over the prior two months.

ADVISORS' PERSPECTIVE

Focus remains on the Fed, the pace of rate hikes, and how long their hawkish stance will need to continue as they navigate inflation and a potential recession. The market is expecting a more hawkish Fed for the remainder of the year, though there is still significant uncertainty about how aggressive the Fed will be in November and December. Heading into 2023, the market is partially expecting the Fed to lift off a bit. However, there is still considerable disagreement in the market.

Since the end of the second quarter, the pain in bond markets has only gotten worse as the Fed has moved into a more hawkish stance over the last couple of months. On a year-to-date basis the Bloomberg US Aggregate continues to have its worst year on record, by a considerable margin. The next worst return at this point in the year is back in 1981 when the index was down 3.92% and ended the year up 6.25%. The index had its worst full-year return in 1994 when it lost 2.92%. In a year of aggressive movements in the yield curve, bonds have offered very limited diversification benefits.

The VIX Index is a frequently discussed gauge of fear in equity markets. However, there is a similar measure for Treasury bonds, called the MOVE Index. Both indices look at the 30-day implied volatility by looking at options markets. During the pandemic, both equity and bond implied volatilities surged upward and then came back down. However, over the last year and a half, and especially over 2022, bond implied volatilities have once again surged to their pandemic-era highs. Meanwhile, equity volatilities have remained elevated, but haven't seen the same trend.

Inflation continues to be a hot topic and one likely on the mind of many investors. Over the last month, economists' expectations for future inflation were relatively unchanged, though Q4's expectations lowered a bit and the gap between the low and high forecasts narrowed. September's CPI will be released on October 13th and should give The Fed an indication whether the rate hikes are accomplishing their goal of lowering inflation.

Current market conditions have struck fear in investors causing them to make impulsive decisions. However, we emphasize, in times of uncertainty it is crucial to follow the data and not allow emotions to intervene. Your portfolios continue to be recalculated bi-weekly ensuring that we are in the best position to achieve your financial goals.