NOVEMBER 2022

MARKET UPDATE

Markets rebounded over the second half of October, with the S&P 500 gaining 8.10%. The gains are a welcome respite during a painful year and an especially painful September. US markets outperformed developed international, with the MSCI EAFE gaining 5.38% and emerging markets losing 3.10% as they continue to struggle amid a strong dollar.

So far, third quarter earnings season has been a bit of a mixed bag with profit margins coming under pressure and a few high-profile disappointments, such as Meta and Amazon, making headlines. With slightly more than half of the S&P 500 reporting, sales and earnings have come in 1.8% and 3.8% above estimates, respectively, and roughly 70% of the S&P 500 that have reported have beat earnings estimates. However, this is slightly below longer-term averages.

The economy outperformed expectations in the third quarter, with the US economy growing at a 2.6% annualized rate. The gain offset the prior two quarters of decline and put the size of the economy, after adjusting for inflation, slightly ahead of where it began the year. The consumer remains in the driver's seat with personal consumption growing at a 1.4% rate, though this was slightly slower growth than in the second quarter. Residential investment dropped at a 26.4% rate, following second quarter's 17.8% drop, as the rapid rise in mortgage rates has severely curtailed the housing market over the last two quarters.

Despite the positive GDP report, the shape of the yield curve came back into focus at the end of the month with yields on 3-month government bonds rising above 10-year bond yields for the first time since early 2020. The widely tracked measure is perhaps the most significant one when used to indicate a potential recession, though historically it can be many months from inversion to a recession. While indications of a future recession may have increased, the positive third-quarter GDP report seemed to put the final nail in the coffin of current recession talks.

ADVISORS' PERSPECTIVE

After one of the worst September's, October was one of the strongest performing stock markets in decades. Forward risk, as measured by credit spreads and implied equity volatility, fell slightly over the month. While GDP has shown positive signs and was helped by strong labor markets, sentiment continues to remain poor. Forward-looking recessionary risks continue to hinge on unemployment and slowing consumer spending activity.

The US economy grew at a 2.6% annualized rate in the third quarter, slightly beating expectations of 2.4%. Adjusted for inflation, the US economy is now slightly larger than it was at the start of the year, recovering the ground it lost in the prior two quarters of contraction. Residential investment, which falls under Fixed Investment, fell at a 26.4% annualized rate, though nonresidential investment grew at a 3.7% rate. Changes in exports and imports have been volatile lately, likely due to the surging dollar along with mixed economic performance around the globe.

While the labor market continues to buoy the overall economy, there has been a slowdown in the job gains over the last few months, along with a similar trend in retail sales. However, despite any slowdown, the consumer continues to push the economy forward, as seen in the Q3

GDP report. Industrial production jumped in September, rising 0.38%, though three of the last five months have shown monthly contractions.

With over half of the S&P 500 now having reported Q3 earnings, just under 70% of companies that have reported have been able to surprise on the upside. This is slightly below last quarter's 75% and the 5-year average of 77%. Despite the below average surprise rate so far, earnings have expanded by 3.8%, a major improvement from second quarter's 18.31% decline. However, profit margins, having surged over the last few quarters, have come under pressure.

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 the Fed to do one or two more multi-step hikes of 50 or 75 basis points to round out the year and then being able to slow down or stop hiking early next year.

Considering that we are in or approaching a recessionary period, it would not be a surprise if we recovered quicker than previous ones. In times like these, investors tend to trade based on emotions. We disagree, it is more important now than ever to follow the data. Hilltops partnership with Helios relies on facts and data, which we use during our recalculations on a bi-weekly basis. Our models adjust appropriately to market conditions.