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Investment Insights Monthly

From The Desk of Bill Hornbarger, Chief Investment Officer

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All Clear?

The 208-point gain for the S&P 500 in reaction to the October CPI report has many investors debating if we have seen stocks bottom for this cycle. The outsized gain was the third-largest point increase on record and came on a day where inflation was “only” up 7.7% year-over-year. In our opinion, the answer to whether we have seen the lows for stocks is related to the outlook for inflation and monetary policy moving forward from here. And while all the answers to these questions are uncertain, we thought a few pictures and tables might provide some perspective.

The Fed

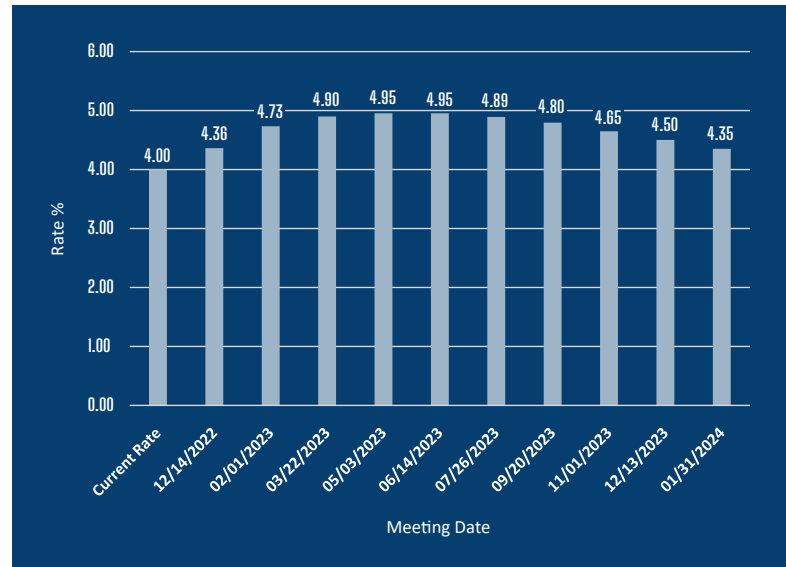
The Federal Open Market Committee increased interest rates for the sixth consecutive meeting in the first week of November, and the target rate now stands at 4% (upper bound). The Fed has been plainspoken in their comments in terms of their intent to raise rates as much as necessary to bring inflation back down to their target range. The markets have been more focused on the possibility of a “pivot” in policy and the recent better-than-expected CPI data fueled speculation that a pivot might be close. However, Fed Governor Christopher Waller quickly weighed in that it was “just one data point” and that the markets are “way out in front.”



Prior to the October inflation report, the markets had been pricing the terminal rate for this cycle at 5.25% in mid-2023. The slightly better inflation report has tempered those expectations to some extent as shown in the chart on right. However, the market expects additional rate increases, and the Fed continues to signal that it concurs.

Fed Fund Futures Implied Rates

As of November 14, 2022



Source: Bloomberg

Inflation

Overall, CPI has declined four consecutive months after peaking at 9.1% in June. The moderation has been relatively broad based, but prices remain elevated – well above the Fed’s comfort zone (see table). Shelter, in particular, is concerning since it is one of the largest parts of CPI with a weight of 32.7%. And it has continued to increase, recording its highest reading of the past 12 months in the most recent CPI report.

Other price measures show similar patterns as the CPI. The Fed’s favored inflation measure, core personal consumption expenditures (CPE), was last at 5.2%, which is down slightly from its peak of 5.4% in March. One of the largest declines has been in the price index of the Institute for Supply Management manufacturing survey, which has fallen from 87.1 in March to 46.6 in October. A reading below 50 indicates more respondents see prices falling than increasing. Additionally, data from the University of Michigan showed long-term inflation expectations remain anchored near more normalized levels at 3.0%. This is only slightly above the 2.8% average during 2000 through 2019.

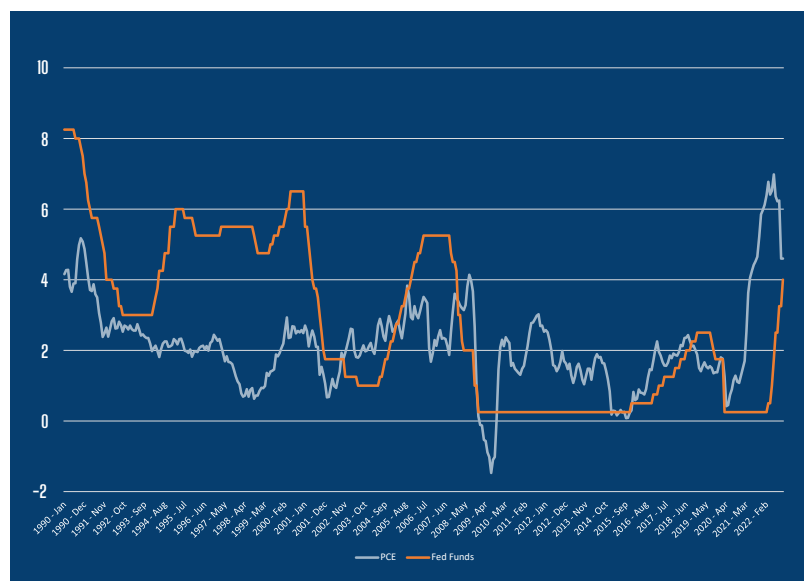
	Peak (last 12 months)	October
Overall CPI	9.1%	7.7%
Core CPI	6.6%	6.3%
Shelter	6.9%	6.9%
Energy	34.6%	17.6%
Food	11.4%	10.9%
Medical Care	6.5%	5.4%
Used Cars and Trucks	41.2%	2.0%

Source: Haver



What does this mean for Fed policy? As stated previously, the Fed has been clear in its intent to bring inflation down. Fed Chairman Jerome Powell stated, “We have to get inflation behind us. I wish there was a painless way to do that. There isn’t.” History suggests the Fed won’t stop raising rates until they are above the rate of inflation as shown on right.

Fed Funds vs. Personal Consumption Expenditures Q4 2022 Estimated



Source: Haver

Stocks

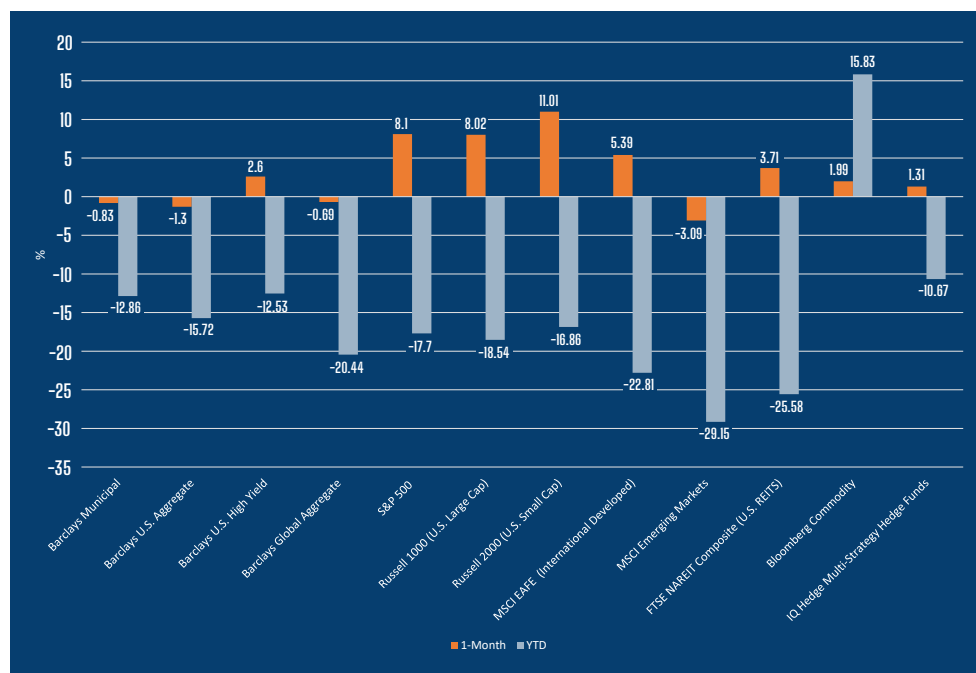
Stocks hit a low for this calendar year on October 12, and as we write this, they have rallied approximately 12% from that low – including the early October CPI surprise. We are mindful of the fact that seven of the ten largest daily percentage gains for the S&P 500 happened during bear markets, and bear market rallies are not uncommon and often unfold rapidly (see table below). With the Fed still committed to raising rates and visible signs that the economy is struggling (i.e., six consecutive negative leading indicator reports), we are still cautious on stocks. But we acknowledge that conditions in the short-term have improved with the mid-term elections behind us, the recent softening in the U.S. currency easing international inflationary pressures, and the march to higher bond yields taking a pause. While a continuation of this rally is possible, equity investors will continue to look for better visibility into inflation and earnings for the “all clear” signal needed for a sustained move higher.

Rank	Date	% Change
1	3/15/1933	16.61%
2	10/30/1929	12.53%
3	10/6/1931	12.36%
4	9/21/1932	11.81%
5	10/13/2008	11.58%
6	10/28/2008	10.79%
7	9/5/1939	9.63%
8	4/20/1933	9.52%
9	3/24/2020	9.38%
10	3/13/2020	9.29%

Source: Yardeni, Wikipedia, Red = bear market, Green = bull market



Asset Class Returns as of October 31, 2022
Comparing Recent Month and Year-to-Date Total Returns



Source: Morningstar

Fixed Income

- Treasuries and other sovereign debt yields continued to march higher in October, leading to losses in core fixed income and municipals.
- Credit spreads generally tightened during October's risk on rally. High yield led the way followed by floating rate loans.
- The impact from currency was largely flat within developed markets and a headwind for emerging market debt.

Equities

- Equities and other risk assets rallied sharply in October, led by domestic markets.
- Value beat growth across large cap and small cap stocks, and small cap outperformed large cap in general.
- The tech-heavy Nasdaq continues to trail other indices in 2022, primarily as some of the large household names provided weak fourth quarter earnings guidance.
- Non-U.S. developed equities posted solid gains in both local currencies and U.S. dollar terms last month.
- Value outperformed growth in October, and unlike the U.S., small cap stocks trailed large cap stocks.
- Emerging market equities were the real laggard in October led by substantial weakness in China (-16.8%). Local returns also fared better than U.S. dollar returns.

Real Assets

- Domestic REITS posted positive returns but are still lagging generally for the year.
- Energy was a standout in October, and the master limited partnership (MLP) space was sharply higher (+14.32%).
- The commodity index was higher in October with energy a large positive contributor. Other commodities were a mixed bag with metals (precious and industrial) generally softer.



October 31, 2022	MTD	QTD	YTD	1-Year	3-Year	5-Year	10-Year
Fixed Income Indices							
Barclays U.S. Treasury Bill 1-3 Month	0.22%	0.22%	0.85%	0.86%	0.56%	1.12%	0.66%
Barclays Municipal	-0.83%	-0.83%	-12.86%	-11.98%	-2.18%	0.37%	1.68%
BBgBarc U.S. Govt/Credit Intermediate	-0.13%	-0.13%	-4.66%	-4.88%	-0.57%	0.68%	0.79%
Barclays U.S. Aggregate	-1.30%	-1.30%	-15.72%	-15.68%	-3.77%	-0.54%	0.74%
Barclays U.S. High Yield	2.60%	2.60%	-12.53%	-11.76%	0.31%	2.01%	4.12%
S&P/LSTA Leveraged Loan	1.03%	1.03%	-2.25%	-1.78%	2.72%	3.07%	3.61%
Barclays Global Aggregate	-0.69%	-0.69%	-20.44%	-20.79%	-6.16%	-2.38%	-0.98%
JPM GBI EM Global Diversified	-0.88%	-0.88%	-19.29%	-20.27%	-8.21%	-3.54%	-2.56%
U.S. Equity Indices							
DJ Industrial Average	14.07%	14.07%	-8.42%	-6.74%	8.83%	9.33%	12.19%
S&P 500	8.10%	8.10%	-17.70%	-14.61%	10.22%	10.44%	12.79%
NASDAQ Composite (Price)	3.90%	3.90%	-29.77%	-29.10%	9.84%	10.31%	13.95%
Russell 1000	8.02%	8.02%	-18.54%	-16.38%	9.99%	10.19%	12.66%
Russell 1000 Growth	5.84%	5.84%	-26.61%	-24.60%	11.75%	12.59%	14.69%
Russell 1000 Value	10.25%	10.25%	-9.32%	-7.00%	7.31%	7.21%	10.30%
Russell Mid Cap	8.88%	8.88%	-17.55%	-17.17%	7.84%	7.95%	11.36%
Russell 2500	9.59%	9.59%	-16.72%	-17.58%	7.94%	7.07%	10.70%
Russell 2000	11.01%	11.01%	-16.86%	-18.54%	7.05%	5.56%	9.93%
Russell 2000 Growth	9.49%	9.49%	-22.57%	-26.02%	5.11%	5.17%	10.15%
Russell 2000 Value	12.59%	12.59%	-11.19%	-10.73%	8.08%	5.31%	9.37%
Non-U.S. Equity Indices							
MSCI World	7.21%	7.21%	-19.74%	-18.09%	6.62%	6.92%	9.52%
MSCI ACWI	6.06%	6.06%	-20.81%	-19.58%	5.34%	5.76%	8.54%
MSCI ACWI Ex-U.S.	3.00%	3.00%	-23.96%	-24.35%	-1.23%	-0.13%	3.75%
MSCI EAFE	5.39%	5.39%	-22.81%	-22.62%	-0.82%	0.39%	4.61%
MSCI EAFE Growth	4.33%	4.33%	-29.91%	-29.35%	-0.94%	1.44%	5.48%
MSCI EAFE Value	6.46%	6.46%	-15.48%	-15.80%	-1.31%	-1.07%	3.50%
MSCI Europe	7.18%	7.18%	-23.28%	-22.42%	0.09%	0.64%	4.62%
MSCI Japan	2.96%	2.96%	-23.92%	-24.37%	-2.88%	-0.58%	5.68%
MSCI AC Asia	-2.87%	-2.87%	-29.18%	-30.47%	-4.04%	-2.14%	3.96%
MSCI EAFE Small Cap	4.24%	4.24%	-28.93%	-29.95%	-1.88%	-0.92%	6.01%
MSCI ACWI Ex-U.S. Small Cap	3.26%	3.26%	-26.75%	-27.39%	0.54%	0.11%	5.16%
MSCI Emerging Markets	-3.09%	-3.09%	-29.15%	-30.73%	-4.07%	-2.73%	1.16%
MSCI EM Asia	-5.85%	-5.85%	-32.73%	-34.19%	-3.87%	-2.93%	2.85%
MSCI China	-16.81%	-16.81%	-42.70%	-47.82%	-13.73%	-9.55%	0.13%
MSCI EM Eastern Europe	13.07%	13.07%	-85.36%	-86.99%	-45.32%	-26.66%	-14.18%
MSCI EM Latin America	9.69%	9.69%	13.38%	16.71%	-1.43%	0.28%	-1.01%
MSCI EM Small Cap	-0.06%	-0.06%	-23.93%	-23.00%	4.66%	0.96%	3.42%
MSCI Frontier Markets	-4.29%	-4.29%	-28.69%	-30.93%	-2.71%	-2.07%	3.59%
Hedge Fund Indices							
IQ Hedge Long/Short	5.62%	5.62%	-16.34%	-17.02%	1.28%	1.53%	--
IQ Hedge Multi-Strategy	1.31%	1.31%	-10.67%	-11.45%	-0.93%	0.35%	1.88%
Real Assets Indices							
FTSE NAREIT Composite	3.71%	3.71%	-25.58%	-19.72%	-0.87%	4.32%	6.98%
Alerian MLP	14.32%	14.32%	35.92%	30.19%	11.59%	5.55%	1.96%
Bloomberg Commodity	1.99%	1.99%	15.83%	11.15%	13.44%	6.92%	-1.56%
S&P Global Infrastructure	5.05%	5.05%	-5.56%	-4.68%	1.02%	2.91%	6.02%
Other							
Oil Price Brent Crude	7.81%	7.81%	21.92%	12.38%	16.34%	9.41%	-1.35%
CBOE Market Volatility (VIX)	-18.15%	-18.15%	50.29%	59.16%	25.10%	20.52%	3.36%

Source: Morningstar



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