Week in Review

Equity Markets:

The S&P 500 rallied on the slowing October CPI report. The S&P spiked on Thursday, ending the day up over 5%, and the week up over 5.9%. The markets bounced on the anticipation that the Fed could slow the pace of the rate hikes. The sooner the Fed signals the end of the rate hiking regime, the quicker it will be a constructive environment for risk assets.

Q3 earnings season is nearing completion. 91% of S&P 500 companies have reported earnings. 69% have beaten earnings expectations. This is below the five- and 10-year averages, but the results are better than expected from the beginning of the quarter.

Fixed Income Markets:

The long end of the yield curve took a nose dive this week as prices spiked and yields collapsed. The 10-year treasury yield dropped nearly 0.4% intraweek. The 10-year treasury opened the week with a yield of 4.21% and closed at 3.88% as bond prices rose on the heels of the better-than-expected CPI report.

Following the CPI report, the yield curve became more severely inverted. The 2's/10's spread closed the week at -0.5%. This is the largest negative spread since 1981, according to data from The Federal Reserve Bank of St. Louis. The steep inversion of the yield curve has likely confirmed, at a minimum, an imminent mild recession. This is not necessarily bad news, because the price action for the majority of the year has already priced this outcome in.

Economic:

The major market-moving news last week was October's CPI release on Thursday. On a year-over-year basis, CPI rose 7.7%, below economists' expectation of 7.9%. Markets surged following the report. The hope is that this is the turning point for inflation and the Fed will alter its pace of rate hikes going forward. Core CPI still remains uncomfortably high. October's Core CPI, which excludes food and energy, came in just below expectations at 6.3%. The good news is that inflation appears to have already peaked and it could be on a trend back to target. The unknown lies in the timeframe and how much further the Fed will need to raise rates to bring it down.

Looking Ahead

Equity Markets:

Analysts have reduced their earnings expectations. According to data by FactSet, the consensus has Q4 earnings declining by 1% year-over-year. As of June 30th, Q4 2022 earnings growth was anticipated to be 9.1%. The deteriorating macro environment appears to have caught up with analysts' expectations.

Headline news varies from pessimistic to optimistic. Long-term investors can be easily distracted by short-term noise and cast doubt on their investment goals. We believe commitment to established objectives will require an investor to go against the consensus. Last week was a perfect example. After 10 months of equities and fixed income moving in synchrony, a surprise report led to them continuing that trend, but in the other direction. Proper diversification that matches an investor's risk tolerance has the objective of achieving their goals over long time frames. 2022 has been a year to cast doubt, but we believe that the investors who don't abandon their long-term allocations have a greater likelihood of reward in the long run.

Fixed Income Markets:

We have remained consistent in our rate expectations as rates pushed higher. To start the year, we believed rates would peak in the 3.5% range. They kept pushing higher. Persistent inflation has forced the Fed to keep its foot on the gas to control it.

The 10-year yield's current peak stands at 4.33%. We are now over half a percent below the peak. We expect yield declines to continue. The Fed is pushing up the short end of the curve, so volatility will likely remain in the long end. There are secular deflationary pressures, and we strongly believe that rates will stay lower for longer from a longer-term perspective. We believe if we haven't seen peak yields, we are close to the cycle high. As the 10-year approaches its peak rate, we anticipate swift price appreciation near that level, driving the yield down. We remain better buyers of bonds than sellers in this environment.

Economic:

The October inflation picture will be more complete with the Producer Price Index and Import Price Index reports this week. These readings can be leading indicators for future inflation. We will also see the Leading Economic Index reading Friday.

Housing will be in focus this week. We are in the most severe housing market slowdown since the GFC. Housing is a major market that acts as the foundation for the broader economy. The NAHB Housing Market Index, building permits, housing starts, and existing home sales will be reported this week.

**** *See Important Disclosures on following page*

Important Disclosures:

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