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Monthly Market Pulse: Looking for a Soft Landing

November 2022

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Key Observations:

- *Risk assets rallied on the back of softening inflation data and "Fed pause" mentality*
- *The Federal Reserve reiterated its commitment to combat inflation, but a pivoting tone hinted at the potential for a slowing pace of hikes in 2023*
- *Emerging markets equities, led by China, were a standout for the month*
- *The U.S. yield curve remains inverted at levels not seen since the early '80s, historically signaling a recession, but estimates of the timing, duration, and magnitude vary widely*

Market Recap

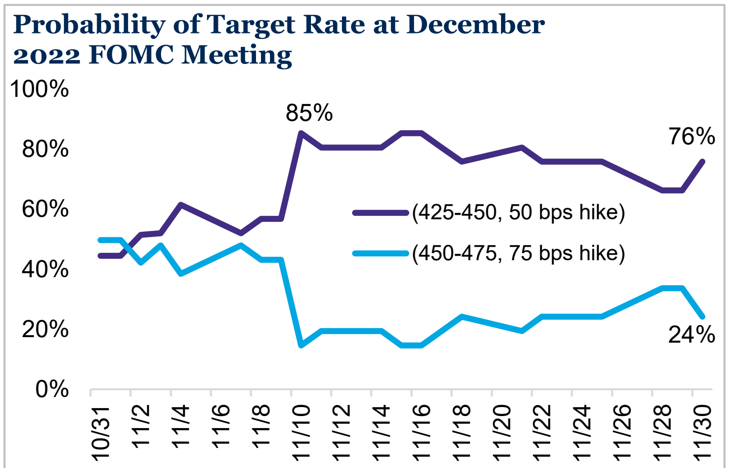
Risk assets extended the October rally into November, continuing to claw back returns from lows earlier in the year. Investor sentiment swung 180 degrees as economic data showed signs of peaking inflation and the resulting potential for a slowing pace of Federal Reserve (Fed) rate hikes heading into 2023. Fears of a recession that spooked markets earlier in the year have either moderated or been accepted by investors and, despite economic activity starting to trend down, markets remained resilient. U.S. equity markets generally saw mid-single digit returns, driven by larger cap companies, while small cap stocks, as measured by the Russell 2000 Index, posted a modest positive return. Non-U.S. equities rose in the month and widely outpaced their domestic counterparts. A new prime minister in the U.K. and clarity on reforms, as well as favorable inflation prints in Germany and Spain, helped push international developed markets (MSCI EAFE Index) higher. The U.S. dollar weakened compared to many major currencies, providing an additional tailwind for international stocks. Emerging market equities (MSCI EM Index) also saw double digit gains in the month. China remained in the headlines; positive sentiment about the potential for easing restrictions on the zero-COVID policy overshadowed protests later in the month. MSCI China returned 29.7% in November.

Fixed income markets also generated positive returns for the month on the back of lower interest rates. The U.S. 10-year Treasury yield fell 42 basis points (0.42%), ending the month below four percent on the heels of better-than-expected inflation data. However, shorter-maturity yields rose after the Fed raised its target rate an additional 75 basis points (0.75%) at the November meeting. Securities down the capital stack, e.g., U.S. corporate high yield, also fared well in the risk-on environment. Inflation sensitive areas of the market such as REITs and commodities eked out modestly positive returns in November. Within the commodities segment, falling energy prices were more than offset by strength in industrial and precious metals.

Financial Market Performance		
	November	YTD
S&P 500	5.6	-13.1
Russell 2000	2.3	-14.9
MSCI EAFE	11.3	-14.5
MSCI EM	14.8	-19.0
Bloomberg US Agg Bond	3.7	-12.6
Bloomberg US HY Corp Bond	2.2	-10.6
FTSE NAREIT Equity REITs	5.8	-20.3
Bloomberg Commodity	2.7	19.0

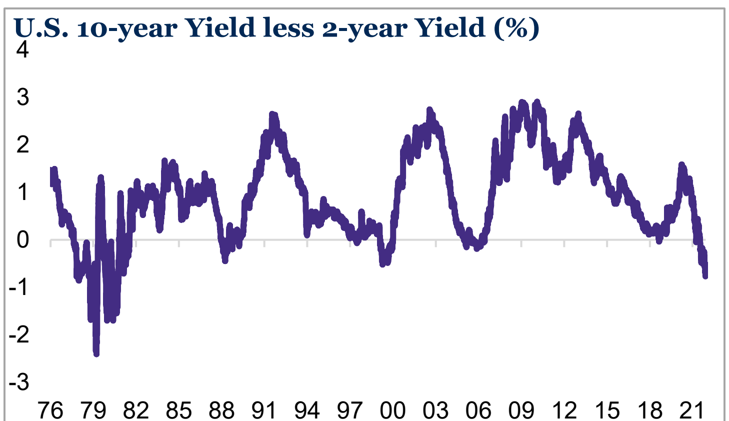
Source: Morningstar Direct. As of November 30, 2022

Shifting Sentiment



Source: CME FedWatch Tool. As of November 30, 2022

The October inflation report marked a turning point in investor sentiment. U.S. CPI grew 7.7% year over year in October. While still elevated, the print marks the lowest reading since January. Investors pivoted to the "Fed pause" narrative, sending the S&P 500 Index up 5.6% on November 10th, the best day of 2022 thus far, and among the top trading days on record[1]. Expectations for a moderating Federal Reserve soared, with the market shifting to an 85% probability of a 50 basis point (0.50%) rate hike in December rather than a 75 basis point (0.75%) hike. Markets are also pricing in a pause in the rate hike campaign in 2023. The Fed remains in a "higher for longer" mindset, but the statement coming out of the November meeting lends some credence to the possibility of a pause in 2023 as the committee accounts for the "lags with which monetary policy affects economic activity and inflation."[2]



Source: FactSet. As of November 30, 2022

Inflation expectations have fallen as investors digested the recent CPI report and Fed messaging. This pushed longer-term Treasury yields lower and, based on the difference between the 10-year and 2-year yields, the curve is now the most inverted it has been since the 1980s (touching -77 basis points [-0.77%] during the month[3]). An inverted yield curve has historically been a warning sign of recession to come, and the Fed has made clear it is willing to sacrifice growth to bring down inflation. We are starting to see signs of slowing activity – PMI numbers moderating, housing data softening, etc. – but the U.S. labor market remains resilient, consumer balance sheets are generally in favorable positions, and GDP growth bounced back to 2.9% in Q3 2022 after negative figures in each of the first two quarters this year. However, it remains to be seen if the Fed can navigate a "soft landing" in the new year.

Conclusions

The Fed's commitment to fight inflation remains at the forefront of the investment discussion. Recent inflation data is showing signs the worst may be behind us and the possibility of a central bank pause in 2023 has breathed recent life into financial markets. However, risks lurk on the horizon and the chance of recession in the next year is elevated as financial conditions have tightened, geopolitical risks persist around the world, and inflation — while slowing — remains very high. As we head into year-end, we are busy finalizing our forthcoming 2023 investment outlook, but we remain steadfast in our view that taking a strategic and disciplined approach to investing allows for the highest probability of achieving long-term investment objectives.

[1] Morningstar Direct. As of November 30, 2022.

[2] FOMC Statement, November 2, 2022. https://www.federalreserve.gov/newsevents/pressreleases.htm

[3] FactSet. As of November 30, 2022

INDEX DEFINITIONS

- ***The S&P 500*** *is a capitalization-weighted index designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.*
- ***Russell 2000*** *consists of the 2,000 smallest U.S. companies in the Russell 3000 index.*
- ***MSCI EAFE*** *is an equity index which captures large and mid-cap representation across Developed Markets countries around the world, excluding the U.S. and Canada. The index covers approximately 85% of the free float-adjusted market capitalization in each country.*
- ***MSCI Emerging Markets*** *captures large and mid-cap representation across Emerging Markets countries. The index covers approximately 85% of the free-float adjusted market capitalization in each country.*
- ***Bloomberg U.S. Aggregate Index*** *covers the U.S. investment grade fixed rate bond market, with index components for government and corporate securities, mortgage pass-through securities, and asset-backed securities.*
- ***Bloomberg U.S. Corporate High Yield Index*** *covers the universe of fixed rate, non-investment grade debt. Eurobonds and debt issues from countries designated as emerging markets (sovereign rating of Baa1/BBB+/BBB+ and below using the middle of Moody's, S&P, and Fitch) are excluded, but Canadian and global bonds (SEC registered) of issuers in non-EMG countries are included.*
- ***FTSE NAREIT Equity REITs Index*** *contains all Equity REITs not designed as Timber REITs or Infrastructure REITs.*
- ***Bloomberg Commodity Index*** *is calculated on an excess return basis and reflects commodity futures price movements. The index rebalances annually weighted 2/3 by trading volume and 1/3 by world production and weight-caps are applied at the commodity, sector and group level for diversification.*

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