

# BUILDING YOUR FUTURE

QUARTERLY MARKET COMMENTARY  
FALL 2022

*Exclusively for Retirement Plan Participants*

FROM THE  
DESKS OF



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Market turbulence continued to dominate the third quarter of 2022 fueled by rapidly rising interest rates, fears of decelerating economic growth, and increasing recessionary risks around the globe. While July delivered solid equity gains, volatility ensued as the U.S. Federal Reserve confirmed that it was not yet ready to pivot from its aggressive rate hiking cycle to curb stubbornly high inflation, despite the market's optimistic view that price pressures were ebbing. As we enter the last few months of the year, the Fed remains in the driver's seat and markets continue to live and die by data releases, especially those related to jobs and the Fed. Below we will review the key areas we are watching and provide our view on what to expect in the coming months.

## Labor Market

The U.S. economy added 263,000 jobs in September, about in line with expectations, while the unemployment rate dropped to 3.5%, matching a five-decade low. September's job growth was the lowest monthly increase since April 2021. On the wage front, hourly earnings were up 5% from a year ago, cooling slightly from the prior month, but still well above the pre-pandemic norm. The August job opening data

showed that the number of job openings decreased by 10%, the most since April 2020, and the fourth decline in the past five months. The gap between the number of jobs and the number of unemployed remains high from a historical perspective, but it is starting to narrow. For now, companies are slowing the pace of hiring before cutting jobs, therefore keeping the unemployment rate low.

## OUR VIEW

With these recent data releases the direction of the jobs market has become clearer, but the degree of softening needed to reduce inflation less so. We believe that the prospect of a soft landing (where rates rise and the economy slows without falling into a recession) still looks challenging with the September jobs report, as there remains a long way to go before the supply and demand for workers is more balanced and inflationary pressures from the labor market are fully curtailed. We believe the relatively strong labor market will reinforce the Fed's view that it is necessary to increase the Fed funds rate materially further during the two remaining meetings this year to try to bring inflation down.

## Federal Reserve

By late July investors were seemingly convinced a soft landing by the Fed was in the cards. Solid jobs data and a cooling of CPI inflation were key drivers of this thinking. Hope turned into anxiety in late August when Fed Chairman Powell delivered a short and stern message, doubling down on his commitment to return inflation to much lower levels by rapidly raising interest rates. A hotter-than-hoped for inflation report in September set the Fed up to fulfill Powell's promise. At the Fed's September meeting an aggressive path forward for interest rates was outlined, including the potential for an additional 1.25% increase in 2022, putting the Fed funds rate at 4.4% at the end of the year. Given the impact this has on the cost of borrowing for households and businesses, the reaction has been negative.

## OUR VIEW

The key for the fourth quarter will be where interest rates go from here. Despite the Fed's guidance on rates, investors know it has a poor track record on making projections. (This time last year the Fed funds rate was projected to be 0.3% at the end of 2022, rather than the current projection of 4.4%.) As the fourth quarter unfolds, investors will grapple with when the Fed can pause – or end – this cycle of raising rates. Currently the market does not anticipate a pause until rates rise above 4.6%. History shows

that the Fed is often done hiking once its policy rate climbs above the 10-year Treasury yield. With the 10-year yield at 3.9% as of October 13, 2022, we may not have far to go. That said, the real driver of Fed action in the coming months will likely be inflation. A cooling of inflation could put the hope of a soft landing back on the table. We don't think the economy is facing an imminent threat of a recession this year, but as the Fed continues to sound more hawkish than ever, we believe that its higher-for-longer policy raises the chances for recession in 2023.

## Equities

Stocks took investors on a roller coaster ride in the third quarter with an early summer rally ending abruptly after the Fed pledged to continue fighting inflation. The summer rally peaked in July as both the S&P 500 Index and the Nasdaq Composite posted strong gains. The fears of economic weakening that plagued the stock market all year seemed to lessen, even though much of the economic data suggested little had changed. The upward momentum continued into the first half of August but ended abruptly as rate hike concerns reasserted themselves. Fed Chair Jerome Powell's hawkish speech at Jackson Hole sent stocks lower and increased the volatility in the market. Stocks saw a brief September upturn but lost momentum ahead of the September 20–21 FOMC meeting, in which the Fed announced its third consecutive 75-basis point hike of the year. Even though markets anticipated the change in interest rates, the Fed's dim outlook surprised many investors, forcing them to confront the potentially unavoidable scenario of an economic hard landing. The Dow Jones Industrial Average dropped 6.65% during the quarter. The Nasdaq Composite lost 4.11%, while the Standard & Poor's (S&P) 500 Index fell 5.28%. Through the end of September, the S&P 500 is having its worst start to a calendar year since 2002 and is still in bear market territory (defined as a decline of 20% on a closing basis without a subsequent 20% increase).

Corporate earnings remain both a bright spot and a wild card. Consensus analysts' S&P 500 earnings estimates for 2022 and 2023 are roughly \$223 and \$240 per share respectively, representing year-over-year growth of approximately 7.5%. While consensus

earnings projections have held up reasonably well during 2022, higher input costs, wage pressures and supply chain shortages represent ongoing challenges to companies' profit margins. Third quarter results and management guidance beginning this month will provide key insights into the magnitude of these issues.

Internationally, Eurozone equities experienced further sharp falls in the third quarter amid the ongoing energy crisis, rising inflation, and consequent fears about the outlook for economic growth. Every sector in the Eurozone posted negative returns. Emerging market equities also posted negative returns in the quarter, against a backdrop of slowing global growth, heightened inflationary pressure and rising interest rates.

### OUR VIEW

As long as uncertainty remains on how restrictive the Fed needs to be, volatility will remain in the equity market. We believe several months of moderating inflation will be required to stage a durable rebound, but given the unpredictable nature of geopolitical events affecting commodity prices, the range of inflation outcomes remain wide. The markets are continuing to price in some type of a recessionary outcome, however the pullback is creating compelling opportunities for those with a broader time horizon.

## Fixed Income

High inflation and the Fed's much more hawkish stance have led to a sharp increase in bond yields so far this year, resulting in negative returns across fixed income markets. (Bond prices move inversely to interest rates and credit spreads). The Bloomberg Barclays U.S. Aggregate Bond index (Agg), which acts as a proxy for the investment-grade bond market, decreased by 4.8% in the quarter, bringing the year-to-date decline to -14.6%. The Agg had by far its worst-ever start to a calendar year since its inception in 1976 – prior to 2022, the worst calendar year performance for the Agg was -2.9% in 1994.

### OUR VIEW

Bonds have not provided the stability to portfolios this year that investors have come to expect.

While the Fed appears likely to continue hiking rates through the end of the year, we believe that increased recession risks should limit further declines in the bond market. Importantly, the sell-off in fixed income has reduced valuations to much more attractive levels. With their much higher yields, we believe that high-quality fixed income can now provide more of a buffer for portfolios in the case of a market correction or an economic downturn.

## CONCLUSION

All of us at TC Wealth Partners/Trust Company of Illinois are so appreciative to serve you through these turbulent times. We have daily discussions and tirelessly analyze and strategize how to invest our clients' hard-earned assets. We will continue to keep you updated with our views as new events unfold. We urge you to keep a long-term perspective, review your financial plan and have conversations with your advisor about plotting your course. Please take care and be safe!

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