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Economic & Market Summary
October 2022

Consumer spending has held up well in the face of high inflation and tightening monetary policy. Adjusted for inflation, spending grew 2.0% in the first two quarters even though overall economic growth was negative. Compared to previous economic cycles, the labor market could be surprisingly resilient in a softening environment. Workers are still hard to find, meaning employers may be slower to reduce staff for fear of not being able to fill positions when the economy recovers. Interest-rate sensitive areas like housing are showing the effects of the change in monetary policy and it's reasonable to think other sectors will decelerate as well. Growth will likely remain modest until inflation is tamed and monetary policy loosens.

One year ago, Federal Reserve officials thought surging inflation was temporary and would normalize once pandemic-related disruptions receded. They waited too long to take action and high inflation proved to be more durable. In response, the Fed has been forced to rapidly tighten monetary policy. The main policy rate was increased from about 0% earlier this year to about 3% currently. Chairman Jerome Powell has made it clear the Fed will continue tightening until inflation retreats even if it weakens the economy. It's uncertain when inflation will cool given so many variables are outside the Fed's control. These include the Ukraine-Russia conflict and the fluidity of global supply chains. However, some inflationary pressures already appear to be lessening. Prices of several major commodities have declined significantly from their peaks, and the run up in used car and home prices appears to be slowing.

The global economic outlook is softening. Many central banks are raising interest rates to address their own inflation issues and defend their currencies against a strengthening dollar. The US' two largest trading partners, Europe and China, are struggling economically. The Ukraine war is disrupting Europe's energy supply which could amplify inflation and harm the EU economy. China's economy is slowing in the face of a deflating property bubble and the highly restrictive "zero COVID" policy.

The decline in stock and bond prices this year reflects a number of issues. Persistently high inflation led to a rapid shift in monetary policy stoking concerns of a recession. These dynamics, along with a weakening global economy and rising geopolitical risks, have pressured many asset valuations that were already high entering the year. After rallying briefly this summer, stock prices turned downward again with the S&P 500 ending the third quarter down 24% year-to-date. With a price-to-earnings ratio of about 15x, the valuation for the S&P 500 is now around historical averages. Earnings estimates will likely come down as the economy softens which could put additional pressure on stock prices. Tightening monetary policy has pushed bond yields up across the maturity spectrum leading to unusually large negative returns for bonds. While we generally expect more short-term volatility, we note that market sentiment is decidedly negative. This is a contrarian indicator for stock prices. It's important not to fixate on current economic or stock market trends. In a pessimistic environment such as this, it might not take much good news for prices to reverse. Maintaining patience and a long-term perspective during market downturns are critical to achieving successful investment outcomes.

Mark J. Sprtel, CFA

If you're a current client and your financial situation has materially changed or you would like to discuss your accounts in detail, please contact your investment manager. To request our SEC Form ADV Part II, please contact Mark J. Sprtel, Chief Compliance Officer, at the address above.