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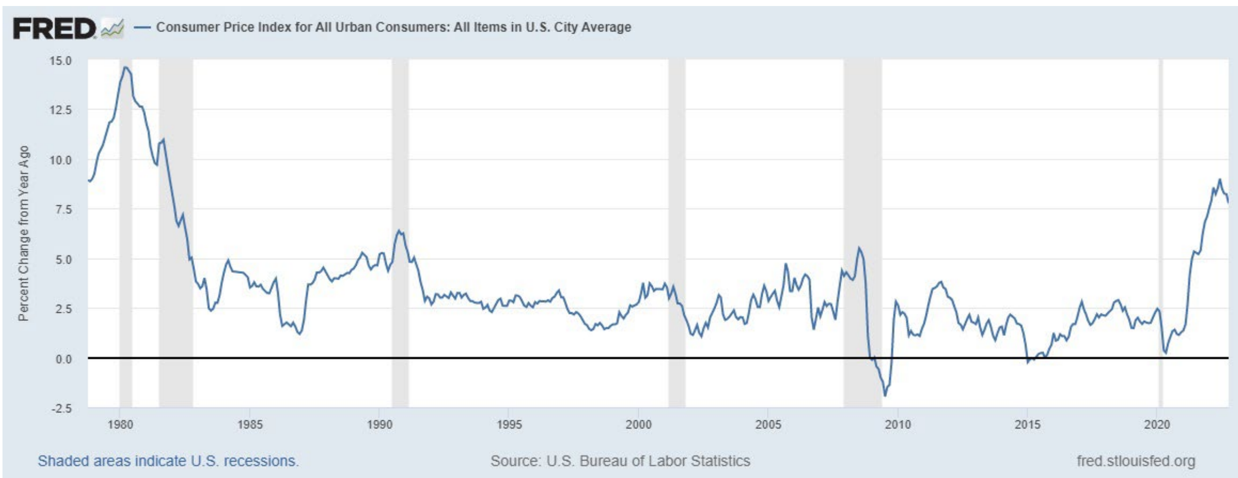
November Market Recap

By Dan Frost

Two major economic releases in the past month highlight the balancing act confronting the markets as we move into the final weeks of 2022. The latest report on consumer prices showed that inflation eased again in the month of October. According to the Labor Department the CPI index rose 7.7% year-over-year, down from 8.2% in September and 9.1% in June. It was the lowest reading for the headline inflation rate since January of this year.



According to the most recent GDP release the economy grew by 2.9% in the third quarter, which was revised higher from the initial reading of 2.6% released last month. Higher consumer spending and stronger net exports were responsible for the increased growth. This follows the first two quarters of 2022 that posted negative real GDP growth.

Taken together, these two reports indicate that the Federal Reserve seems to be making gradual progress in fighting inflation while the broader economy has so far avoided a recession.

The Stock Market

Stocks rallied on the final trading day of November, which put most of the major indexes solidly in positive territory for the second month in a row. The S&P 500 was up 5.6% for November, adding to October's 8.1% return. From the most recent lows on October 12th, the S&P 500 has risen by over 14%. However, for the first 11 months of 2022 the index remains down -14.4%.

The Dow Jones Industrial Average tacked on another 5.7% in November after the prior month's 13.95% gain, which was the 13th best in its history. Mid- and small-cap stocks also enjoyed another month of gains. The S&P 400 (mid-caps) had the best return for the month with a gain of 5.95% while the S&P 600 (small-caps) added just under 4%.

Looking beyond our borders, global stocks rallied as well. The MSCI EAFE and the MSCI Emerging Markets benchmarks both rose double digits, adding 11.3% and 14.8%, respectively, for the month of November.

The Bond Market

The most significant development in the fixed income markets over the past several months has been the increasingly inverted yield curve, where interest rates for short-term bonds are higher than those on longer-term bonds. Normally, investors demand more compensation in the form of higher yields in order to lend their dollars for longer time periods. However, when the market expects that the Fed will cut interest rates in the future to address a weakening economic outlook then the yields on longer-dated maturities will actually decline below those of shorter bonds.

Currently, the yield on the 10-year U.S. Treasury note is trading 0.81 percentage point below that of the two-year yield. The last time this gap was more extreme was in the early-1980s. The current inversion in the yield curve has persisted since the middle of this year. With the softer than expected inflation report as well as comments from Fed Chair Powell indicating the possibility of a smaller rate increase at the December FOMC meeting the yield on the 10-year Treasury traded down 44 basis points to finish November at 3.61%.

Conclusion

Few will shed any tears to turn the calendar on 2022 from a market perspective. This year can best be characterized as a bear market in nearly everything. From stocks to bonds and real estate to cryptocurrency. Unless you were invested entirely in energy stocks it has been a year to forget.

The surprising thing is that earnings have held up quite well. The entirety of the market's decline this year can be attributed to the decline in the price-to-earnings multiple investors are willing to pay for those earnings.

For now, it appears the focus remains on the level of interest rates the Fed will need to apply in order to bring inflation back down and the extent of economic and financial fallout that will result from those actions. Ironically, stronger than expected economic headlines will likely be met with disappointment from the stock market until more clarity is achieved.

All of this is a good reminder of why short-term market action is best ignored. Trying to interpret how markets will react to a headline runs counter to the best advice, which is to invest in a manner that will best serve your personal interests over the long-term. While this year has not been fun, it has re-set the table when it comes to future returns. Higher yields on fixed income and a lower multiple on the stock market will ultimately set the stage for better results going forward.

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