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Investment Institute

Market Commentary

Weekly perspective on current market sentiment — October 12, 2022

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Last week's S&P 500 Index: +1.5%

Capital preservation, not capital appreciation — for now

Key takeaways

- The stock and bond markets have already been hit by a storm and have been struggling in the unsettled seas.
- However, our outlook calls for brighter skies to be on the horizon in the second half of next year.

Driving around town, you might not get the feeling that a recession is likely near. Restaurants are busy, most stores seem to have plenty of shoppers, and everyone's favorite online retailer has delivery trucks out on the streets in force. But as the saying goes, there is often calm before the storm.

The stock and bond markets have certainly already been hit by a storm and have been struggling in the unsettled seas. Interest rates have surged higher while equities, here at home and around the globe, have tumbled. Most investors haven't looked forward to opening their monthly statements, as there have been few places to hide since the S&P 500 Index notched its all-time record high on the first trading day of this year. There has not been too much to cheer about since then, with the S&P 500 Index down more than 25% from that record high and at the time of this writing. It historically hasn't been often that both stocks and bonds lose ground three quarters in a row, but we view this as the case this time around.

As our recent economic projections indicate, we see modest overall growth this year and a moderate recession (economic contraction) beginning late this year and into mid-2023. Stocks have been anticipating some degree of economic angst, but may not yet have priced in all the bad news that we expect to see over the coming six or nine months. This is why neither we nor anyone else can reliably call a stock market bottom at this point, and why we are aiming to keep portfolios in the more defensive posture that we have been favoring since March of this year.

The Federal Reserve's (Fed's) rate-hiking strategy is aimed at cooling inflation by reducing the level of demand (spending) in the domestic economy. That policy approach is moving ahead with additional interest rate increases on the horizon at both the November and December Federal Open Market Committee (FOMC) meetings. Inflation remains at a high level, and our central bankers have made it clear that meaningfully reducing price pressures is Job One. We see inflation this year, as measured by the Consumer Price Index (CPI), coming in at 7.7%. While still well above what the Fed wants to see, the good news is we see headline CPI falling to 2.4% in 2023 as the domestic and global economies slow, U.S. consumer spending eases, and the unemployment rate climbs to just over 5% by the end of next year.

Our outlook calls for brighter skies to be on the horizon in the second half of next year. Whether a short-term investor or a long-term investor, we favor patience. We believe this upcoming recession should not look or feel like 2008 again, and potential buying opportunities are on our expected horizon in the coming months. In the meantime, capital preservation is key, and we favor quality equity sectors and short-term fixed income while we await broadly more positive market views.

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Definitions

Consumer Price Index (CPI) produces monthly data on changes in the prices paid by urban consumers for a representative basket of goods and services.

S&P 500 Index is a market capitalization-weighted index composed of 500 widely held common stocks that is generally considered representative of the US stock market.

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