MONTH IN REVIEW

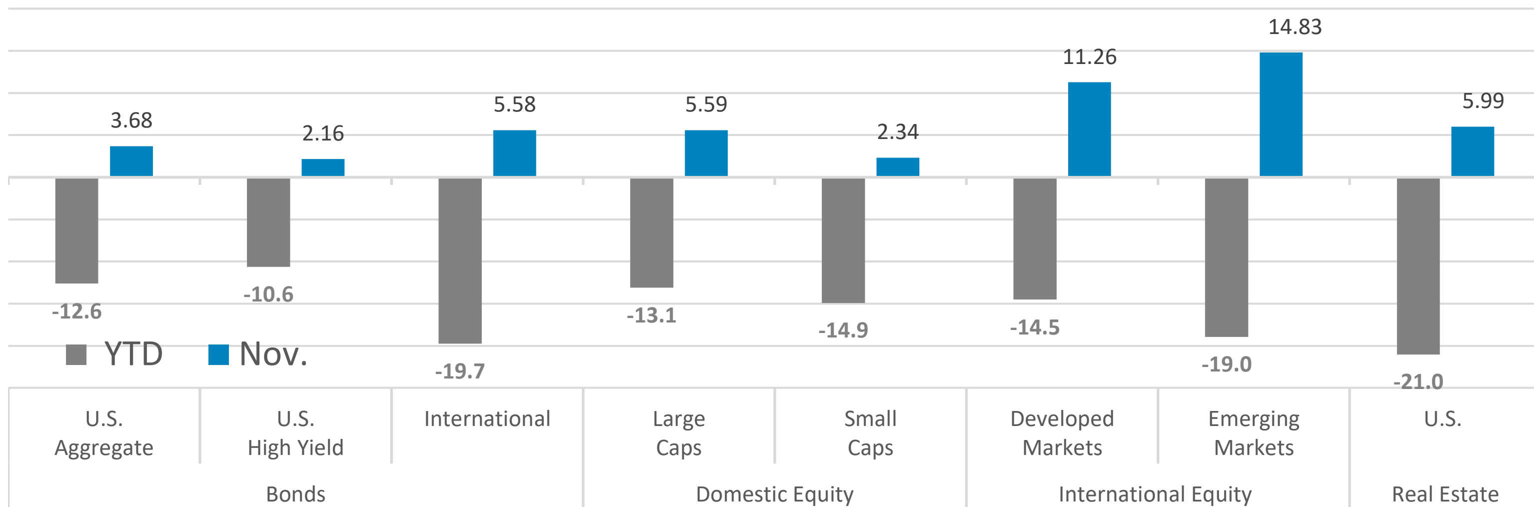
November 2022

Quick Takes

- **Risk Assets Catch a Bid.** Risk assets screamed ahead for the month of November after the inflation reading, as measured by the Consumer Price Index (CPI), came in softer than expected.
- **Will the Fed Slow its Tightening?** With inflation coming in softer than expected, market participants began to speculate that the Fed will slow its pace of monetary tightening in the coming months. Chairman Powell's commentary at the end of the month hinted that further hikes in interest rates may be smaller in the future but that rates will likely be higher for longer.
- **Greenback Weakens on Fed Speculation.** After a massive run up for the year thus far, the dollar finally began to weaken against other major currencies on the back of speculation that interest rate hikes conducted by the Fed may moderate in the future.
- **Economic Production and Labor Markets.** Despite inflation coming in below market expectations, annualized GDP for the third quarter of the year came in above expectations. Additionally, the Job Openings and Labor Turnover Survey (JOLTS) came in above survey estimates as well, hinting that the labor markets remain very tight despite the Fed's year-to-date actions to tighten monetary conditions.

Asset Class Performance

Market participants went risk on for the month of November. While bonds and stocks alike were well into the green for the month, International and Emerging Markets were the best performing asset classes on the back of the dollar depreciating compared to other currencies and speculation that China may slacken their Covid protocol.



Source: Bloomberg, as of December 31, 2021. Asset-class performance is presented by using total returns for an index proxy that best represents the respective broad asset class. U.S. Bonds (Barclays U.S. Aggregate Bond TR), U.S. High Yield (Barclays U.S. HY 2% Issuer-Capped TR), International Bonds (Barclays Global Aggregate ex USD TR), Large Caps (S&P 500 TR), Small Caps (Russell 2000 TR), Developed Markets (MSCI EAFE NR USD), Emerging Markets (MSCI EM NR USD), Real Estate (FTSE NAREIT All Equity REITS TR).

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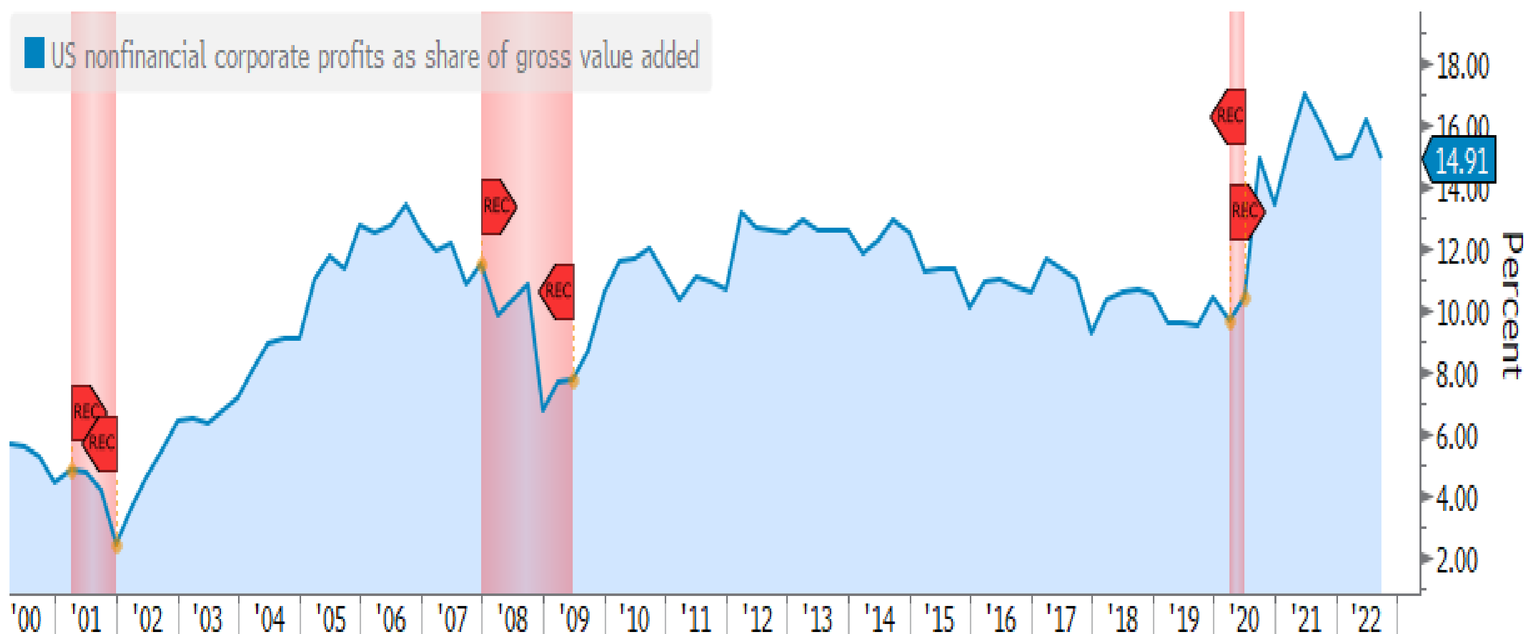
Markets & Macroeconomics

Economy Is Resilient Despite Monetary Tightening

Corporate Profits Slipped but Weather the Storm

US Nonfinancial Corporate Profits as Share of Gross Value Added



Source: US Department of Commerce, Bloomberg

With a vast majority of companies now having third quarter results in the books and reconciled, corporate profits were surprisingly resilient given the year-to-date macro backdrop of rising input and labor costs as well as the Fed's rapid and decisive action to tighten monetary conditions in the economy. As illustrated in the chart above, corporate profits retreated from their peak but remain well above levels seen pre-pandemic. While its encouraging to see that corporate profits have not taken a nosedive on the back of these difficult macro conditions, it should come as no surprise to anyone that if input costs are rising and financial conditions are tighter, that to retain these levels of profit, corporations must pass these increases on to the end consumer. Many consumers have already felt this pain at the checkout register individually, but overall US Personal Consumption for the third quarter came in above expectations of +1.6% at +1.7% (source: Bureau of Economic Analysis). Despite consumers spending more than expected, inflation, as measured by the Consumer Price Index ("CPI"), came in softer than expected for the month of October at +7.7% on the year-over-year metric versus market expectations of +7.9% (source: Bureau of Labor Statistics). Digging into the underlying CPI components, services were flat from the previous readings and there was less of increase in the energy, food, and commodities portion as compared to. the previous reading. Again, this further illustrates that businesses are passing along cost increases to the consumer, but we are starting to see some hints in price increases moderating at some of the areas worst hit by the pandemic, i.e., energy and commodities. As we continue to see the Fed maintain tight, and possibly continue to tighten, financial conditions to moderate aggregate demand, it's possible that consumers may start to see less price increases in the future as the effects of slowing down the economy work their way through the system.

Bottom Line: Overall, corporations have been relatively successful at passing increased input and labor costs onto the end consumer, which means that profit margins have been resilient despite the difficult backdrop of high inflation and the Fed tightening financial conditions. As many consumers have already noticed, this means higher prices at the checkout register, but with CPI coming in below expectations, this could be a hint that price hikes have peaked and may start to moderate as the effects of the Fed's swift tightening of monetary conditions continue to work their way through the US economy.

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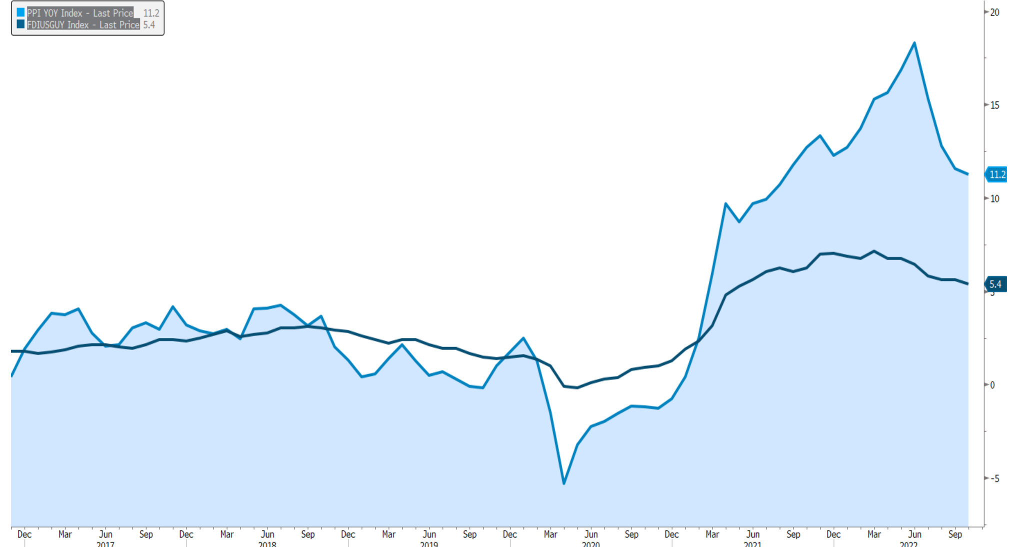
What’s Ahead

Labor Markets, Production, and the Fed’s Path Ahead

Goods and Services are Showing Signs of Disinflation

US PPI Final Goods and PPI Final Services

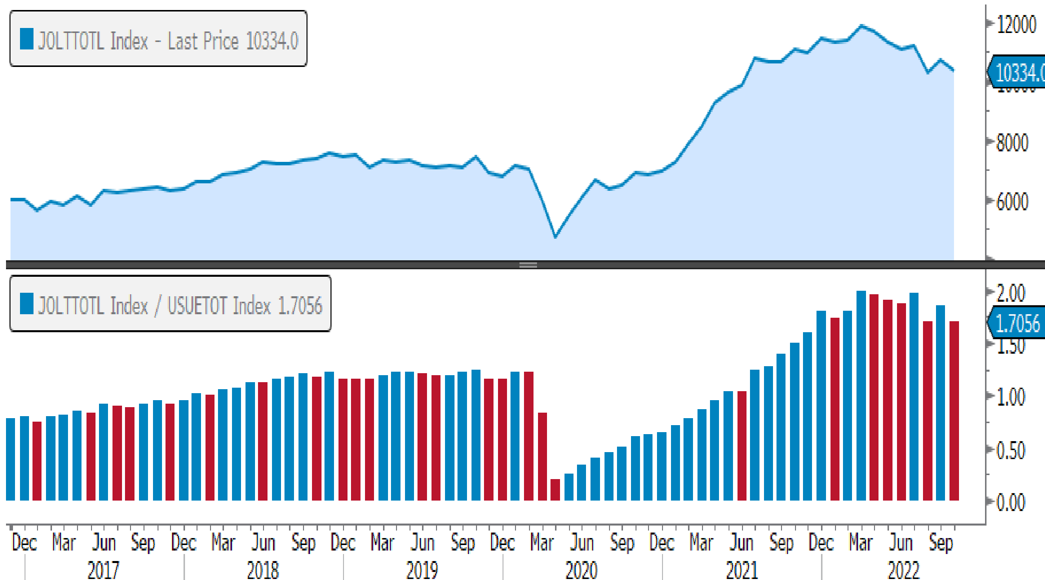


Source: Bureau of Labor Statistics, Bloomberg

As mentioned on the previous page, the Fed’s monetary tightening conducted this year has begun to show signs of working its way through the economic system. The Fed’s tightening of financial conditions has been a combination of interest rate increases as well as allowing their balance sheet to runoff, which means that as bonds that the Fed had purchased mature, they are not buying new bonds. The goal is to wrestle inflation back to its target range by cooling the economy. By raising interest rates, the Fed is reducing the appeal of financing purchases (both to the consumer and businesses) via the debt market. As interest rates increase, the cost to service new loans is higher for consumers and businesses alike. For consumers, this likely means less big purchases, i.e., a new house or car, and businesses will be less likely to expand operations into new ventures or products or delay upgrading existing equipment. If consumers are curbing back some of their purchases and businesses are also managing their expenses more prudently, this should help to whittle demand down over time. As illustrated in the chart above, final demand of goods and services, as measured by the Producers Price Index (“PPI”) are starting to show signs of disinflation, which means that the rate of increase in prices is slowing. If this trend of disinflation continues, its effects should start to work its way into inflation data readings, like we saw in the CPI for the November release. Additionally, as demand for goods and services moderates, businesses will have less need to hire additional workers and with consumers facing high prices and possibly high costs of taking on additional debt, labor markets should begin to slacken. As illustrated in the lower chart, the Job Openings and Labor Turnover Survey (“JOLTS”) has been trending lower in recent readings and there are now approximately 1.71 available jobs per unemployed worker. As labor markets slacken, this should temper wage growth, which should also have effects on inflation. All of this to say that it appears that the Fed is making progress to taming inflation but still has work to go. It remains to be seen if the Fed will take their foot off the gas for tightening financial conditions or continue the current path until data shows a clear and sustainable trend.

JOLTS Surprises to Upside, but Trending Lower

JOLTS (Top), Ratio of Open Jobs to Unemployed Workers



Source: Bureau of Labor Statistics, Bloomberg

<u>Bottom Line</u>: Demand for goods and services are starting to show moderation and the labor market is showing some signs of slackening. It will take some time for this data to work its way to inflation, but this could be the initial signs that the Fed is making progress to taming inflation and may be able to slow the pace of tightening financial conditions in the months ahead.

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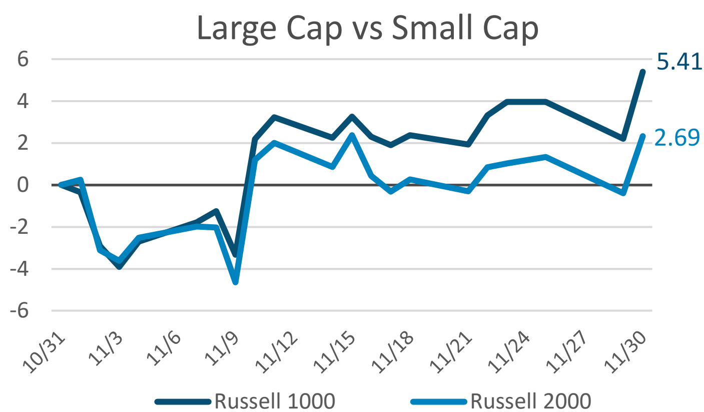
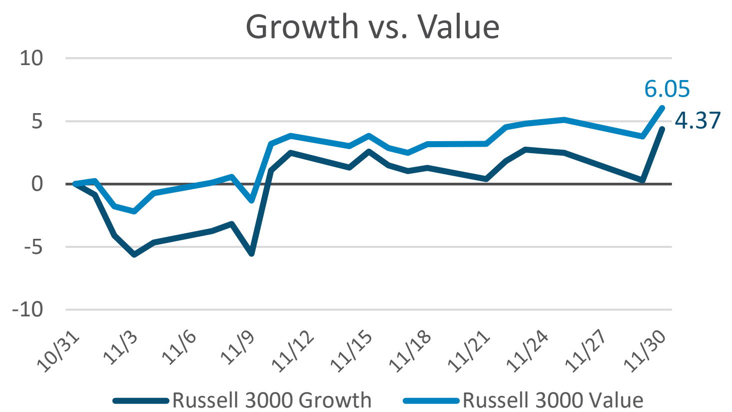
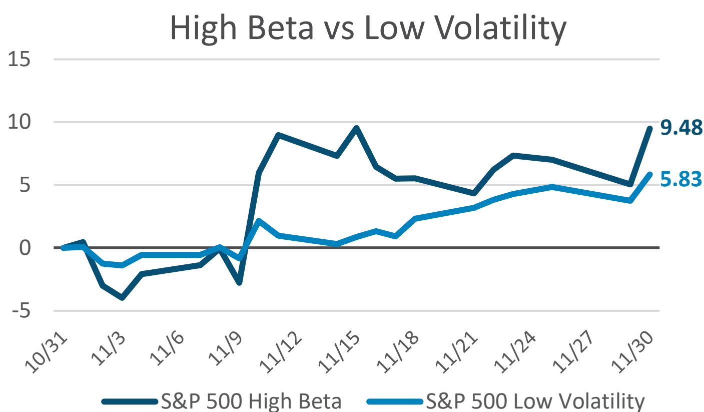
Equity Themes

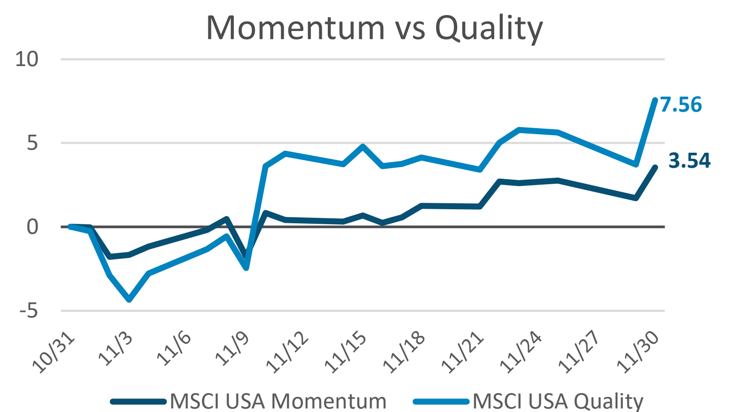
What Worked, What Didn't

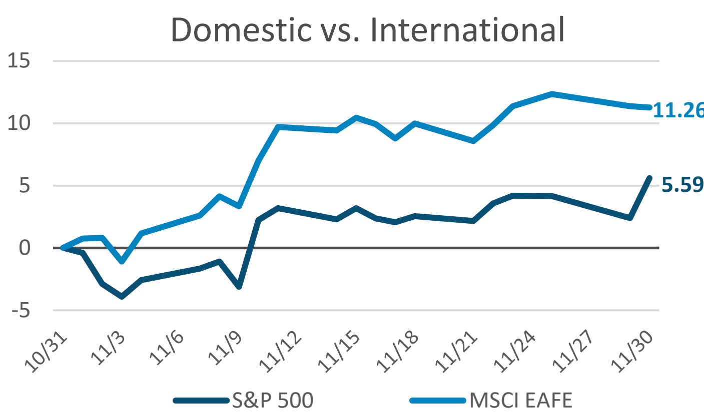
- **Large over Small, Value over Growth.** Small Caps spent the first half of the month closely tracking their Large Cap peers, but Large Caps posted a strong margin of outperformance by the end of the month. Value equities outperformed their Growth peers, but both posted a solid month of positive performance.
- **High Beta and Quality Outperform.** High Beta equities had a stellar month, outperforming their Low Volatility peers and Quality nearly doubled the performance of Momentum equities for November.
- **International Crushes Domestic, Emerging Over Everything.** On the back of speculation that China is beginning to loosen their Covid protocols, Emerging Markets equities were one of the top performing asset classes for the month of November. Hot on their heels, Developed International equities also posted a strong month, candidly outperforming Domestic equities for the month.

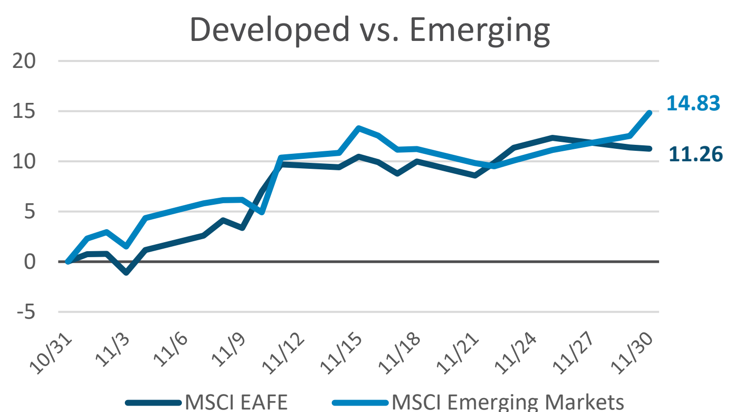












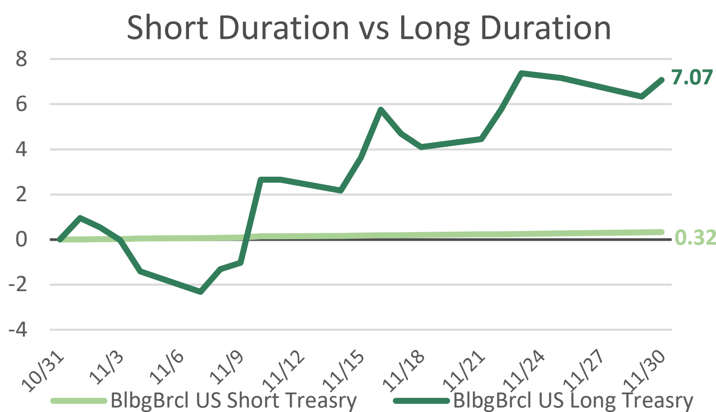
Source: Bloomberg.

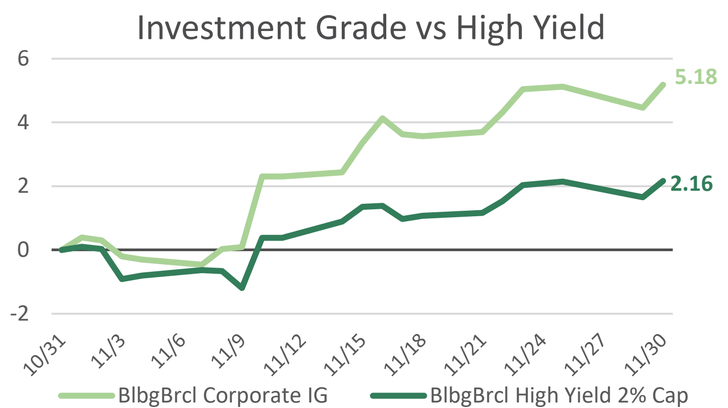
November 2022

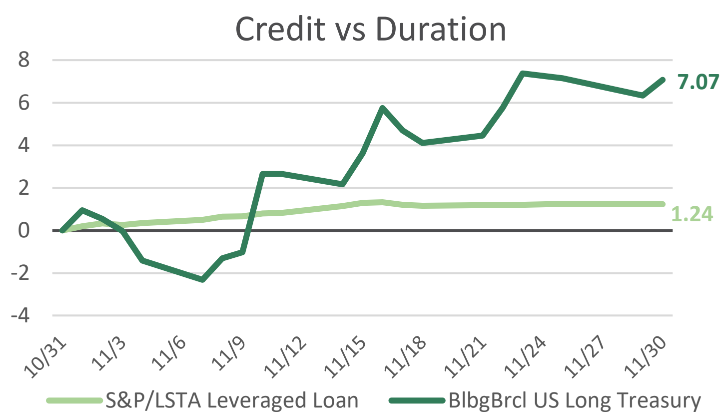
Bond Themes

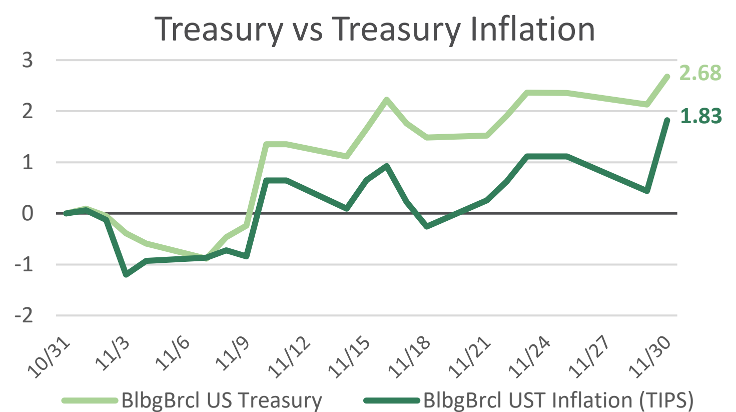
What Worked, What Didn't

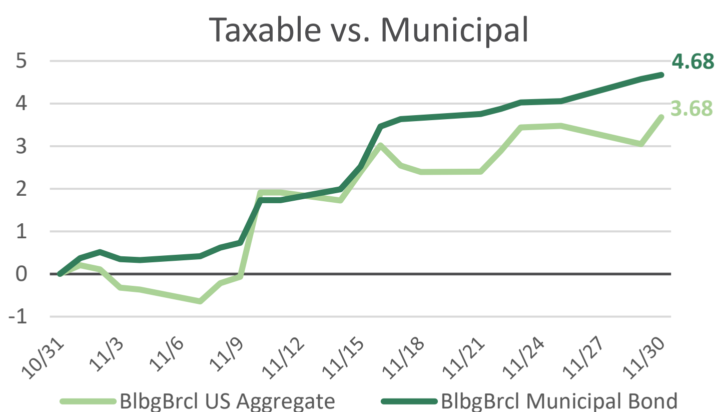
- **Go Long and High Quality.** Longer Dated bonds posted a solid margin of outperformance versus their Shorter Duration peers. It paid to be in quality for the month as well, with Investment Grade outperforming their low-quality peers.
- **Duration over Credit, Treasury over TIPS.** With inflation coming in softer than expected, it's of little surprise that TIPS underperformed for November. With rates retreating from their peak, it paid to be in longer Duration bonds versus Credit for the month.
- **Munis and International Outperform.** Munis posted a decent margin on Corporates and International bonds outperformed their Domestic peers with the dollar falling.

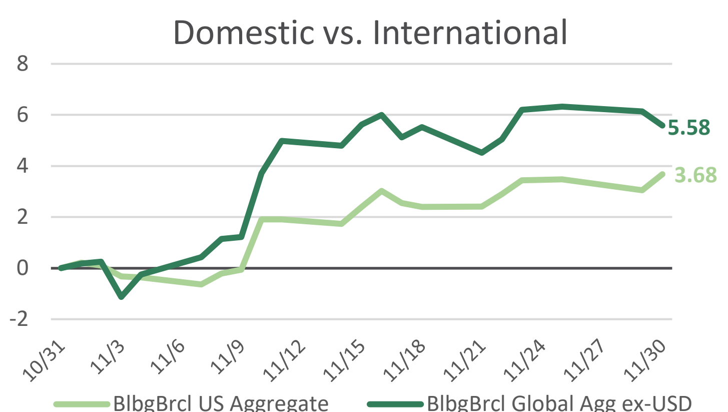












Source: Bloomberg.

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Asset Class Performance

The Importance of Diversification. From period to period there is no certainty what investment will be the best, or worst, performer. Diversification mitigates the risk of relying on any single investment and offers a host of long-term benefits, such as less portfolio volatility, improved risk-adjusted returns, and more effective compounding.

	Nov-01	Nov-02	Nov-03	Nov-04	Nov-07	Nov-08	Nov-09	Nov-10	Nov-11	Nov-14	Nov-15	Nov-16	Nov-17	Nov-18	Nov-21	Nov-22	Nov-23	Nov-25	Nov-29	Nov-30	Nov	YTD
High	EM 1.84	USB -0.17	EM 0.58	EM 4.23	LCG 1.04	IEQ 1.13	USB 0.12	RE 7.28	EM 2.72	IBD -0.22	EM 2.29	IBD 0.74	EM 0.18	RE 1.24	RE 0.54	LCG 1.41	IBD 1.25	RE 0.66	EM 2.15	LCG 4.09	EM 13.50	LCV -3.96
	IEQ 0.79	IBD -0.71	RE -0.07	IEQ 4.01	LCV 0.85	MCG 0.75	IBD -0.37	LCG 7.01	IEQ 1.99	USB -0.28	SCG 1.73	USB 0.62	IEQ -0.05	MCV 0.73	MCV 0.02	IEQ 1.39	IEQ 1.10	IEQ 0.51	RE 1.67	MCG 3.34	IEQ 12.28	MCV -7.56
	HYB 0.60	EM -0.83	USB -0.37	IBD 2.39	MCG 0.65	EM 0.72	RE -0.99	MCG 7.00	MCG 1.48	EM -0.60	MCG 1.65	HYB -0.21	IBD -0.22	LCV 0.66	LCV -0.01	MCV 1.38	LCG 0.96	MCV 0.34	SCV 0.58	SCG 3.00	IBD 8.54	SCV -8.61
	IBD 0.47	HYB -0.91	LCV -0.41	SCV 1.82	MCV 0.63	IBD 0.62	60/40 -1.14	SCG 6.44	LCG 1.48	HYB -0.74	LCG 1.19	IEQ -0.23	LCV -0.35	SCV 0.61	HYB -0.04	MCG 1.34	EM 0.82	LCV 0.29	MCV 0.54	EM 2.89	60/40 6.66	HYB -9.14
	MCG 0.41	60/40 -1.42	MCG -0.41	MCV 1.62	SCG 0.50	LCG 0.58	HYB -1.19	SCV 5.67	SCG 1.11	60/40 -0.77	RE 1.15	60/40 -0.32	60/40 -0.38	SCG 0.58	USB -0.06	LCV 1.31	MCG 0.79	SCV 0.28	HYB 0.43	SCV 2.35	RE 6.37	USB -11.16
	60/40 0.34	IEQ -1.46	MCV -0.44	60/40 1.59	SCV 0.43	60/40 0.58	IEQ -1.40	IEQ 5.61	IBD 1.05	LCV -0.77	SCV 1.09	LCV -0.80	USB -0.42	MCG 0.50	SCV -0.18	IBD 1.23	60/40 0.71	MCG 0.24	LCV 0.32	MCV 2.29	LCV 5.95	IEQ -11.99
	MCV 0.30	LCV -1.92	SCG -0.49	LCV 1.49	IEQ 0.31	LCV 0.49	EM -1.73	MCV 5.43	MCV 0.97	SCG -1.02	MCV 0.99	RE -0.91	HYB -0.43	HYB 0.22	60/40 -0.40	SCV 1.10	USB 0.60	60/40 0.10	IEQ 0.29	RE 2.26	MCV 5.92	60/40 -13.34
	LCV 0.21	MCV -2.39	60/40 -0.58	RE 1.39	60/40 0.24	RE 0.46	LCV -1.82	LCV 4.39	60/40 0.94	IEQ -1.05	60/40 0.97	LCG -0.94	LCG -0.47	IEQ 0.20	MCG -0.56	SCG 1.06	HYB 0.56	SCG 0.04	60/40 0.17	LCV 2.13	LCG 5.51	EM -18.35
	SCG 0.19	RE -2.68	SCV -0.62	LCG 1.02	IBD 0.23	USB 0.43	MCV -1.87	60/40 4.34	LCV 0.71	SCV -1.09	HYB 0.88	MCV -1.13	MCV -0.64	LCG 0.20	SCG -0.74	60/40 0.96	SCG 0.49	USB 0.02	IBD 0.15	60/40 1.92	MCG 4.93	IBD -18.46
	USB 0.19	SCV -2.99	HYB -0.71	HYB 0.69	RE 0.06	MCV 0.41	SCV -2.22	EM 3.63	SCV 0.65	LCG -1.16	IBD 0.82	EM -1.60	SCV -0.73	60/40 0.13	IEQ -0.75	HYB 0.73	LCV 0.31	IBD -0.14	SCG 0.07	IEQ 1.77	USB 3.62	SCG -20.76
	SCV 0.18	LCG -3.21	IEQ -0.85	SCG 0.53	EM 0.06	SCG 0.13	MCG -2.22	IBD 3.59	HYB 0.35	MCG -1.21	USB 0.74	MCG -1.62	RE -0.80	USB -0.14	LCG -0.83	USB 0.52	MCV 0.31	HYB -0.20	MCG -0.16	HYB 1.50	HYB 2.81	MCG -21.75
	RE -0.19	MCG -3.52	IBD -1.07	MCG 0.40	HYB -0.01	SCV -0.08	LCG -2.40	HYB 3.11	USB -0.07	MCV -1.26	LCV 0.73	SCV -1.72	SCG -1.10	EM -0.58	IBD -1.00	RE 0.51	RE 0.14	LCG -0.25	USB -0.36	IBD 1.35	SCV 2.65	RE -22.13
Low	LCG -0.95	SCG -3.68	LCG -1.64	USB -0.01	USB -0.32	HYB -0.10	SCG -3.22	USB 2.15	RE -0.24	RE -2.29	IEQ 0.66	SCG -1.78	MCG -1.36	IBD -0.66	EM -1.26	EM 0.24	SCV -0.02	EM -0.47	LCG -0.65	USB 0.78	SCG 1.22	LCG -23.52

Legend

- 60/40 Allocation (60/40)
- Large Growth (LCG)
- Large Value (LCV)
- Mid Growth (MCG)
- Mid Value (MCV)
- Small Growth (SCG)
- Small Value (SCV)
- Intl Equity (IEQ)
- Emg Markets (EM)
- U.S. Bonds (USB)
- High Yield Bond (HYB)
- Intl Bonds (IBD)
- Real Estate (RE)

Source: Bloomberg. Asset-class performance is presented by using market returns from an exchange-traded fund (ETF) proxy that best represents its respective broad asset class. Returns shown are net of fund fees for and do not necessarily represent performance of specific mutual funds and/or exchange-traded funds recommended by the Prime Capital Investment Advisors. The performance of those funds June be substantially different than the performance of the broad asset classes and to proxy ETFs represented here. U.S. Bonds (iShares Core U.S. Aggregate Bond ETF); High-Yield Bond (iShares iBoxx $ High Yield Corporate Bond ETF); Intl Bonds (SPDR® Bloomberg Barclays International Corporate Bond ETF); Large Growth (iShares Russell 1000 Growth ETF); Large Value (iShares Russell 1000 Value ETF); Mid Growth (iShares Russell Mid-Cap Growth ETF); Mid Value (iShares Russell Mid-Cap Value ETF); Small Growth (iShares Russell 2000 Growth ETF); Small Value (iShares Russell 2000 Value ETF); Intl Equity (iShares MSCI EAFE ETF); Emg Markets (iShares MSCI Emerging Markets ETF); and Real Estate (iShares U.S. Real Estate ETF). The return displayed as "Allocation" is a weighted average of the ETF proxies shown as represented by: 30% U.S. Bonds, 5% International Bonds, 5% High Yield Bonds, 10% Large Growth, 10% Large Value, 4% Mid Growth, 4% Mid Value, 2% Small Growth, 2% Small Value, 18% International Stock, 7% Emerging Markets, 3% Real Estate. 120722009 MKS

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