

This month's Market Minute reflects the views of our Investment Office and was composed by [Thomas Seay, Senior Managing Director, Research](#)


OVERVIEW

October was an interesting month in that Federal Reserve speakers maintained hawkish monetary convictions, inflation remained stubbornly elevated, and interest rates continued to rise; however, risk assets looked through these roadblocks and delivered exceptional performance. For example, the Dow Jones Industrial Average – The Dow – was up 14.07%, its best month since 1976.¹ Although investment grade bond markets printed negative returns, high yield bonds, like equities, delivered positive performance.

There were bright spots to support the performance of risk assets. Outside of disappointing earnings from the Tech sector, earnings have been encouraging, with most companies that have reported showing positive surprise for both earnings and revenues. Nonfarm payrolls continue to grow at a steady pace and unemployment remains low. The challenge remains the inflation rate, that, although it has declined from lofty levels, it mostly likely remains too high for the Fed to take its foot off the monetary brake. The markets will get some clarity in early November when the Fed is expected to continue tightening monetary policy, but the market will be looking for clues as to what they will do in December and early in the new year.

U.S. EQUITY MARKETS *As of October 31, 2022*

U.S. EQUITY MARKETS				
Index	1 Month	Quarter-To-Date	Year-To-Date	1 Year
DJIA	14.1%	14.1%	-8.4%	-6.7%
S&P 500	8.1%	8.1%	-17.7%	-14.6%
Russell 2000	11.0%	11.0%	-16.9%	-18.6%
Russell 1000 Growth	5.8%	5.8%	-26.6%	-24.6%
Russell 1000 Value	10.3%	10.3%	-9.3%	-7.0%

US equities traded up over the month with small cap stocks (Russell 2000 Index +11.0%) leading the way. The S&P 500 Index returned 8.1% in October and across the market cap spectrum value stocks (Russell 1000 Value +10.3% and Russell 2000 value +12.6%) led growth stocks (Russell 1000 Growth +5.8% and Russell 2000 Growth +9.5%). US equity markets were buoyed by the notion that the Federal Reserve may soon signal that it intends to curtail the pace of rate hikes in the face of slowing global growth. This notion was buttressed by the fact that other global central banks such as the Bank of Canada and the Bank of Australia both delivered slightly smaller rate hikes in October than the markets expected and cited a need to balance fighting inflation with clear signs their economies were slowing.

INTERNATIONAL EQUITY *As of October 31, 2022*

INTERNATIONAL EQUITY MARKETS				
Index	1 Month	Quarter-To-Date	Year-To-Date	1 Year
MSCI ACWI ex USA	3.0%	3.0%	-24.3%	-24.7%
MSCI EAFE	5.4%	5.4%	-23.2%	-23.0%
MSCI Emerging Markets	-3.1%	-3.1%	-29.4%	-31.0%
MSCI EAFE Small Cap	4.2%	4.2%	-29.2%	-30.3%

International developed-market equities also traded up in October but lagged US equities. The MSCI EAFE Index gained +5.4% in October, but, unlike the US small cap stocks, modestly lagged their large cap peers (MSCI EAFE Small Index +4.2%). In contrast to the gains, the US and international developed markets, Emerging Markets (MSCI EM Index) lost -3.1% in October, dragged down by Chinese equities.

The MSCI China Index finished October down -16.8%. Chinese Communist Party (CCP) held its 20th Party Congress in October, which featured Xi Jinping receiving an unprecedented third, five-year term (See Research Corner 31-October for a deeper discussion) as leader of the CCP and therefore a new term as the leader of China. Markets did not like the consolidation of power—Xi stacked the CCP's highest deliberative body (Politburo Standing Committee) with proteges and loyalists—and the day after Xi presented his new administration, Chinese equities lost -7.5%—the second largest daily drop in 14 years¹. Despite the weakness in Chinese equities, most China watchers expect Xi's Zero-Covid Policy to continue—despite its negative impact on the economy—and more of policy emphasis on making China less reliant on foreign investment and supply chains.

FIXED INCOME *As of October 31, 2022*

FIXED INCOME MARKETS				
Index	1 Month	Quarter-To-Date	Year-To-Date	1 Year
BarCap US Aggregate	-1.3%	-1.3%	-15.7%	-15.7%
BarCap Global Aggregate	-0.7%	-0.7%	-20.4%	-20.8%
BarCap US High Yield	2.6%	2.6%	-12.5%	-11.8%
JPM Emerging Market Bond	0.1%	0.1%	-22.2%	-22.2%
BarCap Muni	-0.8%	-0.8%	-12.9%	-12.0%

U.S. interest rates continued their upward march as bond market participants become more inclined to follow the Fed than fight the Fed. As such, with the market anticipating that the Federal Funds rate will peak close to 5% (currently in the 3% - 3.25% range), short-term 3-month Treasury bills rose 80 basis points to 4.07%¹. Interestingly, one of the most accurate predictors of an economic recession is when 3-month T-bill rates are higher than the 10-year T-bond. Well, on Halloween (10/31), 3-month T-bills stood at 4.07% and the 10-year T-bond was at 4.05%¹.

Given the rise in rates, the Bloomberg Aggregate Index, Treasury Index, Investment Grade Corporate Index, and Municipal Bond Index all posted negative returns for the month. But, like the equity markets, riskier high yield and emerging market debt spreads tightened and, despite higher Treasury rates, their respective indices were positive with the Bloomberg High Yield Index delivering a positive 2.60%¹ return for the month of October.

CONCLUSION

The monetary policy goals of the Federal Reserve are to foster economic conditions that achieve both stable prices and maximum sustainable employment. The Fed has made it clear their objective is to drive down the rate of inflation from a current rate exceeding 5% (core-PCE Price Index) to 2%. In that the unemployment rate is at a low level of 3.5%, the Fed appears to have the leeway to continue to raise rates. But many market participants are anticipating the Fed will be forced to “pivot” from their current position to stave off the risk of the economy entering a deep and prolonged recession.

An old Wall Street mantra is “Don't fight the Fed” but it appears the risk markets (e.g., equities and high yield) are willing to look through the pain of higher rates in anticipation of the Fed's next monetary easing cycle. The question then is how long the pain will last and how much pain (higher interest rates) the Fed is willing to inflict. Clearstead's opinion is that we are close to the end of the rising rate cycle and that the U.S. economy is in a fairly healthy condition; as such, we believe portfolios should be positioned for markets to recover from the difficult year we have experienced so far in 2022.

SOURCES

1 Bloomberg

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