Email Body 10/13/2022

**What The Numbers Are Telling Us**

I hope all of you are as happy as I am to be done with September and to move into the fourth quarter which contains several good-eating holidays. I am thankful that we live in a country where despite our internal quarrels, we still manage to thrive compared to the rest of the world. No doubt we are going through a challenging period, but we have been there before, and we will get through this.

Historically, September has been one of the worst performing months for the stock market, and it did not disappoint this year. The S&P 500 index lost 9.21%; the Dow Jones Industrial Average dropped 8.76% and the Nasdaq Composite dropped 10.44% for the month. International developed and emerging markets had similar experiences. We are officially in bear market territory.

For the most part, interest rates drove the markets in the third quarter. The Federal Reserve raised its Fed Funds rate 1.25% during the third quarter resulting in the 10-year treasury bond rate rising by almost 1.00% during the same time period. Also, Jerome Powell, the Federal Reserve Chairman, repeatedly committed to raising interest rates in the future to combat inflation. I anticipate more increases in the Fed Funds rate totaling 1.25% by the end of this year. Higher rates typically mean lower stock valuations as investors anticipate reduced earnings.

There are, however, some positive numbers and trends that give me hope for a better forth quarter in the markets. The service sector purchasing manager index declined less than expected to 56.7 which is still solidly in growth territory. Over 263,000 jobs were added during September marking the 21st consecutive month of job growth. Unemployment fell to 3.5%. The interest rate spread between the 90-day T-bill and the 10-year Treasury bond steepened to a positive 0.50% (i.e., a negative spread is a recession indicator). Consumer confidence is recovering as the Conference Board’s consumer confidence index increased to 108 in September from August’ 103.6 level. Other hopeful signs include falling shipping costs, retail inventory liquidation and falling commodity prices (except oil). The conclusion is that economic growth remains the most likely outcome in the next quarter or two. What happens after that depends on the Federal Reserve’s actions.5

Besides interest rates the other main driver to stock market performance is earnings. We are now entering the third quarter earnings reporting season and early reports are showing positive surprises compared to sales and earnings expectations. The piece I have attached by Brad McMillan delves more deeply into this subject but suffice it to say he believes sales and earnings will generally surprise to the upside which would be an offset to the impact of rising interest rates.

The overall bottom line is that the Federal Reserve interest rate hikes (and reduction of its bond portfolio at the rate of $95B per month) are starting to have the effect of slowing the economy. The main questions market participants have is (1) when will the Federal Reserve stop raising interest rates, and (2) how much of the economic damage rising interest rates cause has been already priced into market valuations. The answer to the first question depends on when inflation begins to moderate. Based on this weeks PPI and CPI releases I think we can expect increases totaling another 1.75% over the next six months. I do think the 1.25% increase by year-end I previously mentioned is already priced into the market. So, let’s see what happens with inflation reports in November and December to gauge what the Fed might do next year.

Plenty of risks remain and volatility is to be expected. However, I think the prospects for the fourth quarter are better than the third as earnings uncertainty’s are resolved. Mid-term years are typically volatile, but markets do tend to rally after elections. Let’s hope that is the case this year.

I continue to recommend for long-term oriented investments, that you maintain your current allocation strategies if your risk profiles and time horizons remain long-term (i.e., 4-5 years or more).

Make sure that funds you know you will need in the short-term are safe to relatively safe from volatility and that your long-term oriented investments are well diversified and subject to risk and volatility levels you are able to be comfortable with. If you have any questions or concerns about these things, please call me to discuss them further.

I am always available to you via phone, zoom conference or in person. I look forward to talking with you over the next few weeks. If you have any questions or if we can be of any help, please do not hesitate to contact Linda or me.

*Certain sections of this commentary contain forward-looking statements that are based on our reasonable expectations, estimates, projections, and assumptions. Forward-looking statements are not guarantees of future performance and involve certain risks and uncertainties, which are difficult to predict. Past performance is not indicative of future results.*

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