



THIRD QUARTER 2022 RECAP: MARKET ANALYSIS



The US economy continued to have difficulty in the quarter, as surging inflation and the effects of central bank efforts to tame it, have caused growth to turn negative. Against this backdrop, the Bureau of Economic Analysis released the third estimate of the second quarter 2022 real GDP, a seasonally adjusted annualized decline of 0.6%, in line with the prior estimate, and a slight improvement from the 1.6% decrease in the prior quarter. The employment situation continued to show a strong trend in the quarter, as gains modestly exceeded expectations. The August report showed that employers added 315,000 jobs in the month, and that the unemployment rate rose to 3.7%. The Federal Open Market Committee (FOMC), in an effort to aggressively battle surging inflation, twice raised its federal funds rate target range in the quarter, to 3.00% to 3.25%, from a range of 1.50% to 1.75%. The 75-basis point increase on September 21st was the third this year, and many economists expect the FOMC to continue to aggressively raise rates until inflation is under control.

The decline in stock prices experienced during the first two quarters extended into the third quarter as the FOMC remained aggressive in raising interest rates to combat historically high inflation. Recession now seems likely if the economy has not already entered one, and investors are becoming anxious, liquidating stocks and sending broad-based indices into a bear market. In addition, supply chain bottlenecks remained, as have the issues in the energy and agriculture segments resulting from the ongoing war in Ukraine. The S&P 500 began the quarter by rising steadily, reaching its peak in mid-August, but then experienced a steady decline into the end of the quarter. Many major stock indices ended the quarter in bear market territory (a decline of at least 20%). When the quarter ended, the S&P 500 Index had declined 4.9%, and is down 23.9% year-to-date.

Performance of the 11 primary economic sectors was largely negative during the quarter. Consumer Discretionary, Energy, and Financials were the strongest performers on a relative basis, generating returns of +4.4%, +2.4%, and -3.1%, respectively. The Communications Services, Real Estate, and Materials sectors were the poorest relative performers, posting returns of -12.7%, -11.0%, and -7.1%, respectively. The Russell 1000 Index of large capitalization stocks generated a -4.6% total return.

Within the large cap segment, growth stocks outperformed value stocks. Small cap stocks, as represented by the Russell 2000 Index, slightly outperformed large caps, and finished the quarter with a total return of -2.2%. Small cap value underperformed small cap growth. The NASDAQ Composite, dominated by information technology stocks, finished the quarter with a loss of 3.9%. The Dow Jones Industrial Average of 30 large industrial companies declined by 6.2%. Real Estate Investment Trusts (REITs) were lower during the quarter, with the DJ US Select REIT Index down 10.4%. Commodities also had a difficult time in the quarter, with the Bloomberg Commodity Index declining by 4.1%.



International stocks also generated very poor results during the quarter, and generally perform in line with US equities. The MSCI ACWI Ex-USA Index, which measures performance of world markets outside the US, fell by 9.9%. The MSCI EAFE Index of developed markets stocks were lower by 9.4%. Regional performance was mostly negative for the quarter. Latin America was the strongest performer on a relative basis, with a return of 3.6%. China was the poorest relative performer, declining 22.5%. Emerging markets stocks were lower, as the MSCI Emerging Markets Index fell by 11.6%.

Fixed income securities' prices were materially lower (and yields higher) for the second consecutive quarter, as inflation stubbornly remained near 40-year highs. The FOMC remained aggressive in its attempts to fight the high inflation, by continuing to remove the accommodative monetary policy that has been in place for almost 15 years. Economic growth was negative for the second quarter in a row, and inflation's surge has been prompted by ongoing supply chain issues, among other causes. As mentioned above, the FOMC raised the target range on the fed funds rate to 3.00%-3.25%, from the prior range of 1.50%-1.75%. The committee indicated that it will remain vigilant in bringing down inflation, and analysts expect additional increases of 75 and 50 basis points in November and December, respectively. The consensus is that additional hikes are likely in 2023, with the fed funds rate expected to end 2023 at 4.6%.

OUTLOOK

The global economy is currently teetering on the brink of recession after having delivered a strong post-pandemic recovery. Decades-high inflation caused by supply shortages and rising commodity prices - as well as an aggressive central bank policy response - is undoing the global expansion. In addition, China's economy is facing many challenges, led by a cooling property market. Despite the recent slowdown, analysts expect the global economy to end up with modestly positive growth at year end. Prices have increased for 12 consecutive months, and the inflation rate is at its highest level in more than 40 years. Three primary culprits for the spike in inflation are supply chain bottlenecks that persist from the pandemic lockdowns, the disruption of energy and food supplies resulting from the war in Ukraine, and the trillions of dollars in fiscal stimulus coursing through the economy. With a slowing world economy and high inflation economists are concerned about "stagflation." While there are a few bright spots in the data, including robust employment reports, economists remain subdued regarding the outlook for the economy, citing uncertainty on the supply chain and inflation fronts, as well as an increasingly volatile geopolitical environment.

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The **S&P 500 Index** is an unmanaged index comprising 500 widely held securities considered to be representative of the stock market in general. The **MSCI EAFE Index** represents 21 developed markets outside North America. The **MSCI Emerging Markets Index** is a market-capitalization index that is designed to measure equity market performance in the global emerging markets. The **Russell 2000 Index** is an unmanaged market-capitalization-weighted index measuring the performance of the 2,000 smallest US companies, on a market capitalization basis, in the Russell 3000 Index. The **Bloomberg U.S. Corporate High Yield Index** covers the USO-denominated, non-investment grade, fixed-rate, taxable corporate bond market. Securities are classified as high yield if the middle rating of Moody's, Fitch, and S&P is Ba1/BB+/BB+ or below. The Index may include emerging markets debt. The **Bloomberg Municipal Bond Index** is a widely recognized, unmanaged index of municipal bonds with maturities of at least one year. The **NASDAQ Composite** is an index of the common stocks and similar securities (e.g., AD Rs, tracking stocks, limited partnership interests) listed on the NASDAQ stock market, meaning that it has more than 3,000 components. It is highly followed in the US as an indicator of the performance of stocks of technology and growth companies. Since both US and non-US companies are listed on the NASDAQ stock market, the Index is not exclusively a US index. The **MSCI Europe Index** captures large and mid cap representation across 15 developed markets countries in Europe.* With 432 constituents, the Index covers approximately 85% of the free float-adjusted market capitalization across the European Developed Markets equity universe. The **Russell 1000 Index** is a market-capitalization-weighted benchmark index made up of the 1000 largest US companies in the Russell 3000 Index. The **Dow Jones Industrial Average** is a price-weighted average of 30 significant stocks traded on the New York Stock Exchange and the NASDAQ. The **MSCI ACWI Ex-U.S. Index** is a market-capitalization-weighted index maintained by Morgan Stanley Capital International (MSCI) and designed to provide a broad measure of stock performance throughout the world, with the exception of US-based companies. The **MSCI All Country World Index Ex-U.S.** includes both developed and emerging markets. The MSCI China Index captures large and mid cap representation across China H shares, B shares, Red chips, and P chips. With 143 constituents, the Index covers about 85% of this China equity universe. The **MSCI Emerging Markets (EM) Asia Index** captures large and mid cap representation across 8 emerging markets countries (China, India, Indonesia, Korea, Malaysia, the Philippines, Taiwan, and Thailand). With 535 constituents, the Index covers approximately 85% of the free float-adjusted market capitalization in each country. Sector performance is represented by the **Global Industry Classification Standard (GICS)** sectors, developed by Standard & Poor's and MSCI Barra. The **CBOE Volatility Index (VIX)** is an up-to-the-minute market estimate of expected volatility that is calculated by using real-time S&P 500 Index option bid/ask quotes. The Index uses nearby and second nearby options with at least 8 days left to expiration and then weights them to yield a constant, 30-day measure of the expected volatility of the S&P 500 Index.

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