Convergence Commentary

November 2022 Market Recap

Quick Hits:

- CPI cooled more than expected, leading to optimism about the Fed's ability to fight inflation.
- Stocks once again rebounded nicely in November, driven by a cooler-than-expected inflation report leading to renewed hope around the peak inflation narrative.
- The Dow entered a new bull market on the last day of November – defined as closing 20% above a bear market low – while the S&P 500 is 17% off its lows and the Nasdaq is almost 14% off its lows.

Market-Moving Highlights

CPI increased 7.7% year over year in October, which is the largest deceleration so far in 2022, while core inflation also cooled, coming in at 6.3% year over year. Both food and energy prices increased in October, as the two components continued to be volatile. The core inflation reading slowed due to a decline in prices for used vehicles, apparel, and medical care services, while transportation services and shelter increased in October. After CPI was reported, markets had their best rally since April 2020, with the S&P 500 up over 5% and the Nasdaq up over 7%. The report sparked renewed hope that we have seen peak inflation, meaning the Fed's rate hikes have started to work, will continue to do so, and that they can start to slow the pace of hikes. Jerome Powell made it clear when he spoke on November 30th that they planned to begin slowing hikes in December but were not ready to say they were done conducting restrictive policy.

The bond market also experienced a significant rally on the day of the CPI report with rates falling from about 4.2% to 3.8% and have since stabilized around this level since the day of the report. Volatility in the equity markets throughout the year was driven partially by the rapid rise of interest rates. As we have discussed before, rising interest rates can cause stock prices to fall because they are used as a discount rate when valuing stocks, so stabilization in the bond market should be seen as positive for both the stock market and the economy.

Earnings for the third quarter provided a mixed picture that reflects the current economic environment. While earnings for the S&P 500 did grow, they had the lowest growth rate since the pandemic started, reflecting the economic pressure on companies from inflation, a rising US dollar, and a slowing consumer. In addition, if the energy sector were to be removed from the earnings growth rate of the S&P 500, the S&P 500 would have had contracting earnings. Generally, companies were conservative with their guidance, reflecting the economic uncertainties that are ahead.

FTX, a major cryptocurrency exchange, filed for bankruptcy in November after they were unable to meet withdrawal requests from customers because of risky trading practices. Sam Bankman-Fried, the founder and former CEO of FTX, was formerly considered to be the leader of the cryptocurrency industry, so the news came as a major surprise. Luckily, it does not appear the bankruptcy of FTX is going to affect the rest of the financial markets much, if at all. There could be more bankruptcies to follow in the cryptocurrency industry, but up to this point, they have been contained to companies and exchanges that were affiliated with FTX.

Index Performance

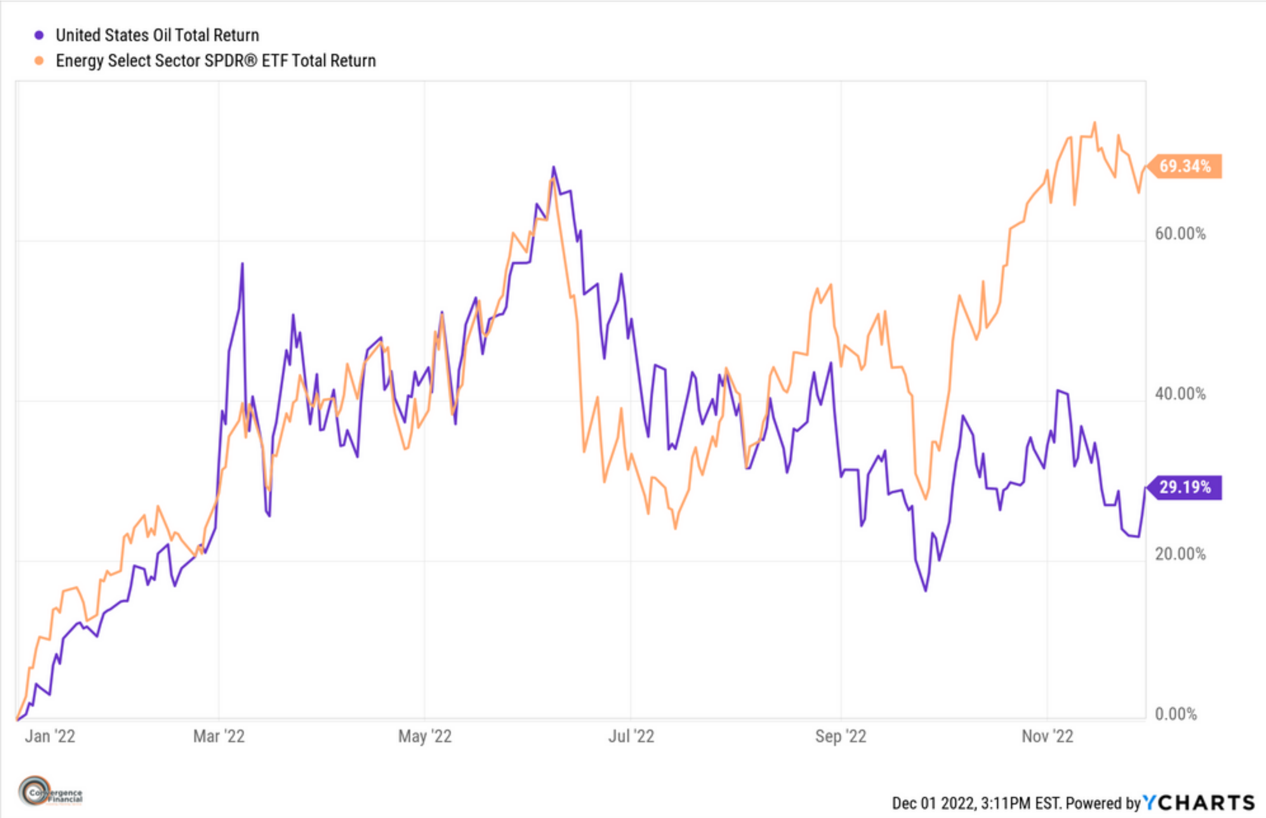
Index	1 Month	YTD	1 Year	5 Year
S&P 500	4.81%	(13.10%)	(9.21%)	10.98%
Nasdaq Composite	3.43%	(26.13%)	(25.59%)	11.78%
Russell 2000	2.33%	(14.91%)	(13.01%)	5.45%
MSCI ACWI ex US	11.94%	(14.97%)	(11.43%)	1.96%
S&P US Aggregate Bond	2.62%	(13.14%)	(13.11%)	0.05%

All the major indexes posted positive returns in November for a second consecutive month for the first time in 2022. The rally started to pick up steam in October and was magnified when CPI was reported. On the day of the CPI report, the S&P 500 rallied 5.5% and the Nasdaq rallied 7.4%, as investors viewed the lower-than-expectation CPI report as a relief from the high inflationary and Fed tightening narrative that has been weighing on the markets for most of the year. Markets were also in oversold territory and there was significant cash on the sidelines leading up to the day of the report. Adding these up allowed markets to have their best day since April of 2020. There was also a significant rally on the last day of November when Jerome Powell spoke and clarified the Fed's direction, saying that the Fed will begin to ease rate hikes in December. The market had already priced in a 50 basis point hike, but his comments provided greater clarity. Bonds also performed well after the report, as rates declined significantly allowing bond prices to increase. Finally, international stocks also performed well, aided specifically by the US dollar declining and hope that China is finally cutting back on their zero-Covid policy that has caused their economy (and global supply chains) to struggle.

S&P 500 Sector Highlights & Commentary

Best Performing Sectors		Worst Performing Sectors	
Materials	10.70%	Consumer Discretionary	0.83%
Industrials	7.50%	Energy	2.13%
Real Estate	6.57%	Health Care	4.64%

Once again, all the major sectors were positive in November, as the market rally was broad. Materials and industrials were leaders as both tend to be highly sensitive to the direction of the economy. With the market seeing some chance of the economy achieving a soft landing, both sectors responded positively. Real estate rebounded nicely as well in response to falling mortgage rates. Consumer discretionary relatively struggled as earnings were disappointing for major companies within the sector like Amazon and Target. Meanwhile, Tesla, the second biggest company in the sector, has been left out of the recent rally largely because of Elon Musk's acquisition of Twitter and concern surrounding Musk's ability to run all his companies. The Energy sector was able to post positive returns despite oil prices falling in November, which may come as a surprise, but companies have been reporting record profits and the correlation between Energy stocks and oil prices has been declining since the middle part of the year. The divergence of oil prices and Energy sector performance can be seen in the chart below.



What to Watch in December

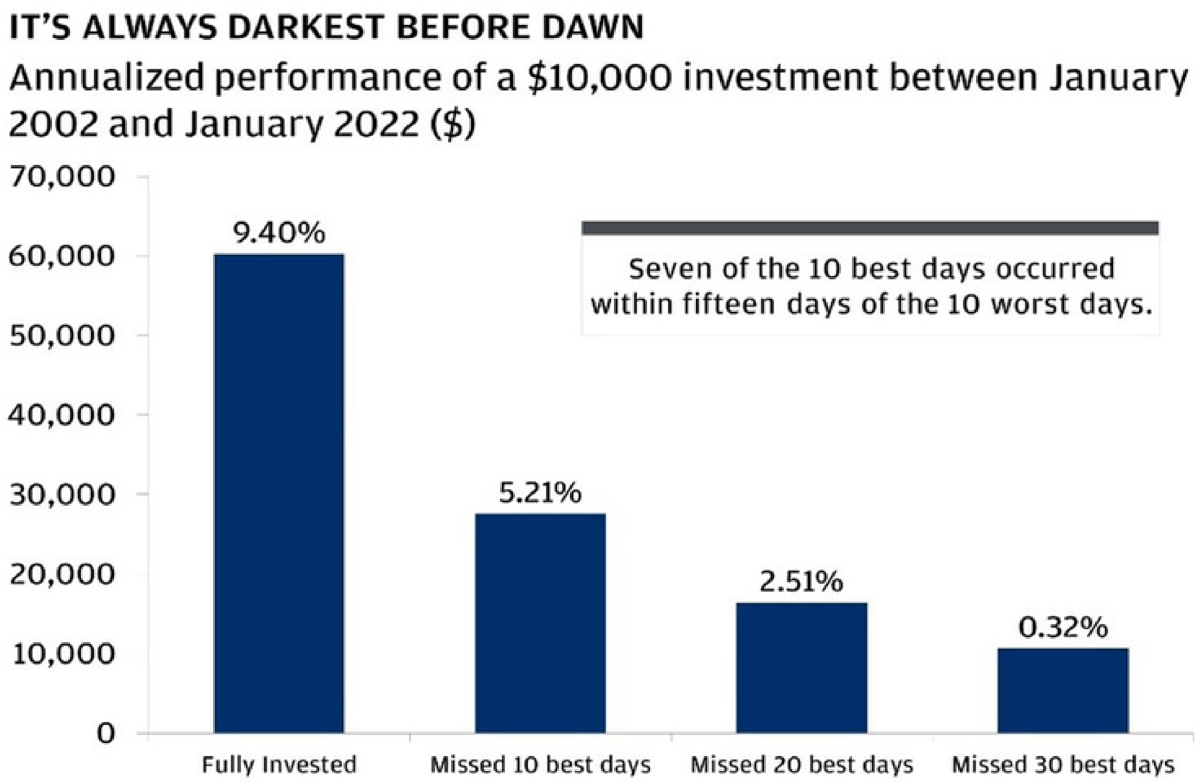
CPI will be reported for the month of November on December 13th. The market will be looking for the reading to decelerate once again to confirm last month's reading was not an anomaly.

The Fed will also be at the same time to announce their next interest rate increase. The market is currently pricing in a 50 basis point hike, but a disappointing CPI report could put another 75 basis point hike back on the table.

Market Wrap

Coming off a very strong month in October, it would not have been a surprise to see the market pull back some. After all, we have seen rallies of similar strength already this year in March and in the summer that ultimately fizzled out. However, the rally in November was driven more by actual good news and less on hope than its predecessors, which is a positive sign for investors. It's possible that the market may revisit lows set in mid-October if the economy continues to slow and company earnings begin to fall. However, if inflation continues to head in a downward direction with continued strong employment data, the possibility of a "soft landing" for the economy could become more realistic. December also tends to be a strong month for market performance, which has led to the frequent use of the term "Santa Claus Rally" to describe the historically strong month. However, given that the market has already seen a strong rally in October and November and that it continues to be driven by macroeconomic data and the Fed's actions, it could make sense for the market to take a breather.

November's strong rally was driven largely by two days of strong performance. While both had clear catalysts, neither were necessarily expected. This highlights the importance of staying invested, as significant single-day rallies tend to happen when they are least expected. If an investor had exited the market and remained in cash to avoid the ongoing volatility, the investor would have missed significant returns. In general, the market's worst days are often soon followed by its best days, and if an investor moves to cash, they are likely to miss the upside, while also locking in losses. The chart below from JP Morgan shows the impact on investment return by missing the best days in the market (JP Morgan).



Source: Factset. Returns are based on the S&P 500 Total Return Index. Past performance is not indicative of future returns. An individual cannot invest directly in an index. Data is as of January 31, 2022.

Sources

The case for (always) staying invested (jpmorgan.com)

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