This Month in the Markets

November 2022

Equity Commentary

Market Pivot

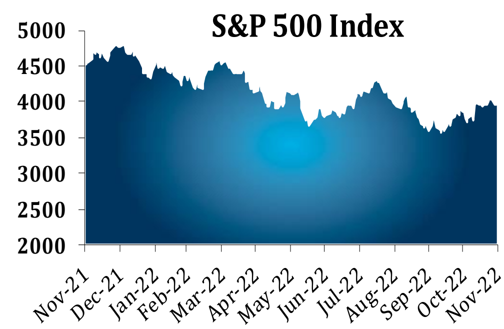
Risk-off pivoted to risk-on in October and continued in November as most major asset classes posted solid returns on lower reported inflation rates in the U.S. The rally has helped both bond and equity markets to recover some of the steep losses that occurred in the first nine months of the year. The MSCI ACWI Net Total Return Index posted a gain of 7.8% for the month. The MSCI World Value Index jumped 7.2% compared to the gain of 6.7% in the MSCI World Growth Index . The S&P 500 rose 5.6%, while the MSCI EAFE Net Total Return Index climbed 11.3% and the MSCI Emerging Markets Net jumped 14.8%. The MSCI ACWI Materials Sector index was the top performer, posting a strong 14% gain on the back of positive news flow from China's COVID and property market plans. The MSCI ACWI Energy Service Sector was the under-performer, with a gain of 3.7%.

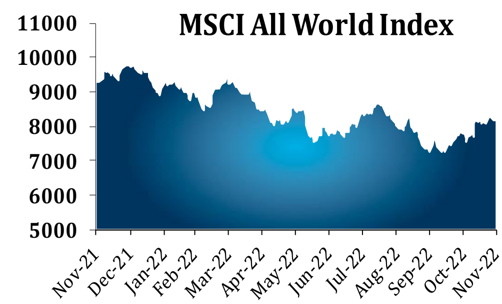
The belief that U.S. inflation has peaked and news on China's 20 measures to relax COVID restrictions fueled more positive sentiment. Fears of a devasting energy crisis in Europe also faded with milder weather, and subsequently lower heating demand, leaving storage facilities for gas over 90% full. The U.S. economy continues to post many economic factors that support a resilient economy, including better than expected retail sales and stable job market conditions. In summary, most of the macro fears and worries that have dominated the news flow through the year have shifted somewhat in tone. Our guess, however, is that it will be difficult to avoid a recession next year but if we have one, it should be mild relative to history and a great deal of this outcome has been factored into markets this year.

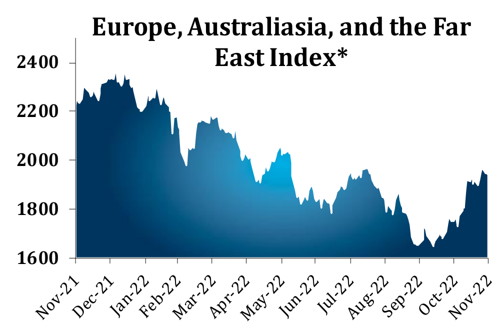
Devon Energy Corp ("DVN") was the largest underperformer in the portfolio for the month, falling 11.4%. After significant outperformance through 2021 and year-to-date in 2022, Devon reported decent numbers, but the market took the opportunity to take some profits. The top performer in the month was GXO Logistics Inc., up 28.2%, which rallied after a strong earnings report that alleviated some concerns surrounding its ability to deliver results in an unsettled macro environment.

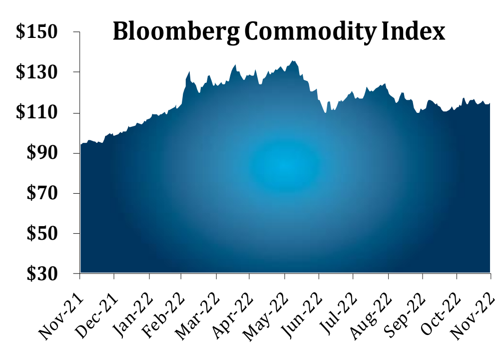
We sold Bristol-Myers Squibb in November as the company's strong performance in 2022 pushed its market price to our assessment of full value. We added two new positions in November. We bought Citizens Financial Group("CFG"). Citizens Financial Group operates 1,200 branches primarily throughout 11 states across the New England, Mid-Atlantic and Midwest regions. We believe that management should have plenty of opportunities to drive earnings growth on the back of deal driven synergies (ISBC, HSBC, JMP) and strategic initiatives. The bank has significantly improved its ROTCE over the past two years and rising interest rates should allow them to grow spread income.

We also purchased the iShares MSCI China ETF ("MCHI"). Our thesis revolved around getting exposure to a part of the market that has seen extreme weakness and was weighed down with what we believe to be excessive pessimism. China's equity market appears attractive for several reasons. First, valuation is very cheap. The MSCI China investable index is trading well below historical multiples, and on a technical basis, at the time of purchase, pointed to oversold conditions. Second, China's zero-COVID is changing, albeit with fits and starts. We believe that the transition to less restrictive measures will continue to evolve and move in the direction that will support further economic growth. Third, a recent 16-point plan to assist the Chinese property market will aid liquidity conditions and growth.









*MSCI EAFE Index

Public

Fixed Income Commentary

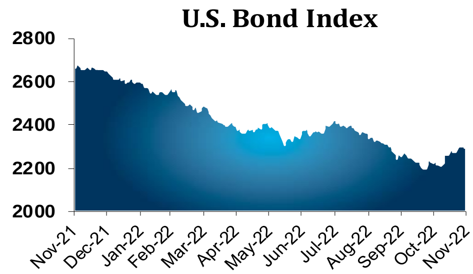
Powell Power

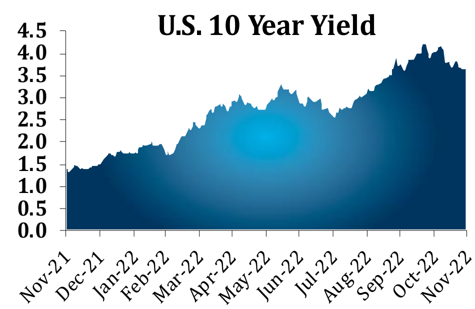
November began and ended with Fed Chair Powell's speeches which garnered considerable attention. After raising the fed funds rate by 0.75% for the fifth consecutive time, Powell was exceptionally hawkish in the November 2nd Federal Open Market Committee (FOMC) press conference. Several times he reiterated they “still have some way to go” regarding further rate hikes and that they will “keep at it” until inflation is tamed. “Keeping At It” was a book written by former Fed Chairman Paul Volcker, famous for aggressively raising rates in the 1970/80’s to quell inflation. Perhaps this comment best summarizes Chair Powell’s hawkishness: ''Prudent risk management suggests the risks of doing too little are much higher than doing too much. If we were to over-tighten, we could use our tools later on to support the economy. Instead, if we did too little we would risk inflation getting entrenched and that’s a much greater risk for our mandate.” These comments were in stark contrast to the hopes of a more balanced approach from the Fed, especially after comments of easing up on rate hikes in October from Federal Reserve Bank of San Francisco President Mary Daly. As a result of Powell’s press conference rates rose and risk assets took it on the chin.

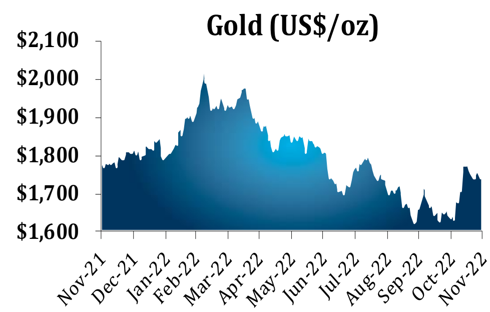
On November 10th, October's highly anticipated Consumer Price Inflation (CPI) data was released. The data came in lower than expected and lower than the prior month. This was on the year-on-year (YoY) and month-on-month (MoM) basis; across both the core measure, which excludes food and energy (6.3% YoY vs 6.6% the previous month), and headline (7.7% YoY vs 8.2% the previous month). This easing of inflationary pressures is exactly what the market and the fed wanted to see. A few days later, the Producer Price Index (PPI) was released with the data following the same dynamic - lower than expected and lower versus the prior month on both a YoY and MoM basis. These inflation data points catalyzed a fall in treasury rates to month-end. The 10Y treasury rate declined from 4.09% on November 9th to 3.75% on November 29th. This inflation data also added fuel to the dollar’s decline, which had begun a few days prior, as proxied by the DXY index.

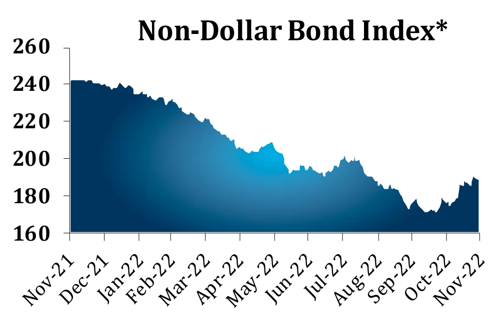
On November 30th Chairman Powell gave a speech at the Brookings Institution. In this speech, he spoke about the need to quell inflation and the Fed’s resolve to do so, however, the tone wasn’t as hawkish. Perhaps that was because it was a more informal setting than an FOMC press conference. Nonetheless, he acknowledged that much of the monetary tightening they have done this year has yet to reach the economy and, as such, a reduction in the pace of rate hikes may soon be warranted. This suggests that the Fed may not be as intently focused on lagging indicators (such as reported inflation rates and employment data) to determine when to slow rate hikes. Various leading indicators, such as purchasing managers indices and the Conference Board US Leading Index, indicate that economic growth is likely to slow or contract going forward. In addition, Powell recognized that housing-related inflation would continue to rise into next year, given the lagging impact of newer rental leases on the overall measure. Reported housing inflation has maintained its upward trajectory, even as other components (such as goods) have rolled over. Housing (owner’s equivalent rent and housing rent) accounts for about 40% of the core CPI index. Also, on the 30th the JOLTS job openings data was released, which showed the labor market is cooling, albeit from a tight level. The job openings to unemployed ratio fell to 1.7x from 1.9x the prior month. Still elevated but heading lower.

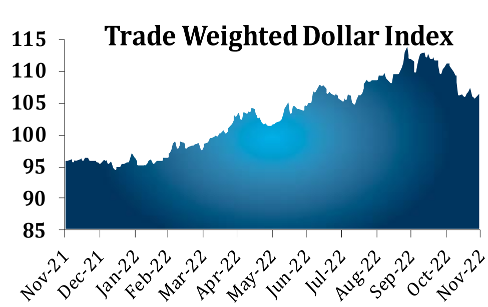
Risk assets rallied, and treasury rates resumed their decline on the back of a less hawkish Chair Powell and softening labor market data. The 10-year treasury rate declined by another 0.14% on November 30th alone, ending the month at 3.60%. Despite the big move in rates in November, the fed funds rate expectations for 2023 were essentially unchanged as per fed fund futures. Instead, it was the 2024 and 2025 timeframes that saw the most notable reduction in policy rate expectations. The market does not believe that the Fed will keep rates elevated (Powell’s stated intention), but rather be forced to cut rates. We saw the impact of this on the dollar in November. The DXY index, a proxy for the US dollar, fell 5%, led by weakness versus the EUR (-5.3%), JPY (-7.2%), GBP (-5.2%), and NOK (-5.3%). The dollar had been on a tear this year, so a pull back was always on the cards at some point. We are wary of declaring the recent weakness as a new trend given Europe’s abysmal growth outlook, and Japan is still employing yield curve control. Uncertainties abound, and the dollar usually outperforms in an uncertain environment.











*Merrill Lynch Global Broad Market, Ex US Dollar Index

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