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DOLL'S DELIBERATIONS

WEEKLY INVESTMENT COMMENTARY

EQUITY MARKETS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
DJIA	0.11%	-5.41%
S&P 500	-0.61%	-15.60%
NASDAQ	-1.51%	-28.23%
RUSSELL 2000	-2.27%	-17.12%
RUSSELL 1000 GROWTH	-1.14%	-25.58%
RUSSELL 1000 VALUE	-0.54%	-6.30%

S&P EQUITY SECTORS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
COMMUNICATION SERVICES	-0.09%	-37.28%
CONSUMER DISCRETIONARY	-3.11%	-31.55%
CONSUMER STAPLES	1.73%	-1.07%
ENERGY	-1.85%	71.81%
FINANCIALS	-1.47%	-8.13%
HEALTHCARE	1.03%	-3.37%
INDUSTRIALS	-0.14%	-4.82%
INFORMATION TECHNOLOGY	-0.79%	-23.77%
MATERIALS	-1.56%	-10.28%
REAL ESTATE	-1.76%	-24.78%
UTILITIES	1.08%	-1.70%

INTERNATIONAL EQUITY MARKETS (INDEX NET RETURN)	LAST WEEK	YEAR-TO-DATE
MSCI ACWI	-0.94%	-17.54%
MSCI ACWI EX U.S.	-0.45%	-17.43%
MSCI EAFE	-0.83%	-16.43%
MSCI EM	0.72%	-21.55%

SUMMARY:

U.S. equities fell last week (S&P 500 -0.6%) after the prior week's strong gains. The equity decline was a function of hawkish Fed speak and further yield curve inversion. Best sectors were consumer staples (+1.7%) and healthcare (+1.0%); worst sectors were consumer discretionary (-3.1%) and energy (-1.9%).

KEY TAKEAWAYS:

1. The 90-day/10-year yield curve turned negative recently and is now -50 basis points. This has been a reliable recession lead indicator. In our view, a recession is now likely in 2023.
2. For further evidence the economy is not collapsing, October retail sales jumped 1.3%, the fastest one month increase since February, and the New York Empire Manufacturing Index improved to a four-month high suggesting the economy is AOK.
3. U.S. PPI inflation slowed to a lower-than-expected 8.0% y/y in October from 8.4%. Core eased to 6.7% y/y from 7.1%. Both goods and services contributed to the decline.
4. According to the New York Fed's October Survey of Consumer Expectations, household inflation expectations have increased with median one-year-ahead expectations increasing from 5.4% to 5.9%, three-year-ahead expectations rising from 2.9% to 3.1%, and five-year-ahead expectations climbing from 2.2% to 2.4%.
5. The market reacted very positively to the better-than-expected CPI release two weeks ago, pushing down its estimate of the peak fed funds rate. Last week, there were a number of attempts by Fed officials to push back against the notion that anything has changed.
6. We expect inflation to continue to fall irregularly, the pace of rate hikes to slow down, that the expected peak rate is around 5%, and that the hurdle for cutting rates in 2023 is very high.
7. The Atlanta Fed's GDPNow model estimate for real GDP growth during Q4 is 4.4%. While growth is unlikely to be that strong, it underscores that the U.S. economy has not yet felt the brunt of Fed hikes.
8. Industrial metals have been enjoying a broad-based rally over the past few weeks, coincident with weakness in the dollar.
9. Technical indicators are closer to neutral territory and suggest that the tailwind from oversold conditions is fading.
10. Generally, what has worked all year has not worked in the last several weeks. For example, last week high-momentum names have underperformed the low-momentum names by 11% after just the opposite since January 1.

FIXED INCOME MARKETS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
BLOOMBERG U.S. AGGREGATE BOND	0.62%	-13.57%
BLOOMBERG U.S. CORP HIGH YIELD	0.60%	-11.67%
BLOOMBERG U.S. GOV/ CREDIT	0.72%	-14.13%
BLOOMBERG U.S. T-BILL 1-3 MONTH	0.06%	1.03%

ALTERNATIVES (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
REAL ESTATE (FTSE NAREIT)	-2.96%	-24.33%
COMMODITIES (DJ)	-1.70%	17.55%
GLOBAL LISTED PRIVATE EQUITY (RED ROCKS)	-5.87%	-33.65%
CURRENCIES (DB G10 CURRENCY FUTURE)	0.94%	4.75%

FOURTH QUARTER RALLY CONTINUES

The recent rally in bonds has allowed stocks to rebound from the deeply oversold conditions that existed in late September/early October when sentiment had turned extremely pessimistic. The risk-on phase which has carried the S&P 500 up more than 10% could have further to run as inflation pressures are easing and the Fed is hinting that it may slow the pace of rate hikes. But we think the 200-day moving average (4067 at this writing) will be difficult to penetrate in part because the Fed has also stated a halt in rate hikes is not yet on the horizon. In addition, the Fed is certainly a long way from envisioning lower rates later next year, in marked contrast to market expectations.

While the level of inflation will remain historically elevated, it will be the direction of inflation that will drive near-term market sentiment. Here the news should be supportive in the coming months. In order to achieve decent investment returns, it is more important than usual to position for tactical moves given the still-challenging cyclical backdrop. Any risk-on phase should be fleeting since we expect inflation to prove sticky absent a full-blown recession. Inflation will level off well above the depressed levels witnessed in recent years, and above central bank targets. Rising and sticky service sector inflation will eventually take center stage and eclipse the excitement over goods disinflation. In other words, inflation will decelerate over the next 6-12 months, but likely will not drop to the low levels necessary to reverse the rate-hiking cycle.

The U.S. dollar has been weak against most currencies since late-September and may have peaked. A weaker dollar would be positive for the world economy and financial markets, by reducing upward pressures on both global inflation and interest rate expectations, and will help prolong the global economic expansion. The key to a period of dollar weakness will be for economic conditions to improve overseas, particularly in China and the euro area. To this end, China is showing signs of taking small steps to support its economy, but not yet enough to declare that a full re-opening is on the horizon. The Covid-zero policy is still in place, and infection rates are rising. Conversely, and more positively, the worst of the decline in euro area economic sentiment may be over. The energy crisis has crested in terms of its impact on economic confidence, although it will still be an expensive and potentially unpleasant winter.

In the U.S., labor conditions remain reasonably tight. Income growth remains strong as the level of employment is rising solidly and wage gains are historically high. While we expect monetary conditions to eventually trigger a meaningful U.S. economic slowdown at some point, that moment is not yet visible.

CONCLUSION:

The risk-on phase should persist in the near run, with the caveat being that government bond markets stay calm. However, the cyclical backdrop is still bearish. Looking into 2023, we anticipate slower growth and perhaps a recession.

Data from Bloomberg, as of 11/18/2022.

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