

# Market Review and Outlook

...

Q3 2022

## Market Performance Review

Despite an early quarter rally, stocks closed lower for the third consecutive quarter amidst elevated levels of cross-asset volatility. Any hope for a potential policy “pivot” was eliminated by the Federal Reserve (Fed) reconfirming their commitment to bring down inflation with two additional 75-basis point interest rate hikes. The economy continues to send mixed signals. Survey-related data has been in decline, whereas hard numbers like unemployment and corporate earnings are generally on more solid footing. The Fed has no easy task in front of them to land the economy softly.

The S&P 500 Index declined -4.9% in the third quarter and has now fallen -23.9% this year. Consumer discretionary (+4.4%) and energy (+2.3%) were the only two GICS sectors notching a positive return during the quarter. Real estate (-11.0%) and communication services (-12.7%) both fell double digits, as rising interest rates had a negative impact on both sectors. Energy remains the only positive sector year-to-date with a return of nearly 35%. Growth outperformed value during the quarter; however, growth is still lagging value year-to-date by more than 12%. For the quarter, small and mid-cap stocks marginally outperformed their large cap peers.

Developed international equities, as measured by the MSCI EAFE Index, fell -9.4% in the third quarter and -27.1% year-to-date. The strength of the U.S. dollar had a major impact on returns, as the dollar appreciated more than 6% against most major developed currencies. The euro even declined to reach parity with the dollar during the quarter for the first time in 20 years. Absent these currency effects, developed international stocks actually performed slightly better than their domestic counterparts. The continuation of the Russian war in Ukraine, the war’s impacts on energy prices, ongoing central bank hikes to tame inflation, and changes to the UK’s political and fiscal policy landscape weighed negatively on sentiment. The MSCI Emerging Markets Index declined -11.6% for the third quarter and -27.2% year-to-date. The effects of dollar strength and Federal Reserve interest rate policy were felt in emerging markets as well. India was a bright spot, returning more than

6% on the quarter, while China gave back the previous quarter’s gains with its -23% third quarter decline.

The Bloomberg US Aggregate Bond Index, a proxy for investment grade fixed income, declined -4.8% during the quarter and -14.6% year to date. The Fed’s rate hiking campaign led to increased yields across the maturity spectrum, with the 10-Year Treasury yield closing the quarter at 3.83% (and briefly touching 4%) after beginning at just 2.98%. Yields declined into the Fed’s July interest rate hike of 0.75%, but as August rolled by and inflation data showed no meaningful signs of slowing, bond markets began pricing in yet another 0.75% interest rate hike in September (there is no FOMC meeting in August). Although this re-pricing of the Fed’s resolve pushed yields higher across the curve, the impact was most pronounced at the shorter end of the curve. Taken together, these moves in the bond market led to the deepest yield curve inversion in decades and also drove interest rate volatility to multi-decade highs. Investment-grade credit spreads widened modestly during the quarter although high yield spreads narrowed somewhat after peaking near 6% in early July.

## Market Outlook

The path forward for the U.S. economy and global financial markets is largely dependent upon the Fed’s response to inflation. An optimistic path features inflation moderating in coming quarters and the Fed pausing their rate hikes due to increasing confidence that 2% long-term inflation is achievable within an appropriate time horizon. This would be very positive for investor confidence and risk assets broadly. A less optimistic scenario presents inflation that remains stubbornly high, causing the Fed to raise rates beyond current expectations, stressing the economy, and causing a meaningful recession.

The resiliency of corporate America and the U.S. consumer may be able to soften the negative impacts of continued interest rate hikes. Companies have been largely able to

pass along higher costs to consumers—including for labor and commodity inputs—and, on balance, corporate America remains very well capitalized. Earnings have beaten Wall Street estimates year-to-date, and the S&P 500 is on pace to deliver high single digit earnings-per-share growth in 2022. Although real (inflation-adjusted) consumer spending has begun to slow over recent months, the U.S. consumer has also been resilient, aided by low unemployment and the stability afforded by record levels of home equity.

We continue to believe that stocks can recover into year-end. As we view an investment landscape with yields significantly higher than a year ago and equity multiples significantly lower, expected returns for both equities and fixed income are more attractive than twelve months ago (or even three months ago). In addition to relatively

attractive valuations, pillars of support for the market are depressed investor sentiment, positive corporate earnings growth, and seasonality. Not only do equities typically perform better in the fall and winter months, but stocks tend to show particular strength following election day in mid-term election years. The likely catalyst for a more durable recovery in global equity markets is an indication from the Fed that it will moderate its pace of interest rate hikes. We are likely to lean into a more favorable forward environment by gradually increasing our equity exposure and lengthening the duration of our fixed income portfolio. However, you should continue to expect that our focus on achieving strong returns will be balanced by our awareness that long-term growth is achieved most successfully by a risk-controlled approach that enables the power of compounding returns to flourish.

## Brinker Capital Market Barometer

### SHORT-TERM FACTORS (< 6 months)

	CHANGE	NEGATIVE	NEUTRAL	POSITIVE	
Momentum		●			Global markets gave up summer gains in September; y/y returns remain negative
Trend		●			Major indices retouched year-to-date lows and are below moving averages
Investor sentiment				●	Surveys continue to show significantly more bears than bulls; tends to be a contrarian signal
Seasonality	→		●		Market entering a seasonally strong period, particularly in mid-term election years

### INTERMEDIATE-TERM FACTORS (6-36 months)

	CHANGE	NEGATIVE	NEUTRAL	POSITIVE	
Fiscal policy			●		Total impact of recently passed Inflation Reduction Act unclear; deficit continues to shrink
Monetary policy	←	●			Rate hikes continue at a rapid pace on top of hawkish Fed rhetoric that is affecting asset volatility
Inflation		●			Headline inflation has moderated but y/y readings are still at very elevated levels
Interest rate environment	←	●			Absolute level of rates is moderate but rate volatility and curve inversion are at historical levels
Macroeconomic			●		Labor market healthy and consumer resilient but wide array of economic data is decelerating
Business sentiment		●			Business confidence measures remain subdued with elevated inflation as a primary driver
Consumer sentiment		●			Consumer sentiment has rebounded over past few months but still near the lowest recorded levels
Corporate earnings				●	Second quarter earnings were generally better than expected; we continue to monitor input costs
Credit environment				●	Credit spreads have widened this year but remain tight relative to long-term averages

### LONG-TERM FACTORS (36+ months)

	CHANGE	NEGATIVE	NEUTRAL	POSITIVE	
Valuation			●		U.S. equity valuations near long-term averages; overseas markets below average valuations
Business cycle			●		Decelerating GDP growth and negative LEI increasing the potential for shallow recession
Demographics			●		Emerging markets possess more favorable trends overall than developed markets

Source: Brinker Capital. Information accurate as of October 5, 2022.



BrinkerCapital.com | 800.333.4573 | Connect: [BLOG](#) [TWITTER](#) [IN](#) [F](#)

Approved for general use. Brinker Capital Investments, LLC, a registered investment advisor. Source: Brinker Capital. Views expressed are for informational purposes only. Holdings subject to change. Not all asset classes referenced in this material may be represented in your portfolio. Indices are unmanaged and an investor cannot invest directly in an index. All returns are calculated gross (before the deduction) of advisory fees payable to Brinker Capital and any other expenses for services not covered by the advisory fee including administrative costs, which would reduce your return. The net effect of the deduction of Brinker Capital's fees on annualized performance, including the compounded effect over time, is determined by the relative size of the fee and the account's investment performance. All investments involve risk including loss of principal. Fixed income investments are subject to interest rate and credit risk. Foreign securities involve additional risks, including foreign currency changes, political risks, foreign taxes, and different methods of accounting and financial reporting. S&P 500 Index: Widely regarded as the best single gauge of large cap US equities. The index includes 500 leading companies and captures approximately 80% coverage of available market capitalization. Bloomberg Barclays US Aggregate Index: AA broad-based flagship benchmark that measures the investment grade, US dollar-denominated, fixed-rate taxable bond market. The index includes Treasuries, government-related and corporate securities, MBS (agency fixed-rate and hybrid ARM pass-throughs), ABS, and CMBS (agency and non-agency). MSCI EAFE Index: A stock market index that is designed to measure the equity market performance of developed markets outside of the US and Canada. MSCI Emerging Markets Index: Measures the equity market performance of 21 emerging market countries. For more information about Brinker Capital and our investment philosophy, including information on fees, you may request a copy of our Form ADV Part 2A from a Brinker Capital Client Services representative at 800.333.4573 or [clientservice@brinkercapital.com](mailto:clientservice@brinkercapital.com).