Weekly Wire

DECEMBER 12, 2022

BRINKER CAPITAL INVESTMENTS
AN ORION COMPANY

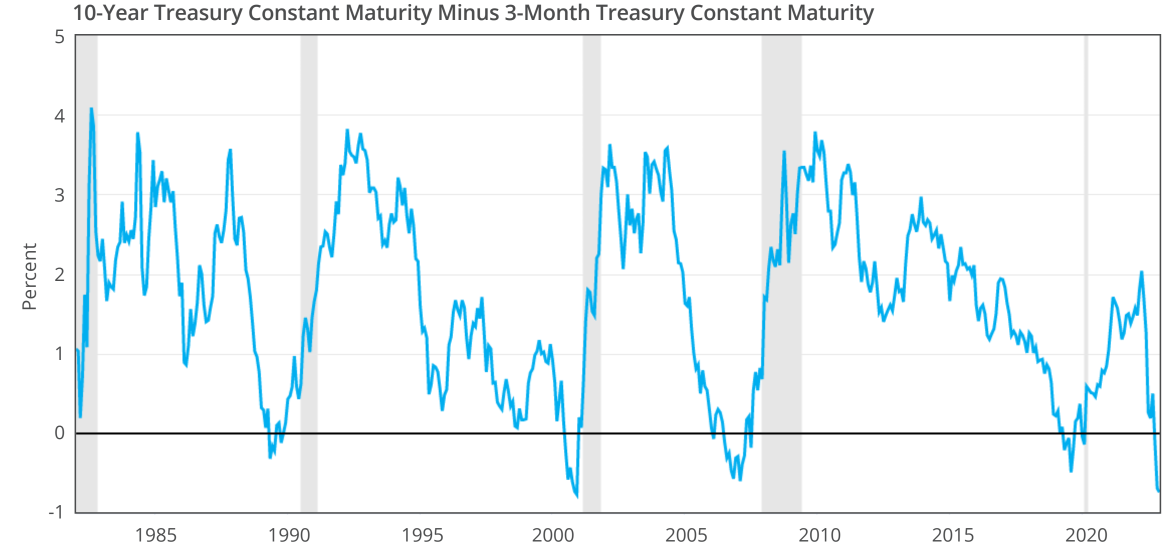
Recession Watch-Revisited

Despite historically high inflation, a very hawkish Fed, still snarled supply chains and the awful events in Eastern Europe, we remained more optimistic than not on the US economy as we moved through 2022, a point of view that we think has largely been proven correct (we recognize GDP contracted by 1.1% during the first half of 2022, but GDP expanded by 2.9% in Q3, and the economy is heading into year-end on reasonably solid footing).

That said, six weeks ago we published a Weekly Wire titled “Recession Watch,” making the case that an economic downturn had become more likely. To back up just a bit, we know that an inverted yield curve is a historic harbinger of a US recession. That said, we don’t think all parts of the curve are created equally when it comes to their predictive power. More specifically, into late October, the US 2 Year Note to US 10 Year Note part of the yield curve had been inverted for some time but the US 3 Month Bill to US 10 Year Note part of the curve (which for our money is the most important part of the curve from an economic forecasting perspective) had not inverted. Then, in late October, the US 3 Month Bill to US 10 Year Note part of the curve did invert, and we took pen to paper on our “Recession Watch” note.

Well, as we move into mid-December, the US 3 Month Bill to US 10 Year Note part of the curve is upside down by approximately 85bps, the most ever (see graph). A US recession is not pre-ordained, but the yield curve and other key indicators, including money supply and The Conference Board Leading Economic Index, point in that direction. While we are cautious on the outlook for the economy next year, we are optimistic on the outlook for US stocks and bonds next year, believing sentiment, valuation and a more dovish policy posture at the Fed should support higher prices for both asset classes as we move through 2023.

10-Year Treasury Constant Maturity Minus 3-Month Treasury Constant Maturity



Stocks, bonds, and commodities (12/9/2022)

Security name	Last	QTD chg	YTD chg	12mo chg
S&P 500	3934.38	9.73%	-17.45%	-16.50%
MSCI AC World ex USA	286.86	16.12%	-16.69%	-15.62%
MSCI EAFE	1978.88	19.10%	-15.29%	-13.57%
MSCI EM	978.28	11.70%	-20.59%	-21.01%
Bloomberg Barclays US Agg	90.15	2.78%	-13.92%	-13.97%
Crude Oil WTI	71.58	-9.95%	-4.83%	-0.13%
Natural Gas	6.31	-6.78%	77.31	60.69%

Treasury rates (12/9/2022)

	Price	Yield
2Y	100.0 / 0.00	4.344
3Y	101.0 / 0.00	4.076
5Y	100.1 / 0.00	3.755
7Y	101.0 / 0.00	3.691
10Y	104.2 / 0.00	3.582
30Y	108.0 / 0.00	3.546

Weekly reports

This week (12/12/2022)

- Nov NFIB Small Business Index
- Nov CPI NSA Y/Y

Week of 12/5/2022

- Nov PPI NSA Y/Y 7.4%
- Dec UofM Sentiment NSA 59.1

Source: Federal Reserve Bank of St. Louis

Brinker Capital Market Barometer

DECEMBER 2022

Global stocks added to their recent rally in November, as intermediate-to-long-term interest rates declined significantly. The Federal Reserve raised their key short-term interest rate by 75-basis points for the 4th consecutive time. However, shortly after the FOMC meeting we learned that the y/y increase in the Consumer Price Index (CPI) decelerated for the fourth consecutive month and came in softer than expectations. This marked a near-term peak in long-term bond yields, and the reversal led to a significant rally in risk assets. US midterm elections led to some short-term uncertainty but proved to be virtually a non-event as the market accepted a split government. Nonfarm payrolls, retail sales, new and existing home sales, and consumer sentiment all came in above expectations for the month. This positive economic data coupled with somewhat softer Federal Reserve rhetoric throughout the month led the market to assign a greater probability to the potential for a soft landing. Negative year-over-year growth was expected for third quarter corporate earnings; however, earnings managed to settle at a positive growth rate and exceed expectations. While broad commodity prices rose slightly during the month, the price of oil and its distillates like gasoline continue to decline. Coupling this with recent drops in mortgage rates has helped to buoy consumer sentiment somewhat. Looking forward, both stock and bond markets have become more attractive this year. While risks of policy mistakes and recession remain, today's market environment is presenting longer-term opportunities across multiple asset classes.

SHORT-TERM FACTORS (< 6 months)

	CHANGE	NEGATIVE	NEUTRAL	POSITIVE	
Momentum		●			Solid gains in November build on October's rally, but y/y returns remain negative
Trend	→		●		Major indices have moved above both short-term and long-term moving averages
Investor sentiment				●	Survey data is off of extremes, but contrarian view still indicates positive returns going forward
Seasonality				●	Markets are in the strongest seasonal period of the year, particularly following midterm elections

INTERMEDIATE-TERM FACTORS (6-36 months)

	CHANGE	NEGATIVE	NEUTRAL	POSITIVE	
Fiscal policy			●		Split government unlikely to pass any meaningful legislation, particularly in the near-term
Monetary policy		●			Indications point towards the pace of rate hikes slowing in December, but still tightening
Inflation		●			Headline inflation has moderated, but y/y price increases remain at elevated levels
Interest rate environment		●			Longer-term rates declined significantly in December, but curve remains deeply inverted
Macroeconomic			●		Economic data continue to show mixed signals, with labor market and consumer spending resilient
Business sentiment		●			Business confidence measures remain subdued with elevated inflation as a primary driver
Consumer sentiment		●			Consumer sentiment has rebounded over the past few months but remains depressed
Corporate earnings			●		Earnings growth and surprises are below average, but Q3 earnings managed to deliver y/y growth
Credit environment				●	Level of credit spreads at or below long-term averages, defaults remain low, credit conditions modest

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			●		Revised Q3 GDP shows moderate growth, avoiding near-term recession risk
Demographics			●		Emerging markets possess more favorable trends overall than developed markets

2401-BCI-12/12/2022