ANATOMY OF AN UPBEAT MARKET

Market Review **OCTOBER 2022**

The US index, comprised of thirty bellwether stocks, experienced its best month since 1976. A bellwether stock tends to show market leadership just like a sheep leading its flock with a bellwether tied around its neck. Last month's US equity returns were even more impressive, given that interest rates tied to economic activity also rose in October. In normal circumstances, the level of economic interest and the prices held on financial assets move in opposite directions. However, investors were able to see through the risks in October and decided that equities represented a strong buying opportunity.

The overall market for public ownership in corporations has benefited from better news. For one, public corporations started to publish third-quarter profits and guide investors on the economy's strength. This quarter's earnings data has come in strong, as consumers seem able and willing to pay higher prices. However, aggregate volumes of goods and services sold appear to be down, indicating that actual production is also lower, and profits are likely higher because of recent inflation. That trend may persist for a short time, but robust economic productivity will one day need to return to maintain stability. Next, the primary market for mergers, acquisitions, and new public offerings has suddenly heated up after a short period of dormancy. A couple of new deals have recently been announced worth billions of dollars. Fortunately, pricing in the primary markets can help reaffirm prices in the secondary markets for stocks and bonds. As a reminder, many of the commonly-used investments, such as index funds, come from the secondary market.

The structural component of the stock market has undergone quite a bit of change caused by new spending habits, higher borrowing costs, and other exogenous shocks. For example, the stock prices of companies with high-quality brands have been more robust than shares of companies that depend on ambitious growth. Therefore, money has recycled from one part of the market to another, helping shield investors from the worst scenarios. As a result of this cyclical rotation, the usual bearers at the top of the index have shrunk. For example, the top ten stocks in the US large-cap index previously occupied almost thirty cents of every invested dollar. That fraction has since fallen to twenty-five cents of every invested dollar. The result is reduced security-level concentrations, and more diversification, in the broader indexes.

These structural changes, and the bear market in general, have

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also helped to diversify investor risk from a sector perspective. Before the current bear market, investor returns depended more heavily on the success of stocks classified as either technology or communications companies in the broad large cap market. However, at the current time, energy has crept into the top ranks of investor wealth, and healthcare has increased its presence as well. As a result, investors that allocate similarly to the broad indexes are now generally receiving a more diversified mix of corporate profits on every investment dollar.

October made investors feel more upbeat about stocks, which is a good change of pace. However, even though it's good to exercise optimism, risks still remain on the horizon. For instance, a European land war still rages with no end in sight. Thankfully, Russia has re-agreed to allow Ukrainian grain exports to pass into the Black Sea after Russia stepped up its attacks and propaganda against Ukraine. In addition, investors would like to know what's next for the Chinese economy as zero-covid policy restrictions lock-down citizens and global supplies. Finally, inflation remains a global phenomenon that has put central banks in reactionary mode throughout most of the developed world.

But, against an uncertain backdrop, investors still found reasons to want the equity risk premiums that stocks offer. The equity risk premium represents the extra return over bonds that investors receive for holding risk when times are tough. Moreover, last month's stock market gains seemed even more meaningful since interest rates rose globally. With all that said, it is important to remember that stocks are leading economic indicators and therefore may very well rebound ahead of a sustained economic recovery.

Asset Categories	US STOCKS	FOREIGN STOCKS	US BONDS	FOREIGN BONDS	HARD ASSETS	HYBRIDS
Monthly	9.50%	2.86%	0.57%	-0.27%	4.41%	0.86%
Year to Date	-15.34%	-26.81%	-11.35%	-19.59%	-14.29%	-16.73%

*DATA USED IS SOURCED FROM MORNINGSTAR®, DATE ENDING OCTOBER 31, 2022.

US STOCKS

US Stocks rose nicely in October and erased the losses from the prior month. As a result, the average year-to-date losses on the broad US stock market narrowed to -15.34%. In addition, higher-risk categories performed better in October. For instance, small caps earned 11.10% in October, while large caps returned 8.03%. Mid-cap performance fell in between the other two categories. For the entire year, mid-caps and small-caps are out ahead of large-caps. Average year-to-date returns on mid and small are -14.46%, whereas large caps show -17.09%.

FOREIGN STOCKS

Foreign Stocks also recovered well in October, except for the emerging markets. Emerging market stocks fell another -1.44% in October to bring the year-to-date return down to -28.91%. However, developed large-, mid-, and small-caps generated robust returns approaching 5.0% by the end of the month. Year-to-date returns on large caps currently reside around -23.93% and -27.60% for the blended category of mid- and small-caps.

US BONDS

US Bond experienced a mix of returns in October. High-quality bonds sold off and added to their year-to-date losses. US governments lost -1.25% and corporates fell by -0.76% in October. The respective losses for this calendar year stand at -13.49% and -18.58%. However, high-yield bonds attracted capital flows in October. High-yield bonds increased by 2.39%, and bank loans added 0.89% for the month.

FOREIGN BONDS

Foreign Bonds suffered more outflows as emerging markets acted as a weight on the category. Global bond prices stayed relatively flat in October. That specific category now operates at -18.07% year-to-date loss. Emerging market bonds lost another -0.49% in October, causing year-to-date returns to finish at -21.12%

HARD ASSETS

Hard Assets were strong on energy returns yet again. Energy rose 12.10% in October. This year, the category is now 25.49% higher and has acted as a hedge relative to traditional stocks and bonds. Real estate posted decent gains in October resulting in year-to-date losses of -27.49%. Precious metals saw modest monthly gains and now stand at a year-to-date loss of -27.66%.

HYBRIDS

Hybrid Assets had split results in October. In October, the risk and optionality of convertible debt saw an increase in value. As a result, convertibles gained 3.31% in October to narrow the year-to-date loss to -17.15%. On the other hand, preferred stocks sold off in October with a -1.58% monthly loss, resulting in year-to-date losses of -16.31%.

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