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WEALTH MANAGEMENT

MACRO MUSINGS

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A Positive Inflation Surprise, Will the Fed Pause?

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SUMMARY

- The **macro**cast™ score suggests the probability of a recessionary bear market continues to be elevated, and the defensive position of **micro**cast™ is reflective of volatile market conditions. The combination of both risk models suggest we are in, and will continue to remain in a challenging market environment into next year.
- Last week's lower than expected inflation data was a welcome change after several months of disappointing figures. Slowing inflation is a significant factor in the Fed's policy framework, but inflation remains high and there are no signs they will stop raising rates before next spring.
- The midterm elections are over, and appears the control of congress will be split by both parties. When paired with a Democrat in the White House, historical market performance has been above average. The total return in the S&P 500 in the 12-month period after a midterm election has been positive over the past 75 years.
- Last Thursday, the S&P registered its 15th largest gain in a single day since 1950. Since that period, this led to positive returns a year later except in two key instances.

INFLATION DATA IMPROVING,
BUT THE FED ISN'T FINISHED YET

The economy got some good news last week about inflation. Both the Headline Consumer Price Index (CPI) and the Core CPI index (which excludes food and energy) came in lower than expectations.

Trying to predict the path of inflation has been a fool's errand this past year, but after the fourth straight month of declines, it appears headline numbers (year over year) have peaked (from the Daily Shot):

US Headline CPI YoY% Including Topline Contributions

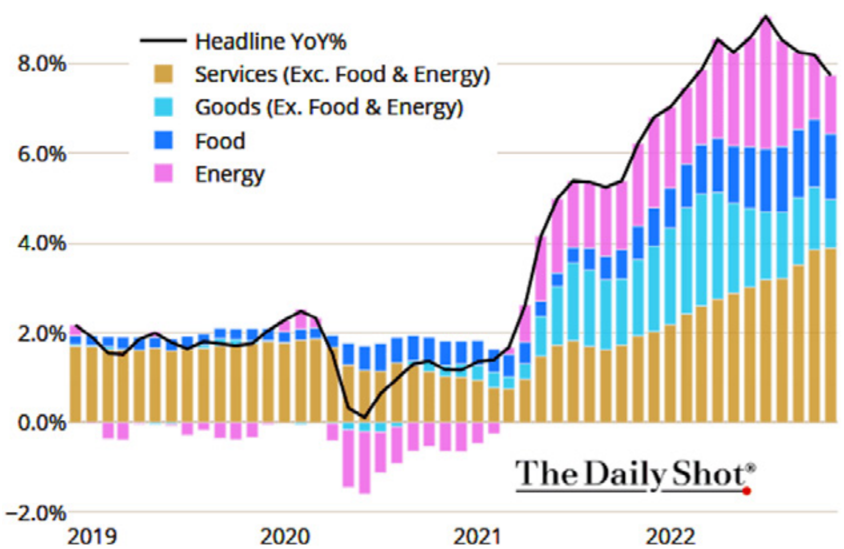

Chart Powered by Bloomberg BQNT using Bureau of Labor Statistics Data

Still, a year-over-year inflation rate of 7.7% is very high. This was quickly pointed out by some Fed officials this week. At a UBS Group AG conference on Monday, November 14th in Sydney, Australia, Fed Governor Chris Waller **explained** that last week's inflation print was not enough to change course:

> *"These rates are going to stay -- keep going up -- and they're going to stay high for a while until we see this inflation get down closer to our target. We've still got a ways to go. This isn't ending in the next meeting or two."*

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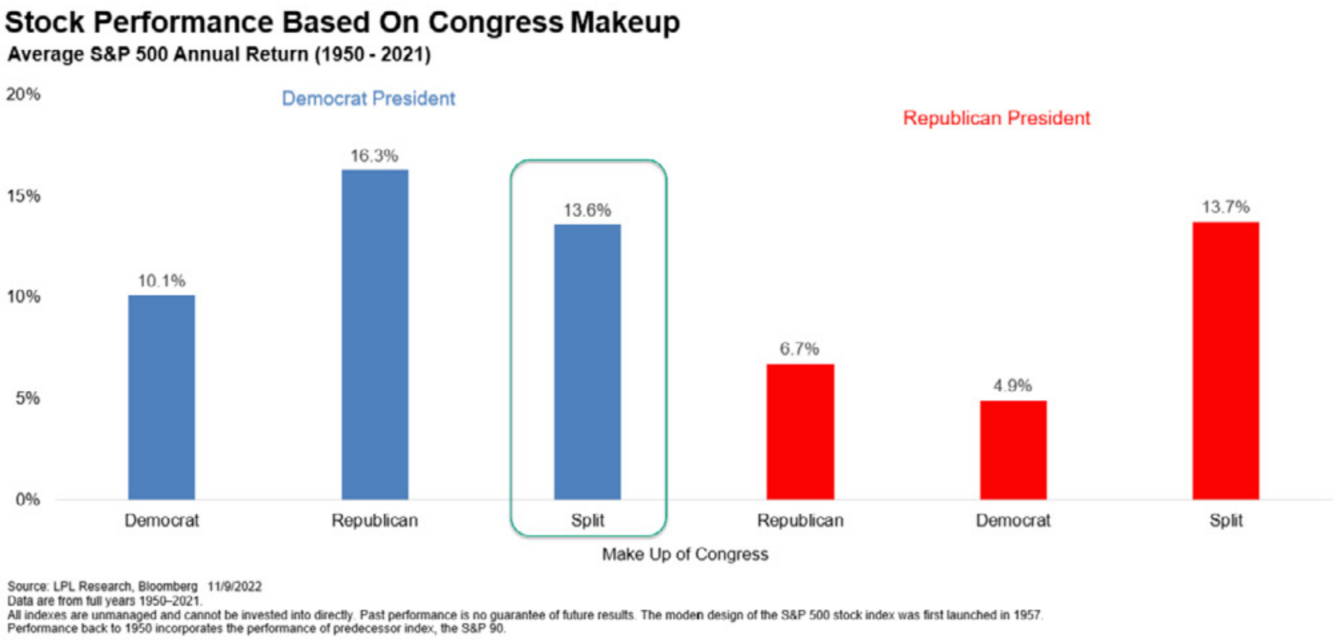
More rate hikes are expected in the coming months. When the FOMC meets in December, they are expected to raise the Fed funds rate .50% or .75%. Heading into the new year, Governor Waller's comments notwithstanding, if inflation continues to surprise to the downside, it is likely that the Fed will raise rates early in February and then pause. In general, monetary policy operates with a lag, so a pause early next year gives the Fed time to assess its impact.

That assumes that the positive inflation data was not just a one-off. Should inflation remain stubbornly high while employment data remains strong, rate hikes may extend further into 2023.

ASSESSING THE POST **MIDTERM ELECTION LANDSCAPE**

The midterm elections are now behind us. Although votes are still being counted, it appears the Democrats will hold onto the Senate, while the GOP will take control of the House. When Congress is split and there is a Democrat in the White House, the stock market has historically performed well (Chart from LPL):



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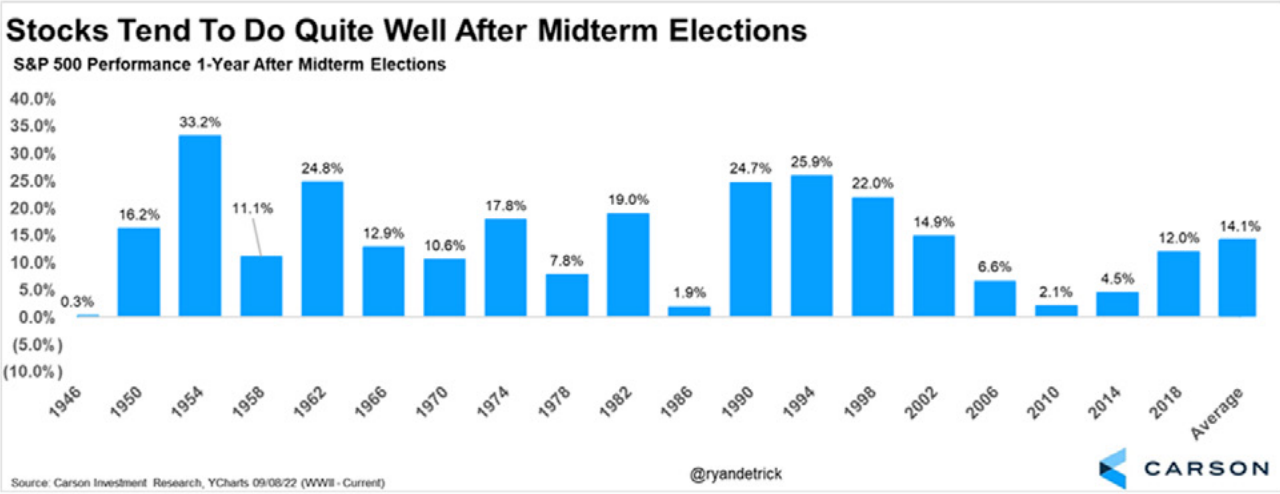
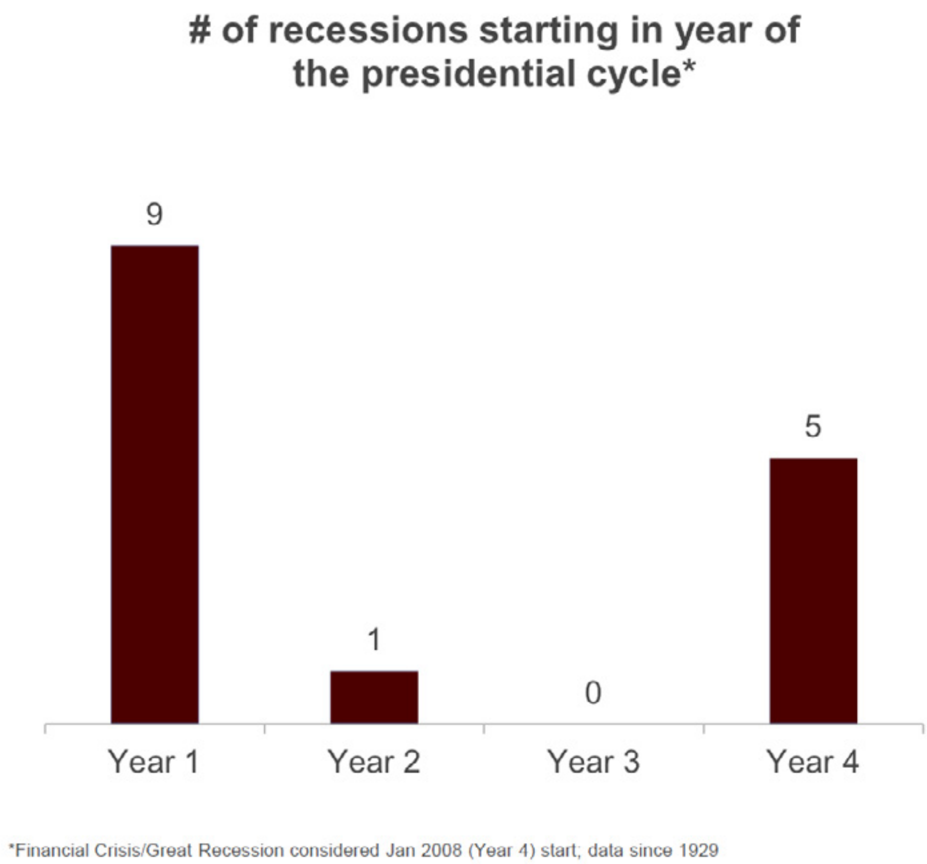
Furthermore, the post-midterm election period has historically been positive for the stock market. Since WWII, the S&P 500 has always moved higher in the 12 months following a midterm election (Chart from Ryan Detrick at Carson Investment Research):



One caveat, it is possible that stocks have always finished higher during this period because since 1929, we have never had a recession begin in the third year of the presidential cycle (Chart from Truist IAG article):



All else equal, an economic recession increases the probability of negative market returns.

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STRONG PRICE ACTION USUALLY LEADS TO **HIGHER STOCK PRICES, WITH A MAJOR CAVEAT**

In the wake of the better-than-expected inflation report, stocks rallied significantly. S&P 500 was up more than 5% while the Nasdaq rose 7%.

The following table displays the top 25 best days in the market since 1950 (from Charlie Bilello at Compound Advisors):

S&P 500: Largest Daily % Gains (1950-2022)				S&P 500 Forward Total Returns					
Rank	Date	S&P 500	% Change	5-Day	10-day	1-Month	3-Month	6-Month	1-Year
1	10/13/2008	1003	11.6%	-2%	-15%	-10%	-12%	-14%	10%
2	10/28/2008	941	10.8%	7%	-4%	-5%	-9%	-6%	14%
3	3/24/2020	2447	9.4%	6%	9%	14%	29%	37%	62%
4	3/13/2020	2711	9.3%	-15%	-6%	5%	13%	24%	49%
5	10/21/1987	258	9.1%	-10%	-3%	-7%	-5%	1%	11%
6	3/23/2009	823	7.1%	-4%	2%	3%	9%	31%	46%
7	4/6/2020	2664	7.0%	7%	3%	7%	19%	29%	56%
8	11/13/2008	911	6.9%	-17%	-2%	-4%	-13%	1%	23%
9	11/24/2008	852	6.5%	0%	4%	2%	-11%	8%	33%
10	3/10/2009	720	6.4%	8%	12%	15%	32%	44%	63%
11	11/21/2008	800	6.3%	2%	14%	8%	-4%	13%	42%
12	3/26/2020	2630	6.2%	-4%	6%	10%	18%	25%	54%
13	3/17/2020	2529	6.0%	-3%	2%	11%	24%	36%	60%
14	7/24/2002	843	5.7%	8%	4%	14%	6%	6%	18%
15	**11/10/2022**	**3956**	**5.5%**						
16	9/30/2008	1166	5.4%	-15%	-14%	-20%	-23%	-29%	-7%
17	7/29/2002	899	5.4%	-7%	1%	4%	0%	-4%	12%
18	10/20/1987	237	5.3%	-2%	6%	4%	3%	10%	22%
19	12/16/2008	913	5.1%	-5%	-1%	-7%	-13%	2%	24%
20	10/28/1997	922	5.1%	2%	0%	3%	7%	22%	18%
21	9/8/1998	1023	5.1%	1%	1%	-5%	16%	27%	33%
22	5/27/1970	73	5.0%	8%	4%	2%	13%	18%	42%
23	1/3/2001	1348	5.0%	-3%	0%	0%	-18%	-9%	-13%
24	12/26/2018	2468	5.0%	-1%	5%	7%	15%	20%	33%
25	3/10/2020	2882	4.9%	-12%	-15%	-4%	12%	17%	38%
	Averages			-2%	1%	2%	4%	13%	31%

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There are a few key points worth mentioning:

1. **Most of these big up days occurred during turbulent market periods.** The majority of these events occurred during recessionary periods (1970, 2001, 2008-2009, 2020) or major market crashes (1987, 2020 again).

2. **In all but two cases from 1950 to the present, stocks rose in the year following a 5% up day.**

3. **The two negative instances were during the last two recessions before the pandemic.** The Global Financial Crisis contributed to the continued decline in stocks in 2008. In 2001, a recession began in March and was exacerbated by 9/11.

Since almost all of these examples occurred during a crash or bear market, we should not make too much of a single day's performance. However, historically, returns have improved dramatically once you look beyond the short term, unless a recession follows. A recession remains our greatest concern heading into 2023.

In summary, inflation surprised to the downside, which is a welcome development for markets. If inflationary pressures continue to abate in the months ahead and trend towards the Fed's target, the Fed is less likely to continue aggressively hiking rates throughout next year. The end of the election cycle removes a major uncertainty from the market, and historically, positive returns have followed. Finally, strong positive market action like we saw last week has generally led to higher future returns in the past, unless a recession followed.

We hope you enjoyed reading our latest thoughts and analyses. Next month, we will publish our outlook for 2023, where we will analyze the chances of recession over the next year and the implications for risk assets.

Thank you for your continued support and trust in Corbett Road.

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