OCTOBER 2022 MARKET RECAP

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The equity market posted a welcome rebound in October as the S&P 500 increased by +8.1%, bringing the year-to-date decline to -17.7%. The S&P 500 has now been in a bear market (a decline of -20% on a closing basis without a subsequent +20% increase) for ten months, which is about the average time it took for the market to go from peak-to-trough during the last fifteen recessions from 1929. The closing low for this year was reached on October 12th at 3,577 and since then the market has increased by +8.3%. While we are pleased with the market rebound, we suspect we are not out of the woods yet. The primary risks causing the market turmoil still remain, including, the Fed tightening monetary policy, increased inflation expectations, the Russia/Ukrainian war, China's zero covid policy.

- **Market Cap**: Small (+11.0%) outperformed Mid (+10.5%) and Large (+8.1%) Caps.
- **Style**: Value (Russell 1000 Value: +10.3%) exceeded Growth (Russell 1000 Growth: +5.8%).
- **Sector**: All eleven sectors were positive in the month with Energy (+25.0%) and Industrials (+13.9%) as the top performers and Consumer Discretionary (+0.2%) and Communication Services (+0.1%) as the laggards.

In the short-term the most important driver of the economy, interest rates, bond market, and stock market will be the level at which the Fed stops raising the federal funds rate. The Fed is in a very difficult position. They have already tightened monetary policy significantly (3.00% rate increase, signaled another 1.50% of rate hikes, and implemented the balance sheet runoff plan) and yet inflation remains high and only modestly below peak levels. The Fed has two choices from here:

- **Option A**: Continue to raise interest rates until current inflation readings hit 2%.
- **Option B**: Pause raising rates around their forecasted peak of 4.6% in anticipation that these new tighter financial conditions will cause inflation to fall to their target.

Our sense is that the Fed will select Option B as Option A is a surefire path to a recession (and probably an environment where the Fed is forced to quickly pivot and cut interest rates aggressively). In recent weeks we have seen some FOMC members signal that they are open to pausing interest rate hikes in late 2022 or early 2023, but it is too early to tell whether the Fed is ready to implement Option B. The Fed will almost certainly raise rates by 0.75% at their next meeting on November 2nd, but the markets will focus on signals on whether the Fed is trending toward Option A or B. How stocks and bonds perform over the rest of the year will likely depend on which path the Fed selects.

Over the long-term, we continue to suspect this difficult economic environment has created a strong buying opportunity for investors willing to live with some short-term discomfort. We believe those who were able to either stay invested, rebalance, or add to their existing holdings may eventually be rewarded. We continue to maintain a disciplined approach while looking for opportunities to tax loss harvest, reposition and rebalance portfolios, and selectively put money to work for clients that have recently made contributions to their accounts. *Historically, equity markets have recovered from recessions and downturns; however, past performance is no guarantee of future returns. It is important to consider your own risk tolerance, financial circumstances, and time horizon.*

The markets have several major events over the next month, including, any update on the Russia/Ukrainian War and China lockdowns, the FOMC Meeting (11/2), October Employment Report (11/4), Midterm Elections (11/8), CPI Inflation (11/10), and PCE Inflation (12/1).

At Winthrop Wealth, we follow a Total Net Worth Approach and we believe the right mindset paired with a comprehensive financial plan and a thorough investment process can provide confidence in pursuing your long-term financial goals, especially during times of heightened market volatility. We help our clients navigate challenging markets by seeking to ensure their short-term cash flow needs are met while managing the rest of their investments in a globally diversified portfolio. By having two to three years of scheduled cash flows invested in ultra-short fixed income instruments, we seek to decrease the likelihood that we will need to sell out of risk assets after a market decline to fund distributions. *Remember, no strategy assures success or protects against loss.*

Please see our recent Client Questions that can help put things into context:

- Framework for Navigating Current Conditions
- Cognitive Biases That Frequently Lead to Investment Mistakes
- Market Timing Does Not Work
- How often does the stock market decline?

Fixed Income Market

Interest rates were volatile throughout October as the 10-Year Treasury yield started the period at 3.83% before increasing to 4.24% (highest level since June 2008) and ending the month at 4.05%. The overall increase in interest rates caused the Bloomberg Barclays Aggregate Bond index (Agg) to decline by -1.3% (bond prices move inversely to interest rates and credit spreads). The Agg is now down by -15.7% year-to-date, which is on pace for the worst calendar year since inception of the index in 1976. Prior to 2022, the worst calendar year performance for the Agg was -2.9% in 1994.

Our objective with fixed income is to provide ballast, stability, and income to portfolios. Bonds have not provided ballast this year as interest rates have increased, but we expect the negative correlation between stocks and bonds to return in the future once yields level out. Note that all else equal the fixed income markets need yields to stabilize rather than decrease from these levels to potentially achieve positive returns. *Bonds are subject to market and interest rate risk if sold prior to maturity. Bond values will decline as interest rates rise and bonds are subject to availability and change in price.*

The increase in interest rates and subsequent price decline has driven the yield to maturity of various bond indices to their highest levels in years. Yield to maturity is defined as the estimated annualized rate of return an investor can expect on a bond if purchased today and held to maturity, assuming the issuer makes all their interest and principal payments (i.e., no defaults). The yield to maturity on the US Aggregate Bond index increased to 5.0% at the end of the month, which is the highest level since 2008. In other words, future returns from the Agg bond index have not been this attractive in 14 years.

Inflation

The increase in inflation is driven primarily by supply chain bottlenecks, surging energy prices, strong consumer demand caused by a solid labor market, and massive amounts of stimulus. Although several readings have decelerated from peak levels, inflation is still far too high. We have seen moderation in energy, commodities, used vehicle prices, expectation surveys, and breakeven rates while stickier categories including wages, shelter, and food away from home remain elevated.

Unfortunately, inflation either increased in September or only slightly decelerated. Here are several key inflation indicators measured on an annual basis:

- **Consumer Price Index (CPI)**: tracks the average change over time in the prices paid by urban consumers for a market basket of consumer goods and services. The index does include food and energy prices.
  - o Latest Reading (September): 8.2%. Prior Reading (August): 8.3%.
  - o Peak (June): 9.1%. Source: Bureau of Labor Statistics.
- **Core Personal Consumption Expenditure (PCE) Index**: measures the prices paid by consumers for goods and services based on surveys of what businesses are selling. Core means that the index excludes food and energy prices. This is the Fed's preferred inflation measure, which they target at an average of 2%.
  - o Latest Reading (September): 5.1%. Prior Reading (August): 4.9%.
  - o Peak (February): 5.3%. Source: Bureau of Economic Analysis.
- **Average Hourly Earnings**: tracks total hourly renumeration (in cash or in kind) paid to employees in return for work done (or paid leave). Data is from the Current Employment Statistics (CES) survey.
  - o Latest Reading (September): 5.0%. Prior Reading (August): 5.2%.
  - o Peak (April 2020): 8.0%. Source: Bureau of Labor Statistics.

Moving forward, the key will be how long it takes for disinflation to increase and the growth rate to move back toward more normal levels. The Fed, most asset classes, and investors would very much appreciate a strong period of disinflation. In this scenario, the Fed can slowdown the pace of tightening, interest rates can moderate, and equity markets can reach a sustainable bottom.

Monetary Policy

The Fed typically focuses on balancing maximum employment and stable prices, however, today the committee is hyper focused on bringing inflation down even if it means causing job losses and a recession. Fed Chair Powell recently admitted that higher interest rates will lead to a "sustained period of below-trend growth that will also bring some pain to households and businesses." This is the Fed Chair's way of telling the American people to prepare for an economic slowdown.

The Fed's response to inflation, tightening financial conditions, is a blunt instrument designed to remove liquidity from the financial system to decrease overall demand for goods and services. A simple definition of inflation is, "too much money chasing too few goods." The Fed is about to shrink the amount of money available. The Fed will tighten monetary policy and overall financial conditions by raising interest rates and shrinking the size of their balance sheet.

Interest Rates: After raising interest rates by 0.75% at three consecutive meetings, the top-end of the federal funds rate now stands at 3.25%. Thus far in 2022, the FOMC has raised interest rates by 3.00% total, the largest calendar year increase since 1980. The Fed will very likely raise rates by another 0.75% at the next meeting on November 2nd. The final meeting of the year occurs on December 14th, where there will likely be a lively debate on whether to increase by another 0.75% or slow the pace down to 0.50%. The FOMC's most recent Summary of Economic Projections (SEP) showed that the median participant expected the federal funds rate to reach 4.3% this year and peak at 4.6% in 2023.

Balance Sheet: The Fed is also beginning to reduce the size of their nearly $9 trillion balance sheet. The runoff plan is for monthly caps of about $60 billion for Treasuries and $35 billion for agency mortgage-backed securities. The monthly reduction of about $95 billion is larger than the $50 billion per month pace that was used during the 2017-2019 runoff plan. At the current runoff rate, it will take over 4 years for the Fed's balance sheet to decrease to its pre-pandemic size.

With hindsight it's clear that the Fed was wrong in their view that inflation was transitory, and the committee waited too long to tighten monetary policy. We will refrain from being overly critical of the Fed (and leave that to pundits) and focus on what matters most, which is analyzing what current and future monetary policy decisions mean for the markets, economy, and ultimately our clients. We will be looking for evidence of the Fed's future plans for monetary policy at the next meeting on November 2nd.

Economic Data

The economy continues to slow from the post-pandemic boom due to fading stimulus, rising inflation, and Fed tightening. The current period is best characterized by high inflation and a lot of uncertainty caused by how high the Fed will raise interest rates, the Russia/Ukraine War, and China's covid lockdowns.

After increasing by +5.9% in 2021, Real GDP Growth is estimated at +1.7% in 2022 and +0.4% in 2023. Economic growth estimates have been decreasing over the past several weeks as economic indicators, consumer spending, and the housing market have all weakened while inflation has stayed elevated. The economy can probably best be described as firing on one cylinder, the labor market. While the labor market continues to show signs of strength, we do expect the unemployment rate to tick up over the next few months as several major firms have begun to announce hiring freezes or layoffs. According to a recent PWC survey of over 700 executives, 50% of firms anticipate a reduction in headcount over the next 6 to 12 months.

While the economy is slowing, Real GDP came in at a solid +2.6% in the third quarter after declining by -1.6% in Q1 and -0.6% in Q2. Economic growth in the third quarter was driven by consumer spending on services and an increase in net exports.

The open debate on whether the economy has already fallen into a recession will continue for a while longer. The agency charged with maintaining official records of expansions and recessions, the National Bureau of Economic Research (NBER) Business Cycle Dating Committee, has stated the current period does not meet their definition of a recession as a significant decline in economic activity. In our opinion, a recession is likely inevitable, and it does not really matter when the official start date is. Our view is still that the potential recession looks mild compared to other severe economic declines like the Global Financial Crisis of 2007 – 2009. The bottom line is that whether the United States has reached the official definition of a recession is mostly just semantics, while there is no debate that the economy has slowed considerably.

OCTOBER 2022 MARKET RETURNS

US Equity											
Index	**October**	**2022**	**2021**	**2020**	**2019**	**2018**	**1-Year**	**3-Year**	**5-Year**	**10-Year**	**20-Year**
S&P 500	8.10%	-17.72%	28.68%	18.39%	31.47%	-4.39%	-14.63%	10.18%	10.42%	12.76%	9.79%
Russell 3000	8.20%	-18.45%	25.64%	20.88%	31.01%	-5.25%	-16.54%	9.76%	9.85%	12.46%	9.92%
Dow Jones Industrial Average	14.07%	-8.42%	20.95%	9.72%	25.34%	-3.48%	-6.74%	8.82%	9.32%	12.16%	9.67%
Nasdaq	3.94%	-29.31%	22.21%	45.05%	36.73%	-2.82%	-28.53%	10.76%	11.36%	15.21%	12.32%
S&P 400	10.52%	-13.29%	24.73%	13.65%	26.17%	-11.10%	-11.58%	9.16%	7.45%	11.27%	10.70%
Russell 2000	11.01%	-16.86%	14.78%	19.93%	25.49%	-11.03%	-18.56%	7.02%	5.53%	9.99%	9.73%
Russell 1000 Growth	5.84%	-26.61%	27.59%	38.49%	36.39%	-1.51%	-24.60%	11.73%	12.58%	14.67%	10.84%
Russell 1000 Value	10.25%	-9.35%	25.12%	2.78%	26.52%	-8.28%	-7.04%	7.27%	7.18%	10.30%	8.79%
International Equity											
MSCI Index	**October**	**2022**	**2021**	**2020**	**2019**	**2018**	**1-Year**	**3-Year**	**5-Year**	**10-Year**	**20-Year**
EAFE	5.38%	-23.17%	11.26%	7.82%	22.01%	-13.79%	-23.00%	-1.27%	-0.09%	4.10%	5.91%
Europe	8.88%	-27.17%	13.54%	7.89%	23.20%	-16.90%	-27.37%	-2.32%	-1.78%	3.92%	5.36%
Japan	2.96%	-24.20%	1.71%	14.48%	19.61%	-12.88%	-24.67%	-3.23%	-0.94%	5.43%	4.81%
China	-16.81%	-42.79%	-21.72%	29.49%	23.46%	-18.88%	-47.90%	-13.83%	-9.67%	0.06%	8.82%
Emerging Markets	-3.10%	-29.42%	-2.54%	18.31%	18.42%	-14.57%	-31.03%	-4.41%	-3.09%	0.81%	8.21%
ACWI ex US	2.99%	-24.31%	7.82%	10.65%	21.51%	-14.20%	-24.73%	-1.68%	-0.60%	3.26%	6.24%
US Fixed Income											
Bloomberg Barclays Index	**October**	**2022**	**2021**	**2020**	**2019**	**2018**	**1-Year**	**3-Year**	**5-Year**	**10-Year**	**20-Year**
Aggregate	-1.30%	-15.72%	-1.54%	7.51%	8.72%	0.01%	-15.68%	-3.77%	-0.54%	0.75%	3.04%
Treasury Bills	0.21%	0.85%	0.04%	0.54%	2.21%	1.83%	0.86%	0.56%	1.12%	0.66%	1.19%
Corporates	-1.03%	-19.56%	-1.04%	9.89%	14.54%	-2.51%	-19.57%	-4.18%	-0.32%	1.50%	4.12%
Securitized MBS/ABS/CMBS	-1.43%	-14.69%	-1.04%	4.18%	6.44%	0.99%	-14.85%	-4.09%	-1.08%	0.45%	
High Yield	2.60%	-12.53%	5.28%	7.11%	14.32%	-2.08%	-11.76%	0.31%	2.01%	4.11%	7.58%
Munis	-0.83%	-12.86%	1.52%	5.21%	7.54%	1.28%	-11.98%	-2.18%	0.37%	1.67%	3.44%
US Equity Sectors											
Index	**October**	**2022**	**2021**	**2020**	**2019**	**2018**	**1-Year**	**3-Year**	**5-Year**	**10-Year**	**20-Year**
Technology	7.82%	-26.08%	34.52%	43.88%	50.27%	-0.30%	-20.26%	16.34%	16.73%	18.71%	13.53%
Real Estate	2.04%	-27.47%	46.14%	-2.17%	29.00%	-2.23%	-20.73%	1.07%	6.02%	6.69%	
Industrials	13.92%	-9.68%	21.10%	11.05%	29.32%	-13.32%	-8.21%	8.22%	7.57%	11.92%	9.71%
Energy	24.96%	68.05%	54.35%	-33.68%	11.81%	-18.10%	64.25%	22.90%	10.95%	5.99%	9.96%
Consumer Discretionary	0.23%	-29.73%	24.43%	33.30%	27.94%	0.82%	-28.53%	6.66%	10.09%	13.41%	10.73%
Communication Services	0.14%	-38.96%	21.57%	23.61%	32.69%	-12.53%	-40.64%	-0.99%	3.61%	4.21%	6.22%
Consumer Staples	9.04%	-3.86%	18.63%	10.75%	27.61%	-8.39%	4.86%	9.39%	9.78%	10.61%	9.49%
Utilities	2.05%	-4.59%	17.67%	0.52%	26.35%	4.11%	2.88%	4.64%	7.44%	10.01%	10.77%
Materials	9.00%	-16.88%	27.28%	20.73%	24.58%	-14.70%	-11.03%	10.73%	6.91%	9.71%	9.60%
Financials	11.99%	-11.81%	34.87%	-1.76%	32.09%	-13.04%	-14.09%	8.00%	7.20%	12.44%	5.40%

DISCLOSURES

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The economic forecasts set forth in this material may not develop as predicted and there can be no guarantee that strategies promoted will be successful.

Rebalancing a portfolio may cause you to incur tax liabilities and/or transaction costs and does not assure a profit or protect against a loss.

Asset allocation does not ensure a profit or protect against loss. There is no guarantee that a diversified portfolio will enhance overall returns or outperform a non-diversified portfolio.

Diversification does not protect against market risk. All investing involves risk which you should be prepared to bear.

All indexes mentioned are unmanaged indexes which cannot be invested into directly. Unmanaged index returns do not reflect fees, expenses, or sales charges. Index performance is not indicative of the performance of any investment. Past performance is no guarantee of future results.

The Standard & Poor's 500 Index is a capitalization weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

The Russell 3000 Index is a capitalization-weighted stock market index, maintained by FTSE Russell, that seeks to be a benchmark of the entire U.S stock market.

The Dow Jones Industrial Average is comprised of 30 stocks that are major factors in their industries and widely held by individuals and institutional investors.

The NASDAQ Composite Index measures all NASDAQ domestic and non-U.S. based common stocks listed on The NASDAQ Stock Market.

The S&P Midcap 400 Stock Index is an unmanaged index generally representative of the market for the stocks of mid-sized US companies.
The Russell 2000 Index is an unmanaged index generally representative of the 2,000 smallest companies in the Russell 3000 index, whic

h represents approxi¬mately 10% of the total market capitalization of the Russell 3000 Index.

The Russell 1000 Index is a stock market index that tracks the highest-ranking 1,000 stocks in the Russell 3000 Index, which represent about 90% of the total market capitalization of that index.

The MSCI EAFE Index is an equity index which captures large and mid-cap representation across 21 Developed Markets countries around the world, excluding the US and Canada.

The MSCI EM (Emerging Markets) Index is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of the emerging market countries of the Americas, Europe, the Middle East, Africa and Asia.

The Bloomberg Barclays US Aggregate Bond Index is a broad-based flagship benchmark that measures the investment grade, US dollar-denominated, fixed-rate taxable bond market.

The Bloomberg Barclays US Treasury Bills 1-3 Month Index is designed to measure the performance of public obligations of the U.S. Treasury that have a remaining maturity of greater than or equal to 1 month and less than 3 months.

The Barclays Capital US Corporate High Yield Bond index is an index representative of the universe of fixed-rate, non-investment grade debt.