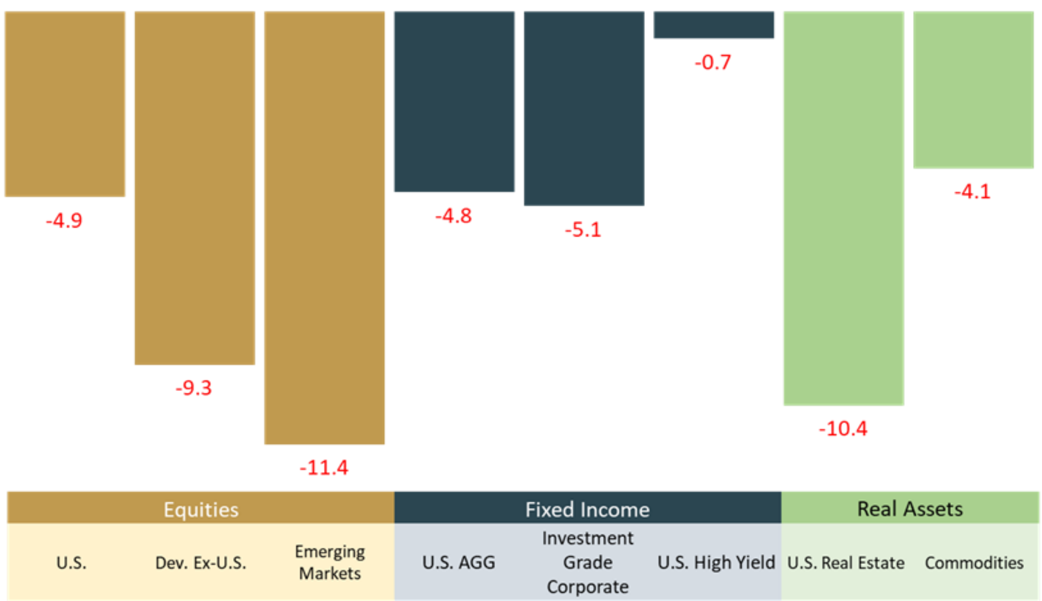
Markets in a Minute:
3Q 2022 Review & Market Outlook

In the third quarter of 2022, the S&P 500's bear market clocked in at ten months old, the Federal Reserve continued to tighten monetary policy as inflation accelerated, and recession predictions filled news headlines. With stocks and bonds down more than 25% and 15%, respectively, 2022 has so far been one of the more painful years in recent memory. But down markets, although they feel treacherous, present disciplined investors with tremendous opportunities for long-term growth opportunities.

Market Review: Q3'22 Returns



Past performance is not a reliable indicator of current or future results. Indexes are unmanaged and not subject to fees. It is not possible to invest directly in an index. Note: views are from a U.S. dollar perspective. This material represents an assessment of the market environment at a specific time and is not intended to be a forecast or guarantee of future results. Source: Kestra Investment Management with data from FactSet. Index proxies: Bloomberg U.S. Aggregate Bond Index, ICE BofA U.S. Corporate, ICE BofA U.S. High Yield, S&P 500, MSCI EM, MSCI EAFE, Dow Jones U.S. Select REIT, Bloomberg Commodity Index. Data as of September 30, 2022

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How Did We Get Here?

For nearly two years, the Federal Reserve and federal government fought the economic effects of COVID through extremely loose monetary and fiscal policy. With that, inflation began to grow, and by early 2022, the Fed began tightening monetary policy. Two issues complicated an already difficult job:

- Russia's invasion of Ukraine sent commodity prices, such as oil, natural gas and wheat, soaring and heightened geopolitical risks. While many of those prices have since retreated, war continues.
- Price increases proliferated elsewhere in the economy, driving wages rapidly higher

With the Fed hyper-focused on taming inflation, the markets are keenly following any sign of inflation abating. While there have been reasons for optimism, such as falling shipping prices, climbing inventories, or lower commodity prices—the Fed still faces an uphill battle with consumer prices climbing by nearly 9% year over year, the biggest change since 1981.

Where Do We Go Next?

With the possibility of a recession on everyone's mind, we monitor two key indicators that have proven to be reliable signals of a looming recession: the treasury yield curve and the ISM manufacturing index. As discussed in our last Markets in a Minute, these indicators point to a growing likelihood that we'll experience a recession within the next year. And where recession risks abound, market volatility surely follows.

While the Fed is working to tamp down economic activity, some areas remain resilient. For instance, jobs remain plentiful, and the consumer has grown more optimistic. But home prices, which tend to be very sensitive to interest rates, are falling rapidly in some markets, and manufacturing is slowing.

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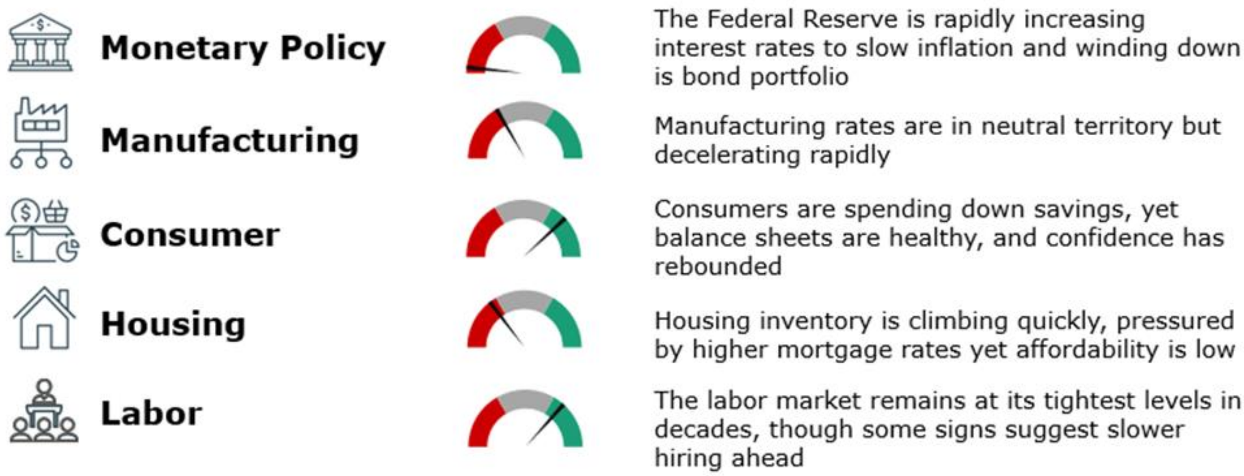
Economic Dashboard



Source: Kestra Investment Management

We will watch for two signs that could suggest we're nearing the end of this bear market:

- A meaningful decline in earnings expectations for 2023 – analysts estimate that earnings for the S&P 500 will grow by 10% next year. Given our expectation of a recession, those estimates appear too rosy.
- Clear evidence that inflation is slowing, particularly with wages – while there are some early signs of slowing price increases, wages remain sticky, and the labor market is extremely tight. The Fed will likely need to see some abatement in wage inflation in order to declare the inflation war won.

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A Summary of Recessions Since 1980

Recession	Recession Start	Recession End	NBER Recession End Announcement Date	Months after End	S&P 500 Total Return: Low to NBER Announcement Date
2020	Mar-20	Apr-20	7/19/2021	15	94%
2008-09	Jan-08	Jun-09	9/20/2010	15	74%
2001	Apr-01	Nov-01	7/17/2003	20	28%
1990-91	Aug-90	Mar-91	12/22/1992	21	60%
1981-82	Aug-81	Nov-82	7/8/1983	8	71%
1980	Feb-80	Jul-80	7/8/1981	12	39%
			Average	**15**	**61%**

Source: Kestra Investment Management and Compound Capital Advisors. Data as of August 11, 2022.

What Should Investors Do?

With equity and fixed-income markets already down significantly this year, much of the economic slowing appears priced in. Remember that stock and bond prices today reflect what's expected in the future. While we expect more economic softening ahead, know that **markets tend to rebound well before the economy does, and sometimes even before we officially know that we're in a recession.**

Some strategies that investors may want to consider taking advantage of volatile markets:

- Dollar cost averaging into investment positions
- Portfolio rebalancing (adding to down positions and possibly trimming positions with profits)
- Tax-loss harvesting

Outside the New York Stock Exchange, there's an iconic statue of a bull to symbolize the long-term upward trend of stocks. But very early in my career, I learned that bear markets also play an important role in the history of the stock market. In fact, the bear markets, when prices are depressed, can provide attractive opportunities for the disciplined investor with a dose of courage and a long-term time horizon. For that reason, I've long had two bookends of a bull and a bear on my bookshelves to remind me that while stocks don't always go up, every bear market we've experienced so far has eventually been followed by a bull.

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