December 12, 2022

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Market Stats & Commentary

Market Vital Signs as of 11/30/2022

Stock Indexes	November	YTD	1 Year
S&P 500	5.59%	-13.10%	-9.21%
Dow Jones Industrial Average	6.04%	-2.89%	2.48%
NASDAQ Composite	4.37%	-26.70%	-26.19%
Russell Mid Cap Index	6.01%	-12.59%	-9.02%
Russell 2000 Small Cap Index	2.34%	-14.91%	-13.01%
MSCI EAFE Developed Int'l Index	11.26%	-14.52%	-10.14%
MSCI Emerging Markets Index	14.83%	-18.95%	-17.43%
Bond Indexes			
BBgBarc US Aggregate Bond Index	3.68%	-12.62%	-12.84%
BBgBarc US Corp High Yield Bond Index	2.18%	-10.60%	-8.90%
Interest Rates	**11/30/22**	**12/31/21**	**11/30/2021**
Fed Funds Target Range	3.75%-4.00%	0.00%	0.00%
10 Yr U.S. Treasury Rate	3.69%	1.51%	1.43%

Data courtesy of Raymond James

November was another good month for U.S. equities but the real winners were the international markets. Both developed international and emerging markets lagged the rally in U.S. stocks during October, so this gets them back on track. Emerging markets were ignited mainly due to signs of relaxing COVID policy in China. As for the MSCI EAFE, to be honest, I think the U.S. rally and EM rally just drug it along with them. Europe is probably in a recession right now and still figuring out what to do to replace Russian natural gas. In fact, there is a firewood and wood pellet shortage in Europe because so many citizens have been installing new and reviving old wood burning stoves (https://fortune.com/2022/10/08/energy-crisis-europe-wood-chimneys-dung-gas-shortage/).

Bond indexes were also up in November due to falling long term interest rates. The yield on the U.S. 10 yr started November at 4.07% and ended at 3.69%, even though the Federal Reserve raised its Fed Funds rate by .75%. I know that seems completely counter intuitive so I will spend the rest of this month's commentary on that topic.

Why are Long Term Interest Rates Going Down While the Fed is Raising Rates?

I've been getting that question a lot lately. In order to make sense of this, let's first establish what interest rates the Fed controls (with traditional methods) and what interest rates it doesn't control.

What the Fed *Does* Control

The rate that markets and the news media focuses on is the overnight Fed Funds rate. This is the rate that banks charge when they lend to other banks overnight. There are a variety of reasons that banks borrow in the overnight market but for our purposes the why is not important. It happens every night and there billions, if not trillions, of dollars that change hands every night. So, changes in the Fed Funds rate directly affect the cost of interbank borrowing.

The other direct effect of the Fed Funds rate is the Prime Rate. Each bank sets its own Prime Rate but they are almost always set at 3% above the Fed Funds rate, which means the Prime Rate is more of a de facto decision rather than something each bank debates. The Prime Rate is used as a benchmark for a large portion of consumer and commercial loans and is the main way the Fed Funds rate affects the economy. Commercial loans, personal loans, car loans – all are mostly Prime Rate driven.

What the Fed *Does Not* Control

Now that we have established what the Fed directly controls, we move on to what it does not control. It's really just one thing but it is a very big thing – the market trading of U.S. Treasury bonds. The U.S. Treasury market is by far the largest and most liquid market in the world and prices (and therefore yields) are market driven rather than policy driven.

The rates in the U.S. Treasury market is what all other interest rates across the globe and based on. Everything starts with the comparable U.S. Treasury maturity as a base rate. It determines how corporate and government bonds all over the globe are priced (and therefore what they yield) daily. The Treasury market is also the main influence on mortgage rates. Finally, the Treasury market reflects where **investors** think rates *should* be and there are times that the market and the Fed think two different things. Like now.

What the Difference in Fed Rates and Market Rates Means

Right now, the market is saying that the Fed Funds rate will not stay this high for very long. Otherwise the long term Treasury rates would be much higher. Below are the U.S. Treasury Rates I write this at 10:00 AM CST on 12/12/22.

⊟ US TREASURY YIELDS		
US01YY-...	US 1Y T-Bill Yield (TPI)	4.78
US02YY-...	US 2Y T-Note Yield (TPI)	4.34
US03YY-...	US 3Y T-Note Yield (TPI)	4.09
US05YY-...	US 5Y T-Note Yield (TPI)	3.75
US10YY-...	US 10Y T-Note Yield (TPI)	3.56
US30YY-...	US 30Y T-Bond Yield (TPI)	3.55

As you can see, the 10 yr Treasury yield is 3.56% right now while the 1 yr Treasury yield is 4.78%. Short term rates tend to be more affected by Fed policy than the longer term rates, and you see that reflected here. The farther you get out in time from the Fed Funds rate, the more the rate is influenced by investors rather than the Fed.

I have written about inverted yield curves in the past and currently the curve is as inverted as it has been since the early 1980's. There is both good news and bad news about that. The bad news is that inverted yield curves have a very high probability of predicting a recession. The good news is that there is the belief in the market that interest rates will be lower in the relatively near future which would be very helpful for both stock and bond markets that have been derailed by rapidly rising interest rates.

David

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Keep in mind that individuals cannot invest directly in any index, and index performance does not include transaction costs or other fees, which will affect actual investment performance. Individual investor's results will vary.

Index Descriptions

S&P 500: Representing approximately 80% of the investable U.S. equity market, the S&P 500 measures changes in stock market conditions based on the average performance of 500 widely held common stocks. It is a market-weighted index calculated on a total return basis with dividend reinvested.

Dow Jones Industrial Average Total Return: The Dow Jones Industrial Average is a composite of 30 stocks spread among a wide variety of industries, such as financial services, industrials, consumer services, technology, health care, oil & gas, consumer goods, telecommunications, and basic materials. The index represents approximately 23.8% of the U.S. market, and is price weighted (component weightings are affected by changes in the stocks' prices). Maintained by the Averages Committee, components are added and deleted on an as-needed basis.

Russell Midcap: A subset of the Russell 1000 index, the Russell Midcap index measures the performance of the mid-cap segment of the U.S. equity universe. Based on a combination of their market cap and current index membership, includes approximately 800 of the smallest securities which represents approximately 31% of the total market capitalization of the Russell 1000 companies. The index is created to provide a full and unbiased indicator of the mid-cap segment.

Russell 2000: Based on a combination of their market cap and current index membership, this index is comprised of approximately 2,000 of the smaller securities from the Russell 3000. Representing approximately 10% of the Russell 3000, the index is created to provide a full and unbiased indicator of the small cap segment.

MSCI EAFE (Europe, Australasia, Far East) Index: A free float-adjusted market capitalization index that is designed to measure the equity market performance of developed markets, excluding the U.S. and Canada. As of June 2, 2014, the index consists of 21 developed market country indices: Australia, Austria, Belgium, Denmark, Finland, France, Germany, Hong Kong, Ireland, Israel, Italy, Japan, the Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland, and the United Kingdom.

MSCI Emerging Market Index: A free float-adjusted market capitalization index that is designed to measure equity market performance of emerging markets. As of June 2, 2014, the index consists of the following 23 emerging market country indices: Brazil, Chile, China, Colombia, Czech Republic, Egypt, Greece, Hungary, India, Indonesia, Korea, Malaysia, Mexico, Peru, Philippines, Poland, Qatar, Russia, South Africa, Taiwan, Thailand, Turkey, and the United Arab Emirates.

Bloomberg Barclays U.S. Aggregate (BCAG): A representation of SEC-registered, taxable, and dollar denominated securities. The index covers the U.S. investment grade fixed rate bond market, with index components for asset-backed securities, government and corporate securities, and mortgage pass-through securities. Must be rated investment grade (Baa3/BBB- or higher) by at least two of the following rating agencies: Moody's, S&P, Fitch; regardless of call features have at least one year to final maturity, and have an outstanding par value amount of at least $250 million.

Bloomberg Barclays U.S. Corporate High Yield: Covers the universe of fixed rate, non-investment grade debt which includes corporate (Industrial, Utility, and Finance both U.S. and non-U.S. corporations) and non-corporate sectors. The index also includes Eurobonds and debt issues from countries designated as emerging markets (sovereign rating of Baa1/BBB+/BBB+ and below using the middle of Moody's, S&P, and Fitch) are excluded, but Canadian and global bonds (SEC registered) of issuers in non-EMG countries are included. Original issue zeroes, step-up coupon structures, 144-As and pay-in-kind bonds (PIKs, as of October 1, 2009) are also included. Must publicly issue, dollar-denominated and non-convertible, fixed rate (may carry a coupon that steps up or changes according to a predetermined schedule), and be rated high-yield (Ba1 or BB+ or lower) by at least two of the following: Moody's, S&P, and Fitch. Also, must have an outstanding par value of at least $150 million and regardless of call features have at least one year to final maturity.