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Market Stats & Commentary

Market Vital Signs as of 9/30/2022

Stock Indexes	September	YTD	1 Year
S&P 500	-9.21%	-23.87%	-15.87%
Dow Jones Industrial Average	-8.76%	-19.72%	-13.40%
NASDAQ Composite	-10.50%	-32.40%	-26.81%
Russell Mid Cap Index	-9.27%	-24.27%	-19.39%
Russell 2000 Small Cap Index	-9.58%	-25.10%	-23.50%
MSCI EAFE Developed Int'l Index	-9.35%	-27.09%	-25.13%
MSCI Emerging Markets Index	-11.72%	-27.16%	-28.11%
Bond Indexes			
BBgBarc US Aggregate Bond Index	-4.32%	-14.61%	-14.60%
BBgBarc US Corp High Yield Bond Index	-3.97%	-14.75%	-14.11%
Interest Rates			
	9/30/22	12/31/21	8/31/2021
Fed Funds Target Range	3% to 3.25%	0.00%	0.00%
10 Yr U.S. Treasury Rate	3.80%	1.51%	1.53%

Data courtesy of Raymond James

September is historically the worst month of the year and it turned out to be especially lousy this year. The month was actually going just fine until the inflation report on September 13th. The number came in hotter than expected which pushed rates up and stocks down. The 10 yr U.S. Treasury yield cut through its previous ceiling of 3.5% like a hot knife through butter and made a run to just shy of 4% before ending the month at 3.8%.

As you can see from the numbers to the left, nothing had a good month and the best performing indexes still had a miserable month. As I have said in previous commentary, until there is clarity that the Fed is coming to the end of the tightening cycle the volatility and downside risk will remain. The natural next

question to that statement is – where does the Fed Funds rate top out and when does that happen? Here is a link to the Fed’s own current projections released after the last meeting:

<https://www.federalreserve.gov/monetarypolicy/fomcprojtabl20220921.htm> . The current projection for the end of this year is 4.4%. In June their year-end projection was 3.4%. That’s quite a difference from June to September and is an indication of how much further the Fed is going than the market, or even themselves, had expected.

The Root of the Inflation Problem

Inflation was already becoming an issue long before Russia attacked Ukraine. That act caused a short but severe spike in oil prices and a larger and more persistent problem in natural gas prices and food prices. But it didn’t start the fire, so to speak. The roots (there are several which are interconnected) lie in the imbalance created by demand staying healthy from government stimulus across the globe and the abrupt halt at most stages of the supply chain. To put it in simple terms – all the government stimulus (globally – not just here) during the pandemic kept people buying things when there was no production capabilities to resupply them. The assumption was that the supply chain would work itself out over the course of 2021 and that the inflation would be “transitory”.

That did not come to fruition for two main reasons:

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First, China adopted a zero COVID policy which was not in step with the rest of the world. As everyone knows, the supply chain for almost every industry runs through China in some form or fashion. If they are on regional lockdowns everything gets backed up again.

Second, there are not enough workers to fill job openings. Not only in the U.S. but in most of the developed world. So even if production is up and running, capacity is nowhere near 100%. Last fall I wrote commentary citing a Fed white paper which discussed the labor market and pointed to an interesting statistic: from March 2020 to September 2021, **3 million more workers retired than were expected to retire**. Combine that with the fact that many immigrant workers, legal and otherwise, went back to their home country during the pandemic and you get a large drop in the available labor force. As long as there is a shortage of workers, wages will be forced up. Wage inflation is more gradual than energy or food shocks, but it is much more permanent. It is also a long term structural problem which Fed tightening can't fix.

Emotion of Loss

One of my grad school classes at Harvard was Behavioral Corporate Finance, which is traditional corporate finance with an additional layer of behavioral economics to try to understand why rational executives or investors might make irrational decisions. It was really interesting and one of the topics is especially relevant these days – the difference in the emotional response of gaining something new and losing something you already have. My professor (who became a friend over many drinks in Cambridge pubs) had helped to develop a device to read the strength and location of responses in the brain to various economic topics. It's been well established that the pain of losing something you have is greater than the joy of getting something new, but his device measured the difference and helped pinpoint what part of the brain controlled the response. You can watch a video demonstration here:

<https://www.youtube.com/watch?v=8FRM09mQ3WU>

There were lots of takeaways from the data they accumulated over time, but the one that is applicable now has to do with the strength of emotional responses to gain and loss. They found that the strength of the brain's pain response to loss is about 2.4 times the strength of the happiness response from gain.

This means that the average person feels the pain of loss 2.4 times more than he or she feels happiness from gain.

So, it's normal to feel disproportionately worse in bad markets. Now, I realize that throwing out this nugget of information isn't going to make anyone feel any better about performance of almost anything this year. But I do think it is worth noting.

I say all that to say this, it is normal for stomachs to churn in times like this. It's also my job to do my best to take emotion out of the decision-making process and make the most rational recommendations and decisions I can. Everyone feels pretty miserable right now about markets, but if that misery is becoming too much and you feel like making an emotional decision – please call me and I will be happy to go over the data as I see it and we can go from there. Sometimes emotions become too much and it forces a decision that is not completely rational. However, even if a result is not completely rational, a more rational decision is better than a less rational decision.

One final note, please don't take my data driven mindset to mean that I'm being obtuse (yes Roger, I just Andy Dufresne'd myself). Trust me, I feel the same emotions as everyone else. However, it's my job to be as rational as possible when markets become this emotional, so that is what I try to do.

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.