Think Strategically: The 8 market developments that may alter Wall Street's year-end

December 5, 2022

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The 8 developments to examine

While our forecast for the markets in 2022 has been that the markets would finish 2022 with small gains. As November approached, we were not anticipating a robust recovery that may take us into 2023. The market gains have made a big push in the last two months, mainly stemming from signs that inflation has peaked. This occurrence has begun to alter the Fed's sentiment and comments hinting that the bank's aggressive interest rate campaign may pivot down.

All the available data demonstrates that US consumers spent more in October than they did the prior month and the Core PCE fell sharply. This complex scenario provided the basis for the most pessimistic investor sentiment ever since 2008.

November was a blessing for Global equities, as they recorded the year's first consecutive monthly gain since 2021. Additionally, investment-grade bonds BBB- or higher recorded the most significant monthly increase since the great financial crisis of 2008, serving as a critical reminder to stick to a diversified and goals-oriented investment approach.

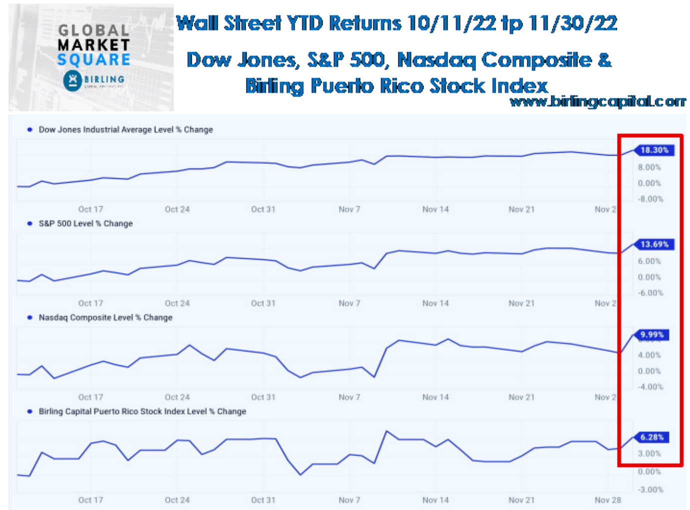
2022 has been the year of the Ukraine war, 40-year high Out of control inflation, aggressive interest rate campaigns, and the possibility of the U.S. falling into a recession, as initially happened in the first two quarters with negative GDP only to recuperate in the third quarter with a 2.90% GDP.

As we review 2022, we provide 8 critical highlights that investors may have missed:

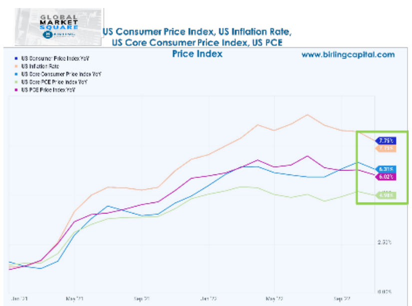
1. **Price of Gasoline:** gasoline prices fell to the lowest cost before Russia invaded Ukraine, with an average of $3.47 from a peak of $5.00 during June, a 30.60% decrease since its peak. The most recent price is $3.649.

2. **U.S. Currency:** The U.S. dollar fell 5% compared to comparable currencies, recording the worst month since 2010. The ICE U.S. Dollar Index (^DXY) fell from $112.97 on November 3, 2022, to 104.51 on December 2, 2022, falling -7.50%.

3. **A November to remember:** the four indices we follow have increased since their lows of October 11, 2022, to November 30, 2022, were as follows:
    - Dow Jones Industrial Average rose 18.30%
    - S&P 500 rose 13.69%.
    - Nasdaq Composite rose 9.99%.
    - Birling Puerto Rico Stock Index rose 6.28%.



4. **The Inflation Readings**: The Core PCE Price Index that reported at 4.98%, slightly above the 4.91% Inflation NowCast estimate. In absolute terms is below last month's 5.15% PCE, some 3.30% less than the previous month's reading. Notwithstanding, this is not a big miss; a miss is not what we all need to see from the Fed's key inflation metric.



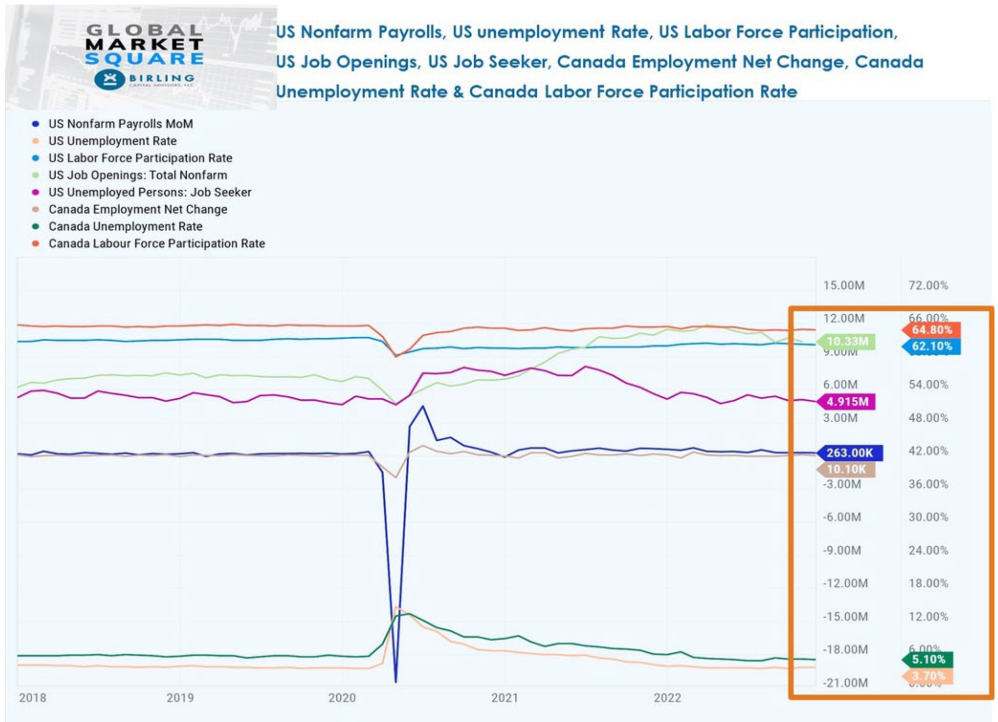
5. **The VIX Volatility Index:** which measures the implied expected volatility of the U.S. stock market, fell to this year's low of 19.84, down from its year high of 36.45 on March 7, 2022.
6. **U.S. Muni bonds rated BBB- or higher**: In November, tax-exempt bonds recorded their most robust monthly return since 1986, rising 5% to erase some of the year's losses.

    The rally in tax-exempt bonds occurs for two key reasons:
    - Investors' pessimism towards inflation pressures has improved as the CPI and PCE fell.
    - New Municipal Issues have slowed.

    Even with this recent rally, the year has not been kind to fixed-income bonds, let's examine:
    - Municipal Bonds have a –8.9% YTD Return.
    - Taxable Corporate Debt has a –15.3% YTD Return.
    - US Treasuries have a –12.4% YTD return.

    The driving force for last week's rally in both bonds and stocks was comments from Fed Chair Powell, who cautioned that the bank's monetary policy would remain restrictive until they see definitive inflation-lowering progress. "Despite some promising developments, we have a long way to go in restoring price stability. Thus, it makes sense to moderate the pace of our rate increases as we approach the level of restraint that will be sufficient to bring inflation down," Chairman Powell said. While it has been painful to stomach these interest-rate increases, we have become accustomed to lower-than-average rates.
7. **U.S. taxable investment-grade bonds rated BBB- or higher**: recorded their best monthly return since 2008. While the spreads have remained in a range of 30 basis points since the end of April 2022, they have broken higher as the Fed took a more aggressive interest rate campaign. There are numerous opportunities for investment at sensible prices.

8. The outlier that could derail the Fed's work and the broader markets is Jobs Growth. Seriously?



Unlike the seven development we discussed above, some outliers could, in their peculiar way, derail the end of 2022, and surprisingly is none other than job growth.

The November jobs report was stronger-than-expected with 263,000 new jobs or 31.5% above the consensus estimates of 200,000. The unemployment rate was unchanged at 3.7%, meeting consensus estimates, and the labor force participation rate fell slightly to 62.1% from 62.2% in October and remains well below the February 2020 rate.

Usually, such a robust and resilient jobs market would be welcomed news. However, the current market scenario is being interpreted as bad news as it suggests the Fed has little impact on slowing wage growth. Following the jobs report, the bond and stock markets reacted negatively and lost some gains. The key message is that a strong labor market may complicate and extend the Fed's efforts to fight inflation. However, we think the FOMC will slow down its interest rate pace and only increase rates by 50 basis points in December.

Lastly, the FOMC and investors feel inflation is receding, the worst-case outcomes may narrow, and the market momentum will keep rising.

The Week in Markets: US Jobs Growth rises 31.5% above estimates, and Wall Street pauses

The U.S. stock markets closed the week with mixed results following stronger-than-expected U.S. jobs reports of 263,000 new jobs or 31.5% above the consensus estimates of 200,000. However, not even the rosy job reports will be able to quell the Fed's aggressive interest rates campaign to fight inflation. While inflation has fallen to 7.75%, below its peak of 9.06% in June 2022, it is still 287.5% higher than the Fed's inflation target of 2%. The Fed has stated that U.S. economy can absorb higher rates without pushing the economy into a recession.

Wall Street Weekly Summary for the week ending December 2:

- Dow Jones Industrial Average closed at 34,429.88, up 82.85 points or 0.24% and a YTD return of -5.25%.
- S&P 500 closed at 4,071.70, up 45.58 points or 0.13% and a YTD return of -14.55%.

- Nasdaq Composite closed at 11,463.78, up 237.42 points or 2.11% and a YTD return of -26.74%.
- Birling Capital Puerto Rico Stock index closed at 2,715.37, down 17.63 points or -1.44% and a YTD return of -5.69%.
- U.S. Treasury 10-year note closed at 3.51%.
- U.S. Treasury 2-year note closed at 4.28%.

Weekly Market Close Comparison	12/2/22	11/25/22	Return	YTD Retun
Dow Jones Industrial Average	34,429.88	34,347.03	0.24%	-5.25%
Standard & Poor's 500	4,071.70	4,026.12	1.13%	-14.57%
Nasdaq Composite	11,463.78	11,226.36	2.11%	-26.74%
Birling Puerto Rico Stock Index	2,715.37	2,747.74	-1.18%	-5.69%
U.S. Treasury 10-Year Note	3.51%	3.68%	-4.62%	1.90%
U.S. Treasury 2-Year Note	4.28%	4.42%	-3.17%	1.90%

The Final Lesson: Will the U.S. and Global Economies suffer from the Interest rate campaigns

In the fight to combat high inflation, U.S. and Global central banks have implemented the most aggressive interest rate campaign since the 1980s, which appears guaranteed to continue into 2023.

We wonder how much the economic growth of the U.S. and the world will suffer because of it.

Date	GDPNow 4Q	Change
10/28/2022	3.10%	0.00%
11/3/2022	3.60%	16.10%
11/9/2022	4.00%	10.00%
11/16/2022	4.40%	9.09%
11/17/2022	4.20%	-4.76%
11/23/2022	4.30%	2.33%
12/1/2022	2.80%	-53.57%

The latest GDPNow from The Federal Reserve Bank of Atlanta shows a 2.8% GDP for the fourth quarter of 2022, down from 4.3% GDP, a -53.57% decrease in the forecast. Should the Fourth quarter US GDP remain strong and is recorded above 2.8%, we may have dodged a bullet.

Also, the forecast for the Global GDP is 3.2% for 2022; should it materialize, the world would be in a good position.

While it is too early to tell now, the forecast is favorable.

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