Marketline September 2022

Stocks:

September lived up to its name as a frightening month – although whether we needed this warm-up for Halloween is questionable. The Dow sank 8.8%, while the S&P dropped 9.3%. The real damage was over at the NASDAQ, where technology stocks helped drag this index down 10.5%. That number would be unsettling for an entire year, let alone a mere month. Sometimes there's a reason for crummy returns, but sometimes there isn't. This time, the primary culprit was interest rates, which rose in earnest (see below). Rising rates weren't an *unexpected* result of the milieu we are enjoying at the moment, though. The Fed has said it would hike rates about a hundred thousand times. Still, market participants choose at times to take what is said more seriously than at other times. That's when we perceive a "reason" for a decline.

Overseas, returns were better. The Canadian exchange was off 4.6%; Mexico fell a mere 0.7%, and Europe was down 5.4%. These returns, though, are raw numbers and do not include translation back into the ever-stronger US dollar. Had we made that exchange, the numbers would not look so moderate.

After the waterfall of returns we saw in September, the most common question we are hearing is – when will this end? No one knows, but it is reasonable to expect that we are more than halfway finished with the bear market. We have noted before that there is no "bottom" per se; instead, finding support for prices is a process. That includes bad days, bad months, good days, and good months – all of which are the trial and error of the marketplace determining if $X is the right price given the extant uncertainties, or if it should be $Y instead. The one thing we do know is that a bear market like this clears the way for higher returns later.

Last month we mentioned that the stocks of several homebuilders had been given space on our watch list. We just migrated those to our buy list and will filter them into portfolios as appropriate over time. Our philosophy around making purchases in uncertain times is to take a gradual approach, adding a partial position and then filling in if we see lower prices later. The homebuilders may seem to be a contrary idea, but long-term investors will recognize that the US is under-housed. Meanwhile, despite rising interest rates, the stocks have been rising, not falling. This indicates to us that investors in this sector are looking beyond the trouble that higher rates bring to the housing market, and toward the day when the economy has adjusted to the rate scene.

Bonds:

Yes, we still have an inverted yield curve! It didn't go away last month; in fact, it worsened. Short-term interest rates from about one year to five years are at or in excess of 4% now. But the long bond closed the month at 3.78%. Thanks to a fat rally in the first days of October, it's at 3.69% today. So yes, there's a recession in the offing. It's worth remembering that we are not alone: credit is contracting globally, with many central bankers hiking interest rates at the same time.

On the other hand, we may already be in a recession. While the labor market is strong, plenty of other indicators have dropped precipitously. Even commodity prices are down recently – including oil. And it's difficult to remember with every pundit on television making the same error over and over, but the labor market is the *last one to know about a recession*. There's a momentum to hiring that isn't broken until an abundance of evidence points to a downturn. Likewise, companies are slow to hire when orders pick up on the other side.

Given the perspective of the last several years, bonds offer a much happier hunting ground these days. From struggling to find 3% yields on municipals to locking in over 4.5%, from high-grade corporates paying no more than Treasuries to supplying at least a small spread now, we find it's ever easier to secure higher future returns. That is the silver lining in this historic bond market correction.

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