Marketline November 2022

Stocks:

The conclusion of earnings season helped spur stocks last month to a roughly 5% gain across the domestic indices, with technology lagging slightly. But the real propulsion came from interest rates, which dropped significantly in longer maturities. Overseas, returns were similar to the US. Mexico's Bolsa rose by 3.5%; Europe performed a bit better with a 6.7% return; and Canada was up 5.3%. We keep repeating – but it bears another mention – that returns largely derive from math, specifically a formula that combines interest rates, earnings and dividend flows. When interest rates rise, valuations tend to fall, but when rates fall, values tend to rise. That's what we saw last month.

Aside from rates, supply chains are beginning to untangle. We have seen price softness in apparel and a smattering of other goods. Shipping prices have fallen. Gas prices are down a bit. It's clear that some inflation drivers are dissipating, though others are not. The job market is still strong, and wages are still rising. Some of these crosscurrents will not be good for corporate bottom lines in the future. A flat spot or decline in earnings might well temper stock gains, no matter what rates do.

Over the last couple of months, clients will have seen tax-related trades. Rules for wash sales mean we must wait thirty days before repurchasing a stock we've used to harvest losses. We usually wait slightly longer just to be safe. Occasionally we will not repurchase a stock we've used for losses, at least not in any short time frame. We're also adding a few new stocks to our buy list again – Baxter International and Google. Baxter is down due to a poorly timed purchase of a hospital bed maker – a business that turned down during the pandemic and still has not recovered. Google is off with the rest of the technology complex, and particularly over concerns about advertising volumes. For clients with the right risk tolerance, one or both of these may eventually be incorporated in your portfolios.

Bonds:

Liquidity in the Treasury market has not improved much. This had a hand in producing a booming month for bonds on the long end of the maturity spectrum. But intraday volatility was marked. Once in a while this worked in our favor, such as when we were making tax loss sales during the month, then reinvesting, but equally often, sales produced proceeds only to be met with higher bond prices. For now, we remain devoted to the idea that we should aim for higher coupon bonds, to increase cash flow generation. We see this tactic as the best way to capitalize on higher rates, as opposed to sticking with low coupon bonds and taking our return in the form of capital appreciation at some point in the future.

In terms of shape and yield: The short end of the market continues to rise in yield. The month ended with the one year note at a 4.7% yield, up ten basis points (0.10%). Meanwhile, the long bond closed down forty-three basis points to 3.73%. In the municipal market, that made for the best month since 1986. Of course, you can see that the ski slope from short to long has only grown steeper. It bears repeating that this inversion is a precursor to a recession, and has an excellent predictive record. It does not, however, predict the severity of a recession.

Longer term, the issue of not enough buyers for US Treasury securities looms. Perhaps this will dissipate if larger buyers such as nations and pension funds decide the Fed's rate hike cycle is over. Perhaps the market will clear at a higher level of rates than we are used to over the last few years. Perhaps volatility will be a fixture of our markets for the foreseeable future. Perhaps an adjustment in our currency value will occur. But somehow demand needs to increase in order to absorb all the new Treasuries we are issuing.

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