Graves Light Lenhart
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Graves Light Lenhart November '22 Market Commentary

November Brings Continued Relief Across Markets

Market Overview:

Positive price momentum continued through November, with markets rallying on better than expected inflation data. The headline year-on-year inflation rate dipped again and importantly, the "core" measure for inflation also cooled. Markets took solace as the alarming and seemingly constant increases that started early last year have finally started to roll over. The result was a near instant shift in expectations for the Federal Reserve's future monetary policy, reducing expectations for future interest rates (albeit, remaining at relatively high levels compared to recent history).

Separately, there were nascent signs that China's authorities are preparing to reopen and end the zero-COVID policies that have held back the economy for the past three years. The reopening signs provided a resultant surge in Chinese stocks which also propelled monthly outperformance of emerging markets. We believe it is unlikely that China will suddenly and materially step away from its stringent zero-COVID protocols before the end of winter, especially while COVID cases have been rapidly climbing (according to China's National Health Commission). On balance, communicated measures indicate movement beneath the surface to *eventually* reopen. Markets clearly responded positively to the likely boost were the economic reopening to occur.

Lastly, the cryptocurrency markets continued to experience drama, with the rapid implosion of crypto exchange firm FTX, along with others, signifying further strain in the space. While the turmoil in the digital assets ecosystem persists, so far, there haven't been signs that the recent bursting in this market is stressing the US financial system in general or the banking system.

Asset Performance:

A strong rally on the last trading day of November rounded out a month of relief for the markets in the form of slowing inflation and increasing optimism surrounding the potential slowing pace of rate hikes in the US. Indeed, the S&P 500 posted its second straight month of improvement, with a total return of +5.6%. Gains were broad-based, irrespective of market capitalization, with the S&P 400 (mid-caps) gaining +6.1% and the S&P 600 (small-caps) +4.2% for the month.

Value-oriented securities – which trade cheaply based on their fundamentals – continued their relative outperformance when compared to their growth-biased counterparts. For the month, the S&P 500 Value Index returned +6.0% compared to a still strong +5.1% return from the S&P 500 Growth Index. Having experienced a multi-year period of underperformance, year-to-date, we have witnessed a significant reversal. Specifically, the S&P Value Index is down -1.4% through November-end, compared to the -23.6% drubbing experienced by the S&P 500 Growth Index over the same time period.

Key US Index Returns	YTD '22	November '22
S&P 500	-13.1%	+5.6%
Nasdaq	-26.1%	+4.5%
Dow Jones Industrial Average	-2.9%	+6.0%

Relevant Fixed Income Yields	YE 2021	November '22
US 10-Year Treasury Note	1.51%	3.70%
Investment Grade Corp. (C0A0)	2.4%	5.4%
High Yield Corp. (H0A0)	4.3%	8.6%

Source: Factset as of 12/02/22

As concerns for a possible recession linger in the markets, analysts continued to lower their earnings-per-share (EPS) estimates for both the 4th quarter as well as 2023. According to Factset, from September 30th to November 30th, 4Q22 bottom-up EPS estimates for S&P 500 constituents decreased by 5.6% (to $54.58 from $57.79). While analysts typically reduce earnings estimates during the first two months of the quarter, the recently observed round of estimate cuts is outsized from a historical perspective. This has affected overall valuations, as the price of the S&P 500 Index has *increased* while EPS estimates for calendar-year 2022 and 2023 have *decreased* during this time. As a result, higher prices combined with lower EPS estimates have produced a pricier market, with the forward 12-month price-to-earnings ratio (P/E) for the S&P 500 increasing to 17.6x from 15.2x since September 30th.

With Treasury yields declining as a result of decelerating inflation, US fixed income asset performance was positive across the board. Indicatively, the Bloomberg US Aggregate Index – representing a consortium of bonds from government to corporate securities – increased +3.7% for the month, its best of the year. While positive for the month, the index remains down -12.6% year-to-date through November-end, by far its worst year on record.

Closing Thoughts:

We emphasize that even though inflationary trends appear to be heading in the right direction, we certainly aren't out the inflation woods just yet. Research Affiliates recently provided some sobering data points, including the following. Reverting to 3% inflation, which is viewed as the upper bound for benign sustained inflation, is easy from 4%, hard from 6% and very hard from 8% or more (June '22 levels). Above 8%, reverting to 3% usually takes 6 to 20 years, with a median of over 10 years. In short, we do have a ways to go! Moreover, at current valuations, the equity market is trading at relatively high levels when compared to bear market troughs since the 1950s (as referenced above). We see valuations acting as a governor on markets, especially if forward earnings estimates continue to be trimmed.

Warm regards,

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