Weekly Commentary 11/09/2022

An Oxford Harriman & Company Market Commentary

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After declining over 9% in September, the S&P 500 gained 8.1% during October. Likewise, the Russell 2000 Index of small cap stocks reversed direction, gaining 11.2% during October after declining 9.7% in September. In the bond markets, high yield corporate bonds outperformed as credit spreads tightened. However, investment grade bonds produced a slight loss as Treasury yields continued to move higher. As we have discussed in our previous commentaries, we attribute this stock and bond market volatility to investor uncertainty, and perhaps anxiety over the Federal Reserve's interest rate policy.

The October equity market rally was driven by the concept of a "Fed pivot", which is defined as reversal in the Federal Reserve raising interest rates. The pivot concept gained steam recently as Fed officials started to debate when and how to stop raising interest rates, which the market interpreted as fewer rate hikes and a lower terminal rate. Stocks traded higher as the market priced a lower terminal rate. Until the direction of Fed policy is clearer, the market's projected terminal rate will continue to fluctuate. This means volatility could remain elevated in coming months.

Similar and related to Fed policy is inflation, which remains a closely watched topic. Core inflation, which excludes volatile food and energy prices, increased 6.6% year-over-year during September, which was the fastest annual pace since August 1982. Early inflation pressures were attributed to clogged supply chains and strong demand overwhelming limited supply. However, a new source of inflation is gaining attention as supply chains normalize – wage inflation. As we started October, hourly wages increased 5% over the same period for 2021. This increase, which is significantly above the pre-pandemic trend, indicates labor demand is outpacing labor supply and employers are paying more to attract and retain workers. Data has shown that millions of workers left the labor market during the pandemic and have not returned. This is a significant factor behind wage inflation. The number of people not in the labor force includes people who are neither employed nor unemployed and consists of retired persons, students, individuals taking care of children or other family members, and others not seeking work. At the end of February 2020, approximately 95 million individuals were not in the labor force. This number spiked to 103.5 million at the end of April 2020 as workers left the labor market due to the coronavirus, health concerns, childcare responsibilities, and early retirement. While some of those individuals returned to the labor market, there were nearly 5 million more people not in the labor force at the end of September 2022.

Wage inflation is one of many factors potentially complicating the Federal Reserve's goal to bring inflation under control. Bringing the labor market back into equilibrium could ease wage inflation, but it could also significantly increase unemployment. Despite the near-term employment risk, the Fed views the risk of inflation becoming entrenched as a larger long-term risk to the overall economy. Additionally, based on commentary from several Federal Reserve officials, the Fed is not concerned with the volatility and pressure placed on the capital markets because of their efforts.
We will be watching labor statistics in the fourth quarter and will continue to keep you updated on how the labor market may impact Fed policy and your investment portfolio.

While we continue to believe the market will remain volatile as these issues are debated among investors, we do recognize that, historically, the market is forward looking. At some point, the market will have discounted any potential recession and will begin to reflect future growth. Our team will continue to monitor the above uncertainties, among others, in the coming months to help guide investment portfolio positioning.

Sincerely,

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