FLIPPIN, BRUCE & PORTER

A BUSINESS OF CANTOR FITZGERALD INVESTMENT ADVISORS

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2022 has been a difficult year for stock and bond investors, and the third quarter was no exception. Stocks ended the quarter at or near their lows for the year and have fallen for three quarters in a row. Fixed income markets were also weak with both markets heavily influenced by inflation and the Federal Reserve's response to it. Optimism abounded early in the quarter as expectations that inflation was easing produced a significant rally in stock prices during July. About half of the year-to-date losses for the S&P 500 were recovered that month. It didn't last. August's CPI report, showing persistently high numbers, threw cold water on the rally, and a broad selloff lasted through the balance of the quarter.

The old adage "don't fight the Fed" seems to be playing out true to form in the markets this year. In September, the FOMC announced a 75 basis point increase in the fed funds rate. The committee increased the rate by that same amount in its two previous meetings. Taken together, these moves are the most aggressive rate hikes since 1994. Despite hopeful comments from the Fed about inflation being transitory, rising costs have persisted and even worsened during 2022. Oftentimes, inflation is driven by strong consumer demand as economies get overheated, but this bout with escalating prices appears to be more closely related to global supply chain issues coming out of the pandemic. Energy prices, which had been a major driver of inflation early in 2022, dropped over the summer, with gasoline prices well off peak levels and down 10% for the month of August, giving rise to the expectation that inflation had improved. But declining fuel costs were not enough to offset rising prices for food, shelter and medical expenses. Even excluding more volatile food and energy components, inflation was higher than expected at 0.6% for the month of August and 6.3% year over year. Investors were seemingly caught off guard by this news, and stock prices fell quickly as the reality set in that higher interest rates for an extended period were likely.

It is becoming more and more obvious that attempts to bring down sky-high inflation that harkens back to the 1970s will be challenging. Fed Chairman Jerome Powell has acknowledged that this fight will bring real economic pain to Americans. The good news is that employment levels remain quite strong. It will be important to watch those numbers in the coming quarters. Most analysts now place low odds on Powell being able to facilitate a soft landing that would dampen inflation without causing a recession. It appears to us that the most probable scenario is a mild recession that has either already started or will begin shortly. We would expect to see deteriorating economic indicators heading into 2023 with corporate earnings coming under pressure as a result. A year from now, it seems likely that GDP growth will have resumed, and another economic expansion will be underway.

With rising interest rates comes weak bond markets. For the year ended 9/30, fixed income benchmarks suffered double-digit percentage declines. We have maintained short duration portfolios for some time, which is a defensive positioning. Consequently, that has led to significant outperformance this year for the fixed income portion of our balanced accounts. As the 10-year Treasury note nears 4%, we will likely begin extending maturities going forward. It is worth noting that after a decade or more of paltry returns from money market funds, yields are much higher today with the fed funds rate at 3-3.25%.

Despite negative returns, our Equity & Dividend Plus account has outperformed large cap benchmarks in 2022. The account fell behind during the rally in July, and that underperformance generally continued during the selloff in August and September. During the quarter, we sold Tyson Foods after the company announced changes to its management team that made us uncomfortable. We purchased Home Depot, a well-managed home supply retailer that should perform well when investors begin favoring risk assets again.

We encourage you to contact us with any questions you may have. For additional firm wide information please visit our website at www.fbpinc.com or call us at 1-800-851-3804. As always, we appreciate your continued interest in our firm.