Market Perspectives

4th Quarter 2022

Market Outlook for Q4

This quarter will move quickly—from the changing colors of the leaves to Election Day to the holiday season that follows.

Recession?

Economists, including Louisiana economist Loren Scott, predict the US economy will likely experience a mild recession starting early next year. The potential downside risks that economists are warning for include lackluster housing market, elevated energy prices and weak consumer sentiment.

There are two key reasons to expect this national downturn. First and foremost is that the U.S. has a non-trivial inflation problem. With a CPI at 9.1%, the Fed will have to attack this problem with two primary tools. These tools will be raising interest rates and open market operations to take lendable money out of the financial system.

Some things to watch

- The Federal Reserve's plan to continue raising rates to cool inflation could negatively impact the economy. These rate hikes could diminish the economic expansion.
- Inflation is affecting the spending power on income distribution. The Fed's tightening policies that make inflation run higher than wage gains are weakening consumer demand.
- Many feel that The Inflation Reduction Act which includes tax increases is a peculiar fiscal policy in the face of a looming recession. Increasing business taxes causes firms' cost to shift upward. This, in turn causes them to produce less output and hire fewer people —the very makings of a recession.
- Ideally, the labor force participation rate will continue to go up so unemployment continues to increase, beneficial for both the Fed and the markets. An increase in the labor force participation rate will help reduce the pressure from higher wages on inflation which, today, seems to be at the top of the Fed's concerns.

Until inflation abates and Fed policy clarifies, market volatility is likely to continue.

What to do

Patience and sticking with your game plan will be key to long-term success. Diversification, asset allocation, and a long-term mindset are timeless yet critical skills for any investor.

Questions

If you have any questions about these topics, please let our team know.

Economic Snapshot

Although US economic activity has been decelerating for some time, the US labor market seems to be on a completely different path, and this has the financial markets on edge as they believe the Fed will be more prone to overdo its interest-rate hand than not. This has kept the markets on a roller coaster over the last several months as they try to decipher not only the next moves but also the size of coming rate hikes as well as the duration of high interest rates. It is clear the housing market has been the most affected by rates hikes, and now we are also seeing consumer demand weakening considerably due to higher inflation. However, an average of 400,000-plus new workers every month has kept the labor market humming as the service sector economy fully recovers from the pandemic. We see higher risks of recession for next year as the Fed continues to increase interest rates.

	ECONOMIC INDICATOR	COMMENTARY
FAVORABLE	THE DOLLAR	Stronger. Central bank policy is a key factor in the near-term currency outlook and the Fed is likely to be more aggressive in tightening. The dollar has benefitted from global tensions, and it has surged for most of the year. While a strong currency lowers the cost of imported goods, it also negatively impacts overseas revenues.
NEUTRAL	GROWTH	GDP growth is expected to continue to moderate.
NEUTRAL	EMPLOYMENT	Nonfarm payrolls are still very strong. Expectations are for nonfarm payrolls to start to weaken while the unemployment rate increases.
NEUTRAL	CONSUMER SPENDING	Consumer spending continues to weaken due to high inflation.
NEUTRAL	BUSINESS INVESTMENT	Interest rates will continue to bite into the strength of business investment in the coming quarters.
NEUTRAL	MANUFACTURING	Although manufacturing output has slowed down, export growth continues to be supportive of further expansion.
NEUTRAL	LONG-TERM INTEREST RATES	Bond yields have increased considerably, and the yield curve has inverted further during the last several months.
NEUTRAL	FISCAL POLICY	A reduction in fiscal stimulus (compared to the massive levels of 2020 and 2021) will weaken the contribution to GDP from government spending.
NEUTRAL	REST OF THE WORLD	COVID-19 is still a factor globally. The war in Ukraine will have a bigger impact on Europe's economy than that of the US. Inflation is higher everywhere, which is an issue for emerging economies. Repeated droughts, floods, and other natural disasters continue to negatively impact crops, housing, and more.
UNFAVORABLE	HOUSING AND RESIDENTIAL CONSTRUCTION	There are important signs of slowing housing demand due to the strong increase in mortgage rates. We should continue to see weaker housing and lower home prices in the coming months.
UNFAVORABLE	INFLATION	Elevated. Inflation remains the biggest risk for the economic outlook. The shift toward service consumption should help reduce price pressures on goods. However, oil prices remain the biggest threat to inflation.
UNFAVORABLE	MONETARY POLICY	The Fed has become more aggressive with rate hikes and increased its ending fed funds rate target. This raises the risk of overdoing it, leading to a possible recession in 2023.

Raymond James, "October 2022 " *Investment Strategy Quarterly,* Pg. 2-6, 17 Web. Loren C. Scott, *Louisiana Economic Forecast* 2022 Pg. 18-19

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