WestStar Wealth Management | Wealth Watch

For Managed Portfolios

2022 Q3 Review & Q4 Outlook

We understand the concern many of our clients feel given the tremendous market volatility investment portfolios have experienced through September. They are not alone, as feeling beaten-up is shared universally among investors as we enter the fourth quarter of 2022. "Don't fight the Fed" is a well-known Wall Street idiom, yet investors have had no choice but to contend with aggressive rate hikes and persistent inflation. Meanwhile, the fight between Ukraine and Russia rages on, the fight between political parties in the US is escalating as we approach the mid-term elections, and investors fight to remain focused on achieving their long-term goals during this turbulence.

"Let's Get Ready to Rumble...!"

Author Manoj Arora once said, "In life and in a boxing ring, the defeat is not declared when you fall down but only when you refuse to get up." In their 1951 fight, though Rocky Marciano was knocked down in the first round by Jersey Joe Walcott, he remained resolute and came back to win by knockout later in the bout. Like Marciano, as harrowing as markets have been for investors in 2022, we must stay steadfast in our resolve to achieve our long-term goals through near-term setbacks. We therefore draw inspiration from boxing to guide us in assessing the markets and economy throughout this edition.

Bill Brady, CFA
SVP, Director of Investments
WestStar Wealth Management
bill.brady@weststarbank.com
915.747.4930

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What You Need To Know:

- Markets continued their descent for the third consecutive quarter
- With all major asset classes down, no diversified strategy was able to counter the late quarter decline
- The 2022 market has actually been consistent with past bear markets in terms of the magnitude and duration of the decline
- Recession risk is rising, but current assessments suggest that if one occurs it may be mild
- Midterm election years tend to be weak but rally post-election
- Discord in Washington tends to bode well for the stock market
- Remain focused on your long-term strategy even amid volatility

Asset Class Index Performance* Year-to-Date As of September 30, 2022

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- Commodities 13.57%
- Money Market (Cash) 0.58%
- Alternative Investments -7.30%
- US Investment-Grade Bonds -14.61%
- High Yield Bonds -14.75%
- US Large Cap Stocks -23.87%
- International Bonds -23.88%
- US Small Cap Stocks -25.10%
- International Developed Market Stocks -27.09%
- International Emerging Market Stocks -27.16%
- Real Estate -29.42%

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Performance: *Taking It On the Chin*

Boxer Sonny Liston once said, "My punches are just as hard in Chicago as in New York." Fed Chairman Jay Powell and inflation could echo that sentiment as it relates to the third quarter. Aside from cash equivalents, nearly all categories in all forms and locations were negative, with the worst performers being Emerging Markets stocks and Real Estate. The sting of being knocked down yet again was particularly brutal following what had seemed like a potential comeback early in the quarter when the S&P 500 rallied +17.4% between the June 16th low to the August 16th high. Alas, the aggressive Fed and persistent inflation proved overwhelming for the market which ended the quarter at new lows while the Bloomberg Aggregate Bond Index dropped nearly -15% — the worst three quarters for the bond market in history.

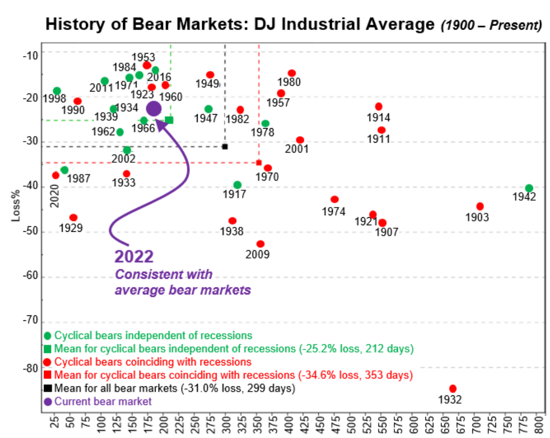
Tactical Strategy: *Rolling With the Punches*

The challenge of 2022 for investors has been the fact that there has been no safe havens. Whereas diversification typically helps due to some assets being up when others are down, this year everything is down. Indeed, the traditional 60/40 stock/bond portfolio has had its worst first nine month run since 1974 and its third worst since 1926. An astute fighter will adjust his or her strategy when needed as we have done throughout 2022. While these changes have helped, again, there has been no strategy that would have prevented a decline. While some may contemplate quitting and declaring "No mas" as did Roberto Duran when he surrendered to Sugar Ray Leonard in 1980, doing so would sacrifice the ability to recapture investment growth and win when the market rebounds.

Fourth Quarter Perspective: *The Championship Rounds*

Investors should follow Rocky Marciano's example and remain focused on winning the fight despite losing rounds in the interim. Modern professional boxing bouts are typically 10 rounds in duration unless a title is on the line, at which time two more rounds are added. Like a title fight, 2022 has endured 10 brutal rounds (i.e. months) through October and, accordingly, November and December can be thought of as the 11th and 12th championship rounds. What is the likelihood of a late-fight comeback for investors?

The chart below shows past bear markets in the US, the associated depth of the decline in the stock market, and the length of time it lasted. The 1932 crash amid the Great Depression was clearly an outlier. Yet as bad as the 2022 decline has felt, it is actually consistent with the average bear market which sees a -25% decline and lasts around 10 months—the depth and duration of this year's decline. In other words, from a historical bear market analysis perspective, we may soon see a bottoming process forming. While a recession could lead to a further stock market weakness, much of the total peak-to-trough decline may have already occurred.



Sources: S&P Dow Jones Indices, Ned Davis Research Calculations

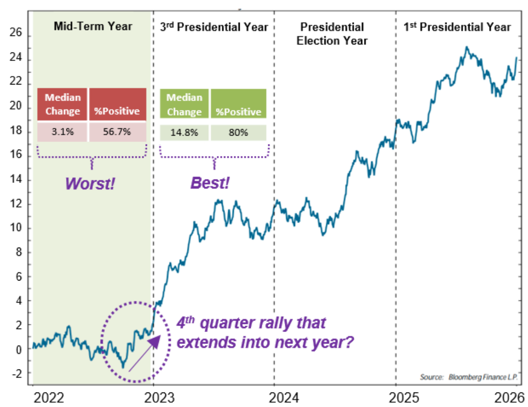
*Large Cap: S&P 500 Index; Small Cap: Russell 2000 Index; Int'l Devel: MSCI EAFE Index; Int'l Emerg: MSCI Emerging Markets Index; Core Bond: Bloomberg Aggregate Index; Int'l Bond: Bloomberg Global Aggregate ex-USD Index; High Yield: Bloomberg US Corporate High Yield Index; Cash: BofA Merrill Lynch 3-Month US Treasury Index; Real Estate: FTSE EPRA/NAREIT Developed Index; Commodity: Bloomberg Commodity Index; Alternatives: Wilshire Liquid Alternatives Index

As it relates to recession, one might ask if we are already in one given the two consecutive quarters of negative GDP growth. It should be noted that the "two quarters" guideline has always been a rule-of-thumb rather than the official definition which, as outlined by the National Bureau of Economic Research, is the rather vague, "significant decline in economic activity that is spread across the economy and that lasts more than a few months." The NBER has not called an official recession as of this writing given the resiliency of employment, wages, etc., however the risks of recession are undoubtedly rising. One of our consultants, Ned Davis Research, outlines the ten factors they have identified as being recession signals in the table at right. Among the ten, only the three highlighted in red are signaling recession at this time, meaning that an official recession is not imminent and, should one occur, it may be milder and of shorter duration.

Indicator	Current Level	Key Recession Level	Date
NDR Recession Probability Model	2.1	50	08/31/2022
Housing Starts (Smoothed 3-Mo)	-6.05	-7.85	08/31/2022
NDR Economic Timing Model	-6	0	08/31/2022
NDR Composite Leading Index	-2.8	-2.6	08/31/2022
National Financial Conditions Index	-0.1	0.9	09/30/2022
Unemployment Initial Claims (4-wk avg)	206.5	500	09/30/2022
Consumer Confidence Index	108	63.2	09/30/2022
CEO Confidence Index	34	43	09/30/2022
ISM Manufacturing Index	50.9	48.0	09/30/2022
ISM Non-Manufacturing Index	56.7	51.4	09/30/2022

Fourth Quarter Rebound?: *Getting Up Off the Mat*

Dow Industrials Four-Year Presidential Cycle *(1900 – 2021)*



Source: Ned Davis Research

We have discussed that based on analysis of past bear markets a rebound from near current levels would be within the realm of possibility, but we would be remiss to omit an examination of the potential effects of the November mid-term election. The chart at left shows the average market performance during each of the four years of a presidential term. One notes that the mid-term year tends to be the weakest among the four, however said weakness occurs over the first three quarters with a rally following the election. In this regard, the 2022 market has followed the typical pattern for a mid-term year and, as such, a post-election rally may also be in the cards. Also of note is the fact that the third presidential year tends to be the best, with the market up a median of 15% and ending the year positive 80% of the time. Purely by this historical analysis, 2023 could be a good year for the market. But might the specific outcome of the midterms affect a potential recovery?

Post-Election Rally?: *Fight Night in DC*

Jack Dempsey once said, "a champion is someone who gets up when he can't." On top of everything else with which investors have had to deal in 2022, it may be difficult to imagine a late year rally when entering a close and contentious election. As of this writing polls indicate Democrats may retain the Senate while Republicans may take over the House. The top table at right shows that historically under a Democratic president a split congress would be the best for markets. Furthermore, the bottom table shows that when there is a high degree of political disagreement among Federal politicians (index above 100), the market does immensely better. Should election prognostications prove correct, this would again bode well for the markets in the near future.

DJIA vs. Presidential & Congressional Combinations *(1901 – 2022)*

	% Gain/Annum	% of Time
Dem Pres/R Cong	9.05	9.85
Dem Pres/Split Cong	10.37	3.29
Dem Pres/D Cong	6.70	34.24

S&P 500 vs. Philly Fed Partisan Conflict Index *(1984 – 2022)*

	% Gain/Annum	% of Time
Above 100	16.63	46.13
Below 100	2.69	53.87
Buy/Hold = 8.90% Gain/Annum		

Source: Ned Davis Research

Investment Strategy: *Throw Your Hat in the Ring, Not the Towel*

There was a time when, in order to challenge someone to a boxing match, one would signal the referee accordingly by literally throwing a hat into the ring. Conversely, when one wishes to surrender during a fight, his corner will throw in a towel. Following the pain and turmoil of the 2022 markets, investors may be tempted to throw in the towel. Yet they should remember George Foreman who once said, "the question isn't what age I want to retire, it's at what income." Quitting now by liquidating one's investments would lock in the year-to-date declines and prevent recovering when the market rebounds. Don't throw in the towel; throw your hat in the ring and we will help you win the fight.

The team you can trust.

As true fiduciaries, our focus isn't on selling products to our clients. Instead, we focus on providing personalized service and real financial solutions.

Our team of wealth management professionals has the valuable depth of expertise you need to navigate life's events.

From retirement planning and investment management to trust services and estate settlement, we can help you devise the most effective plan to meet your financial goals.

Joe Sayklay
President,
Wealth Management
(915) 747-1645
joe.sayklay@weststarbank.com

Bill Brady, CFA
Senior Vice President,
Director of Investments
(915) 747-4930
bill.brady@weststarbank.com

Tami Gladkowski
Senior Vice President,
Senior Trust Officer
(915) 747-1651
tamara.gladkowski@weststarbank.com

Colleen Marusich, CTFA
Senior Vice President,
Senior Wealth Advisor
(915) 747-1635
colleen.marusich@weststarbank.com

Rose Gonzalez
Vice President,
Relationship Manager
(915) 747-4111
rose.gonzalez@weststarbank.com

Crystal Martin, MBA
Assistant Vice President,
Trust Officer
(915) 747-1675
crystal.martin@weststarbank.com

Tommy Gabriel, MBA
Assistant Vice President,
Relationship Manager
915-747-4153
tommy.gabriel@weststarbank.com

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Wealth Management

weststarbank.com