September 30, 2022

	[redacted]	Year-to-Date
Standard & Poor’s 500	-4.9%	-23.9%
Russell 2000®	-2.2%	-25.1%
International Stocks		

Market conditions fluctuated considerably during the recently completed quarter. Stocks rallied broadly until mid-August only to give it all back, and then some, in the second half of the period. Equities fell as investors anticipated economic headwinds given renewed inflation concerns and heightened resolve by the Federal Reserve to fight it. In total, the S&P 500 Index had a -4.9% return for the quarter, with the year-to-date decline now amounting to 23.9%.

The primary international indices fared worse, posting double digit losses for the quarter with year-to-date returns approaching -30%. Beyond their own bouts with post-pandemic related inflation, many international economies are confronting unique challenges. Europe is grappling with deteriorating relations with Russia, which is a major supplier of oil and gas for the continent but is cutting supplies in retaliation for Europe’s support of Ukraine. China continues to invoke periodic lockdowns due to its “zero- the economy and given the National Bureau of Economic Research (NBER) reason to hold off on officially deeming the economy in recession thus far.

The Federal Reserve, as it emphasized last autumn, has remained data

US Stocks

Inflation has remained higher and more persistent than economists and investors originally anticipated, but its causes have evolved. For example, supply-related shocks have begun to subside. Supply chains, roiled by numerous pandemic-related disruptions, labor shortages, and other issues, are recovering. The New York Fed tracks and integrates relevant supply chain data into a Global Supply Chain Pressure Index. Though the Index remains at historically elevated levels, it shows considerable easing from the peak of the strains in late 2021. Such progress may serve to increase availability—and limit cost pressures—of intermediate goods used in manufacturing, as well as final goods purchased by consumers.

Another driver of recent inflationary pressure, commodity price shocks stemming from Russia's invasion of Ukraine, has also abated. Global prices of grains and other raw materials produced in the region have retraced their recent gains, while global oil prices have come down from their peaks. With these one-time shocks in the rearview mirror, such price declines can actually provide a measure of *disinflation*. The exception to such relief has been natural gas. Sanctions involving Russian gas have introduced significant supply/demand imbalances and gas prices have remained elevated. Principally a localized commodity, this dynamic weighs especially heavily on Europe's economy given the region's dependence on the fuel source.

Resolving supply shocks may provide some inflationary reprieve, but the employment situation is providing anything but. Though the Fed's efforts to increase borrowing costs and slow the economy are bearing fruit, it has yet to affect the labor market in a meaningful way. Headline unemployment remains near its lows, while the "quit rate" is still historically high—both evidence of still tight labor conditions favorable to workers. Consequently, the pace of wage growth continues at multi-decade highs and accelerated during the third quarter.

We view the labor market, and wages in particular, as a critical determinant of continued inflationary pressure and the Fed's future actions. Simply put, it is difficult to imagine a scenario in which the Fed is able to achieve its inflation targets without cooling the pace of wage growth. Thus, we expect the Fed to monitor such data especially closely while determining policy.

A central risk remains that inflation becomes entrenched. Prolonged inflation may lead companies toward anticipatory price hikes and workers to demand higher wages, as they assume inflation will persist. This is known as a wage-price spiral, as the cause and effect of inflation feed off of each other. While we are attuned to this possibility, forward looking indicators point to such a risk moderating. The New York Fed conducts a regular survey of consumers' expectations of future inflation. In its most recent release, the survey points to shorter-term expectations (1 year forward) of the inflation rate receding from June highs, while medium-term (3 years forward) inflation expectations have returned to pre-pandemic levels. Market-based measures of expected inflation, such as those implied by prices of Treasury Inflation Protected Securities (aka TIPS), also indicate that concerns over a longer-term inflationary cycle have lessened.

The Inflation Reduction Act became law in August. Despite its name and projections of lowering the deficit, we do not expect the law to contribute materially to low (9B-6.3 (e)1.9 ().l1 (n)95 (g)1C /TT0 0.9 (n)-2.2 (e)1 (d)-5.577 0 .3 (lo)3 .9 (b)-6.(e
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