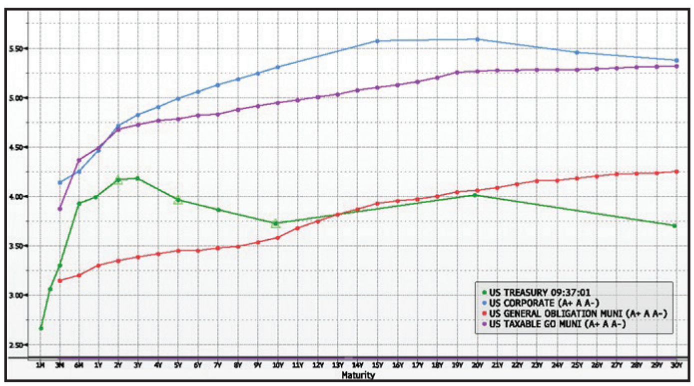
A View
FROM THE TOWER

The third quarter of 2022 continued the rollercoaster environment experienced during the year's preceding six months, with numerous items once again impacting not only the broad, global equity front, but also the fixed income markets. Post a strong showing in July, the S&P 500 declined in both August and September, resulting in a negative return for the quarter overall. Additionally, bond prices and corresponding yields experienced material volatility throughout the quarter as rates once again increased significantly across the yield curve. The end result was the third consecutive quarter with negative returns for both stocks and bonds; a rarity.

Yield curve as of 09/30/2022:



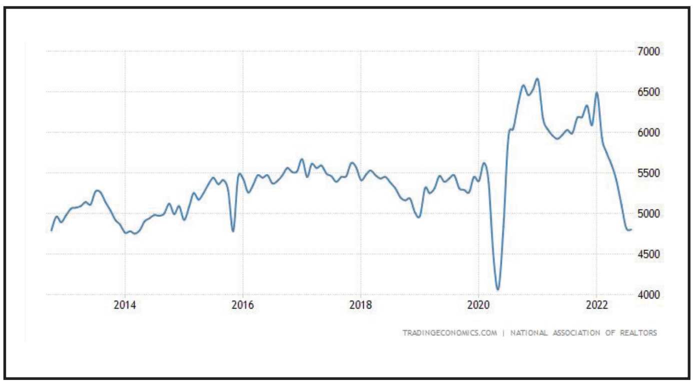
Source: BLOOMBERG

At the risk of being redundant, as we entered 2022, one dynamic we particularly noted was mid-term election years tend to be the most volatile within the four-year Presidential cycle and include many relatively sharp stock market selloffs, accompanied by strong rebounds. This has certainly continued to be the case this year as there have been several very volatile days, and even weeks, unfortunately more to the negative than the positive to date.

Some of the reasons for this environment were anticipated: the continuation of a very tight labor market; supply chain disruptions; inflation concerns; and higher interest rates. On the positive side of the ledger, significant liquidity, strong consumer financial positions/spending and stellar corporate profits were thought to have been positioned to provide ample support. As tends to happen, however, the unexpected can arise and tilt the scales. Certainly, this has been the case regarding the Russian invasion of Ukraine, along with China's ongoing, aggressive COVID lockdown approach, leading to calls for economic deglobalization. And, we have not even mentioned additional geopolitical issues, namely those potentially concerning Taiwan. However, in September, there was public criticism of Russia's Ukraine invasion by both China and India, potentially signaling a shift in the global perceptions of war. Additionally, President Biden stated the U.S. would defend Taiwan in the event of Chinese aggression. Hopefully, this can be avoided, for a variety of reasons.

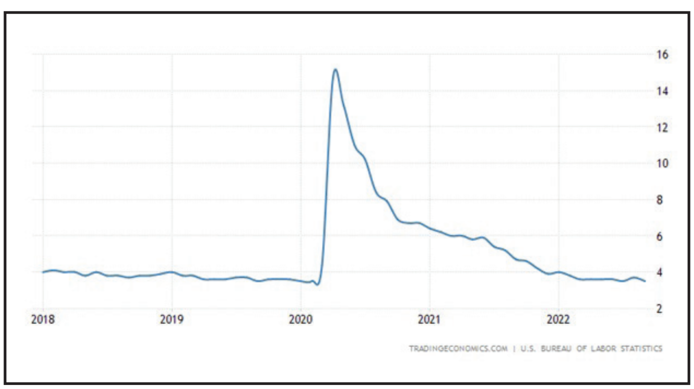
During the third quarter, the Federal Reserve maintained its hawkish position, employing a "raise and hold" mantra, in an effort to crush inflation for the first time since 1982. Approaching 2022, we knew the Fed would be tapering bond purchases and were under the assumption/guidance that up to three rate hikes would be in the offing this year. To date, the Fed has already made moves totaling 3.00%, including .75% in September, with more expected during the November and December meetings (possibly .75% and .50% respectively), with an eventual rate in the 4.6% range. Central banks worldwide have been aggressively increasing rates as well. Additionally, as planned, the Fed will be shrinking its balance sheet by letting its bond positions "runoff" at a rate of $95 billion monthly. A worry is that this "tightening" process will result in an overly corrective pendulum swing, resulting in a "policy mistake" and consequently a potential recession, although there is a debate that the United States is already experiencing one. As we have mentioned previously, a casualty of this environment could be on what has been a robust U.S housing market, as rising mortgage rates (recently reaching the 7% level) impact affordability. On this front, we have already experienced some declining statistics. Also, we will continue to track yield curve inversions (defined as scenario where shorter-term U.S. Treasury securities yield more than their longer-term counterparts) as this circumstance is often a precursor to an economic slowdown. Also, a U.S. recession tends to go hand-in-hand with labor market weakness, which as alluded to, is not the dynamic currently. However, the Fed is now projecting an unemployment rate of 4.4% in 2023/2024 compared to the 3.5% level currently.

United States Existing Home Sales:



Source: TRADINGECONOMICS.COM | U.S. BUREAU OF LABOR STATISTICS

United States Unemployment Rate:

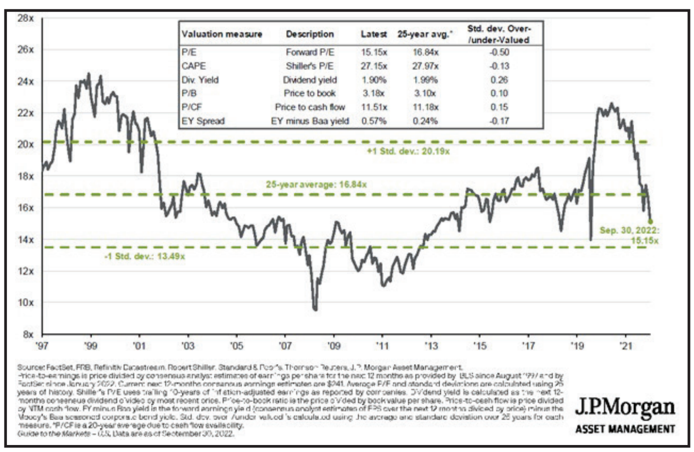


Source: TRADINGECONOMICS.COM | U.S. BUREAU OF LABOR STATISTICS

At the end of the day, will the Fed be able to corral inflation (the latest annual statistic being an 8.2% increase) and succeed in having a "soft landing"? It will not be easy. Historically, to get control of inflation, the Fed Funds Rate needs to exceed the inflation rate. And, it has been debated whether or not the Fed's actions will indeed have the intended impact on reducing inflation given multiple international factors outside of its control, including a significant portion of the current inflation scenario seeming to be supply-side driven as supply chain issues around the globe continue. This would seem to be more difficult for the Fed to impact than the more traditional demand side scenarios. Also, we should consider the general make-up of the U.S. Consumer Price Index, which is 20% food and energy; 20% core goods; and 60% services. A significant rise in shelter related prices has been a material factor. Aside from Fed moves, one would think that a reduction in supply bottlenecks would help. As previously discussed, ongoing COVID related shutdowns in China have been a major culprit in this regard, however. Lastly, longer-term inflation expectations seem to be falling, possibly supporting a decline.

As one would imagine, this has been quite a lot for the financial markets to digest. Concerning stocks specifically, to date the primary reason for the negativity has been the inverse relationship between inflation/interest rates and earnings multiples. As inflation and interest rates rise, price earnings ratios tend to compress and this has been the scenario in 2022. So far at least, there has not been an overwhelming wave of downward earnings estimate revisions, although projections for both 2022 and 2023 have declined. This is a concern on Wall Street and we do have it on our radar. Additionally, the dollar has shown significant strength, hitting its highest level since 2002, causing increasing angst in the global currency markets.

S&P 500 Index Forward Price to Earnings Ratio as of 09/30/2022:



On the political front, Build Back Better (BBB) legislation, which had been considered dead multiple times, evolved into the trimmed down Inflation Reduction Act. The five primary focus areas of this bill are: 1) extension of existing health care subsidies through 2025; 2) prescription drug price controls starting in 2026; 3) more than $300 billion in renewable energy spending via tax credits; 4) tax increases, including a 15% corporate minimum tax rate and a 1% stock buyback tax; and 5) additional IRS funding for taxpayer audits. Only time will tell what effect this will have on inflation. Theoretically, it would take flat CPI ratings for the next seven months to result in a level of 3% or below. Although inflation may have indeed peaked, the "stickiness" of some of its key components may make a return to acceptable levels in the near future troublesome. In regard to the upcoming election season, although most prognosticators are calling for a shift of control in the House of Representatives to the Republican Party, the degree of the anticipated majority has declined. The Senate is being called a "toss-up" by most experts at this point.

Despite the difficult market environment so far this year, we remind you once again that we believe the race is usually won by the investor focused on the long-term versus those chasing the illusion of "timing," as missing just a handful of market "best days" could result in a materially lower long-term, realized return. Despite discomfort during times of uncertainty, discipline and patience have historically been rewarded. The key has been "time in the market" vs. the timing of it. And, we continue to note that the S&P 500 has not declined in the twelve months following a mid-term election since 1946.

All of us at Country Club Trust Company, along with the entire Country Club organization, continue to hope that you and your families are well. Please be assured that we continue to work diligently on your behalf, remaining fully capable to provide the level of service you have come to expect and deserve. As always, we are ready and more than willing to be of assistance in any way we can. Should you have any questions, we are always here for you.

Thank you!

Take care!

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