OCTAVIA
WEALTH ADVISORS

Economic and Market Overview

Third Quarter 2022

Building a Lifelong Partnership

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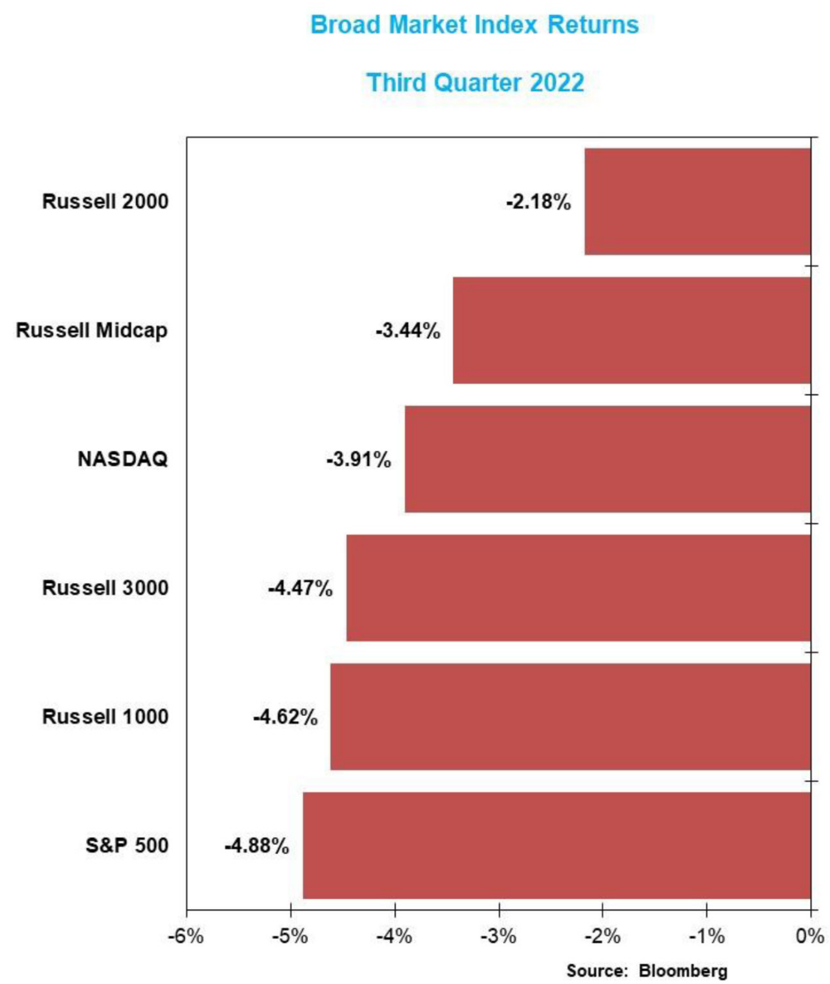
The Economy

The US economy struggled onward in the third quarter as surging inflation and resultant rising interest rates caused further economic contraction. The Bureau of Economic Analysis (BEA) released its third estimate of the second quarter real GDP, which showed a seasonally adjusted annualized decline of 0.6%, in line with the prior estimate and a slight improvement from the 1.6% decrease in the first quarter. Employment remained resilient in the quarter, as job gains slowed but modestly exceeded expectations. The September payrolls report showed that employers added 263,000 jobs and the unemployment rate fell to 3.5%. In an effort to battle surging inflation, the Federal Open Market Committee (FOMC twice raised its federal funds rate targets. Those hikes brough the range to 3.00% to 3.25%, up from 1.50% to 1.75% at the end of the second quarter. The 75 basis point increase on September 21st was the third this year, and many economists expect continued rate hikes until inflation slows substantially.



Highlights and Perspectives

GROSS DOMESTIC PRODUCT (GDP)

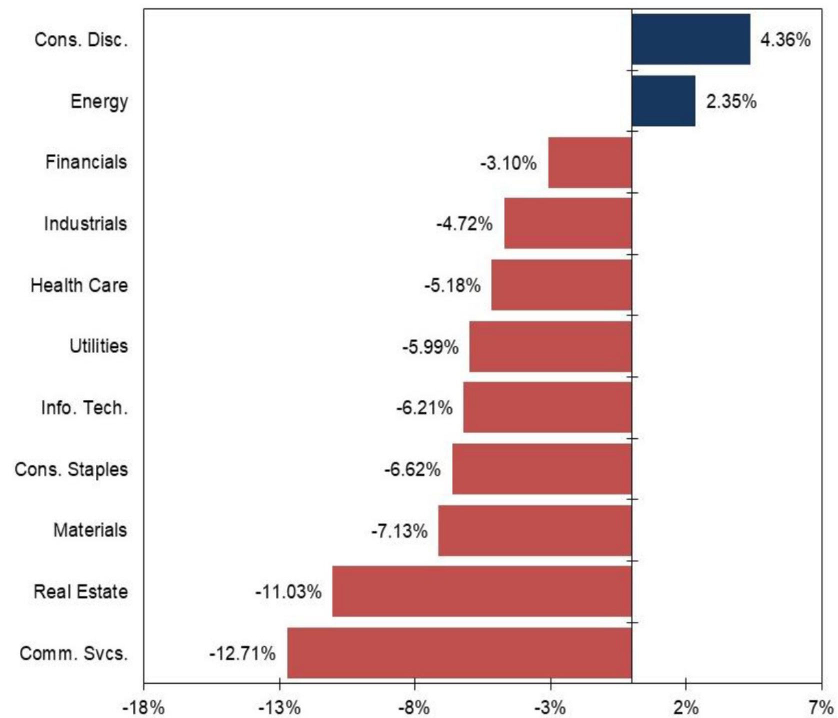
The BEA's third estimate of the second quarter real GDP showed an annualized decline of 0.6%, in line with the prior estimate and modestly better than the 1.6% decline in the first quarter. Many of the same factors continued to slow growth, including commodity shocks from the war in Ukraine, near-record levels of inflation, and supply chain disruptions. Inventories were a significant drag on growth, as was government spending, which fell at the federal, state, and local levels. Corporate profits rose by 4.6% (not annualized) during the quarter after edging higher by 0.1% in the prior period. Inflation expectations inched down from the prior quarter but remain elevated.

HOUSING

Traffic in the housing market slowed as mortgage rates spiked to their highest levels since before the Global Financial Crisis. Existing-home sales for August (the latest monthly data available) dropped 0.4% to an annualized rate of 4.8 million units, down 19.9% from year-ago levels. The inventory of existing homes rose slightly to 3.4 months of supply. Existing-home prices increased 7.6% over the prior year, but declined month-over-month in both July and August. In the new home segment, the NAHB Housing Market Index, a measure of homebuilding activity, ended the quarter at 46, down from 49 in the prior month. The index's monthly decline was the ninth in a row, reflecting worsening sentiment as a result of higher interest rates and inflation. Readings below 50 indicate that builders perceive conditions as poor in the short term. Permits for new housing construction also slowed as homebuilders scale back new housing supply to protect profit margins amid weaker demand.

U.S Equity Market Returns by Major Sector

(GICS Sectors in S&P 500, Third Quarter 3Q22)



Source: Bloomberg

EMPLOYMENT

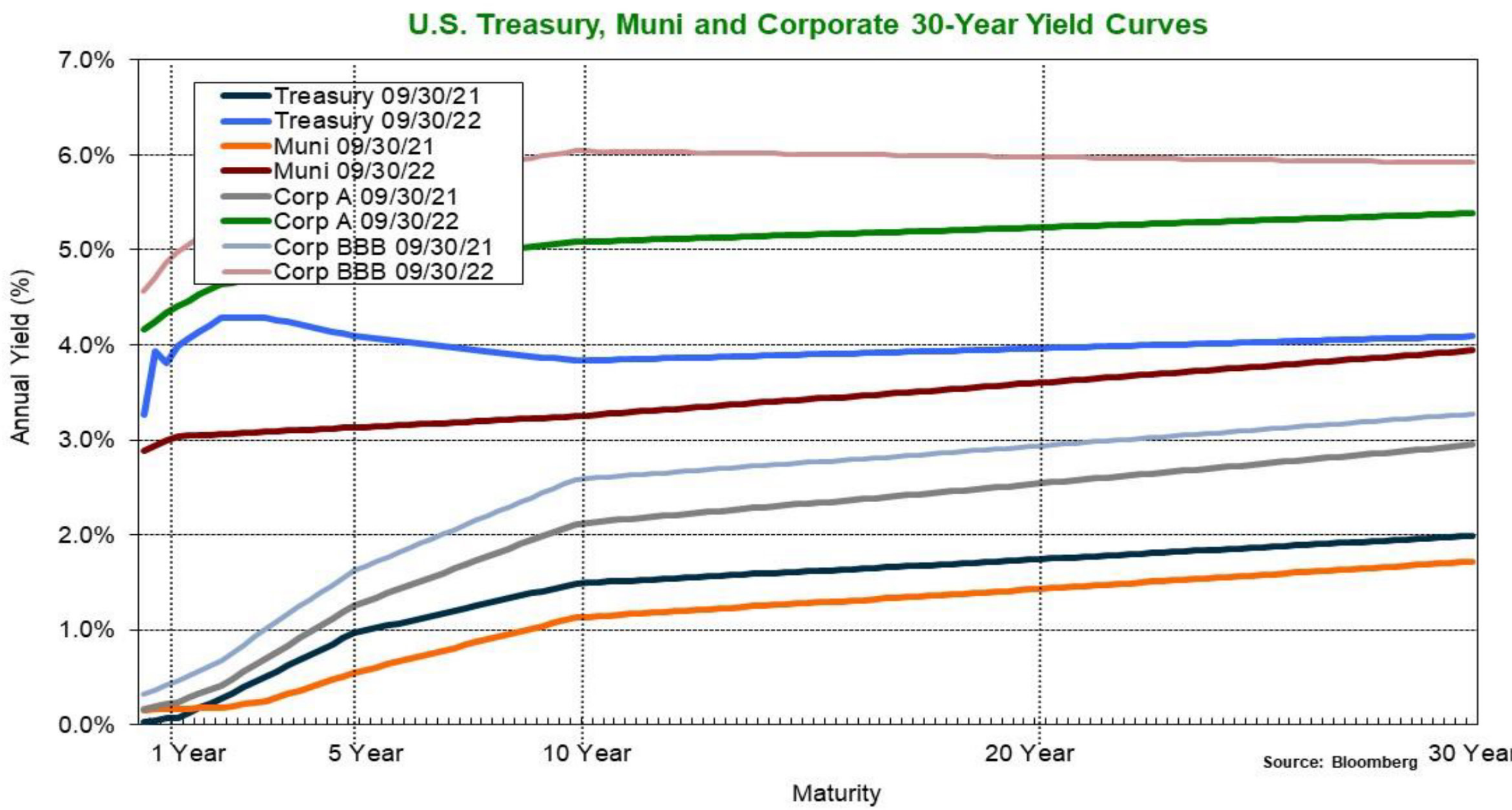
The September employment report showed job growth slowing but still modestly above expectations. Employers added 263,000 jobs, beating the consensus estimate of 255,000. While jobs gains have remained positive, they slowed dramatically from the 537,000 jobs added in July. The unemployment rate fell to 3.5% from 3.7% August as labor force participation ticked down to 62.3%. Analysts believe that gains will continue to slow, and the unemployment rate will rise modestly moving into next year.

FEDERAL RESERVE POLICY

The FOMC continued to aggressively tighten monetary policy throughout the third quarter. In an effort to combat surging inflation, the FOMC raised its federal funds rate target range by 75 basis points twice during the quarter, to a range of 3.00% to 3.25%. The committee's statement accompanying the most recent increase indicated that the FOMC will continue to be aggressive as appropriate, and will be focused on combatting inflation even at the expense of job gains. Analysts are expecting the FOMC to implement another 75-basis point hike in November and a 50-basis point hike in December. The FOMC's "dot plot" forecast indicates that the committee now expects the fed funds rate to be at 4.4% at the end of this year, and 4.6% at the end of 2023.

INTEREST RATES

Fixed income securities' prices were materially lower (and yields higher) for the second consecutive quarter, as inflation stubbornly remained near 40-year highs. The FOMC remained aggressive in its attempts to fight the high inflation, by continuing to remove the accommodative monetary policy that has been in place for almost 15 years. Economic growth was negative for the second quarter in a row, and inflation's surge has been prompted by ongoing supply chain issues, among other causes.



The Treasury yield curve inversion steepened as short-term rates rose faster than long-term rates. Yields on shorter-term maturities of between one and five years rose up to 165 basis points, while yields in the intermediate- and long-term segments of the curve rose between 60 and 100 basis points. At the end of the quarter, 2-year Treasury yields were 39 basis points above 10-year yields. Historically, an inversion between 2-year and 10-year yields has been viewed as a potential indicator for impending recession. The curve first inverted in early April, and after a brief recovery, has remained constantly inverted since July 7.

The yield on the 10-year Treasury began the quarter trending down, then marched higher for the final two months of the quarter. The yield reached a high of 3.95% in late September following the FOMC's second 75-basis point rate increase of the quarter. 3-month Treasury bill yields settled at 3.27%, higher by 160 basis points from the previous quarter. The yield on the 5-year Treasury Note ended the quarter at 4.09%, compared to 3.04% on June 30. Yields on 10-Year and 30-Year Treasuries moved higher in tandem, finishing the quarter at 3.83% and 3.78%, respectively.

Total returns on fixed income securities were once again sharply negative during the quarter. The Bloomberg Treasury 5-7 Yr. Index declined by 4.5%, and the Bloomberg US Credit Corporate 5-10 Yr. Index sank by 4.7%. High yield securities, which often follow the performance of equities, fell 0.7%. Non-U.S. bonds were dinged by both rising interest rates in their home countries as well as weaker currencies against the strengthening dollar. The Bloomberg Global Aggregate ex-U.S. bond index fell 8.9%, while the JPMorgan Emerging Markets Global Index lost 4.2%.

EQUITIES

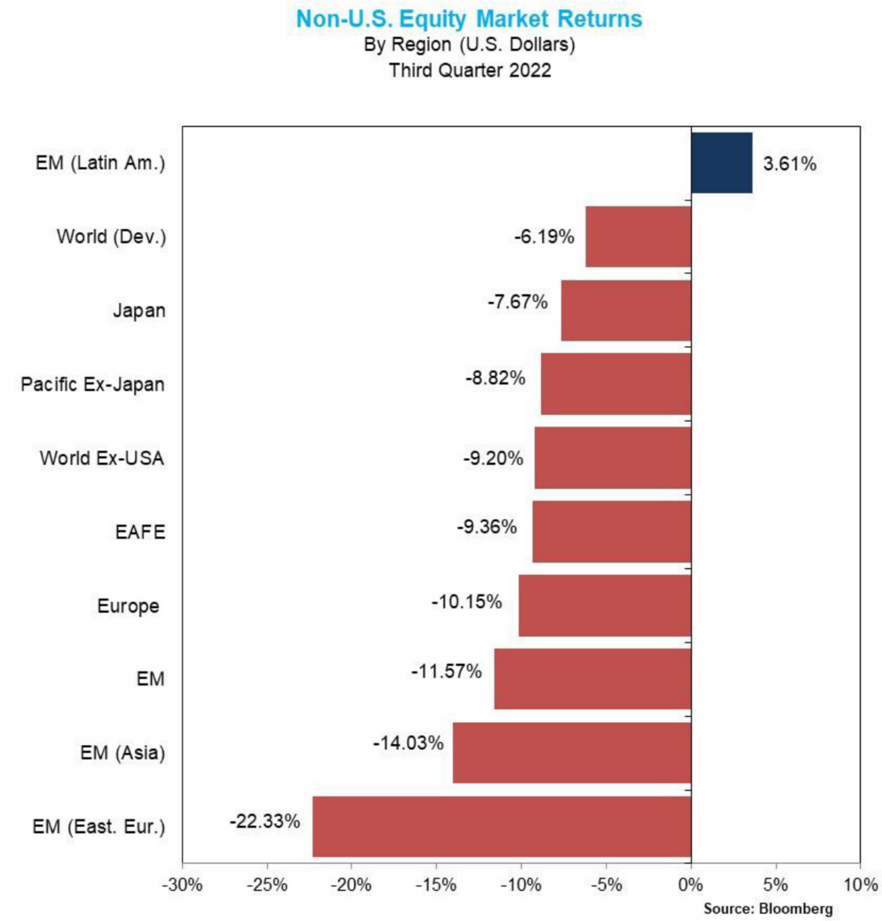
This year's equity losses extended into the third quarter as aggressively rising interest rates threaten stock valuations. Recession now seems likely if the economy has not already entered one, and investors are becoming anxious, liquidating stocks and sending indices into a bear market. In addition, supply chain bottlenecks have yet to abate, along with issues in the energy and agriculture segments resulting from the ongoing war in Ukraine. The S&P 500 began the quarter with strong returns in June, but steadily declined into the end of the quarter. Many major stock indices ended the quarter in bear market territory (a decline of at least 20% from most recent peak). The S&P 500 Index declined 4.9% in the third quarter and is down 23.9% year-to-date.

Most of the 11 primary economic sectors generated negative returns. Consumer Discretionary, Energy, and Financials were the strongest relative performers, returning of +4.4%, +2.4%, and -3.1%, respectively. The Communications Services, Real Estate, and Materials sectors were the poorest relative performers, posting returns of -12.7%, -11.0%, and -7.1%, respectively

The Russell 1000 Index of large capitalization stocks returned -4.6%. Small cap stocks, as represented by the Russell 2000 Index, slightly outperformed large caps, and finished the quarter with a total return of -2.2%. Growth stocks outperformed value stocks in both large caps and small caps. The NASDAQ Composite, dominated by technology stocks, finished the quarter with a return of -3.9%. The Dow Jones Industrial Average of 30 large industrial companies returned -6.2%.

Real Estate Investment Trusts (REITs) were lower during the quarter, with the Dow Jones US Select REIT Index down 10.4%. Commodities prices also fell from mid-summer highs as recession concerns threaten to reduce demand. The Bloomberg Commodity Index declined by 4.1%.

International stocks fell and underperformed U.S. markets. The MSCI ACWI Ex-USA Index, which measures performance of all markets outside the U.S., fell by 9.9%. The MSCI EAFE Index of developed markets stocks were lower by 9.4%. Among individual regions, Latin America was the strongest relative performer, gaining 3.6%. China recorded the worst performance, falling 22.5%. Emerging markets stocks were lower, as the MSCI Emerging Markets Index fell by 11.6%.



Outlook

The global economy is currently teetering on the brink of recession after having delivered a strong post-pandemic recovery. Multi-decade high inflation and an aggressive central bank policy response have slowed global expansion. In addition, a growing real estate crisis and ongoing COVID lockdowns have stymied growth in China.

Despite the recent slowdown, analysts expect the global economy to grow moderately in 2022, but the picture beyond is less clear. Consumer prices have increased for 12 consecutive months, and the inflation rate is at its highest level in more than 40 years. Concerns about "stagflation" have grown as catalysts for higher inflation remain, including elevated commodity and energy prices and supply chain disruptions that have not yet eased. Economic and market expectations for the remainder of 2022 and early 2023 are likely to remain subdued for as long as these forces persist.

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INDEX OVERVIEW

The **Dow or DJIA** (Dow Jones Industrial Average) is an unmanaged index of 30 common stocks comprising 30 actively traded blue chip stocks, primarily industrials, and assumes reinvestment of dividends. The **NASDAQ Composite** is a stock market index of the common stocks and similar securities listed on the NASDAQ stock market. The **S&P 500 Index** is an unmanaged index comprising 500 widely held securities considered to be representative of the stock market in general. The **DJ US Select REIT Index** is a subset of the Dow Jones Americas Select RESI and includes only REITs and REIT-like securities (The Dow Jones US Select Real Estate Securities Index (RESI) represents equity real estate investment trusts (REITs) and real estate operating companies (REOCs) traded in the US). The **Bloomberg Commodity Index** is a broadly diversified commodity price index that tracks prices of futures contracts on physical commodities on the commodity market, and is designed to minimize concentration in any one commodity or sector. The **MSCI EAFE Index** is recognized as the preeminent benchmark in the US to measure international equity performance. It comprises the MSCI country indices that represent developed markets outside of North America: Europe, Australasia, and the Far East. The **MSCI Emerging Markets Index** is a free float-adjusted market-capitalization index that is designed to measure equity market performance in the global emerging markets. The **MSCI ACWI Index** is a free float-adjusted market-capitalization-weighted index that is designed to measure the equity market performance of developed and emerging markets. The MSCI ACWI consists of 46 country indices comprising 23 developed and 23 emerging markets country indices. The **MSCI Emerging Markets (EM) Eastern Europe Index** captures large and mid cap representation across four emerging markets (the Czech Republic, Hungary, Poland, and Russia) countries in Eastern Europe. With 52 constituents, the Index covers approximately 85% of the free float-adjusted market capitalization in each country. The **MSCI EM (Emerging Markets) Latin America Index** is a free float-adjusted market-capitalization-weighted index that is designed to measure the equity market performance of emerging markets in Latin America. The **MSCI ACWI Ex-US Index** is a market-capitalization-weighted index maintained by Morgan Stanley Capital International (MSCI) and designed to provide a broad measure of stock performance throughout the world, with the exception of US-based companies. The **MSCI China Index** captures large and mid cap representation across China H shares, B shares, Red chips, and P chips covering about 85% of this China equity universe. The **Bloomberg Barclays Municipal Bond Index** is an unmanaged index comprising investment-grade, fixed-rate municipal securities representative of the tax-exempt bond market in general. The **Bloomberg Barclays Global Aggregate ex-US Index** is a market-capitalization-weighted index, meaning the securities in the index are weighted according to the market size of each bond type. Most US-traded investment-grade bonds are represented. Municipal bonds and Treasury Inflation-Protected Securities are excluded, due to tax treatment issues. The Index includes Treasury securities, government agency bonds, mortgage-backed bonds, corporate bonds, and a small amount of foreign bonds traded in the US. The **Bloomberg Barclays US 5-10 Year Corporate Bond Index** measures the investment return of US dollar-denominated, investment-grade, fixed-rate, taxable securities issued by industrial, utility, and financial companies, with maturities between 5 and 10 years. Treasury securities, mortgage-backed securities (MBS), foreign bonds, government agency bonds, and corporate bonds are some of the categories included in the Index. The **Bloomberg Barclays Capital US 5-7 Year Treasury Bond Index** is a market-capitalization-weighted index, and includes Treasury bonds issued by the US with a time to maturity of at least 5 years, but no more than 7 years. The **Russell 1000 Index** is a market-capitalization-weighted benchmark index made up of the 1000 largest US companies in the Russell 3000 Index (which comprises the 3000 largest US companies). The **Russell 2000 Index** is an unmanaged index considered representative of small cap stocks. The **Russell 3000 Index** is an unmanaged index considered to be representative of the US stock market, and measures the performance of the largest 3,000 US companies representing approximately 98% of the investable US equity market. The **Russell Midcap Index** is a subset of the Russell 1000 Index. It includes approximately 800 of the smallest securities based on a combination of their market cap and current index membership. The **Housing Market Index** (HMI) is based on a monthly survey of **NAHB** members designed to take the pulse of the single-family housing market. The survey asks respondents to rate market conditions for the sale of new homes at the present time and in the next six months, as well as the traffic of prospective buyers of new homes. The **JPMorgan Emerging Market Bond Index** (EMBI Global) tracks total returns for traded external debt instruments in the emerging markets, and is an expanded version of the JPMorgan EMBI+. As with the EMBI+, the EMBI Global includes US dollar-denominated Brady bonds, loans, and Eurobonds with an outstanding face value of at least $500 million. The **CBOE Volatility Index** (VIX) is an up-to-the-minute market estimate of expected volatility that is calculated by using real-time S&P 500 Index option bid/ask quotes. The Index uses nearby and second nearby options with at least 8 days left to expiration and then weights them to yield a constant, 30-day measure of the expected volatility of the S&P 500 Index.

DEFINITIONS

The **Federal Open Market Committee** (FOMC) is the monetary policymaking body of the Federal Reserve System. The **federal funds rate** is the interest rate at which a depository institution lends funds maintained at the Federal Reserve to another depository institution overnight. The **European Central Bank** (ECB) is the central bank for Europe's single currency, the euro. The ECB's main task is to maintain the euro's purchasing power, and thus price stability, in the euro area. The euro area comprises the 19 European Union countries that have introduced the euro since 1999. The **Gross Domestic Product** (GDP) rate is a measurement of the output of goods and services produced by labor and property located in the United States. The **Bureau of Labor Statistics** (BLS) is a unit of the United States Department of Labor. It is the principal fact-finding agency for the US government in the broad field of labor economics and statistics, and serves as a principal agency of the US Federal Statistical System. The **Bureau of Economic Analysis** (BEA) is an agency in the US Department of Commerce that provides important economic statistics, including the gross domestic product of the US. It is a governmental statistical agency that collects, processes, analyzes, and disseminates essential statistical data to the American public, the US Congress, other Federal agencies, state and local governments, business, and labor representatives. The **PCE (Personal Consumption Expenditure) Index of Prices** is a US-wide indicator of the average increase in prices for all domestic personal consumption. Using a variety of data, including US Consumer Price Index and Producer Price Index prices, it is derived from personal consumption expenditures, and is essentially a measure of goods and services targeted towards and consumed by individuals. Sector performance is represented by the **Global Industry Classification Standard** (GICS) sectors, developed by Standard & Poor's and MSCI Barra.

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