CURBSTONE FINANCIAL
MANAGEMENT CORPORATION

From the Curb

Letter to Clients
Quarter Ending September 30, 2022

The third quarter started with a solid rebound in stocks and bonds, driven by resilient corporate earnings, signs of a possible peak in inflation, and hints from the Federal Reserve that the end of the rate hiking cycle may come sooner than markets initially expected. Corporate results for the second quarter were much better than feared. Despite high inflation and lingering supply chain issues, the majority of Q2 earnings reports beat estimates. That solid performance by corporate America showed investors that, despite numerous macroeconomic challenges, earnings for US companies were holding up well.

On the inflation front, several survey-based economic reports showed price declines offering hope that inflation pressures were peaking. That said, while it appears inflation is stabilizing, prices remain stubbornly high. Finally, the Federal Reserve raised interest rates by another 75 basis points at both its July and September meetings. That action, along with its plans to lift rates by another 1.25%, targeting a rate between 4.25% and 4.50% by year-end, has dashed premature hopes of interest rates easing any time soon.

In sum, the third quarter started with optimism surrounding a resilient corporate earnings outlook, a potential peak in inflation, and a closer-than-expected end to the current Fed rate hiking cycle. But, throughout August and September, that optimism was eroded by sticky inflation data and a more hawkish-than-expected Federal Reserve. As we start the fourth quarter, markets remain in search of concrete positive catalysts that signal an end to the decline in asset prices.

As the fourth quarter opens, an honest assessment of the macroeconomic landscape reveals that the markets and the economy are still facing numerous challenges from high inflation, ongoing Fed rate hikes, and geopolitical instability. While the outlook for risk assets remains challenged, that reality must be considered in the context of a market that has declined substantially and, presumably, already priced in a lot of “bad news.” Valuations on many quality companies are quickly approaching pre-pandemic levels, while the S&P 500 more broadly is trading at a valuation that has, historically speaking, been attractive over the longer term.

We are closely following corporate fundamentals and look to earnings to help determine fair value in this current environment. We acknowledge that prices typically overshoot on the up and downside before finding equilibrium. Inflation expectations will be key as investors begin to focus on where future prices for goods, services and commodities are heading. Any indication of lower future inflation will likely result in the Fed pausing and/or pivoting as many investors believe will happen. With a resolution in these factors, the major known potential disruptor remains the war in the Ukraine. Unfortunately, at this point, there does not appear to be an immediate resolution to this conflict.

We recognize that this has been a very difficult market and a complicated period for investors. History is clear, however, positive surprises can and have occurred even in difficult times such as this. Through similar periods of macroeconomic turmoil, markets have eventually recouped the losses and moved to meaningful new highs. There is no reason to think this time will be any different.

We are committed to helping you effectively navigate this challenging investment environment. Proper asset allocation, aligned to your risk profile, is designed to weather such periods of extreme volatility. Successful investing is carried out over a long period of time, and even extended bouts of downside volatility, like we’ve experienced so far this year, are unlikely to alter a diversified approach set up to meet your long-term investment goals.