

### Third Quarter Summary

The stock market rally that began in September of 2022 has begun to cool, with S&P 500 losing 3.2% during the third quarter. There were a number of catalysts for the pullback, in addition to traditional profit taking actions on the heels of the roughly year-long rally. First and foremost is the Federal Reserve's continued hawkish monetary policy. Short-term interest rates now stand at a generational high of 5.5% and another increase of 0.25% by year end is within the realm of possibility. Although inflation has come down markedly from a year ago, the latest reading of the Consumer Price Index (CPI) at 3.7% annualized is well above the Fed's oft stated 2% target. Hence, the Fed has not hinted at the near-term possibility of rate cuts and has continued draining liquidity from the global financial system through its quantitative tightening (QT) program. The yield on the benchmark 10 Year U.S. Treasury Note was recently within striking distance of 5.0%. Higher interest rates permeate through the entire economy, with one noticeable example of mortgage rates on new home sales averaging roughly 8%, also a generational high.

Higher gasoline prices have also resulted in both consumer and investor angst with prices at the pump averaging approximately \$4.00 per gallon nationally and \$6.00 in California. Although the strike with Hollywood writers has ended, the United Auto Workers strike is ongoing with no quick end in sight. If supply chains are further disrupted, auto prices may increase yet again. The resumption of student loan payments, which have been halted for many borrowers since the onset of the COVID pandemic, has some investors concerned about moving from what had been a relatively strong economy into one on the precipice of recession. Adding to the uncertainty was for the first time ever, during an intra-election period, the removal of a Speaker of the House, Kevin McCarthy, from power. Without a permanent leader in place, the scenario of a federal government shutdown again looms on the horizon next month.

The Fed's impact on interest rates and the gradual realization by investors that rates will remain "higher for longer" resulted in the most widely followed bond index, the Bloomberg Barclays US Aggregate Bond Index, also falling 3.2% in Q3. This loss has wiped out prior year to date gains and has "The Agg" on the precipice of delivering annual losses to its investors for three consecutive years. Bond investors who hugged the short end of the yield curve likely remain in positive territory due to the aforementioned Fed rate hikes, which most directly affect money market securities. Although the performance of the "Magnificent 7" technology stocks has noticeably cooled since August, Growth stocks remain in solidly in the green on a year-to-date basis, while Value and Small Cap stocks are struggling to remain above the 0% return levels.

### Market Outlook

We expect continued volatility in asset prices as the economic data begins to weaken in Q4 after a surprisingly strong summer "revenge spending" period. Investors will have greater clarity on consumer spending habits once companies begin to report Q3 earnings over the next month or two. Excess savings from the pandemic have largely been dissipated, except for the affluent. Despite elevated mortgage rates, real estate prices remain near all-time highs due to a lack of inventory for sale. Hence, home equity loans may provide one lever for some consumer to continue spending. We expect the Fed to pause its rate hike campaign but do not see any material interest rate cuts until at least the middle of 2024, absent a "black swan" type market shock.

On the positive side, the recent slide in stocks has made valuations more attractive. The S&P 500 is now trading at roughly 17x forward earnings and the median stock is trading closer to 15x forward earnings. We continue to favor companies that have pricing power in an inflationary environment as well as those companies that may perform relatively well in a slow growth/contractionary economic environment. Once market participants fully digest the structural change in interest rates away from the prior 0% rate policy, they will realize that valuations are near historical averages and therefore may result in a decent entry point for long-term investors, especially on a dollar

cost averaging basis. Stock markets tend to look 3-6 months ahead. Hence, even if the economy begins to weaken, investors may see light at the end of the tunnel resulting in a quick rebound from a subsequent correction or down market. In other words, if the economy does experience a material downturn or fall into a recession in the months ahead, a recovery in financial assets may occur *before* the economic rebound is evident to most investors.

Geopolitical risks always exist, with fallout from the ongoing Russia-Ukraine War being the most prominent. Tensions between China and the United States remain a longer-term structural issue despite olive branches being extended from both parties. China continues to grapple with the aftermath of a collapsing real estate market and the loss of some manufacturing jobs as global producers seek to diversify their supply chains outside the country. The large federal budget deficit is a problem that must eventually be faced, in the form of economic growth, higher taxes, and/or less spending. The perennial federal debt ceiling and government shutdown threats are symptoms of a fundamental problem of spending in excess of tax receipts that may only be resolved through bipartisan agreement.

**John M. Longo, PhD, CFA**

Chief Investment Officer, Portfolio Manager

 **Beacon Trust** 163 Madison Avenue, Suite 600 | Morristown, NJ 07960 | 973.377.8090 | [BeaconTrust.com](http://BeaconTrust.com)

Investment Advisory Services, Inc. ("BIAS") is an SEC registered investment adviser, under the name Beacon Trust, and is wholly owned by Beacon Trust Company ("BTC"), which is a subsidiary of Provident Bank. Provident Bank is a subsidiary of Provident Financial Services, Inc., a holding company whose common stock is traded on the New York Stock Exchange. Beacon Trust may only transact business in those states where they are notice filed or qualify for a corresponding exemption from notice filing requirements. Additional information is contained in the respective Form ADV disclosure documents, the most recent versions of which are available on the SEC's Investment Adviser Public Disclosure website at <http://www.adviserinfo.sec.gov>.

SECURITIES AND INVESTMENT PRODUCTS: Not FDIC Insured | May Lose Value | No Bank Guarantee

This publication is limited to the dissemination of general information pertaining to the wealth management products and services offered by Beacon to U.S. residents of those states where not prohibited by applicable law. No portion is to be construed as a solicitation to effect transactions in securities or the provision of personalized investment, tax, or legal advice. Investing involves risks which may lead to losses, including loss of principal. Different types of investments involve varying degrees of risk and there can be no assurance that any specific investment will be profitable. Any reference to a market index is included for illustrative purposes only, as it is not possible to directly invest in an index. Indices are unmanaged vehicles that serve as market indicators and do not account for the deduction of management fees or transaction costs generally associated with investable products, which otherwise have the effect of reducing the performance of an actual investment portfolio. Calculation methodologies are available from BIAS upon request. **Past performance is not a predictor of future results.** It should not be assumed that any information discussed herein will prove to be profitable or that decisions in the future will be profitable or provide specific performance results. Any discussion of tax matters contained within this communication should not be used for the purpose of avoiding U.S. tax related penalties or promoting, marketing, or recommending to another party any transaction or matter addressed herein. Beacon Trust does not provide legal advice. 00209617