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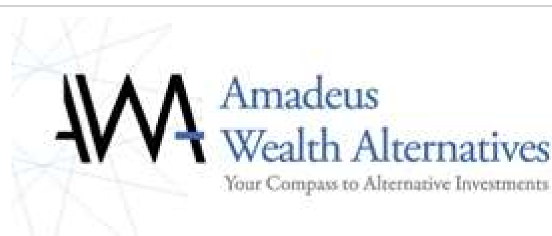


212-697-3930

Edward Papier, CIMA®, CFF

ep@amadeuswealth.com

In this week's recap: U.S. and U.K. see financial turbulence.

Weekly Economic Update

Presented by Ed Papier, October 3, 2022

THE WEEK ON WALL STREET

Rising recession fears and uncertainty in the bond and currency markets sent stocks to new 2022 lows last week.

The Dow Jones Industrial Average declined 2.92%, while the Standard & Poor's 500 slumped 2.91%. The Nasdaq Composite index fell 2.69%. The MSCI EAFE index, which tracks developed overseas stock markets, lost 1.94%. [1,2,3]

A TUMULTUOUS WEEK

U.S. stocks were under pressure all week due to recession concerns and unsettled trading in the bond and currency markets. This stress followed economic steps out of the U.K. During the previous week, the Bank of England (BOE) raised interest rates, and its prime minister announced unfunded tax cuts that the markets interpreted as inflationary.

U.S. bond yields rose early last week, sending stocks lower until Wednesday's rally following news that the BOE would buy U.K. government bonds. U.S. stocks resumed their descent the following two days to close out a disappointing week, month, and third quarter.

THE BANK OF ENGLAND ACTS

Global bond and currency markets have been volatile recently due to global central bankers raising interest rates to combat inflation. Developments in the U.K. took center stage last week when the BOE

announced it would be buying long-dated U.K. government bonds. Upending the financial markets was the previous week's announcement of tax cuts by the country's new prime minister, a step many investors viewed as counterproductive to the BOE's inflation-fighting efforts.

The BOE's decision to begin temporary purchases of government bonds was well-received by capital markets, sending U.K. bond yields lower and boosting U.K. stock prices in the immediate aftermath.

THE WEEK AHEAD: KEY ECONOMIC DATA

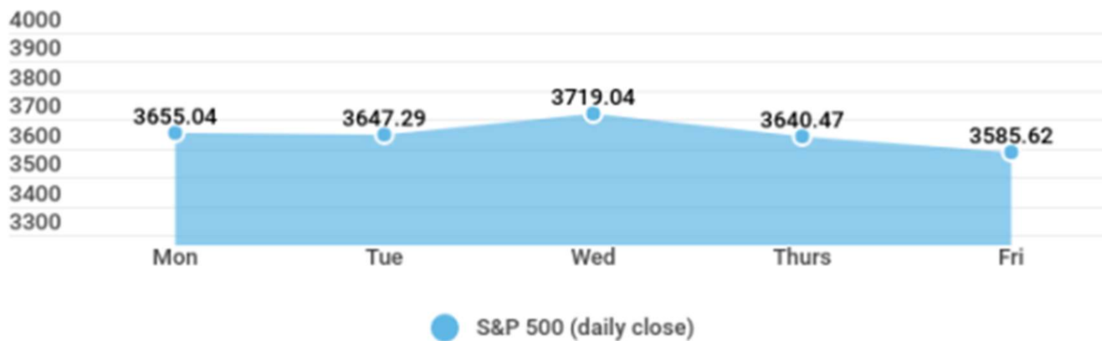
Monday: Institute for Supply Management (ISM) Manufacturing Index.
Tuesday: Factory Orders. Job Openings and Labor Turnover Survey (JOLTS)
Wednesday: Automated Data Processing (ADP) Employment Report. Institute for Supply Management (ISM) Services Index.
Thursday: Jobless Claims.
Friday: Employment Situation.

QUOTE OF THE WEEK

" He who fights too long against dragons becomes a dragon himself"

FREDERIK NIETZSCHE

Market Index	Close	Week	Y-T-D
DJIA	28,725.51	-2.92%	-20.95%
NASDAQ	10,575.62	-2.69%	-32.40%
MSCI-EAFE	1,655.31	-1.94%	-29.14%
S&P 500	3,585.62	-2.91%	-24.77%



	Treasury	Close	Week	Y-T-D
	10-Year Note	3.83%	+0.14%	+2.31%

Sources: The Wall Street Journal, September 30, 2022; Treasury.gov, September 30, 2022
Weekly performance for the Dow Jones Industrial Average, Standard & Poor's 500 Index, and NASDAQ Composite Index is measured from the close of trading on Friday, September 23, to Friday, September 30, close. Weekly performance for the MSCI-EAFE is measured from Friday, September 23, open to Thursday, September 29, close. Weekly and year-to-date 10-year Treasury note yield are expressed in basis points.

OF NOTE

Investors may need to prepare themselves for the possibility that the good times are over.

Stock market investors have generally enjoyed a decade of great returns dating back to 2013, when the market emerged from the doldrums of the 2008 financial crisis.

The S&P 500 has now lost almost 25 percent in 2022 after a week of selloffs following the Federal Reserve's latest round of 75-basis-point-benchmark interest rate hikes. The outlook from here isn't very optimistic.

Before we dive into what the future may hold, it's worth revisiting how spectacular returns have been over the last decade. In the three years from the beginning of 2019 to the end of last year (2021), the S&P 500 has increased 89.9 percent, or at an annual rate of 23.8 percent. During the decade from 2011 to 2021, the market gained 274.7 percent, or an annual return of 14.1 percent over the decade.

Prior to that, though, the U.S. stock market had gone through long periods of lackluster returns. In the eight years from the beginning of 2000 (near the height of the "dot-com" bubble) to the end of 2008 (the midst of the great financial crisis) the S&P 500 returned -5.8 percent annually. And in the twelve years from 1968 to the end of 1981, the index returned only 1.4 percent annually.

If the S&P 500 index ends this year at the same level as today, 2022 would register as the third-worst annual return going all the way back to 1975, with 2008 and 2002 being the only worse years, with returns of -38.5 percent and -23.4 percent respectively.

All of this is to say that investors have generally been rather spoiled over the last few decades. We certainly don't expect (or hope for) annual declines of 20 percent or more in the next few years, but the macroeconomic environment also does not encourage optimism.

Could the market trade sideways over the next several years, with small pockets of gains and losses but ultimately without sustained positive momentum? A few experts believe a "lost decade" could indeed be in the cards.

Albert Edwards of Société Générale had argued for years that the most recent bull market—propped up by years of zero-to-negative interest rates and massive money printing—would end and usher in a period of high inflation, high interest rates, and high government spending in an attempt to boost the economy.

Morgan Stanley's chief U.S. economist put it succinctly in a note to clients on Sept. 23: "We now see the Fed delivering additional pain to households and businesses via a higher rate. While the alternative—persistently high inflation—is harder to bear, the path to a soft landing has narrowed. The higher interest rates go, the greater the risk of a recession."

The bank now expects another 75-basis point hike in November, followed by a 50 basis point hike in December and a smaller 25 basis point increase in January 2023. Morgan Stanley also lowered 2023 GDP growth to 0.5 percent and revised down 2022 GDP growth to zero.

Major banks are cutting year-end targets for the S&P 500, with generally bullish Goldman Sachs projecting the index to end the year at 3,600 points, slightly below its current mark. Michael Harnett, chief investment strategist at Bank of America, told Reuters that the S&P could end the year as low as 3,020, which is another sizable drop from today.

Looking ahead, several factors will create headwinds for much of 2023, if not beyond. Inflation remains sticky. High interest rates will cut into consumer budgets and make debt more expensive, from mortgages and car loans to credit card balances. Higher debt service burden will also hit companies. Businesses facing higher costs and lower revenues will look to lay off and cut staff, further exacerbating the situation.

We hear investors looking for signs of "capitulation" in the market that typically would indicate a near-term bottom in stocks. But such tried-and-true investing methods may no longer work, with the Federal Reserve having effectively abandoned the stock market, and economic fundamentals are so weak.

All of this will come as a wake-up call for those accustomed to the market going up the majority of the time, and a central bank that has always had the market's back. The previously useful passive index investing strategy of holding a market index and depending on the "tide to lift all boats" should also be thrown out.

From here on out, investors may need to resort to old-school stock picking, choosing quality companies with healthy balance sheets and high dividends, and short-term buying and selling.
Sustained periods of market stagnation? It may just be the new "old" normal. [4]

Ed Papier may be reached at 2126973930 or ep@amadeuswealth.com
www.amadeuswealth.com

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The forecasts or forward-looking statements are based on assumptions, may not materialize, and are subject to revision without notice.
The market indexes discussed are unmanaged, and generally, considered representative of their respective markets. Index performance is not indicative of the past performance of a particular investment. Indexes do not incur management fees, costs, and expenses. Individuals cannot directly invest in unmanaged indexes. Past performance does not guarantee future results.
The Dow Jones Industrial Average is an unmanaged index that is generally considered representative of large-capitalization companies on the U.S. stock market. Nasdaq Composite is an index of the common stocks and similar securities listed on the NASDAQ stock market and is considered a broad indicator of the performance of technology and growth companies. The MSCI EAFE Index was created by Morgan Stanley Capital International (MSCI) and serves as a benchmark of the performance of major international equity markets, as represented by 21 major MSCI indexes from Europe, Australia, and Southeast Asia. The S&P 500 Composite Index is an unmanaged group of securities that are considered to be representative of the stock market in general.
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