POST OAK PRIVATE WEALTH ADVISORS
ADVISORY, CONSULTING & INVESTMENT MANAGEMENT

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Monthly Market Commentary

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It's good to end the year on a high note. The enthusiasm we are seeing in the financial markets are a welcome sign as the holiday season approaches. I hope you and your families enjoyed your Thanksgiving and are looking forward to celebrating as we close out what's been a wild year in the market and economy. There is much for us to be thankful for and many reasons to be optimistic about the year ahead.

For much of 2022, the defining narrative in the market has been one of accelerating inflation and a Federal Reserve that's been mostly behind the curve. That story changed somewhat recently as stocks rallied strongly to end November on news of the Fed relaxing the pace of rate hikes. A statement by Fed Chair Jerome Powell set the course for a half-point hike at the Fed's December meeting, noting signs of easing inflation in certain sectors of the economy such as housing.

Inflation and its impact on the economy was top of mind among Americans as November began and voters went to the polls. A survey by the Pew Research Center just before the November 8 midterms found that nearly four out of five likely voters ranked the economy first among "very important" issues. During the month, we saw more emerging signs of possible peak inflation. This news, along with the potential aftereffect of a Fed rate hike pause, contributed significantly to November's market rally.

Inflation under the hood

The headline inflation rate, as measured by the Consumer Price Index (CPI), remained steady in October at a 0.4% monthly increase. Year-over-year CPI growth for October was reported at 7.7%, down from the 8.2% annual pace of growth in September. Core CPI, which excludes volatile food and energy prices, also showed signs of easing with a year-over-year growth rate of 6.3% in October, down from September's 40-year high of 6.6%. The monthly report on wholesale prices also brought some good news; the Producer Price Index showed a year-over-year increase of 8.0% in October, slower than the 8.4% growth rate in September and the record 11.7% growth rate this past March.

What may get lost in looking at these top-line numbers are the components that actually make up the inflation index. The different parts of CPI have different weights, so a big swing in a large component such as housing can strongly influence the inflation numbers.

This month, I thought it would be a good time to present an "under the hood" view of the Consumer Price Index, taking a closer look at some of the bigger components that can sway inflationary trends. As previously mentioned, housing or shelter (which includes rent and mortgage payments, among other expenditures) is the largest piece of the CPI puzzle, comprising nearly one-third of the calculation. Food, transportation, energy and medical care combine to make up around another third. So, the top five components represent the bulk of the index – and changes in these prices can have significant effects on inflation, as discussed on the next page.

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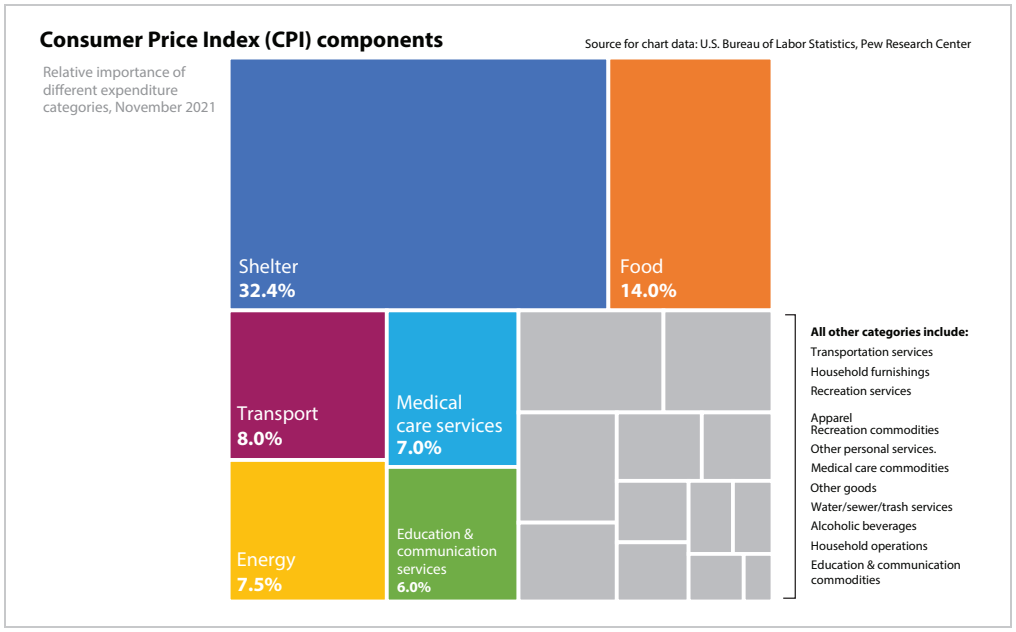

Shelter includes rent and owners-equivalent rent (i.e., mortgage payments), along with homeowners' and renters' insurance and lodging away from home, but most of the shelter component of CPI comes from mortgages. (By itself, mortgages represent 24% of CPI.) So, you would expect rising home prices have a big influence on inflation, and we haven't really seen the housing market start to decline just yet. But a stiff jump in rates for 30-year fixed-rate mortgages, from a national average of around 3.0% early this year to over 7.0% in November, is already slowing home sales and should cascade to lower home values. However, the rise in mortgage rates could also push more potential buyers into the rental market and lift rental costs. It will be interesting to watch how these dynamics could play out in future CPI reports.

Food covers both spending for in-home consumption and outside of the home. Anyone who has been to a grocery store or restaurant this year has confronted rising prices that has outpaced other goods and services in the economy. The costs for many food items often include other inputs, especially energy-intensive costs such as fertilizer and transportation. Elevated food prices are historically persistent and difficult to bring down. For example, while energy prices have fluctuated month to month this year, food price inflation has remained relatively steady.

Transportation includes both new and used vehicles (cars and trucks), as well as leased vehicles. Both new and used vehicles are mostly equally weighted at present. You may recall how used vehicle prices escalated last year as supply chain pressures crunched inventories for new vehicles. Prices for used cars and trucks have come down substantially from their peaks earlier this year, but new vehicle prices have continued climbing, mostly as supply chain issues have persisted.

What's going on with jobs?

Persistently high inflation numbers prompted the Federal Reserve to raise rates again in November, adding another three-quarter points to the Federal funds rate early in November. In seeking to cool inflation, the Fed has aimed to slow economic activity by increasing borrowing

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costs for businesses and consumers. This comes with the consequence of slowing employment growth at the expense of workers and wages.

Conditions in the job market have remained tight throughout 2022, although growth in non-farm payrolls and wages have slowed more recently; only 261,000 jobs were added in October, the lowest level in 12 months. Several large firms including Amazon, Ford and Meta Platforms have notably announced plans for layoffs. Still, workers appear to have the upper hand with the number of job openings outpacing the number of people looking for work. According to the recent Department of Labor's Job Openings and Labor Turnover Survey (familiarly known as the JOLTS report), the ratio of open jobs to unemployed workers is a little over 1.8. That means in the present job market there are approximately two open positions for every one person looking for work.

One of the shortcomings of the JOLTS number is that it only counts unemployed people seeking work and doesn't include job seekers who are currently employed but looking for better positions. A team of economists and data scientists at LinkedIn recently applied a different analysis of labor market conditions and came up with a different picture, suggesting that the current employment market may not be as tight as the official numbers indicate. The LinkedIn researchers calculated an alternative ratio of active job openings on the site with active LinkedIn job seekers. By this measure, the labor market seems to have more slack, with a ratio of one open position per one job seeker.

What are the implications of this alternative look at employment? If the LinkedIn analysis is on point, it could mean Federal Reserve rate tightening may have a more immediate impact on workers and the economy. Employment will likely be hit as economy activity sputters and more companies lay off workers. A less heated job market should slow wage growth, which would help ease inflation pressures. It could also lead to a sooner conclusion to the Fed's current campaign of rate hikes, which is sure to please the financial markets.

The start of something good?

The potential for this scenario seemed to boost investor sentiment in November, helping the stock market to its second-consecutive monthly gain for the first time this year. There's some interesting data emerging that supports the idea of inflation turning the corner and economy rolling over. As of this writing, the Fed funds futures market sees a pause in Federal Reserve rate hikes coming in the first half of 2023. Bear in mind that one month is not a trend, so patient investors should remain vigilant and keep watch to see how these factors play out in the coming year.

The positive month for stocks boosted returns for the S&P 500 Index and all 11 S&P 500 sectors in November. Top sector performers included materials, industrials, financials and utilities, indicating a continued rotation toward value stocks and away from growth. Technology stocks marginally outperformed the benchmark with a 6.0% for the month. Energy stocks lagged but managed a positive return of 1.3% as oil prices declined in November; the per-barrel price of West Texas Intermediate crude dropped from a monthly high of $92 to below $80 by Thanksgiving. Investors in energy stocks won't be too displeased with these modest monthly gains, with the sector still outperforming all others with a year-to-date gain of 70%.

Looking toward year-end

The next three weeks are likely to be critical in defining the direction stocks take in the coming year, and we are cautiously optimistic about the near term. Much of the latest economic data

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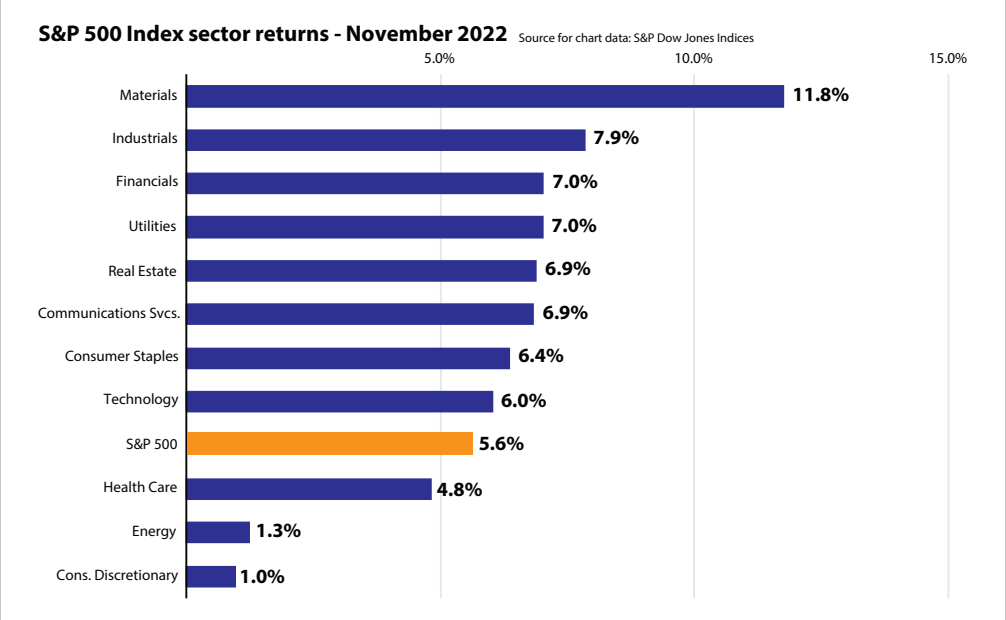

we've seen recently has been good, and the stock market rallies following these reports have been good as well. We were expecting to see a rally coming out of the midterms and some lift from the traditional "Santa Claus" rally that often appears as the year winds down.

Possibly the best news is that inflation appears to be rolling over and may soon recede. If this trend materializes, it will likely prompt the Fed into slowing down and eventually pausing rate hikes in the near future. That would be further good news for markets and the economy. As prudent investors, we won't get ahead of ourselves and will patiently watch to see how things progress in future CPI reports. There are plenty of reasons for optimism, which is something we haven't seen much of this past year.

On behalf of everyone at Post Oak Private Wealth Advisors, I hope you have a joyful holiday season with your families and friends. We will return with our year-end review and outlook in the new year. In the meantime, please feel free to contact us with any questions or concerns you have