COLONIAL TRUST COMPANY
EST 1913

4TH QUARTER
2022

COLONIAL TRUST *Quarterly*

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3RD QUARTER OVERVIEW

We ended the quarter with Hurricane Ian devastating much of Florida before barreling down on the Carolinas. Our thoughts and prayers are for the safety and rapid recovery of the communities impacted by the storm.

Storms seemed to continue to circle around the markets and economy during the second half of the third quarter. The quarter began with equity market strength, building on the rally that began on June 17th. The high-water mark for the S&P 500 for the quarter was on August 16th, with an increase of 17.4% from the June 16th low. This proved to be a bear market rally which reversed, and the market fell in six of the last seven weeks of the quarter. We began the quarter with the broad equity market in bear market territory, down 21.1% from the January 3rd all-time high. The June through August upswing resolved the bear market, but the reversal brought us to new lows for the year. The S&P 500 ended down 5.1% for the quarter and 24.8% for the year. The sell-off was not confined to the S&P 500 with all major indices in the red.

Total Return	3Q	9 mths
S&P 500	-4.9%	-23.9%
Dow Jones	-6.2%	-19.7%
Nasdaq	-3.9%	-32.0%
Russell 2000	-2.2%	-25.1%
MSCI EAFE	-9.3%	-26.7%
MSCI Emerging Markets	-11.5%	-27.0%
Bloomberg Agg. Bond	-4.8%	-14.6%

Source: Bloomberg

In our last newsletter, we described how the economy is facing the dual risk of higher interest rates and a slowdown in economic growth. Both catalysts for poor equity performance are being driven by the Fed's hawkish monetary policy which is intended to reduce inflation. The economic, inflation, and market backdrops worsened over the quarter. We hope to provide you an update in these areas and our thoughts on prospects for the rest of 2022 and into 2023.

THE ECONOMY

GDP growth for the 2nd quarter was -0.6%, marking two consecutive quarters of falling GDP. While this is economic shorthand for recession, the NBER has not officially declared the US to be in recession. The median forecast from Wall Street economists for 3rd quarter GDP growth is 1.4%, which has been reduced from the August survey. The Atlanta Fed GDP Nowcast increased sharply at month-end, to 2.4%. It is undeniable that the US and global economies are slowing in 2022. We will separate areas of the economy and outline their health below.

The engine of the US economy, the consumer, is beginning to pull back. Employment remains healthy, with strong job growth year to date. The pace of job gains is slowing, with monthly job gains decelerating – the eight-month average gain is 438,000 and the three-month average is 378,000.

THE UNEMPLOYMENT RATE IS 3.7%, UP SLIGHTLY FROM 3.5% IN JULY.

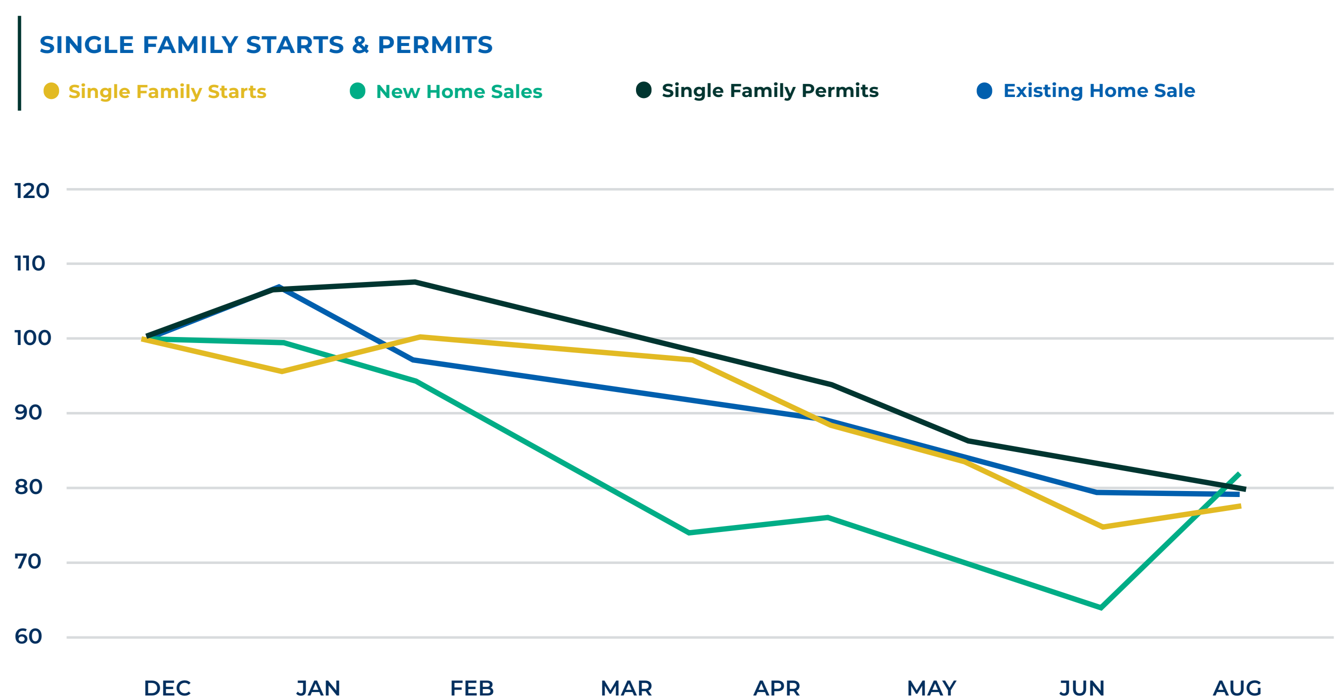
Job openings are down from record highs, but at 10 million, we have nearly two jobs for every unemployed person. While this is a positive backdrop, wages are not keeping pace with inflation. Average hourly earnings are up 5.2% year over year, well below 8.3% CPI. Real wages are falling, and this is impacting the consumer. Retail sales continue to grow, up 9.1% year over year, but most of this increase is due to inflation. Facing higher prices, consumers have increased revolving credit by 9.1% this year and the savings rate has fallen from 7.5% of income to 3.5% of income since December. The Consumer Sentiment Index bounced from its June lows, which were due to falling gas prices, but remains below the 2020 pandemic lows. Although employed, consumers are struggling to keep up with rising prices.

The business sector is slowing, yet most measures point to growth. The ISM indices of the manufacturing and service economies are 50.9 and 56.9 – a reading above 50 signals expansion. Both measures were above 60 a year ago. Industrial production is still expanding, with the August read up 3.7% over the prior year, but the pace is slowing. Capital goods orders increased 9.8% in August over the prior year, pointing to continued investment in the corporate sector. However, businesses are not immune to the global economic environment. Businesses are pointing to the strengthening of the US dollar having a negative impact on their overseas profits. Management teams are signaling caution and the Business Roundtable's CEO Survey has fallen from 123.5 at year end to 84.2 today. We will learn more as companies report earnings for the 3rd quarter, but we expect companies will strike a cautious tone in their reports.

Rising interest rates have a demonstrable impact on credit sensitive industries. No industry is more sensitive than housing, where activity has slowed dramatically due to higher mortgage rates.

THE 30YR MORTGAGE RATE HAS INCREASED FROM 3.18% TO 6.83% OVER THE LAST YEAR.

This increases the monthly payment on a 30yr mortgage by 51.6%, and a borrower with a $500,000 mortgage would pay an additional $13,353 per year. As a result, measures of the housing economy have fallen by approximately 20%. Housing alone has a minor impact on GDP, but the knock-on effects of furniture purchases, moving expenses, electronics, etc. mean a slowdown has an outsized impact on the economy.



INFLATION & MONETARY POLICY

Headline inflation measures reached 40-year highs in June, with CPI of 9.1%. Gas prices have fallen 24.2% from their June highs, which has caused headline inflation to retreat. Headline CPI was 8.3% in August. However, the reduction in headline CPI evaporates when volatile food and energy prices are removed. Core CPI has risen since June and was 6.3% in August. Two areas of concern remain wages and rents. As mentioned above, wages are rising 5.2% annually, which forces companies to either raise prices or lower profits to pay higher wages. According to Realtor.com, median monthly rent is increasing by more than 20%. Higher mortgage rates are making home purchases unaffordable for many, creating more demand for rental properties.

THE FED HAS INCREASED THE FED FUNDS RATE FIVE TIMES SINCE MARCH TO COMBAT INFLATION, FROM 0.0% TO 3.0%/3.25%.

At their September meeting, the Fed forecasted this rate would be 4.4% by year end. The market is forecasting increases of 0.75% and 0.5% in the November and December meetings. The market and the Fed are forecasting a 4.6% Fed Funds rate next year. In addition to raising short-term rates, the Fed is reducing the size of its balance sheet, or quantitative tightening. Since beginning quantitative tightening in March, the Fed has taken $170 billion of liquidity out of the financial system. The Fed implements quantitative tightening by not refinancing maturing treasury debt or mortgages. Rather, new capital for treasury debt and mortgages must come from the private sector, who may demand a higher yield, and this can crowd out other borrowers.

It has become apparent that inflation is a global problem and nearly all global central bankers are raising rates to combat inflation. There are commonalities to the global inflation, such as snarled supply chains and excessive fiscal and monetary policy during the pandemic. Europe is facing more pronounced inflation due to its dependence on Russian gas supplies which have been disrupted by the Ukrainian war. Inflation measures in Europe are higher than the US, with the UK at 9.9% and Germany 10.0%. The Fed has moved faster and more forcefully than the Bank of England and the European Central Bank. This increase in our rates relative to our trading partners has caused the dollar to strengthen sharply. The dollar index has increased by 20% in a year. As the world's reserve currency, many commodities are priced in dollars. A 20% increase the value of the dollar makes these commodities 20% more expensive for foreign buyers. This is worsening the inflation and economic impacts for Europe and other countries.

The rate hiking cycle has been global, but as of yet it has not been coordinated. This has caused wide swings in currencies and sovereign bond yields. During the quarter, the Bank of England was forced to intervene to calm the UK bond market and Japan was forced to defend its currency. In a globally connected financial system, the actions of a central bank are not confined to their shores; they reverberate across the world and have increased global volatility.

MARKETS

The combination of slowing growth and rising interest rates has been negative for capital markets. Valuations have reset to lower levels. The resetting process is painful to live through but sets markets up for better future returns from more realistic levels. The trailing price to earnings (P/E) ratio for the S&P 500 was 24.7x at year end and has fallen 28.9% through quarter-end, greater than the fall in the market. The dividend yield has increased from 1.27% to 1.85% over this period, a 45.6% increase.

While valuations have become more attractive, expectations for earnings for the rest of the year and 2023 are being marked down. Wall Street analysts have reduced forecasts for the S&P 500 3rd quarter and 4th quarter earnings estimates by 6.0% and 4.5% in the last 90 days. Higher inflation and a stronger dollar are reducing profit margins for companies, therefore reducing earnings. For the 2nd quarter, S&P profit margins have fallen from 13.5% to 10.9% year-over-year. This is returning profitability to the levels that existed prior to COVID, where the S&P 500 profit margin averaged 10.4% from 2016-2019. In March, analysts expected earnings to rise 8.3% this year, but current estimates are for flat earnings growth.

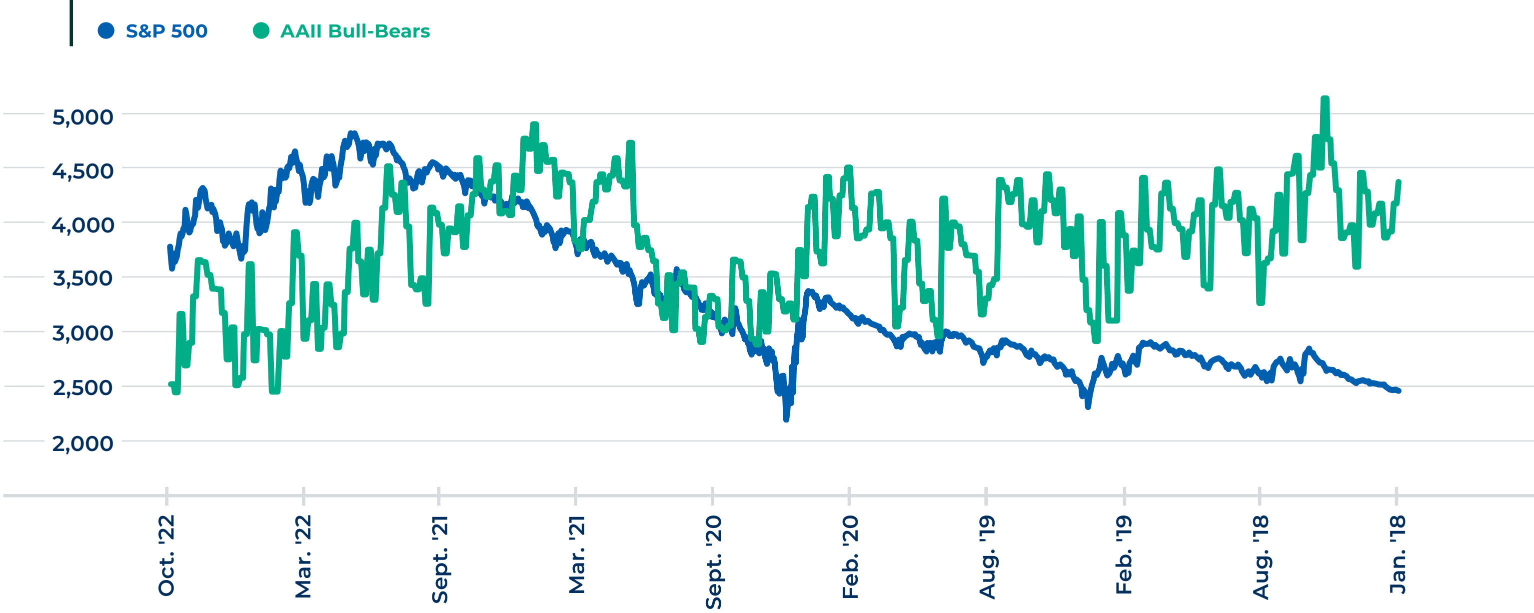
THE SLOWDOWN AND HIGHER RATES HAVE BEEN REFLECTED IN MARKET PRICES.

We believe we are close to the end of this bear market. We expect the Fed may raise rates a few more times, but most of the rate increases are behind us. Peak inflation occurred this summer and we expect inflation rates will remain elevated, but slower job growth will reduce wage pressures as the economy slows down.

We believe the market will remain volatile over the next few quarters as the Fed reaches its terminal interest rate. As we have seen in 2022, the market selloffs are fast and furious on negative news about inflation and the prospect of more rate hikes. When sentiment becomes too negative, the selling is exhausted, and buyers enter the market. The rebounds in the market have been as powerful as the selloffs. These sharp bounce backs move too far, too fast and are followed by a pause and more selling. The American Association of Individual Investors (AAII) conducts a weekly survey of investor sentiment, with a percentage of bulls and bears. By subtracting bears from bulls, we are able to gauge the level of pessimism in the market. In the last week of the quarter, sentiment was at its lowest level in more than five years.

This is a contrarian indictor and signals the market is oversold. As we begin the fourth quarter, the markets are bouncing off the quarter-end lows. These sharp selloffs and rebounds have been the market narrative in this rate hiking cycle, and we expect it to continue until the Fed is near the finish line.

MARKET SENTIMENT



The backdrop may become more constructive in the fourth quarter if history is a guide. September is historically the worst month for the market, and it certainly was in 2022. But markets tend to rally in the fourth quarter of mid-term elections. In mid-term years, since 1931, the average return for the S&P 500 was negative going into October and bounced in the fourth quarter. Volatility is typically elevated in the June through November timeframe but returns in the fourth quarter are strong. Elections remove uncertainty and mid-terms normally see the party in power lose seats, which leads to gridlock. Markets like gridlock and it appears we will see at least the house flip in November. This reduces the likelihood of a fiscal package or change in tax policy.

This has certainly been a challenging first nine months. The reset in the equity and fixed income markets has been jarring for investors. As we mentioned above, we do believe the worst of the sell-off is behind us. The economy and earnings growth are slowing, which is the objective of the Federal Reserve to fight inflation. We believe they are accomplishing their goal of lowering inflation. The reset in valuations is creating more attractive opportunities in both the equity and fixed income markets. We believe long-term investors will be rewarded for their patience and perseverance.

IN THE SPOTLIGHT

Reid Thompson
Corporate Retirement Plan Specialist

We wish to honor **Reid Thompson** our 401k specialist these last few years. Reid has retired to address difficult health issues and to spend time with his young family. Reid joined Colonial in February of 2020 and then persevered through the pandemic servicing our clients and providing excellent advice. Reid was our first stand alone 401k specialist and proved what an indispensable role that it is. We thank Reid for his optimism and dedication throughout the pandemic. We wish him our love and prayers, and we look forwards to visiting him in his retirement along with his wife Sharon and sons Myers (2) and Montford (5).

Joining us in this position is **Matt Van Name** who comes most recently from Truist and has spent more than a decade in the retirement plan space. Matt is a Greenville native having graduated from Riverside High School in Greer and then from Clemson University. He and his wife Rachel reside in Inman with their two children Turner (6) and already a serious golfer, and Vera Kate (8) an aspiring future US Women's Soccer Team Captain. Matt enjoys traveling, playing golf, and cheering on the Tigers. We welcome Matt. Please look to Matt for any questions you may have about retirement plans.

Matt Van Name
Corporate Retirement Plan Specialist

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