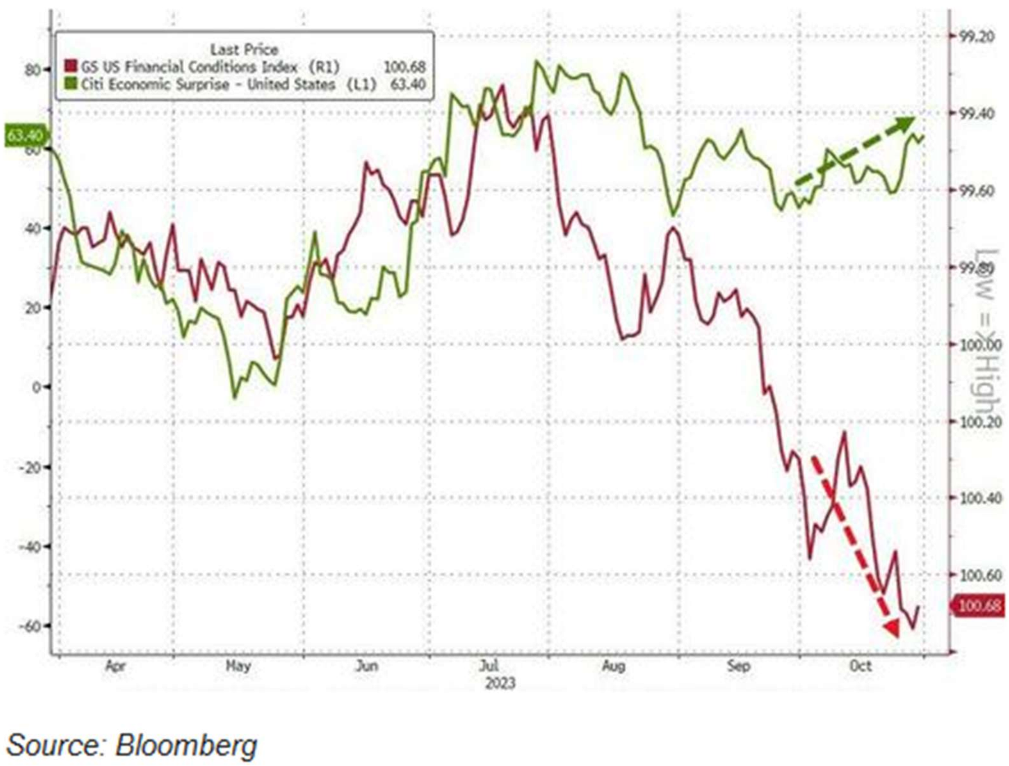
MARKET REVIEW & OUTLOOK

OCTOBER 2023

BREAKING NEWS:

- As expected, the Fed did not change policy rates. The market's initial reaction was a nothingburger, but then Powell offered up a lot of contradictory statements and the bulls ran with the ones they liked! As the chart below shows, since the last Fed hike in late July, financial conditions have tightened, but economic activity is generally coming in better than expected. So, economists are expecting a slowdown, but so far have been reducing expectations greater than any impact to the actual economic activity.



Source : https://www.zerohedge.com/markets/stocks-spooked-3rd-straight-month-ww3-fears-spark-surge-usd-gold-crypto-not-oil

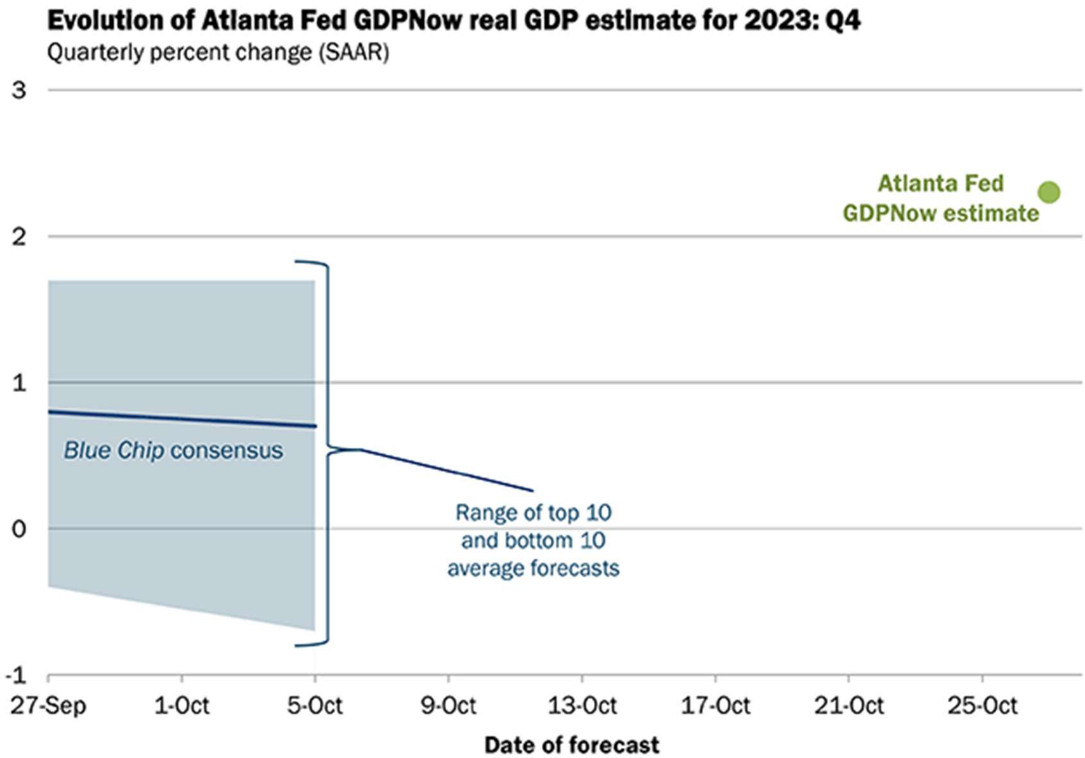
Back to our regularly scheduled program…

KEY TAKEAWAYS

- The equity markets saw heavy selling pressure in the second half of the month, but the last couple of days rallied off the lows.
- The 10-year Treasury Yields continued higher, stalling near the 5% mark.
- The world pushes closer to WWIII and Crude oil sells off hard, didn't have that on my bingo card!

The U.S. Economy

The initial 3rd quarter GDP report came in strong at 4.9% and in line with the GDPNow forecast. Additionally, core PCE, the imbedded inflation measure, dropped to 2.4%, down sharply from the report last quarter of 3.7%. With the 3rd quarter reported, we get our first look at the 4th quarter estimate for GDP from GDPNow, which is just north of 2%. The Blue-Chip consensus forecast is just below 1%, as shown in the chart below. Economic activity is very robust, even if fiscal deficit enhanced, and the PCE deflator is continuing to signal moderating inflation. The data continues to support the Fed's stance of at minimum to hold rates higher for longer, stay tuned for tomorrow's Fed meeting.



Sources: *Blue Chip Economic Indicators* and *Blue Chip Financial Forecasts*
Note: The top (bottom) 10 average forecast is an average of the highest (lowest) 10 forecasts in the *Blue Chip* survey.

Source : https://www.frbatlanta.org/cqer/research/gdpnow

Stocks and Bonds

Interest rates continued marching higher through mid-month, reaching levels last seen in July 2007 at 5.00% on the 10-year U.S. Treasury. The 5% level marked strong resistance, as buyers saw value and short sellers captured large profits. Further, the perceived headwind that 5% represents for the economy also weighed in. The Fed meets tomorrow and is widely expected to leave interest rates unchanged, with a possible hike at the December meeting. Coming into an election year, December is likely the last opportunity for many months if the Fed feels another hike is necessary. Financial conditions continued to tighten during the month and the great uncertainty of the Israel/Mid East further increases the likelihood that the Fed stands pat tomorrow. The general economic environment still seems too strong for the Fed to start cutting interest rates soon and inflation continues to show signs of life in a few indicators. The increase in yields continues to create a headwind for High Quality fixed income, which as measured by the iShares US Aggregate Bond ETF fell -3.32% for the month. The U.S. 10-year Treasury bond yield ended the month at 4.88%, up from September's close of 4.57%.

The Dow Jones Industrial Average eased -1.36%, the S&P 500 dipped -2.20%, and the small cap Russell 2000 dropped -6.88%. The international markets traded in line with the U.S. The MSCI EAFE iShares Core International Developed Markets ETF Index slid -1.57%, and the MSCI Emerging Markets iShares Core ETF Index slumped -3.61%.

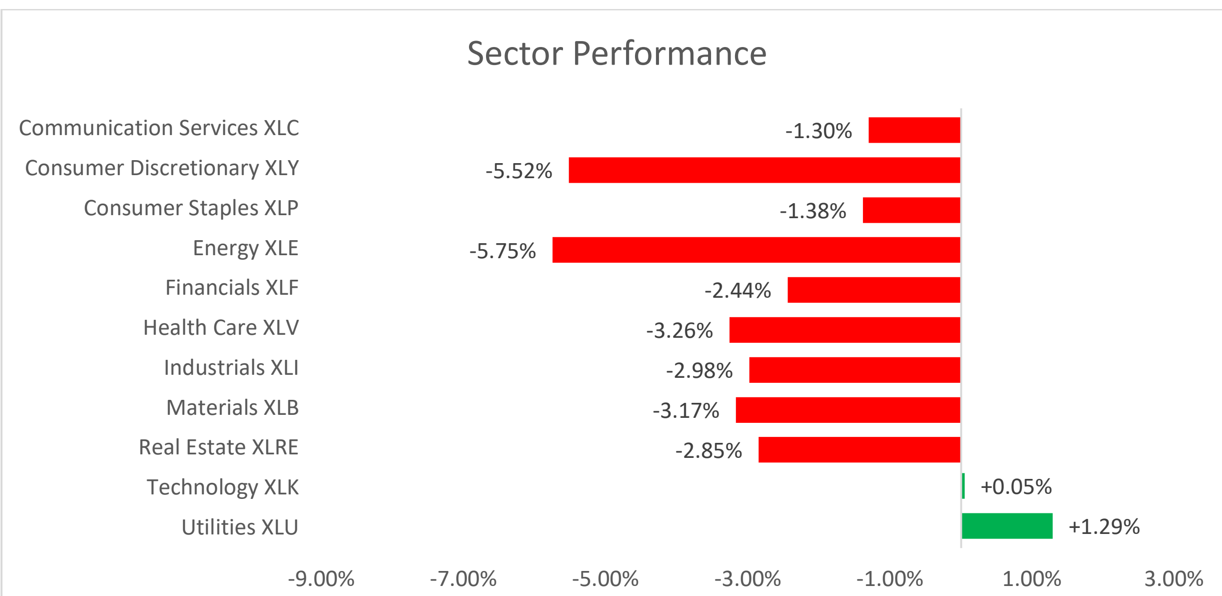
October's performance repeated the last 2 months, with Utilities the only sector meaningfully in the green.

The best performers were…

- Utilities: +1.29%
- Technology: +0.05%

The worst performers were…

- Energy: -5.75%
- Consumer Discretionary: -5.52%
- Health Care: -3.26%



Source: https://www.morningstar.com

Oil Report

The oil market continued trading weak after the late September spike to $95. Prices found support on the back of the Hamas attack on Israel, but the strength was short lived. The fact WWIII hadn't actually been declared and weakness in Chinese economic data were cited as reasons for weakness. The situation in Israel and the surrounding areas is, putting it mildly, intense. The jawboning and rhetoric out of Israel, Iran, Hamas, Hezbollah, Syria, China, Russia, the US, and others is deafening. A lot of posturing and not much thought of how close we seem to be to, at a minimum, a broad regional conflict is shocking. The oil markets literally are waiting for an actual disruption to supplies to price in what seems like a serious situation in the heart of the crude oil markets. This statement from last month certainly didn't account for an out of left field event like the Hamas attack, "Unfortunately, nothing in the immediate future appears likely to derail the continued strength in the oil markets." The current NYMEX WTI Crude Oil futures settled at $81.02 posting a loss of almost 11% from the prior month's close of $90.77 a barrel. The decrease in crude oil correlated with RBOB gasoline, which finished with another loss of over 7% vs September's close. So, the big break out from the 9-month range was short circuited by the prospect of a large regional war, that's not what I was taught in Economics class. Sometimes markets are collectively smarter than everyone, sometimes they are wrong, we will have to wait and see. The only good news is that we seem to have made it through hurricane season with little disruption to the energy complex.

The Rest of the Data

The September ISM Manufacturing Index increased to 49 from August's reading of 47.6. However, the ISM Services Index decreased to 53.6 in September, from August's print of 54.5. The prices paid component for Services remained close to elevated and Manufacturing prices dropped meaningfully toward deflating levels. Any reading below 50 generally indicates deteriorating conditions and any reading above 50 generally indicates improving conditions. Consumer confidence dropped to 102.6 in October, which compares to an upwardly revised figure of 104.3 in September. The unemployment rate remained unchanged at 3.8%, while the economy added a strong 336,000 jobs in September, which crushed expectations of 170,000 jobs. The Consumer Price Index for All Urban Consumers (CPI-U) increased by +0.4% in September, on a seasonally adjusted basis. Over the last 12 months, the All-Items Index rate remained at +3.7% on a non-seasonally adjusted basis. The CPI ex Food and Energy eased further to 4.1% over the last year. The economic data remains solid, employment reports are strong, and inflation is stable, though higher than the Fed target of 2%. The only real weakness is in the Manufacturing sector, with pricing soft, but the sector seems to be stabilizing if not moderately improving. The market continues to price in less rate hikes for 2023 but is also reducing expectations for the number and start of rate cuts in 2024, i.e., higher for longer. We will continue to monitor economic activity along with inflation reports and how that may impact Fed policy.

Summary

The broad equity markets have continued to stair step down the last 3 months. The Fixed Income markets have generally been a one-way trade lower the last 6 months, though have stalled out around the 5% mark on the 10-year Treasury, hard to say if this is the “bottom” or not. Earnings reports have been met with volatile swings, some have seen large post earnings gains and others have seen significant selling. The markets and likely the economy are seeking direction, will the economy escape a recession or not. The signals are mixed, and the market is selling first on signs of weakness. The Fed likely stands pat tomorrow, but does the press conference suggest a hike is likely in December? My guess is the market is not ready for that statement given the wide range of uncertainties currently on the docket. The 4th quarter seasonal strength usually starts mid-October, that didn’t happen, but maybe it started the last few days.

As always, the markets can be emotional, so we retain our focus on what we can control, which is the amount of equity risk that is taken in a clients’ portfolio in concert with the clients’ risk tolerance and long-term goals. The markets will always face different “worries”, today it is inflation/war vs. growth and growing debt, tomorrow it will be something else. We have built our asset allocation models with dynamic features and quarterly rebalancing, both in fixed income and equities. The further softening in equities has resulted in U.S. Mid-cap transitioning to 100% Treasury bills and International has transitioned from 100% Equity exposure to 50% Treasury bills, Real Estate remains defensive and allocated to floating rate Treasuries.

If you have specific questions about your portfolio or financial situation, we are here to help. Long-term financial planning is designed to deal with uncertainty like those we discussed above. Our portfolio management process is to design a prudent allocation across many asset classes. Equities are for long-term growth and several vehicles that we utilize offer defensive mechanisms to mitigate equity market declines.

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