MARKET REVIEW & OUTLOOK

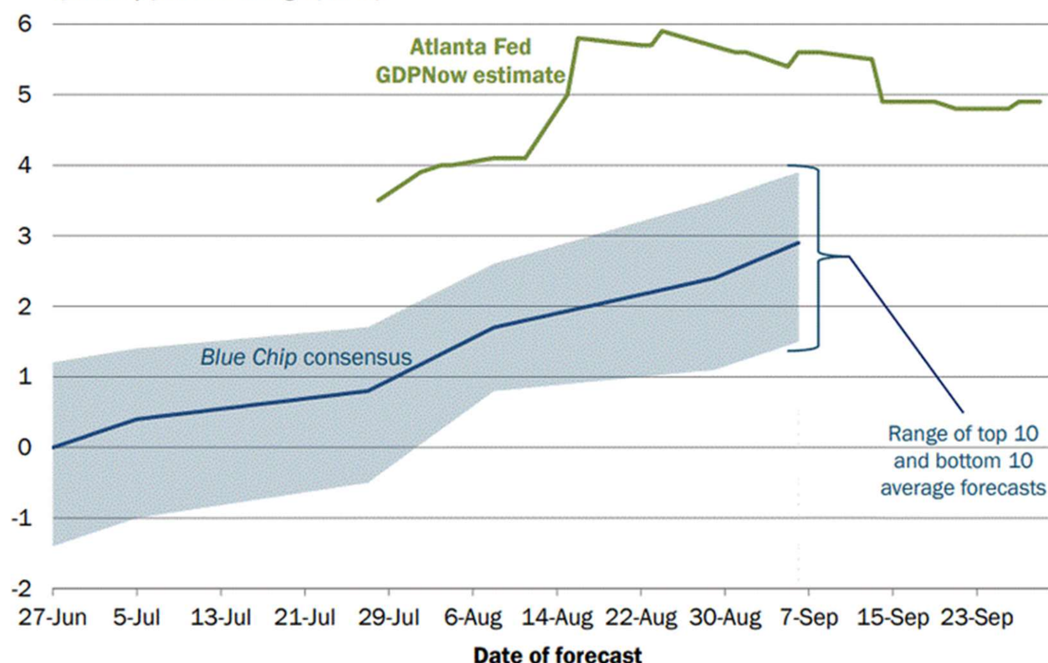
SEPTEMBER 2023

KEY TAKEAWAYS

- The equity markets chopped around the first half of the month but saw heavy selling pressure the second half of the month, closing near the lows.
- The 10-year Treasury Yields saw persistent strength throughout the month, moving higher by nearly 0.50%.
- Crude oil continued powering out of its large base, pushing prices north of $90.

The U.S. Economy

The final 2nd quarter GDP report remained unchanged at 2.1%. Additionally, core PCE, the imbedded inflation measure, also came in unchanged at 3.7%. The shocker was Personal Consumption (PCE) being revised lower to 0.8% vs. 1.7% in the initial report. The 3rd quarter GDP estimate from GDPNow is down modestly, but still near 5%. The Blue-Chip consensus has moved up to nearly 3%, as shown in the chart below. The economic activity in the expected GDP is very robust and the PCE deflator is continuing to signal moderating inflation, but the focus will likely be on the PCE and the state of the consumer. The data continues to support the Fed's stance of at minimum to hold rates higher for longer.



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

Stocks and Bonds

Interest rates steadily traded higher throughout the month, surpassing the highs seen last month and the highest levels seen since October 2007 at 4.69% on the 10-year U.S. Treasury. The Fed met and as expected left rates unchanged in the September meeting. The markets are still pricing in another rate hike before year end, with November the likely hike. The markets have been taking a cue from the Fed and tightening financial conditions since the last Fed rate hike in late July, please see the chart below. The market has reversed over 50% of the easing that occurred since the market bottom of October 2022. The tightening of financial conditions is in line with the Fed's desires and causes a headwind for interest rates. The general economic environment still seems too strong for the Fed to start cutting interest rates soon. The increase in yields again created a headwind for High Quality fixed income, which as measured by the iShares US Aggregate Bond ETF fell -2.43% for the month. The U.S. 10-year Treasury bond yield ended the month at 4.57%, up from August's close of 4.09%.

Source: https://www.zerohedge.com/markets/feds-last-hike-triggers-q3-carnage-traders-sell-all-things-september

The Dow Jones Industrial Average decreased -3.50%, the S&P 500 dropped -4.87%, and the small cap Russell 2000 slumped -6.03%. The international markets traded in line with the U.S. The MSCI EAFE iShares Core International Developed Markets ETF Index slid -4.21%, and the MSCI Emerging Markets iShares Core ETF Index slipped -3.87%.

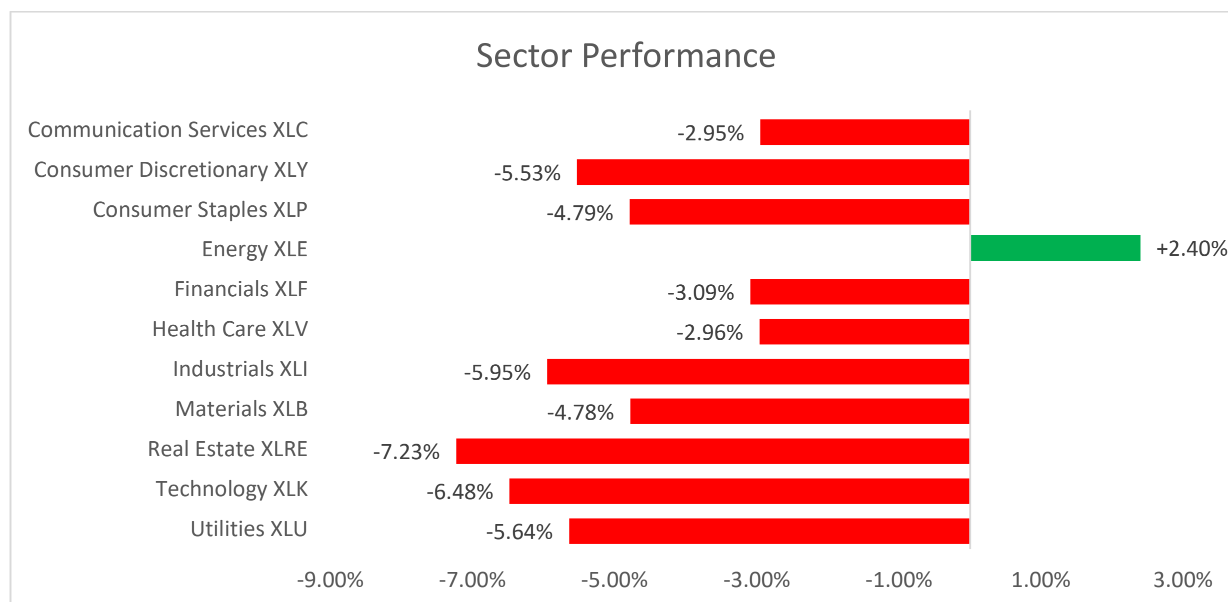
September's performance looks a lot like August, with Energy, again, the only sector in the green.

The "best" performers were…

- Energy: +2.40%
- Communication Services: -2.95%
- Healthcare: -2.96%

The worst performers were…

- Real Estate: -7.23%
- Technology: -6.48%
- Industrials: -5.95%



Source: https://www.morningstar.com

Oil Report

The oil market traded with strength throughout the month, pushing through $90 mid-month, with a late month spike to $95. Prices found strong selling at the $95 mark, but still held $90+ at month end. The strength in the market is supported by OPEC+, especially Saudi Arabia and Russia curtailing supplies on fears of future weakening demand. Additionally, reports are suggesting that oil demand will eventually outstrip supplies by 3 million barrels per day next year. All of that combined with the continued developed markets war against fossil fuels and thus investment in future production is supporting the big rally. 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 $90.77 posting a gain of over 8% from the prior month's close of $83.63 a barrel. The increase in crude oil again disconnected from RBOB gasoline, which finished with a loss of over 7% vs August's close, though it doesn't seem to be resulting in lower prices at the pump, they at least seem to have stopped going up. Last month we discussed that oil appeared to have escaped the 9-month range, which in fact has happened. Will it continue to rally or will economic slowdown concerns creep in and stifle prices? We are testing the area that found resistance in early 2022 before the Russia/Ukraine conflict and the October 2022 highs that ushered in the long consolidation period. So, the easy part of the move is likely behind us, the overhead resistance is likely to put up more of a fight. Continued strength in the energy complex makes renewed inflationary pressures more likely.

The Rest of the Data

The August ISM Manufacturing Index increased to 47.6 from July's reading of 46.4. Additionally, the ISM Services Index increased to 54.5 in August, from July's print of 52.7. The prices paid component for Services moved closer to elevated and Manufacturing prices moved back to neutral levels. Any reading below 50 generally indicates deteriorating conditions and any reading above 50 generally indicates improving conditions. Consumer confidence dropped to 103.0 in September, which compares to an upwardly revised figure of 108.7 in August. The unemployment rate jumped to 3.8%, while the economy added another 187,000 jobs in August, which beat expectations of 170,000 jobs. The Consumer Price Index for All Urban Consumers (CPI-U) jumped by +0.6% in August, on a seasonally adjusted basis. Over the last 12 months, the All-Items Index rate rose to +3.7% up from +3.2% rate last report on a non-seasonally adjusted basis. The CPI ex Food and Energy eased further to 4.3% over the last year. The economic data remains good, with a bump in the unemployment rate, and inflation is showing signs of turning higher. The only clear weakness was in the Manufacturing sector, but prices are firming, and the sector seems to be stabilizing if not moderately improving. The market has been pricing 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 markets ended weaker on fears the Fed may be serious about keeping the punchbowl away from the party, i.e., higher for longer. That is causing the market to reassess the Fed's ability to thread the needle with a "soft" landing, though I certainly wouldn't say they are pricing in a hard landing/recession. The one beneficiary has been the U.S. dollar, as most other central banks are further along the pause/stop hiking cycle then the Fed seems to be at this point. The strength of the U.S. dollar was a weight on most commodity prices except for the aforementioned Crude Oil prices. So, a heavy influencer of inflationary prices, Oil, is strong, but the other commodities are weakening, if you recall back to 2007, oil prices made a last spike near $150 even as the economy and especially housing were weakening. Will history repeat itself? The last couple of months of relative weakness has the markets a bit on their heels, though we are nearing the start of seasonal strength, mid-October through year end.

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. growing debt and deficits, 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 softening in equities has resulted in U.S. Mid-cap transitioning from full 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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