Week in Review

Equity Markets:

A spike in yields led to a down week for the markets. The S&P 500 finished the week down 2.9% and the NASDAQ finished the week down 3.6%. The market selloff was broad but investors favored Large Cap Value over its growth counterpart. Large-Cap Value finished the week -2.6% while Large-Cap Growth was down 3.4%[1]. Current valuation concerns were also highlighted by the rise in yields. The S&P 500 is trading at 18.6x forward price-to-earnings[2]. Historically, this is near the top end of the normal range but not at extreme overvaluation levels.

Third-quarter earnings season will be starting soon, and the earnings outlook remains stable. Earnings growth estimates stand at 1.5% currently. Following months of consistent downgrades in earnings estimates, the stabilization is a welcomed sight. Full-year 2023 earnings estimates have improved slightly since July 1st. Current estimates have 2023 S&P earnings growth at 2.3%, up from 1.3% at the beginning of the quarter[2].

Fixed Income Markets:

Yields jumped for the second consecutive week as commentary following the Fed meeting indicated that policymakers see the potential for one more rate hike this year. For now, the Fed chose to continue its rate pause and kept the target rate at 5.25-5.50%. Chairman Powell stated that the decision to continue the pause was to allow the committee for more data because despite the stickiness of inflation there have been significant improvements in recent reports. The dot plot indicated that the majority of members are in favor of one more rate hike through the end of the year, but as Chairman Powell pointed out during his press conference, the path is not set in stone and the dot plot is just an opinion at that point in time.

Commentary around the level of rates in the future also influenced the bond sell-off. Higher for longer remains the narrative. Forecasts showed that rate cuts have been pushed further into 2024 as the labor market and economy remain stronger than initially expected. The 10-yr yield closed the week yielding 4.44%, slightly off of the intraweek high of 4.5%.

Economic:

The NAHB Housing Market Index declined for the second consecutive month to 45. Home builders cited higher mortgage rates as the largest contributor to the decline in builder confidence. Housing starts were down 14.8% in August from the previous year as higher mortgage rates have pulled consumer demand down significantly. The Conference Board's Leading Economic Index fell 0.4% in August, marking the 17th straight monthly decline.

Looking Ahead

Equity Markets:

Our theme for the year still remains that earnings and fundamentals will be the driver for the next market move. Valuations expanded early in the year following the narrow leadership in the S&P 500. Higher rates pose a threat to these valuations because, unlike the previous cycle, there is a suitable alternative for return, and high rates have the potential to impact future earnings potential for companies.

It is important for investors to stay committed to long-term allocations and proper diversification. As we look at different areas of the market, there are some that are trading at much more reasonable valuations. Mid-cap and small-cap companies are trading at suppressed levels relative to the S&P 500 and near historical low levels. Small-caps trade at 12.6x forward P/E; while Mid-Caps trade at 13.1x forward P/E.[4]. Valuations can take time to normalize, but disciplined allocations can assist in not missing the normalization.

Fixed Income Markets:

The sell-off last week saw the highest yield on the 10-year Treasury since 2007[3]. An encouraging sign is that the yield curve inversion stayed consistent as a parallel shift upward in the curve occurred. The 2's/10's inversion closed the week at -0.66%. The yield curve inversion considered to be restrictive to growth and a steepening process has historically pointed to a more accommodative environment for economic growth. Despite the volatility, we still have a positive multi-year outlook for the fixed-income markets. There could still be upward pressure on rates that occurs, but will likely be short-lived. For fixed-income-oriented investors, current yields are at attractive levels, and if the fears of an economic slowdown come to fruition, the negative correlation benefits of high-quality, longer-term maturities have only increased.

We believe investors should view bond market volatility in the future just like equity investors should. A multi-year focus and a contrarian point of view will likely reward disciplined investors.

Economic:

The headline report for the week will be the Personal Consumption Expenditures Price Index released on Friday. Following the FOMC meeting where policymakers indicated that one more rate hike could still be on the table, their preferred inflation gauge will garner much scrutiny. Also on Friday will be the final University of Michigan Consumer Sentiment Index. The third estimate of second-quarter GDP and the Consumer Confidence Index will also be closely watched.

***** See Important Disclosures on following page*

Sources:

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1)JP Morgan
https://am.jpmorgan.com/content/dam/jpm-am-aem/americas/us/en/insights/market-insights/wmr/weekly_market_recap.pdf

2)I/B/E/S Refinitiv
https://lipperalpha.refinitiv.com/wp-content/uploads/2023/09/TRPR_82221_716.pdf

3)CNBC
https://www.cnbc.com/quotes/US10Y

4)Yardeni Research Inc.
https://www.yardeni.com/pub/stockmktperatio.pdf

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