Week in Review

Equity Markets:

The markets experienced significant drawdowns last week. The S&P 500 fell 2.5% and closed in correction territory. Down 10.6% from the recent July high of 4,607. The NASDAQ fell 2.6% and the Dow was down 2.1% for the week. Large Cap Value is negative on the year by 3.66%, significantly behind Large Cap Growth's year-to-date surge of 21.01%[1].

We are nearly halfway through the third quarter earnings season with 49% of S&P 500 companies having reported. Once again, corporate earnings remain resilient and are outpacing analysts' estimates. So far, 78% of companies have exceeded analysts' earnings estimates, which is above the 5-year average of 77% and the 10-year average of 74%[2]. The expected earnings growth is now 2.7%. If the estimate holds, it will mark the first quarter of earnings growth since Q3 2022. Thus far, companies have also been able to hold up their profit margins. The blended net profit margin for the S&P 500 is 12%, an improvement from the 11.6% margin last quarter[6].

Fixed Income Markets:

After multiple weeks of bond market volatility, last week saw a more subdued market. Yields across the curve ticked slightly lower but the flattening trend continues. The 10-year Treasury finished the week with a yield of 4.86%. The 2's/10's spread narrowed to -0.16% as the 10-year closed the week yielding 5.02%. The 2's/10's spread in July was -1.08%, which was the widest it had been since 1980[3].

Fixed-income markets believe policymakers are done with rate hikes following months of improving inflation data. The Fed Funds Futures market has priced in a 98% probability that policymakers will not raise rates at their meeting this week and a 75% chance they will not raise in December[4].

Economic:

Inflation ticked higher in September and despite the significant progress over the past 18 months remains well above the Fed's 2% target. The Core Personal Consumption Expenditures Index (PCE) rose 0.3% for the month of September, up from the 0.1% reading in August. On an annual basis, Core PCE rose 3.7%. Core PCE is the preferred inflation gauge for policymakers because it takes into account consumer behavior such as opting for lower-priced goods as prices increase. The first estimate for third-quarter GDP came in better than expected. The economy grew at a 4.9% annual rate, above the consensus estimate of 4.7%. The consumer remains resilient and the backbone of our economy. Personal spending rose 0.7% in September. The October University of Michigan Consumer Sentiment Index was revised slightly higher from the preliminary reading of 63 to 63.8. This marks the lowest reading since May as consumer expectations fell by 9.9% due to concerns about current business conditions and personal finances.

Looking Ahead

Equity Markets:

Following the sharp declines last week, valuations have improved as earnings have stabilized and multiples have lowered. The 12-month forward P/E for the S&P 500 sits at 17.1x[4]; which is slightly below the 5-year average of 18.7x and the 10-year average of 17.5x[2]. Longer-dated Treasury yields have become real competition for equities for some investors. The 5% yield level could keep downward pressure on multiples so investors should not expect to see multiple expansion alone fueling further rallies, but should rather focus on earnings improvement.

Earnings have come in better than expected and have been fueled by large beats in the Information Technology and Communication Services sectors[5]. So far this year, the majority of the return has been concentrated in a few large names in the S&P 500. The equal-weight S&P 500 index is down 4.98% year-to-date[6], while the market-cap weighted S&P 500 is up 8.66%[1]. The dispersion of returns across the market has been extreme this year. On the surface, the S&P 500 has appeared to be strong and nearing overvalued levels. But, the S&P 500 Value forward P/E is 15.8x while growth stands at 20.5x[4]. The S&P 600 SmallCap Index is trading near extreme lows of 11.3x forward earnings. We believe there are still pockets of the market that present attractive valuations and investors should not abandon these markets due to recent underperformance. Market trends can quickly shift, and investors should ensure they capture these shifts by developing a purposefully diversified portfolio that aligns with risk objectives.

Fixed Income Market

The Federal Open Market Committee (FOMC) will conclude its two-day policy meeting on Wednesday concluding with Fed Chairman Powell's press conference announcing their interest decision and outlook for future meetings. All indications point to policymakers continuing to hold rates at the current level of 5.25-5.50%.

Our view remains positive on the fixed-income markets, with an emphasis on quality as fears about the future of the economy continue to grow. We believe we are still very close to the cyclical peak in rates and fixed-income investors are being offered attractive long-term opportunities at the current yield levels.

Economic:

Outside of the Fed's policy meeting, there is also a full slate of economic reports for the week. The labor market will be in focus starting with the ADP National Employment Report and the Bureau of Labor's Job Openings and Labor Turnover Survey (JOLTS) on Wednesday. To end the week, the Bureau of Labor will release the Non-Farm Payrolls on Friday. Other notable releases throughout the week include The Conference Board's Consumer Confidence Index, the ISM Manufacturing PMI, and ISM's Services PMI.

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

Sources:

1)JP Morgan
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