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WEEKLY MARKET RECAP | October 16, 2023

Week in Review

Equity Markets:

The markets finished the week mixed with the S&P 500 and Dow Jones up slightly while the NASDAQ finished slightly in the red. The large disparity in year-to-date returns amongst various equity styles, market capitalizations, and geography are eye-opening. Much of the year-to-date rally has been due to only a handful of the largest companies in the world. Year-to-date, the "Magnificent Seven" account for more than 70% of the S&P 500's 14.19% return year-to-date[1]. Recently, the Dow turned negative year-to-date but has recovered those losses and is now up 3.29%. The Russell 2000, which represents small capitalization companies, is down 1.18%. Large-Cap Value is up 27.93%; while its value counterpart is positive a meager 0.70%[2].

Earnings season started to pick up steam last week with the start of the major banks. Although still very early, with only 32 S&P 500 companies having reported, 87.5% of companies have exceeded earnings estimates and 62.5% have beaten revenue expectations[3]. Expectations for earnings growth currently sits at 2.2%; if expectations are met, it will mark the first quarter for earnings growth in three quarters[3].

Fixed Income Markets:

The minutes from September's Federal Reserve policy meeting were released on Wednesday. The minutes confirmed Chairman Powell's comments at the post-meeting press conference that the majority of members believed one more rate hike this year would be appropriate.

The bond market had a small rally last week. The yield on the 10-year Treasury fell 0.15% from the prior week and finished at 4.63%. The steepening of the yield curve took a pause last week following the inflation reports and investors' fears of the potential for the Fed to raise rates again. The 2's/10's spread ended the week at -0.41%, 11 basis points steeper than the prior week.

Economic:

The Producer Price Index rose 0.5% in September, higher than the 0.3% estimate from Dow Jones[4]. Core PPI rose 0.2% which was in line with estimates. Much of the increase was due to the recent jump in energy prices. CPI rose 3.7% year-over-year, slightly above the 3.6% estimate. Core CPI, which excludes food and energy, rose 4.1%, in line with estimates. The preliminary University of Michigan Consumer Sentiment Index came in at 63, down from the 68.1 reading in September. Much of the decline came from a downward shift in the near-term outlook for growth. The one-year inflation expectation rose to 3.8%, a significant increase from 3.2% in September[5].

Looking Ahead

Equity Markets:

Since the start of the year, we have believed that a sustained move higher will need to be supported by fundamentals and earnings. With downward earnings revisions becoming less frequent; companies will now have to pass a higher bar than the one's set over the past three overly pessimistic earnings seasons. The strength of corporate margins and balance sheet stability coming out of the pandemic period have shown to be a lynchpin in navigating the challenging environment over the past year. These two factors are something we will be closely watching going forward as a breakdown in either could be an indication of weakening future earnings.

The wide range of performance so far this year can be a challenging time for disciplined investors. Following a year of tough losses in the two most prominent asset classes, equity and fixed-income, it can be easy to forget the large performance spread last year. Large Cap-Value outperformed Large-Cap Growth by 21% in 2022[6]. It is our belief, that a thoughtfully developed, diversified portfolio, that aligns with your risk tolerance, is the easiest way to navigate challenging markets. All investors will face times of uncertainty at some point. As quickly as one trend ends, another begins, and the timing of these market trends is nearly impossible to identify. As long-term investors, we acknowledge this and construct diversified portfolios that are positioned to capture the shifts of the market current when they do occur.

Fixed Income Market

Fixed-income investors have had a tough 2+ years following a multi-decade secular bull market in bonds. In 1981, the 10-year Treasury had a yield of 15.82%. In March of 2020, the 10-year Treasury had a yield of 0.50%[7]. There were short bouts of volatility during that 39-year run, but overall, long-term fixed-income investors reaped the rewards as bond prices rallied; as yield goes down the price of the bond goes up. Since the 2020 secular low in yields, a common long-term Treasury ETF, TLT, has sold off 51% at the close on Friday[7]. The S&P 500 declined 57% during the Great Financial Crisis[8].

Our positive long-term outlook for the bond market is only strengthened by the statistics above. Using history as a guide, being optimistic when all others are selling attractive long-term opportunities present themselves.

Economic:

The housing market will see a slew of reports this week. Starting Tuesday with the Housing Market Index from the National Association of Home Builders, housing starts on Wednesday, and Existing Home sales will end the week on Thursday. Other notable reports include the retail sales numbers on Tuesday and The Conference Board Leading Economic Index on Thursday.

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

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Sources:

1)ETF Trends
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3)LSEG I/B/E/S
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4) CNBC
https://www.cnbc.com/2023/10/11/ppi-september2023-.html

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7) Morningstar Direct, KPS Research

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