KRILOGY

WEEKLY MARKET RECAP | October 23, 2023

Week in Review

Equity Markets:

Following a string of two weekly gains, the S&P 500 fell 2.38% last week. The NASDAQ fell 3.16% as yields jumped; the Dow was down 1.57% as investors abandoned high-growth sectors and flocked to value-oriented ones. Large-Cap Growth was down 2.9% for the week while Large-Cap Value finished the week down 1.8%[1].

The earnings landscape has started to show signs of weakness this quarter. For three -consecutive quarters, companies have been able to exceed analysts' estimates despite experiencing year-over-year declines in earnings. Analysts entered 2023 with an overly pessimistic outlook on the ability of corporations to maintain their margins and navigate the higher interest rate and inflation environment. This is the first quarter analysts' estimates have leveled off and a higher bar was set. So far, 17% of S&P 500 companies have reported. 73% have reported earnings above estimates, which is below the 5-year average of 77% and the 10-year average of 74%[2]. The blended earnings growth, which combines actual reports and the estimates for companies yet to report, is 0.4%. This is down from 0.3% growth from the week prior[2].

Fixed Income Markets:

The 10-yr Treasury Yield jumped last week, officially crossing the 5% level intraday on multiple occasions but closed the week up 30 basis points at 4.93%. Comments from Chairman Powell's press conference at an Economic Club meeting in New York last week opened the door for volatility to return. His comments reiterated that inflation remains too high, despite the tremendous slowdown in the data, and he does not believe that the current policy is too tight[3].

Economic data and the labor market remain strong. The current estimate for third-quarter GDP growth is 5.4% and the most recent jobless claims report was near the year-to-date lows. Chairman Powell also stated economic and labor market weakness may be necessary to reach the ultimate target of 2% inflation.

Economic:

Home builder sentiment declined for the third consecutive month, dropping four points to 40 in October. High costs for financing through decades-high mortgage rates have builders using incentives once again; such as buying down mortgage rates[4]. Existing home sales dropped to the slowest pace since October 2010 as mortgage rates have again reached 8% and affordability has dampened consumer demand. Pockets of the economy have slowed but consumers continue to spend. Retail sales rose 0.7% in September, well above the 0.3% consensus estimate by Dow Jones[5]. The Conference Board's Leading Economic Index fell 0.7% in September, marking the 18th straight month in September[6].

Looking Ahead

Equity Markets:

Our view is that earnings and valuations are likely to be the driving force for the next move in the markets. In the current interest rate environment, we believe multiple expansions will be limited and corporations will need to show earnings resiliency. Currently, the S&P 500 is trading at 17.9x forward price-to-earnings. The valuation is not extreme but still remains near the high end of the historical range[7]. The slowing economic backdrop is likely not a tailwind for this multiple to expand so investors will need to see improvement in the denominator of the equation for a strong move higher.

Analysts have stabilized their earnings estimates for the quarter and this means companies now have a higher bar to surpass. To start the year, third-quarter earnings estimates were 5.5%. Since July, negative revisions have leveled off and remain in the 1% range[8]. 158 S&P 500 companies will report this week, so, a clearer earnings picture should be here by Friday. The past few months have experienced very low levels of volatility but we anticipate this changing and investors should be prepared for it through the end of the year. A thoughtfully diversified portfolio, that aligns with your desired risk, will be instrumental in navigating short-term volatility.

Fixed Income Market

Following the recent surge in the 10-year Treasury Yield, we believe investors should not abandon fixed-income strategies. The Federal Reserve has been open about the potential for one more increase, but there is also the potential for them to not raise and keep their policy rate at the current level. This scenario aligns with the "higher for longer" narrative. This presents a positive long-term investment experience for fixed-income investors. The "income" component is back in fixed income. Investors have the ability to realize sufficient returns without increasing their duration or credit risk which was necessary in the previous cycle.

Our positive outlook on the bond market remains, with a focus on credit quality. Investors have the ability to lock in positive real returns for a multi-year timeframe. With high-quality treasuries, the current yields present attractive negative correlation potential in the event of any future equity market weakness.

Economic:

The headline release for the week will be the Personal Consumption Expenditures Price Index (PCE) on Friday. This is the favored inflation reading for the Fed and has a large impact on their policy stance. Other notable releases will be the first estimate for 3rd quarter GDP on Thursday and the University of Michigan Consumer Sentiment Index on Friday.

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

Sources:

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

2) FactSet Research Inc.
https://insight.factset.com/sp-500-earnings-season-update-october-20-2023?utm_source=Direct&utm_medium=Email&utm_campaign=FO-10-20-2023&utm_content=httpsinsightfactsetcomsp500earningsseasonupdateoctober202023

3)CNBC
https://www.cnbc.com/2023/10/19/powell-says-inflation-is-still-too-high-and-lower-economic-growth-is-likely-needed-to-bring-it-down.html

4) CNBC
https://www.cnbc.com/2023/10/17/homebuilder-sentiment-drops-to-10-month-low-as-mortgage-rates-soar.html

5) Trading Economics
https://tradingeconomics.com/united-states/retail-sales

6) The Conference Board
https://www.conference-board.org/topics/us-leading-indicators

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

8) LSEG I/B/E/S
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