KRILOGY

WEEKLY MARKET RECAP | November 7, 2023

Week in Review

Equity Markets:

October marked the third consecutive month of declines, but strong economic data, slowing labor market numbers, and the pause by the Fed fueled a strong rally to start the month of November. The S&P 500 moved out of correction territory and ended the week up 5.9%. All major markets were in the green, but the swift drop in yields fueled cycle-sensitive areas of the market. The Russell 1000 Growth finished the week up 6.25% and the Russell 2000, which represents small capitalization companies, surged 7.59%[1].

The bulk of earnings season has concluded, with 81% of S&P 500 companies having already reported. 82% have exceeded earnings estimates and 62% have beaten revenue estimates[2]. The blended earnings growth rate for Q3 2023, which combines current estimates with companies that have already reported, stands at 3.7%[2]. If this trend continues it will mark the first quarter of positive earnings growth after three consecutive quarters of declines.

Fixed Income Markets:

The Federal Open Market Committee held the Fed Fund's rate at the current range of 5.25-5.50%. this marks the second consecutive meeting the FOMC has decided to not raise rates. They cited continued improvement in inflation numbers but acknowledged that core inflation remains well above the 2% target with Core PCE at 3.7%[3]. Policymakers noted that economic growth remains strong and believe the potential for a "soft landing" is still present.

Treasury yields reversed significantly last week. The 10-year Treasury yield dropped from 0.27% last week and ended the week at 4.57%. This is significantly lower than the recent peak of 5%. The 2's/10's inversion widened as the long end of the yield curve plunged on strong economic news and investors' belief that the rate hiking campaign has come to an end. The inversion stood at 0.26% at the end of the week.

Economic:

Last Friday's jobs report showed that the labor market added 150,000 new jobs which was a slight miss compared to the expected 170,000 estimate. The month-over-month change is one key data. Following the month of September which saw 297,000 jobs created, the labor market cooled significantly last month. Also, the unemployment rate ticked up to 3.9% from the previous months 3.8%. The ISM manufacturing PMI fell to 46.7 in October. This marks the eleventh consecutive month of a contraction reading. The services sector has been a bright spot in the economy and remains in expansion territory but the ISM Services PMI fell to 51.8, below the forecasts of 53.

Looking Ahead

Equity Markets:

Third quarter earnings season has come in well above expectations. At the beginning of the quarter, estimates were for a modest 1.6% year-over-year earnings growth[4]. Analysts had improved earnings their outlook for earnings, but for the fourth consecutive quarter have underestimated the ability of companies to navigate the challenging macroeconomic environment. The earnings improvement has caused valuations to become more reasonable. The forward four-quarter P/E for the S&P 500 closed the week at 18.2x[4].

On the surface, the S&P 500 has the appearance of a strong year. The "Magnificent Seven" has become the popular headline for the year. Year-to-date the S&P 500 is up 10.69%, excluding the Magnificent Seven, the index is barely in the green, only up 0.3%[5]. We understand the pitfalls and hard times that come with disciplined portfolio construction and broad diversification. But, 2022 was a different story. The S&P 500 was down 18% while the equal weight S&P 500 was only down 11.6%[6]. As long-term investors, we believe that in times of market concentration, whether to the upside or downside, is an inopportune time to make any changes. Using history as a guide, markets will revert back to normalcy and investors who stay disciplined will be rewarded for their patience.

Fixed Income Market

The rapid decline in yields last week was a welcomed reprieve for investors, but we believe these types of large moves are overdone and will settle into a new range. It is the same view we have when rates have climbed higher in a short amount of time. These large moves can change investor sentiment drastically and long-term investors should remain disciplined and ignore the up, or downside, volatility in yields. Chairman Powell indicated that policymakers are not even beginning to consider rate cuts. We believe the 10-year yield will stay rangebound in the 4.25-4.75% range in the near term before settling into the 4% range over the long term.

We still have a positive outlook on the fixed-income markets. Volatility will likely arrive in short bursts, but the current yield levels still present attractive portfolio allocations.

Economic:

After a few weeks of heavily covered economic reports, this week will be a lighter one. On Tuesday the Federal Reserve will release its Consumer Credit Report. After a decline in consumer confidence in October, this will be a timely look at the financial health of the consumer. On Thursday the weekly unemployment report will be released and to finish the week will November's Preliminary University of Michigan Consumer Sentiment Index.

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

Sources:
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