# Market Perspectives

## October 2023

### KEY HIGHLIGHTS

- Performance 3-Peat, Can November Turn it Around?
- Economic Data – Good or Bad?
- An Update on the Fed
- Eight is Not Great, for Housing
- The Earnings Game

### PERFORMANCE

Well so much for relying on the historical performance patterns in October to right the stock markets' ship. Thanks in large part to the steady march higher in interest rates, the S&P 500 shed another 2.10% during the month. This marks the third month in a row of negative performance which so far has amounted to a pullback of a little over 10%. Since WWII, there have been 38 other three-month losing streaks with an average decline of 9.7%. Historically, the months following these pullbacks have seen improved performance with a gain of 0.93% on average.

November has historically been a good month for stocks which have an average gain of 1.99% over the last 20 years (as measured by the S&P 500). So far, November is off to a good start mostly because of easing interest rates that have come on the back of weaker than expected economic data.

It's likely going to take continued help from the interest rate markets if investors want to see the nascent rebound sustained, but at some point, stocks will have to reckon with weaker economic data which should keep gains contained.

**Average Monthly % Change for the DJIA**

| Month | Last 100 Years | % Positive | Last 50 Years | % Positive | Last 20 Years | % Positive |
|---|---|---|---|---|---|---|
| January | 1.00 | 63% | 1.10 | 60% | -0.66 | 45% |
| February | 0.20 | 56% | 0.32 | 60% | 0.17 | 70% |
| March | 0.27 | 58% | 0.84 | 64% | 0.76 | 65% |
| April | 1.46 | 62% | 2.21 | 68% | 2.21 | 85% |
| May | -0.01 | 55% | 0.33 | 58% | 0.01 | 60% |
| June | 0.47 | 50% | 0.16 | 52% | -0.52 | 40% |
| July | 1.65 | 66% | 1.02 | 62% | 1.45 | 75% |
| August | 0.97 | 62% | -0.20 | 56% | 0.07 | 60% |
| September | -1.21 | 40% | -0.92 | 38% | -0.37 | 50% |
| October | 0.24 | 60% | 0.75 | 62% | 1.38 | 65% |
| November | 1.18 | 63% | 1.57 | 70% | 1.99 | 70% |
| December | 1.52 | 74% | 1.43 | 70% | 1.00 | 65% |

*Source: Bespoke; As of 10.31.23*

Stocks weren't alone in October as far as poor performance goes. Fixed income benchmarks were down almost as much as stocks and fell 1.58% as represented by the Barclays U.S. Aggregate Bond Index. As bad as three months in a row of negative performance feels in stocks, with the 10-year yield cresting at 5%, bond investors were certainly feeling the pain. With the pain has come opportunity for bond investors who are benefiting from yields at levels not seen in two decades.

| Index | MTD | QTD | YTD | 1 Year | 2022 |
|---|---|---|---|---|---|
| S&P 500 | -2.10 | -2.10 | 10.69 | 10.14 | -18.11 |
| Dow Jones Industrial Average | -1.26 | -1.26 | 1.44 | 3.17 | -6.86 |
| Russell 2000 | -6.82 | -6.82 | -4.45 | -8.56 | -20.44 |
| NASDAQ Composite | -2.76 | -2.76 | 23.61 | 17.99 | -32.61 |
| Europe, Australia, & Far East (EAFE) | -4.04 | -4.04 | 3.24 | 15.01 | -14.05 |
| MSCI Emerging Markets | -3.87 | -3.87 | -1.80 | 11.26 | -19.78 |
| Bloomberg Barclays U.S. Aggregate Bond | -1.58 | -1.58 | -2.77 | 0.36 | -13.04 |

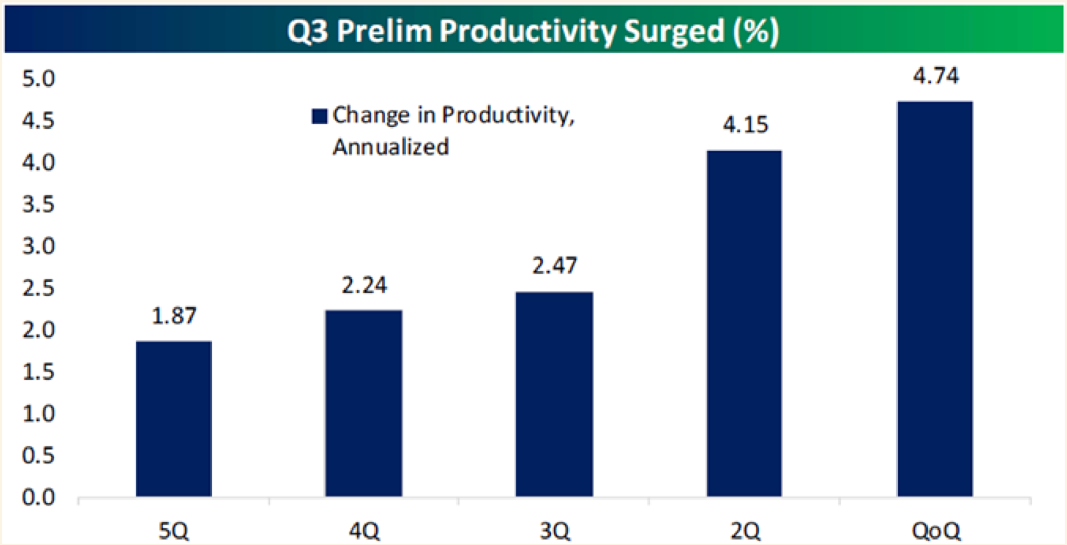
*As of 10.31.23; Returns in percent*

**ECONOMIC DATA GOOD OR BAD?**

Investors were treated to a blowout quarterly GDP report over the month with the first release of the third quarter data showing a 4.9% annualized gain. This would seemingly put to rest any concern around the hard-soft landing debate, but there's always disagreements on how much good data versus noise is in the report. The one thing we can agree on is that it is a backward-looking report and doesn't necessarily give us the best information regarding future economic activity. We believe at best, the report confirms the U.S. economy was on a stable footing during the third quarter and compared to other developed economies, like those in the Eurozone and Germany specifically, the U.S. does seem to be bucking the restrictive headwinds of inflation and higher interest rates better than others.

Higher frequency data gives us a better idea on the current state of things economically, and the data indicates some cooling at work in the U.S. economy. For instance, the ISM Manufacturing and Services surveys for October were reported last week and both underperformed expectations. The manufacturing report showed further contraction in the space and the services report signaled only slight expansion during the month. The JOLTS report for October also showed that the job market is loosening up after being quite robust up until the fourth quarter. Probably one of the best real-time indicators of economic activity comes by way of qualitative commentaries from management teams who provide information during earnings releases. The overall tone of activity is gloomy with many management teams pointing out weakening business trends and reduced guidance.

Turning to jobs, the October BLS report came in below expectations showing 150k non-farm payrolls added during the month, below the 180k estimate. There were also large, negative revisions to the previous months taking some of the shine away from September's blow-out report. One bright spot in employment data has been the strong productivity gains reported during the quarter which increased 4.7% versus last quarter. This continues the upward incremental trend in the data series over the last year which economists view as a disinflationary development with fewer workers doing more work.




*Source: Bespoke; As of 11.03.23*

**LATEST ON THE FED**

The Fed didn't officially have a meeting during October, but they convened shortly after we flipped the calendar to November. During their meeting and in the post meeting press conference, Powell kept the door open to further interest rate increases. With the economic data that we've received following their meeting, it seems likely that the Fed is done with rate hikes. Regardless, if they are finished hiking or not, the economy will continue feeling the effects of rate increases since transmission impacts are typically felt 6 months following each hike.

The "higher for longer" mantra remains the order of the day for Fed policy with the debate now focused around how long before policy rates start to go lower. Market odds currently predict the Fed will start to cut rates in the June 2024 timeframe. The Year-End 2024 Fed Funds rate is projected to be 4.40% implying cuts in policy rates of 1% versus current policy. Relative to the last reported "Dot" in the Fed's Summary of Economic Data, Fed presidents on average, expect Fed Funds of 5.1% at Year-End 2024. The market should mind the gap between expectations and what the Fed is signaling. There will be ample time for Powell to make his thoughts known as he's scheduled for two speaking engagements the week of November 6th. We expect the Fed to remain vigilant on inflation, which means any talk of cutting rates or adjusting qualitative easing policy will likely be met with cold water.


*Source: Freddie Mac & FRED Economic Data; As of 11.02.23*

**EIGHT IS NOT GREAT**

While markets were falling in October, interest and mortgage rates were on the ascent. For the first time since 2000, the conventional 30-year mortgage topped 8% on October 18th which is in stark contrast to the 3%-4% mortgage rates we have all become accustomed to. Rates have fallen since then, but still are within striking distance of the 8% level. Why does it matter? Housing is 15-18% of GDP on average so if housing slows, the effect is broadly felt throughout the economy. Mortgage applications fell to a 28 year low in October on the heels of the spike in rates. Notably, existing home sales are selling at the slowest pace since 2008. With existing homeowners locked into low mortgage rates and first-time homebuyers discouraged, potential buyers have little incentive to purchase new homes and finance at much higher rates. Housing affordability has become an issue. As rates have risen, affordability has declined. However, demand still outstrips supply, but the imbalances are quite regionalized with the south and the sunbelt remaining hot spots of activity. Nonetheless, a watchful eye should be applied to the housing market as it is such a large constituent of the broader economy. We believe rates are likely near a cycle peak and should level off, and then begin to decline in 2024 leading to sustained, yet not robust housing activity.

**Earnings: A Mixed Bag of Tricks & Treats**

As fundamental investors, we rely on the quarter-to-quarter flow of information we receive in the form of quarterly earnings reports from Corporate America. To summarize, the previous quarters leading up now were quite good versus expectations and instilled hope that another quarter of strong reports would be enough to turn the tide of the market pullback.

*Unfortunately, third quarter earnings were a mixed bag with positive financial results being offset by lowered forward guidance.*

Looking to the numbers, earnings have grown 3.7% since last year versus expectations that they would fall 0.3% when reporting began. Relative to estimates, we're seeing positive beat rates with 82% of companies beating earning per share estimates relative to a historical average of 74%. However, only 62% are beating revenue expectations. Many companies, including many of the "Mag-7", are flexing their earnings power by protecting margins and controlling expenses closely. The result is that earnings have remained strong but the overall top line for many companies hasn't been signaling strong growth. In some cases, this reflects a stretched consumer and economy on the verge of downshifting. This somewhat gloomy take on things has been corroborated by guidance which has left something to be desired as 10.8% of companies reporting have lowered guidance with only 8.3% of them raising guidance.

Only a few mega cap companies remain left to report this week. Soon, we'll turn our attention to the November-end reporting period with many retail and consumer oriented companies announcing results and providing a read through on how the U.S. Consumer is performing.



*Sources: YCHARTS, Barron's, NDR, Bespoke, CME Group, FRED*