Monday October 16, 2023

SUMMARY-

I. Rising oil prices in September causes inflation to rise.

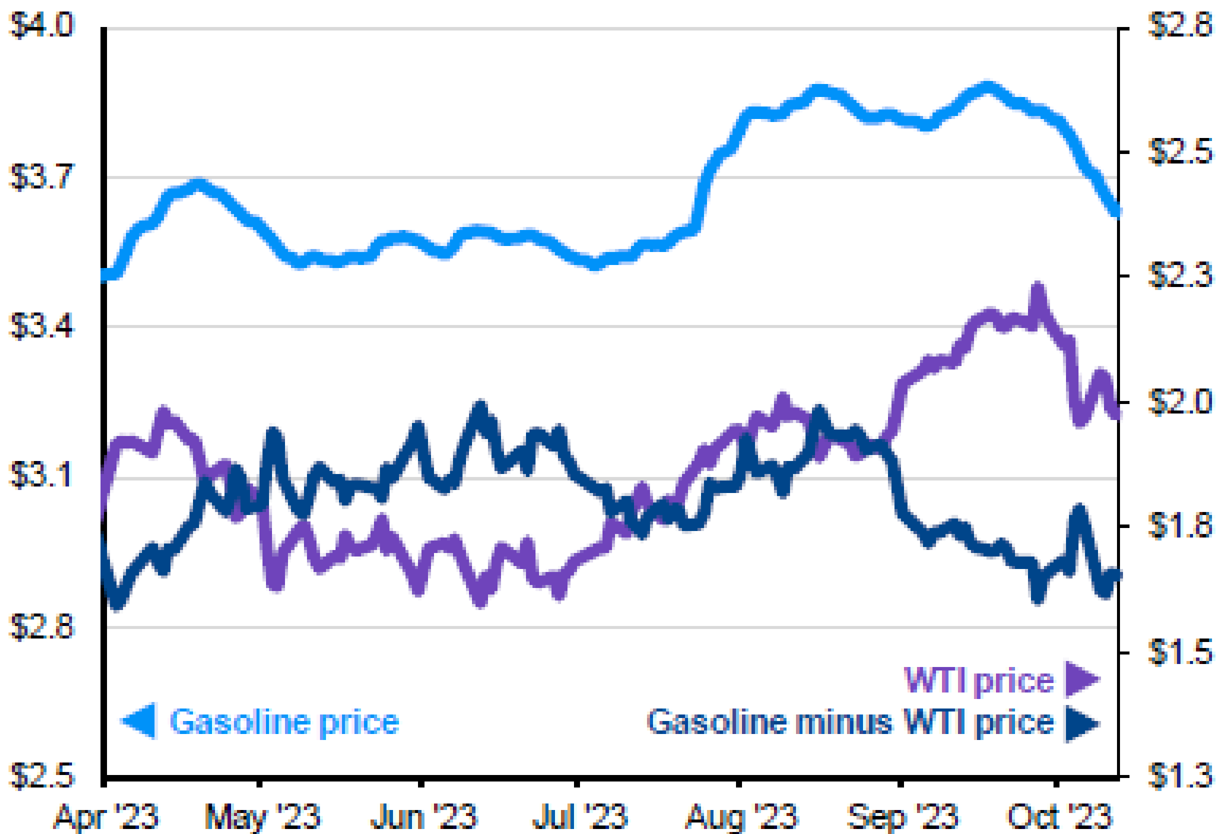
II. Events in Israel add to market anxiety amongst investors.

III. Higher bond yields may prompt Fed to remain on hold.

IV. Highly concentrated market produces unusual recovery so far.

Good afternoon:

Higher crude oil prices in September caused inflation to tick higher in last week's report. Headline CPI rose 0.4% month/month and 3.7% for year/year. Core inflation rose 0.3% in September and 4.1% over the past year. In response, small caps and the NASDAQ lost ground while the S&P 500 and Dow Jones 30 both gained less than 1%. However, even with the recent Middle East turmoil, oil prices have declined since last month's peak and gasoline prices are softening because of some additional factors. As this chart illustrates, increasing U.S. and global refining activity and the end of the summer driving season helped prices at the pump decline in the past few weeks. This trend may result in a declining CPI in the coming few months and therefore lessen the chances of another Fed hike in November.



Source: J.P. Morgan Asset Management

The terrible events unfolding in Israel in recent days have added new areas of concern for many investors. While the human cost has been significant and likely to grow considerably in the coming weeks, market strategists are trying to assess the economic impact of an even wider conflict should one develop. The direct involvement of Iran is particularly worrisome if that was to occur. It is likely that oil prices and inflation would then surge higher until tensions ease. In most such events, fear of the unknown often causes snap emotional decisions among some investors which later usually prove unwarranted. Examining 10 such prominent historical episodes of military conflicts/attacks shows that the knee-

jerk reaction is for stocks to decline the day of the event and performance to be mixed over the following month, as investors have a natural aversion to uncertainty. But the impact on returns usually proves temporary, as equities were higher in most cases six months and one year later.

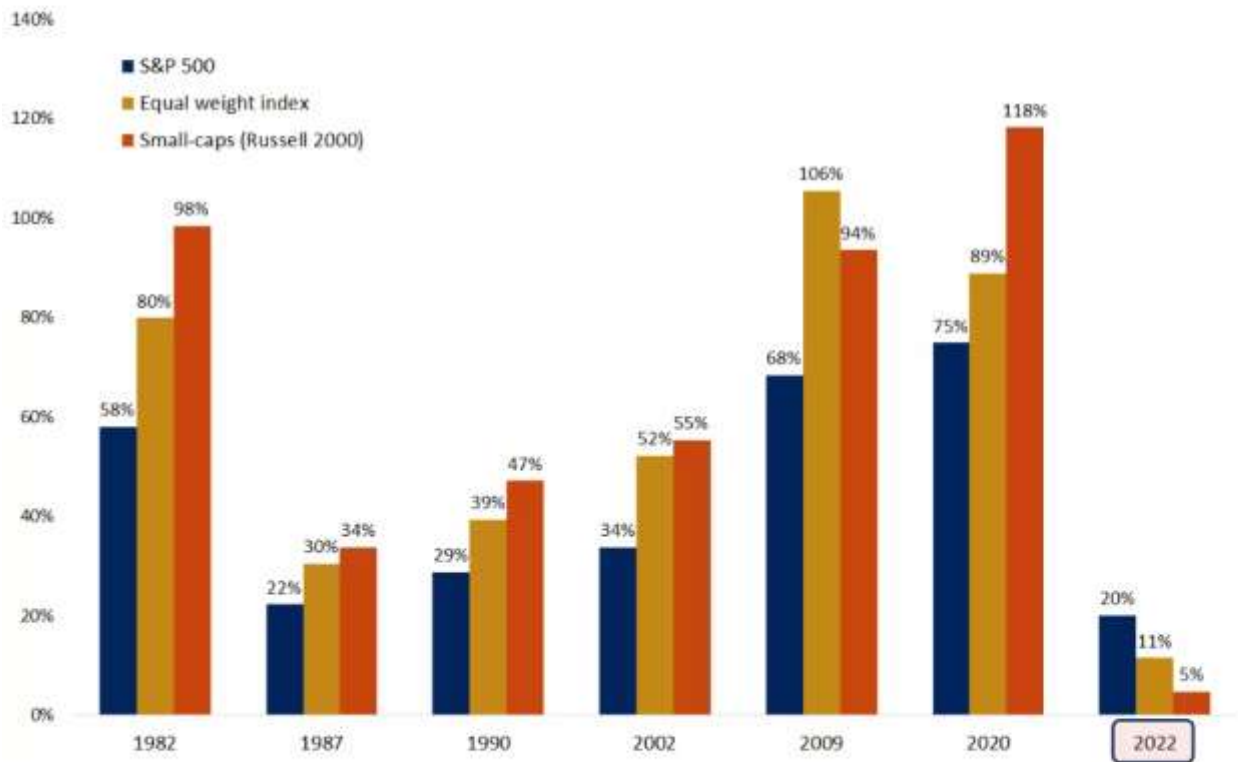
S&P 500 performance following major geopolitical events					
Event	Date	day of	1 month later	6 months later	1 year later
Pearl Harbor attack	12/7/1941	0.0%	-3.4%	-10.2%	-0.2%
Cuban missile crisis	10/16/1962	-0.3%	5.0%	20.7%	27.4%
Six-day war	6/5/1967	-1.5%	1.7%	6.1%	11.2%
Iraq invasion of Kuwait	8/2/1990	-1.1%	-9.3%	-3.5%	8.9%
1st World Trade Center bombing	2/26/1993	0.2%	1.2%	4.2%	5.4%
9/11 terrorist attack	9/17/2001	-4.9%	-1.4%	6.7%	-20.0%
Iraq war	3/20/2003	0.2%	2.2%	18.6%	27.0%
Libyan civil war	2/22/2011	-2.1%	-3.7%	-16.3%	1.1%
Russian annexation of Crimea	2/20/2014	0.6%	2.4%	8.6%	15.4%
Russian invasion of Ukraine	2/24/2022	1.5%	7.0%	-2.0%	-6.0%
Israel invasion	10/9/2023	0.6%	?	?	?
	Average	-0.6%	0.2%	3.3%	7.0%

Source: Morningstar Direct

As we have seen in recent weeks, Treasury bond yields have moved higher, generally causing weakness in equities. However, today's spike in yields is being shrugged off, enabling stocks to stage a strong broad-based rally of more than 1%

in all major averages. After the correction between August and early October, and the recent events in Israel, some believe the recent rise in equities may reflect the increased chance of Fed *inaction* at their next meeting. Higher bond yields and loan rates may just be doing the Fed's job for them, giving them further justification to stay on hold and see how things play out through the end of the year.

Markets will also be reacting to the slew of major corporate earnings reports set to announce Q3 results each day for the next couple weeks. Continued strong results from major banks like we saw last week could help promote interest in many such companies and sectors that have yet to show much life in the one-year period since the market's low in October 2022. As a market-cap-weighted index, the S&P 500 is heavily influenced by the 10 largest companies, which have enjoyed outsized returns of late. The so-called "magnificent seven" (Amazon, Apple, Alphabet, Meta, Microsoft, NVIDIA and Tesla) are up 77% over the past 12 months. However, the S&P 500 Equal Weight Index, which assigns the *same* weight to all the stocks that are included, is up a more modest 11% for the same timeframe, highlighting the narrow leadership and participation. This is a highly unusual dynamic coming off a major bear-market low.



Source: Morningstar Direct

Currently the S&P 500 is now more concentrated than at any point over the past 33 years, with the 10 largest stocks accounting for over 30% of the index. The natural trend of investors to chase the "hot dot," along with the increased use of index funds within many investment portfolios has helped create this current investment disparity. Over time, however, we believe there will be a reversion to the mean, and a return to long-term broader investment participation tied to diversification, dividends and earnings, and healthy investment fundamentals. When that happens, it is likely this period will be looked back upon as not just an anomaly but an excellent investment opportunity for many currently under-loved and under-owned sectors of the market.

Source: Morningstar Direct

Until that happens, we expect the current geopolitical and macroeconomic environment to remain fluid and result in heightened volatility in both directions through the end of the year. Remaining focused on longer-term objectives, and sound investing principals versus short-term market performance or fluctuations will be key.

Have a great week!

Mark and Jeff

Mark S. Loftus, CFP®
Managing Partner & Founder, LPWP

Registered Principal, RJFS
CA Insurance License #0C83705

Jeffrey C. Preusser, CFP®
Senior Partner, LPWP
Registered Principal, RJFS
CA Insurance License #0E01600

O: 630.566.9200 // T: 844.890.8750 // F: 630.566.9292
1901 Butterfield Road, Suite 100, Downers Grove, IL 60515
www.loftus-preusser.com

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