Monday October 2, 2023

SUMMARY-

I. Third quarter ends on another losing month.

II. 10-Year Treasury yields hit 16-year high but may be peaking.

III. Fourth quarter and peaking bond rates have been good for stocks.

IV. Upcoming results depend on Fed, earnings, and consumer in Q4.

Good afternoon:

Equity markets closed out Q3 last week with the second consecutive losing month against a backdrop of higher bond yields and ongoing hawkish rhetoric from the Fed. For September, the S&P 500 dropped 4.9%, the Dow fell 3.5%, while the NASDAQ led major averages lower with a decline of 5.8%. While a market correction of at least 10% occurs (and should be expected) in most years, they usually do not signal a market top. On the contrary, they often prevent valuations from getting too far ahead of earnings fundamentals and may prompt renewed buying interest from institutional investors once prices have reached more attractive levels.

After more than 15 years of ultra-low interest rates, the 10-year Treasury bond eclipsed 4.6% last week, the highest since 2007. However, with the Fed seemingly near the end of its long tightening cycle, and inflation still declining, it is possible that we may be approaching a peak in this all-important bond's interest rate. History has shown that while rising rates can be counterproductive to stock returns, peaks in 10-year yields

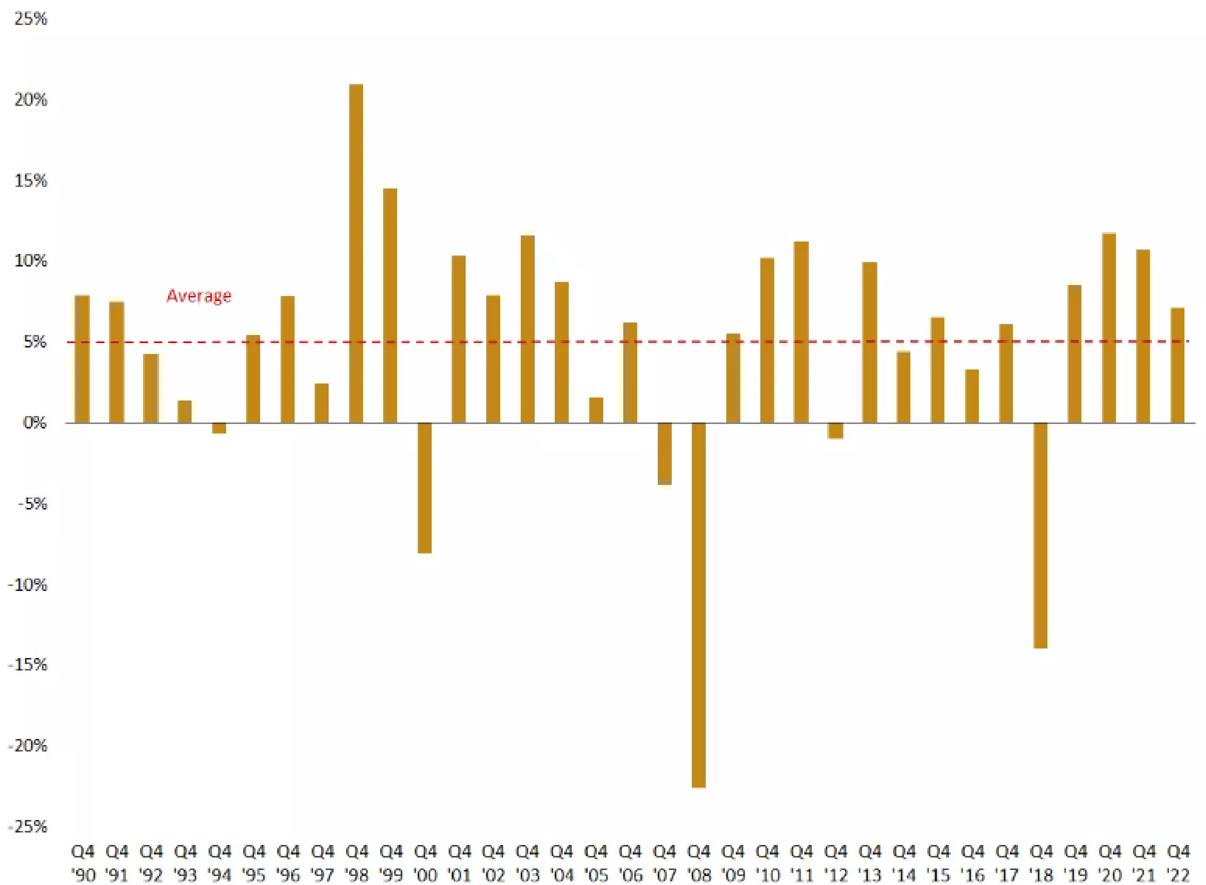
have been a catalyst for stock market rallies. Remember, equity markets do not move in synch with economic data but rather attempt to anticipate future conditions by a period of six to nine months in advance. Such was the case in these recent historical examples.

Interest Rates vs. the Stock Market

Source: FactSet, S&P 500 Index and 10-year U.S. Treasury Yield. Past performance does not guarantee future results.

September's market decline not only was the fourth consecutive year of such losing results, but it also confirms the long-term historical pattern of September being the worst performing month of the year. Fortunately, we are now entering the fourth quarter, one of the best

historical periods for the market. This is particularly true when following a third quarter market decline. Since 1990, stocks averaged a 5% quarterly increase in Q4, and nearly twice that in the 2019-2022 period.



Source: Bloomberg, fourth quarter price performance of the S&P 500 Index. Past performance does not guarantee future results.

Whether this year will end on a similarly positive note or not will likely come down to a few familiar factors. Top of the list has to be the Fed who has one final FOMC meeting in early November. Their decision on

another potential hike, along with their accompanying comments will carry a lot of weight in determining investor sentiment into year end. Additional concerns about Q3 earnings results and revenue forecasts in the coming weeks will also be important. And finally, with nearly 2/3 of our economy directly tied to consumer spending, deteriorating consumer sentiment data as we move into the critical holiday shopping period later this quarter will be pivotal to many manufacturer and retailers' yearly results.

With all this uncertainty on the horizon, at least the anxiety among some regarding another potential government shutdown was taken off the table over the weekend. Both houses of congress passed, and the president signed a 45-day funding bill to give both sides more time to negotiate a full fiscal budget over the next six weeks. If past is prologue, however, we may be right back to these political brinkmanship tactics in November if broader agreements cannot be forged. Fortunately, equity markets have grown somewhat numb to such events and even shutdowns, realizing they are temporary and rarely moving much in either direction in response.

We remain cautiously optimistic for a stronger Q4 and finish to 2023. Compared to a year ago when inflation was over 9% and the Fed was just beginning their tightening cycle, the economy has been remarkably resilient and could be poised for continued growth as the Fed concludes their hikes. Once they do, the long-awaited broadening of market sector performance could also finally materialize.

Have a great week!

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