Monday October 23, 2023

SUMMARY-

I. Spiking bond yields worry stock investors last week.

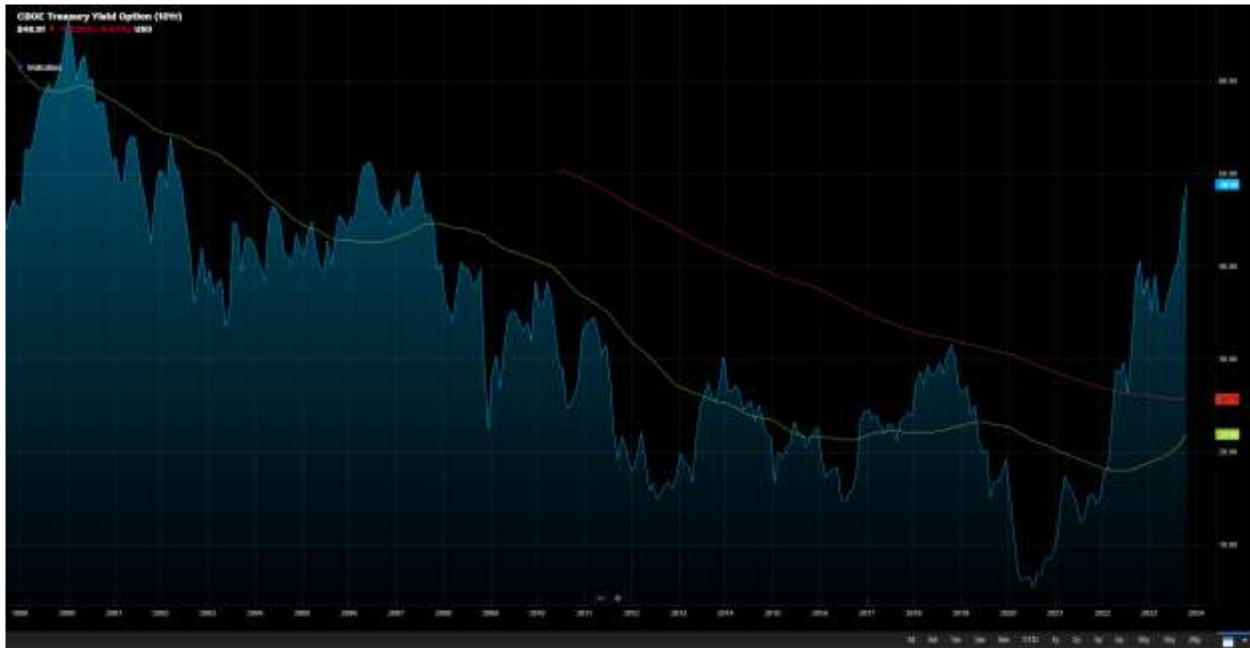
II. Consumer spending remains resilient.

III. Savings shows depletion except among higher earners.

IV. Projected rate cuts could prompt improved market breadth.

Good afternoon:

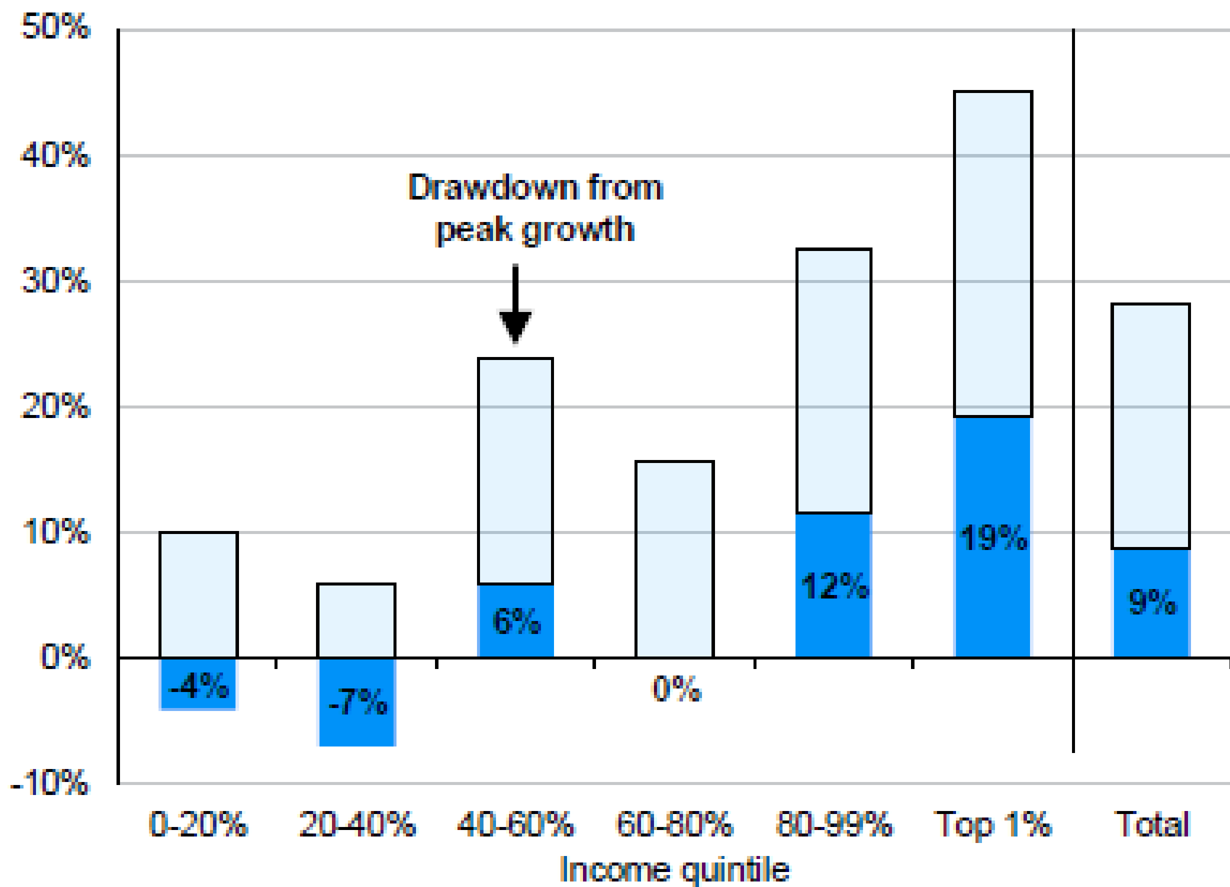
Equity markets retreated last week against backdrop of rising bond yields. As illustrated below, the 10-year Treasury bond is approaching the 5.0% level for the first time since 2007. This particular bond is key as it is often cited as the basis for residential mortgage rates. Since the housing market is an important driver to broader economic activity, even higher mortgage rates could spell a downturn in near-term GDP. However, it may also serve to keep the Fed on hold next week.



Source: FactSet

Meaning, if the bond market's higher rates increase borrowing costs to both consumers and enterprises, slower growth could prove disinflationary and a substitute to more Fed action. Of course, it has been the resilient consumer this year that has driven much of the surprising level of domestic growth. Despite calls for a slowdown in spending due to depleted savings, last week's Retail Sales report showed an increase in September of 0.7%. However, concerns about reduced savings are not unfounded. The Federal Reserve's Distributional Financial Accounts report shows an increase of $2.9 trillion in checking/savings/money market accounts between 4Q2019 and 2Q2023. Unfortunately, high inflation during this time has reduced the *buying power* of these deposits. Those who still have surplus funds on deposit varies greatly by income. As the chart shows, only those with incomes in the top 20% on average still have any funds in reserve when adjusted for inflation. This can still prove to be a driver of economic growth, but more likely concentrated in the

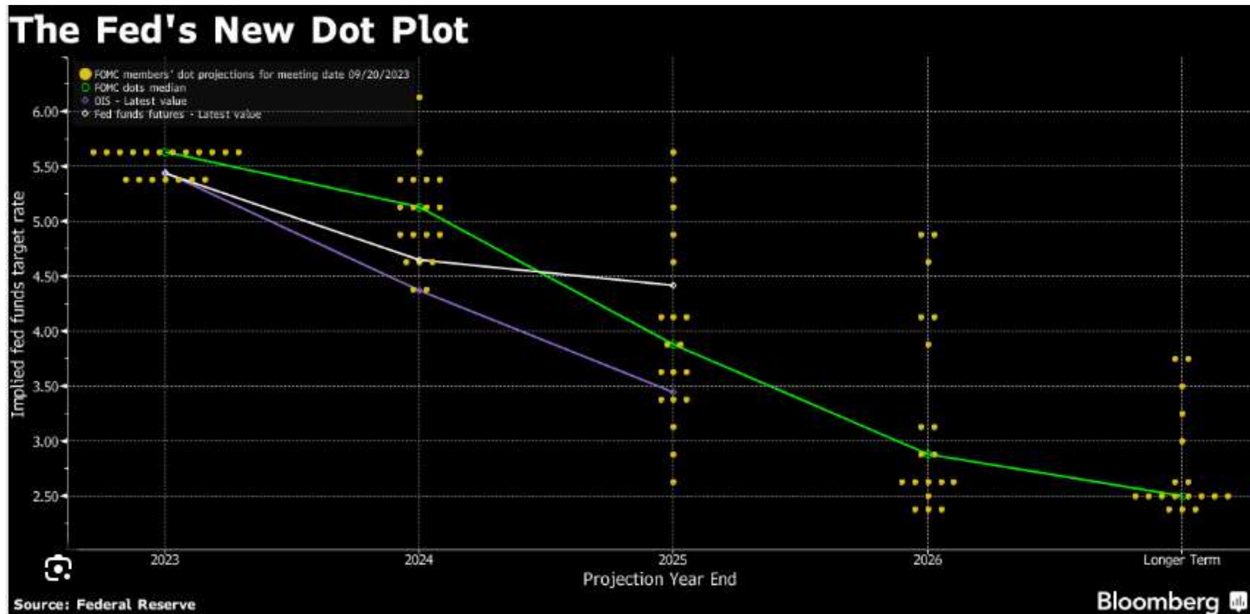
areas of luxury goods, leisure services, and consumer durables than areas like consumer staples.



Source: J.P. Morgan Asset Management

Irrespective of the recent move higher in bond yields, the fact remains that inflation is well off its 2022 peak and seemingly headed down towards the Fed's 2% target. Therefore, the long and aggressive tightening cycle should be at or near an end. The Federal Reserve's own "Dot Plot" chart predicts a series of rate *cuts* over the next few years. If that materializes, investing in bonds in this

current period of spiking yields could prove timely. Remember, fixed-rate bonds also generally see price appreciation in periods of falling interest rates.



Equity averages fully recovered this morning's negative opening to post modest increases by midday. Much of this week's attention will soon be focused on several mega-cap tech firms as they announce their Q3 earnings results. As we have continued to point out, most of any gains in the market this year have been attributable to the "Magnificent Seven" tech stocks, each with an oversized mathematical weighting in the benchmarks of the S&P 500 and NASDAQ. By comparison, the Dow Jones Industrial Average is *down* less than 1% YTD even though it contains two of these seven companies. Similarly, the Russell 2000 index of small cap companies is down -4.5% YTD. Unless an investor has the majority of their portfolio in this handful of tech stocks, their YTD results will not match these "benchmarks" in this unusually narrowly focused market

environment. As this is a true historical anomaly, we fully expect a broadening out in sector participation in the coming months as many areas play catchup.

Data by YCharts

And finally, while the world braces for increased military action in Israel, investors should remain focused on the longer term while expecting the possibility of increased volatility as events unfold. Fortunately, crude oil prices are easing in today's trading as odds of production interruptions are discounted.

Have a great week!

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