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MARKET MINUTE

OCTOBER REVIEW 2023

This month's Market Minute reflects the views of Clearstead's Investment Office and was composed by
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OVERVIEW

The only positive comment one could say about October is that it wasn't as bad as September. Interest rates continued to march higher as the U.S. Treasury 10-year bond tests 5% and the U.S. equity markets (the S&P 500 and NASDAQ) entered correction territory. Small cap stocks (Russell 2000 Index) are at new bear market lows – down over 30% since their previous all-time high set in November 2021.[1] Making it even more challenging in the equity markets, if you didn't own the "Magnificent Seven" (Apple, Microsoft, Alphabet, Tesla, Meta, Amazon, and Nvidia), at best, your returns are essentially flat for 2023.[1] And you thought 2022 was a difficult year.

On the macroeconomic front, life is looking pretty good. The U.S. economy sizzled in Q3, growing at a real (inflation adjusted) +4.9% annualized rate—more than double Q2's +2.1% growth rate.[1] In September, 336,000 jobs were created—nearly double the consensus expectations—while the unemployment rate held steady.[1] Inflation also continues to grind lower. Core PCE—the Fed's preferred inflation gauge—declined in September to 3.7% year-over-year (YoY), which was lower than August's 3.8% YoY reading.[1] All this positive news reinforced the markets new mantra – Higher for Longer – and left participants fearing what problems may arise as the consumer and Corporate America learn to deal with higher interest rates.

U.S. EQUITY MARKETS As of October 31, 2023

U.S. EQUITY MARKETS				
Index	1 Month	Quarter-To-Date	Year-To-Date	1 Year
DJIA	-1.3%	-1.3%	1.4%	3.2%
S&P 500	-2.1%	-2.1%	10.7%	10.1%
Russell 2000	-6.8%	-6.8%	-4.5%	-8.6%
Russell 1000 Growth	-1.4%	-1.4%	23.2%	18.9%
Russell 1000 Value	-3.5%	-3.5%	-1.8%	0.1%

There was no place to hide in equities in October since everything traded lower. The S&P 500 Index fell -2.1%, U.S. mid-caps (Russell Mid-Cap Index) fell by -5.0%, and U.S. small caps (Russell 2000 Index) fell by -6.8%. Every sector of the S&P fell in October except Utilities, which gained +1.3%. Energy stocks fare the worst with the S&P 500 Energy sub-Index falling -6.0% in October. Growth stocks fared slightly better than value stocks on a relative basis during the month (Russell 1000 Growth Index -1.4% vs Russell 1000 Value Index -3.5%), but both still declined.

Despite the fact that S&P 500 has returned +10.7% year-to-date (YTD) through the end of October, it masks how the magnificent seven have skewed the results. The magnificent 7 are up a combined +78.4% YTD, while the median S&P 500 stock is actually down -1.7% YTD, US small caps have lost -4.5% YTD and US mid-caps have fallen by -1.3% YTD.

INTERNATIONAL EQUITY As of October 31, 2023

INTERNATIONAL EQUITY MARKETS				
Index	1 Month	Quarter-To-Date	Year-To-Date	1 Year
MSCI ACWI ex USA	-4.1%	-4.1%	1.0%	12.1%
MSCI EAFE	-4.1%	-4.1%	2.7%	14.4%
MSCI Emerging Markets	-3.9%	-3.9%	-2.1%	10.8%
MSCI EAFE Small Cap	-5.9%	-5.9%	-4.2%	6.5%

International equities also declined in October. The international developed equities (MSCI EAFE Index) fell by -4.1% while emerging market equities (MSCI EM Index) fell by -3.9%. International growth stocks also fared a little better on a relative basis during the month as the MSCI ACWI ex U.S. Growth Index fell by -3.9% while the MSCI ACWI ex U.S. Value Index fell by -4.6%. International small cap names also underperformed in October (MSCI ACWI ex U.S. Small Cap Index -5.6% vs MSCI ACWI ex U.S. Index -4.1%). The U.S. dollar also strengthened modestly during the month, which presented an additional headwind to non-U.S. equity returns.

FIXED INCOME As of October 31, 2023

FIXED INCOME MARKETS				
Index	1 Month	Quarter-To-Date	Year-To-Date	1 Year
BarCap US Aggregate	-1.6%	-1.6%	-2.8%	0.4%
BarCap Global Aggregate	-1.2%	-1.2%	-3.4%	1.7%
BarCap US High Yield	-1.2%	-1.2%	4.6%	6.2%
JPM Emerging Market Bond	-1.5%	-1.5%	-0.4%	6.9%
BarCap Muni	-0.9%	-0.9%	-2.2%	2.6%

Interest rates continued to march higher, but the real pain occurred at the backend of the yield curve. During October, the 2-year U.S. Treasury yield was up 4 basis points (5.05% to 5.09%) while the 10-year yield rose 36 basis points (4.57% to 4.93%).[1] As happened in September, the longer duration sectors were the worst performers – Bloomberg U.S. Treasury 1–3 year was up +0.34%, while the Bloomberg U.S. Treasury 7-10 year was down -1.92%.[1] Although corporate spreads, both investment grade and high yield, were wider, the shorter duration Bloomberg High Yield index again outperformed the longer duration Bloomberg Investment Grade Corporate index. As investors continue to grapple with how long intertest rates will remain at these elevated levels, bond market returns will remain volatile even though yields at these levels look most enticing.

CONCLUSION & OUTLOOK

Given the positive U.S. economic news, it is surprising how grumpy consumers and small businesses are about the state of the economy. The Conference Board's consumer confidence index showed a second straight month of declining confidence in September. The Conference Board's survey suggests families are increasingly concerned about their financial situation and more are worried now about a potential recession.[1] Small business optimism declined in September to 90.8, which is the 21st consecutive month that it has been below its nearly 50-year average of 98. Small business owners continue to cite high inflation and labor quality as the top problems impacting small businesses.[2]

Looking forward, rate hikes are likely to remain a function of the Fed's data dependency and the focus should be on higher for longer rather than if the Fed will hike one or two more times. Higher for longer means that pressure is likely to mount for those companies that relied on a zero-interest rate policy regime to effectively fund their businesses. Over 35% of companies now have negative free cash flow and U.S. corporate bankruptcies are creeping higher. Meanwhile, delinquencies are beginning to rise for some consumer segments in credit cards and auto loans. While pressure is building for those financially stretched corridors of the economy, employment remains strong, and the economy continues to chug along.

During turning points in the economic cycle, it is just not crystal clear how the road before us is traveled. Inflation is lower and trending in the right direction. The Fed is close to calling it quits on its tightening monetary activities. The American consumer is employed, seeing higher wages, and is spending their hard-earned dollars. Yes, the markets will be volatile, but history informs us this is not the time to panic.

SOURCES

1 Bloomberg LP
2 https://www.nfib.com/surveys/small-business-economic-trends/