October 23, 2023

Weekly Viewpoint

"Higher for Longer" Spooks the Market

Performance for Week Ending 10/20/2023

The Dow Jones Industrial Average (Dow) finished off 1.61%, the Standard & Poor's 500 Index (S&P 500) lost 2.39% and the Nasdaq Composite Index (NASDAQ) fell 3.16%. Sector breadth was negative with 9 of the 11 S&P sector groups closing lower. The rate sensitive Real Estate (-4.63%) sector was the worst performer followed by Consumer Discretionary (-4.45%) and Technology (-3.13%). On the upside Consumer Staples (+0.71%) and Energy (+0.68%) closed the week higher.

Index*	Closing Price 10/20/2023	Percentage Change for Week Ending 10/20/2023	Year-to-Date Percentage Change Through 10/20/2023
Dow	33127.28	-1.61%	-0.06%
S&P 500	4224.16	-2.39%	+10.02%
Nasdaq	12983.81	-3.16%	+24.05%

Market Observations: 10/16/23 – 10/20/23

Stocks finished the week lower as the yield on the 10-year Treasury approached the 5 percent level, Fed Chair Powell reminded investors that rates are likely to stay higher for longer and as geopolitical tensions pushed WTI oil prices back toward $90 per barrel. Higher yields increase competition to stocks, raise funding cost for corporations, and put downward pressure on valuation multiples.

Fed Speak Signaling "Higher for Longer": The Fed speaking calendar was chock full last week as Fed Heads wanted to get their messages out ahead of the traditional 10-day blackout period before the October 31 / November 1 Federal Open Market Committee (FOMC) meeting. The highlight was Fed Chair Powell who spoke at the Economic Club of New York on Thursday. Powell suggested the US central bank is inclined to hold interest rates steady again at its upcoming meeting while leaving the door open to the possibility of a future hike if policymakers see further signs of resilient economic growth. The Fed chief also said a recent run-up in long-term Treasury yields, if they persist, could lessen the need for further hikes, echoing his colleagues and underscoring the importance of tightening financial conditions to the rate outlook over the coming months. Powell also warned that “geopolitical tensions are highly elevated and pose important risks to global economic activity.” Meanwhile, Chicago Fed President Austan Goolsbee said he’s hopeful the US is able to avoid a recession despite rapid and steep interest-rate hikes over the past 18 months. “There’s a widely held conventional wisdom that if you get the inflation rate down more than 5 percentage points you will have to have a big recession to do that,” Goolsbee said. “So far, we haven’t had that recession, I’m still hopeful we can avoid it entirely.” New York Fed President John Williams said interest rates will have to stay at restrictive levels “for some time” to bring inflation back down to the US central bank’s 2% target. “We’re going to stick at it to make sure that we really achieve that goal of 2% on a sustained basis,” Williams said. Federal Reserve Governor Christopher Waller said the US central bank can wait and gather more data before deciding if the economy needs further monetary restraint, signaling that he favors holding interest rates steady when officials meet in two weeks.

Economic Roundup: US retail sales increased in September by more than forecast in a broad advance as consumer continued to open their wallets as the third quarter drew to a close. According to the report, retail purchases increased 0.7% after an upwardly revised 0.8% gain in August. The so-called control group sales — which are used to calculate GDP and exclude food services, auto dealers, building materials stores and gasoline stations — rose a better-than-expected 0.6%. Applications for initial unemployment benefits dropped last week to the lowest level since January as the labor market kept powering ahead. Initial jobless claims fell to 198K in the week ending Oct. 14, while the four-week moving average of initial claims, which smooths out some of that volatility, ticked down for a seventh straight week, to the lowest level since February. In the housing sector, existing homes sales fell in September to the lowest level since 2010 as affordability worsened even further. Contract closings decreased 2% from a month earlier to a 3.96 million annualized pace, according to the National Association of Realtors. The number of homes for sale ticked up to 1.13 million but was still the lowest for any September in data back to 1999. At the current sales pace, it would take 3.4 months to sell all the properties on the market, up slightly from the prior month. Realtors see anything below five months of supply as indicative of a tight market. Higher rates continue to affect the housing market. According to the Mortgage Bankers Association, the contract rate on a 30-year fixed mortgage edged up 3 basis points to 7.7%, marking the sixth-straight weekly advance and the highest level since October 2000.

Beige Book: Last week the Fed released its Beige Book report. The publication, released eight time per year and used as a road map at upcoming FOMC meetings, highlights current economic conditions across the 12 Federal Reserve Districts. According to the report, “the near-term outlook for the economy was generally described as stable or having slightly weaker growth,” adding “labor-market tightness continued to ease across the nation.” Most districts indicated little to no change in economic activity since the September report, using data compiled by the St Louis Fed on or before Oct. 6. “Consumer spending was mixed, especially among general retailers and auto dealers, due to differences in prices and product offerings,” the report stated. Prices continued to increase at a modest pace overall, the report said. Sales prices increased at a slower rate than input prices, as businesses struggled to pass along cost pressures because consumers had grown more sensitive to prices, it said.

Q3 Earnings Season – So Far, Better than Feared: While it is still early, third quarter earnings season is off to a better than feared start. Through Friday, 86 members of the S&P 500 have reported results with 88% beating expectations. Aggregate earnings for the group are up over 2%, but still ahead of the 0.7% decline that the Bloomberg consensus is currently forecasting for the overall quarter. On the sector front, Energy has delivered the strongest growth while the Technology sector has delivered the weakest. According to Bloomberg data, earnings growth is expected to turn positive during the fourth quarter of this year with the momentum carrying over into 2024 where full year growth is estimated at 11.9%.

The Week Ahead: Earnings season will shift in high gear this week with 158 members of the S&P 500 scheduled to release results. Amongst this group are 12 members of the Dow Jones Industrial Average. On the data calendar, the initial release of the Q3 GDP report on Thursday will be watched very closely amid increasing optimism about the economy's growth trajectory. According to Bloomberg, the economy is expected to grow by 4.3% during the quarter, up from 2.1% in Q2. The GDP release will be followed by personal income and spending data on Friday, together with the Fed's preferred inflation gauge, the PCE. The data will come after the recent resilient consumer price index (CPI) report as well as last week's stronger than expected retail sales data. Other notable reports include durable goods orders as well as new home sales on Wednesday.

Definitions

The Dow Jones Industrial Average is a price-weighted average of 30 blue-chip stocks that are generally defined as the leaders in their industry. It has been a widely followed indicator of the stock market since October 1, 1928.

Standard and Poor's 500 Index is a capitalization-weighted index of 500 stocks. The index is designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

The Nasdaq Composite Index is a broad-based capitalization-weighted index of stocks in all three NASDAQ tiers: Global Select, Global Market and Capital Market. The index was developed with a base level of 100 as of February 5, 1971.