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INVESTMENT MANAGERS

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Stocks and bonds continued to struggle in October. Large cap stocks in the S&P 500 index declined -2.1% for the month reducing their year-to-date gain to 10.7%. Small cap stocks in the Russell 2000 declined sharply again this month – down -6.7% – which erased their gains and resulted in a year-to-date loss of -4.5%. International stocks in the MSCI EAFE index were down -4.1% in October and are now only up 2.7% for the year. Emerging market stocks also fell -3.9% for the month pushing them into negative territory with a loss of -2.1% so far this year. The yield on the 10-year Treasury bond rose again and ended the month at 4.9%. The Barclays US Aggregate Bond Index lost -1.6% in the month and is now down -2.8% year-to-date. If bonds end the year negative, it will be the first time in history the bond index has had three consecutive negative years.

The S&P 500's strong positive performance is very misleading because it is a cap weighted index. That means larger companies have a larger impact on returns. An equal weighted S&P 500 has a negative year-to-date return of -2.4%. Growth stocks are greatly outperforming value stocks. The consumer discretionary, technology and communications services sectors have a combined weighting of about 47% of the S&P 500 and have had returns of 21%, 35% and 38% respectively. Of the remaining 8 sectors, 7 are negative and the remaining positive return from industrials is only 1.4%.

According to Zacks, after three quarters of negative earnings growth, third quarter seems to have turned the corner and earnings are expected to be positive. Of the S&P 500 companies that have reported so far, total earnings are up 2.3% from third quarter 2022, and more than 80% of the companies have beaten their earnings expectations. Once the remaining companies have reported, third quarter earnings are expected to show growth of 1.5% but the full year is still expected to be negative.

Economic growth in the third quarter was strong at 4.9%. Coupled with continued low unemployment and declining inflation, some analysts seem to think the Fed has managed a soft landing and have pushed their recession calls into next year or even 2025. The Fed's projection for the full year has been increasing and GDP growth is now estimated at 2.1% in 2023 and 1.5% in 2024.

The Core PCE Deflator, which is the inflation measure the Fed uses, is now 3.7%. The Fed's main tool for fighting inflation has been raising interest rates. The Fed has paused since its July meeting. The Fed Funds rate currently is between 5.25% and 5.50%. Chairman Powell has not ruled out another increase before year end. He has also indicated that rates will likely stay higher for longer. Analysts who had been projecting a rate cut next year may need to revise their projections.

Following the large cap stocks in the S&P 500, cash has been the best performer. Many purchased money market funds are now yielding 5% or more. With higher yields, money markets and bonds are more attractive than they have been in the last decade. Investors who had favored dividend paying stocks and REITs for income are returning to bond investments.

Risks remain that could disrupt markets including the war in the Middle East, high interest rates, inflation, high government spending and debt. We continue to encourage investors not to try and time the market by trading in and out and instead invest according to their risk tolerance. If you have questions about your account, please contact your advisor.

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