Economy and Markets Slow as Headwinds Build

Throughout the run of the Federal Reserve's (Fed) inflation-fighting, rate-raising program, the equity market has shown uncommon enthusiasm supported by a growing economy, a strong labor market and healthy consumer spending. Contrary to the expected way of these things, inflation continued to cool even as the economy and the markets remained hot.

However, in September, "We believe the economic cycle may be reaching an inflection point," Raymond James Chief Investment Officer Larry Adam said. "The S&P 500 had its second-best start to a year since 1997, and we've warned that equity markets were due for a pullback. Our view is that the economy is slowing, not imploding."

Inflation remains persistently higher than the Fed's 2% target. And while the Fed declined to raise interest rates at its September meeting, it left the door open for another rate increase by the end of the year.

A potential government shutdown, softer consumer confidence, a slowdown in home sales and home starts, higher oil prices, persistent inflation and the Fed's message that the fed fund's rate will be higher for longer combined to bring the S&P 500 down 4.87% for the month.

We'll dive into some of these details, but first let's review the year-to-date results:

	12/30/22 Close	9/29/23 Close*	Change Year to Date	% Gain/Loss Year to Date
DJIA	33,147.25	33,507.50	360.25	+1.09
NASDAQ	10,466.48	13,219.32	2,752.84	+26.30
S&P 500	3,839.50	4,288.05	448.55	+11.68
MSCI EAFE	1,943.93	2,075.85	131.92	+6.79
Russell 2000	1,761.25	1,785.10	23.85	+1.35
Bloomberg Aggregate Bond	2,048.73	2,024.02	-24.71	-1.21

*Performance reflects index values as of market close on Sept. 29, 2023.

Congress reaches last minute funding deal

By the end of the month, uncertainty about whether Congress would meet the October 1 deadline to fund the government for fiscal year 2024 without interruption faded into near certainty that a shutdown was imminent. However, a compromise deal approved in the final hours in the fiscal year created a 45-

day stopgap. Significant challenges lie in the path of a longer-term funding bill, but this measure suggests they are not insurmountable.

Treasury yields surge on Fed's words

The 10-year Treasury yield remained elevated through September and hit a 15-year high after the Fed's steadfast language suggested it would keep interest rates higher for longer than investors have expected. Compared to August, rates for notes beyond seven years were up 40-49 basis points while two-year rates went up 19 basis points and five-year rates increased 34 basis points. "Higher for longer" interest rates are expected to weigh on the economy but have also created opportunities to lock in elevated yields.

Suppliers' discipline pushes oil higher

Oil prices ended September above $90 a barrel, a 10-month high, demonstrating that the macroeconomic backdrop is not everything. While there is no escaping worldwide weak economic headlines creating headwinds for oil demand, the supply side of the equation is currently driving prices. The OPEC+ group, led by Saudi Arabia and Russia, is actively curtailing oil supply, and for longer than originally expected. OPEC+ has been disciplined with supply from the first days of the COVID-19 pandemic, and even with global demand having surpassed pre-COVID levels, that discipline remains visible.

Britain and EU reach potential interest rate plateaus

While avoiding being boxed in by statements claiming their aggressive interest rate raising strategies have reached a "keep high and hold" stage, the positions of both the Bank of England and European Central Bank were similarly hawkish as the U.S.'s Federal Reserve as they adopted no change to their current, heightened rate in the U.K., and a quarter-percentage point raise in a single currency area in the euro zone

Japanese markets suggest ending of "ultra-easy" money

Financial market pricing suggests the Bank of Japan may end its 16-year run of negative interest rates as part of its "ultra-easy" monetary policy stance. If Japan is going to depart from its long-held policy position it seems unlikely before January, at the earliest. Given that local financial institutions are nursing losses on local sovereign bond holdings, any further adjustment in the country's monetary policy position is thought more dependent on any offsetting moves in the stock market than on inflation's future pathway.

The bottom line

September saw some investors' hopes for a "soft landing" – a corrective to inflation without a recessionary side effect – challenged, pulling air out of the equity market. Though the economy and labor market remained strong in the third quarter, data continue to suggest a mild recession in the first half of 2024.

We expect volatile conditions to continue into the fourth quarter, but our overall outlook remains positive. As long-term investors, down markets present opportunities to acquire high-quality assets.

We are honored to have earned your trust as we pursue your financial goals together. If you have any questions about your portfolio, financial plan or wish to discuss the movement of the market, please reach out at your earliest convenience.

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