

Markets Haunted by Looming Uncertainty and Volatility

Many words have been published about the U.S. economy plowing through conventional expectations amid the Federal Reserve's (Fed) campaign to lower inflation by raising interest rates. Through October, this theme would continue as headline economic data told the tale of an ultra-resilient U.S. economy, even as volatility churned financial markets.

Among those data: Third-quarter retail sales were higher than expected. September saw 336,000 nonfarm jobs added (a robust number) as unemployment remained at 3.8%. And the biggest of all, the U.S. economy grew at an annualized rate of 4.9% in the third quarter, more than twice the second quarter's 2.1%.

Does this mean a recession is off the table? While these results will likely change some analysts' expectations, one should be cautious when using backward-looking indicators to develop a forecast. History, here, provides an antidote to exuberance.

"The question is: can the economy pivot that fast from robust growth to a recession? History says it can," said Raymond James Chief Investment Officer Larry Adam. "In fact, in the last 12 recessions, the quarter before the recession begins, GDP growth averaged 2.6%. The quarter the recession began, growth was down 3.5%. That's a quick turnaround."

The Raymond James Investment Strategy Committee continues to expect a mild recession in early 2024.

Interest rates, world events and underlying economic conditions suggest more uncertainty to come, and thus more volatility. We'll dive into those details below.

	12/30/22 Close	10/31/23 Close*	Change Year to Date	% Gain/Loss Year to Date
DJIA	33,147.25	33,052.87	-94.38	-0.28%
NASDAQ	10,466.48	12,851.24	+2,384.76	+22.78%
S&P 500	3,839.50	4,193.80	+354.30	+9.23%
MSCI EAFE	1,943.93	1,951.96	+8.03	+0.41%
Russell 2000	1,761.25	1,662.28	-98.97	-5.62%
Bloomberg Aggregate Bond	2,048.73	1,994.02	-54.71	-2.67%

*Performance reflects index values as of market close on Oct. 31, 2023. Bloomberg Aggregate Bond and MSCI EAFE reflect Oct. 30, 2023, figures.

A look at equities underneath

Though buoyed by a narrow vanguard of seven high-flying tech stocks, equities continued to pull back through a volatile October as headwinds stacked up against them: high Treasury yields, weak corporate earnings, geopolitical conflicts and energy prices among them. The significant influence of those leading stocks on the S&P 500 has also hidden what has been, underneath, a more challenging equity market than seen at first glance. The average S&P 500 constituent stock is down 3.1% for the year, and nearly half are in a bear market against their respective 52-week highs. As lessons of too many eggs and too few baskets will tell you, this one-dimensional market is primed for volatility.

Reading the Fed's furrowed brow

Fixed income markets weathered a volatile October as strong economic data left investors wondering if the Fed will raise interest rates beyond expectations. Meanwhile, high yields produced further downward pressures on the secondary market, with the 10-year Treasury closing the month at 4.90%. The ongoing yield curve inversion – when short-term yields are higher than long-term yields – began to reduce as Treasury yields with maturities two years and under declined through October, slightly, and as yields for maturities five years and out increased anywhere from 21 to 36 basis points. A yield curve inversion is seen as a reliable predictor of a future recession.

International appetite for risk plummets

While the economic impact of the conflict in Gaza will likely be limited, the risk of escalation across the region has led investors to seek the traditional safe havens, including gold and U.S. dollars. Amid surging sovereign bond yields and falling stock markets, the dollar's performance stands out, a reflection of the sudden increase in the importance of risk sentiment and sensitivity to equity market weakness.

U.S. House selects new leader as old issue looms

The election of Mike Johnson of Louisiana to the House of Representatives speakership lessens the likelihood of a government shutdown in mid-November after the prior speaker, Kevin McCarthy of California, was ousted from the seat October 3 after making a stopgap deal to prevent a shutdown. Current expectations are for another short-term funding bill to fund the government beyond the current November 17 deadline. A key thing to watch will be the ability of Congress to pass all 12 Appropriations bills to avoid a 1%, across-the-board spending cut that is triggered in January.

Conflicts create energy uncertainty

The impact on energy markets of the current confrontation between Israel and Hamas will likely be less far-reaching than that of the long-running conflict between Russia and Ukraine, or of the Yom Kippur War of 1973, in which an ensuing oil embargo drove a material spike in the price of crude, driving many economies into recession while simultaneously generating a surge in inflation.

While direct involvement of Iran in the Gaza conflict seems unlikely given its careful, 44-year track record of avoiding all-out war with Israel. If such a scenario were to occur, it would lead to much larger-scale geopolitical turmoil, of which disrupted energy supplies would be only one of the side effects.

The bottom line

October is typically a month when slumping late-summer markets perk up, but this year those markets reflected significant global headwinds. It is easy to read these challenges through a gloomy lens, but also worth noting that the U.S. economy has remained a bastion of strength in the world through this time, inflation continues to trend downward and evidence suggests that if there is a recession in 2024, it will be a mild one.

No matter what comes, we'll be helping you navigate it, keeping eyes forward and your goals in sight. Thank you for your continuing trust in our guidance. If you would like to discuss anything related to your financial plan, please get in touch at your earliest convenience.

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