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Quarterly Insights – October 2023

Rising bond yields were the main driver of the markets in the third quarter as high Treasury yields caused reversals in performance on a sector and index basis, relative to the first and second quarters. Starting with market capitalization, large caps once again outperformed small caps, as they did in the first two quarters of 2023, although both posted negative returns. That relative outperformance by large caps is consistent with rising Treasury yields, as smaller companies are typically more reliant on debt financing to sustain operations and rising interest rates create stronger financial headwinds for smaller companies when compared to their larger peers.

From an investment style standpoint, however, we did see a performance reversal from the first two quarters of the year as value relatively outperformed growth in the third quarter, although both investment styles finished with a negative quarterly return. Rising bond yields tend to weigh more heavily on companies with higher valuations and since most growth funds overweight higher P/E tech stocks, those funds lagged last quarter. Value funds that include stocks with lower P/E ratios are less sensitive to higher yields, and as such, they outperformed in the third quarter.

On a sector level, nine of the 11 S&P 500 sectors finished the third quarter with a negative return, which is a stark reversal from the broad gains of the second quarter. Energy was, by far, the best performing S&P 500 sector in the third quarter thanks to a surge in oil prices. Communications Services also finished Q3 with a slightly positive quarterly return on hopes integration of advanced artificial intelligence would boost search and social media companies' future advertising revenues.

Looking at sector laggards, the impact of rising bond yields was again clearly visible as consumer staples, utilities and real estate were the worst performing sectors in the third quarter. Those sectors offer some of the highest dividend yields in the market, but with bond yields quickly rising those dividend yields become less attractive and investors rotated out of the high-dividend sectors and into less-volatile bond funds as a result.

US Equity Indexes	Q3 Return	YTD
S&P 500	-2.08%	13.07%
DJ Industrial Average	-1.28%	2.73%
NASDAQ 100	-1.30%	35.37%
S&P MidCap 400	-3.57%	4.27%
Russell 2000	-4.76%	2.54%

Source: YCharts

Internationally, foreign markets saw moderate declines and again lagged the S&P 500 in the third quarter as disappointing economic data in Europe and China bolstered regional recession fears. Emerging markets did relatively outperform developed markets, however, thanks to the announcement of larger-scale Chinese economic stimulus late in the quarter.

International Equity Indexes	Q3 Return	YTD
MSCI EAFE TR USD (Foreign Developed)	-3.22%	7.59%
MSCI EM TR USD (Emerging Markets)	-2.48%	2.16%
MSCI ACWI Ex USA TR USD (Foreign Dev & EM)	-2.96%	5.82%

Source: YCharts

Commodities saw substantial gains and were the best performing major asset class in the third quarter thanks to a significant rally in the energy complex. Oil rose throughout the quarter on continued supply concerns as Saudi Arabia and Russia extended voluntary supply cuts to the end of the year. Meanwhile, demand estimates rose late in the third quarter following the aforementioned announcement of the large-scale Chinese stimulus plans, causing prices to rise sharply late in the quarter. Gold, meanwhile, declined moderately thanks primarily to the stronger U.S. dollar, which rallied steadily over the course of the third quarter, hitting a fresh 2023 high in September.

Commodity Indexes	Q3 Return	YTD
S&P GSCI (Broad-Based Commodities)	17.06%	7.24%
S&P GSCI Crude Oil	29.85%	12.73%
GLD Gold Price	-3.10%	1.40%

Source: YCharts/Koyfin.com

Switching to fixed income markets, the leading benchmark for bonds (Bloomberg Barclays US Aggregate Bond Index) declined moderately for a second consecutive quarter as hawkish Fed rhetoric and hints of a rebound in inflation weighed broadly on fixed income markets.

Looking deeper into the bond markets, shorter-duration debt securities posted a positive quarterly return and outperformed those with longer durations in the third quarter, as the Fed did not signal it intended to raise interest rates any higher than previously expected. Longer-duration bonds, however, were pressured by the combination of a rebound in some inflation indicators and as investors digested that the Fed may well delay any rate cuts in 2024, keeping rates “higher for longer.”

Turning to the corporate bond market, lower-quality but higher-yielding “junk” bonds rose slightly while higher-rated, investment-grade debt declined moderately in Q3. The large performance gap reflected continued optimism from investors regarding future economic growth, as investors “reached” for higher yields offered by riskier companies amidst broadly rising bond yields.

US Bond Indexes	Q3 Return	YTD
BBgBarc US Agg Bond	-2.94%	-1.21%
BbgBarc US T-Bill 1-3 Mon	1.36%	3.71%
ICE US T-Bond 7-10 Year	-4.20%	-2.86%
BbgBarc US MBS (Mortgage-backed)	-3.84%	-2.26%
BbgBarc Municipal	-3.95%	-1.38%
BbgBarc US Corporate Invest Grade	-2.59%	0.02%
BbgBarc US Corporate High Yield	0.80%	5.86%

Source: Ycharts

Fourth Quarter Market Outlook

Markets begin the fourth quarter decidedly more anxious than they started the third quarter, but it’s important to realize that while the S&P 500 did hit multi-month lows in September and there are legitimate risks to the outlook, underlying fundamentals remain generally strong.

First, while there are reasonable concerns about a future economic slowdown, the latest economic data remains solid. Employment, consumer spending and business investment were all resilient in the third quarter and there simply isn’t much actual economic data that points to an imminent economic slowdown. So, while a future economic slowdown is certainly possible given higher interest rates, the resumption of student loan payments and declining U.S. savings, the actual economic data is clear: It isn't happening yet.

Second, fears that inflation may bounce back are also legitimate, given the rally in oil prices in the third quarter. But the Federal Reserve and other central banks typically look past commodity-driven inflation and instead focus on "core" inflation and that metric continued to decline throughout the third quarter. Additionally, declines in housing prices from the recent peak are only now beginning to work into the official inflation statistics, and that should see core inflation continue to move lower in the months and quarters ahead.

Finally, regarding monetary policy, the Federal Reserve's historic rate hike campaign is nearing an end. And while we should expect the Fed to keep rates "higher for longer," high interest rates do not automatically result in an economic slowdown. Interest rates have merely returned to levels that were typical in the 1990s and early 2000s, before the financial crisis, and the economy performed well during those periods. Yes, the risk of higher rates causing an economic slowdown is one that must be monitored closely, but for now, higher rates are not causing a material loss of economic momentum.

In sum, there are real risks to both the markets and the economy as we begin the final three months of the year. But these are largely the same risks that markets have faced throughout 2023 and over that period the economy and markets have remained impressively resilient. So, while these risks and others must be monitored closely, they don't present any new significant headwinds on stocks that haven't existed for much of the year.

That said, as we begin the final quarter of 2023, we remain vigilant towards economic and market risks and are focused on managing both risk and return potential. We remain firm believers that a well-prepared, long-term-focused, and diversified financial plan can withstand virtually any market surprise and related bout of volatility, including "higher for longer" interest rates, stubbornly high inflation, geopolitical tensions, and recession risks.

At Zick Whitted Taub Investment Strategies, we understand the risks facing both the markets and the economy, and we are committed to helping you effectively navigate this challenging investment environment. Successful investing is a marathon, not a sprint, and even intense volatility is unlikely to alter a diversified approach set up to meet your long-term investment goals.

Therefore, it’s critical for you to stay invested, remain patient, and stick to the plan, as we’ve worked with you to establish a unique, personal allocation target based on your financial position, risk tolerance, and investment timeline.

We thank you for your ongoing confidence and trust. Please rest assured that our entire team will remain dedicated to helping you accomplish your financial goals.

Please do not hesitate to contact us with any questions, comments, or to schedule a portfolio review.

Sincerely,

Allen Zick, CFP®	Brad Whitted, CPFA	Alex Taub, CRPC®
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