Market Update

Markets Rebound in October

Equity markets showed signs of improvement in October, helping offset September losses. The S&P 500 gained 8.1 percent during the month, while the Nasdaq rose 3.94 percent. The Dow Jones Industrial Average (DJIA) experienced the best month of the three major indices, soaring 14.07 percent. Although these solid results were encouraging, all three indices remain down for the year.

That positive performance coincided with improving fundamentals. As of October 31, with 53.6 percent of companies having reported actual earnings, the blended earnings growth rate for the S&P 500 in the third quarter was 3.8 percent, according to Bloomberg Intelligence. At the start of earnings season, the growth rate was expected to be 2.6 percent. Over the long run, fundamentals drive market performance, so better-than-expected earnings growth was an encouraging signal, even though its pace has slowed this year.

Although fundamentals were supportive during the quarter, technical factors were mixed. Both the S&P 500 and Nasdaq finished the month well below their respective 200-day moving averages, marking seven consecutive months with both finishing below trend. The DJIA, on the other hand, ended above trend for the first time since March. The 200-day moving average is an important technical indicator because prolonged breaks above or below this level can signal shifting investor sentiment for an index. Continued technical weakness for the S&P 500 and Nasdaq should be monitored.

International equities were mixed. The MSCI EAFE Index increased 5.38 percent, while the MSCI Emerging Markets Index lost 3.09 percent. Emerging markets were hurt by the stronger dollar and a sell-off in Chinese equities, which was caused by uncertainty surrounding the country's economic outlook. Technicals for developed and emerging markets were challenging; both indices finished below trend. In fact, they have ended every month this year below their respective 200-day moving averages, indicating continued investor unease with international stocks.

Fixed income markets continued to experience losses due to rising interest rates. The 10-year Treasury yield rose from 3.83 percent at the end of September to 4.1 percent at the end of October. That marked the first time the 10-year yield finished a month above 4 percent since May 2008, highlighting the rise in interest rates over the past year. The Bloomberg Aggregate Bond Index declined 1.3 percent.

Although investment-grade bonds experienced losses, high-yield fixed income fared better. High-yield credit spreads declined notably, dropping from 5.43 percent to 4.63 percent. Those declining credit spreads helped the Bloomberg U.S. Corporate High Yield Index gain 2.6 percent.

Interest Rate Uncertainty Remains

Interest rate volatility continued, as investors remained concerned about higher rates from the Federal Reserve (Fed) in the short term. The Consumer Price Index showed that consumer inflation accelerated, leading to higher fixed income yields due to expectations for additional Fed rate hikes. The central bank remains committed to tightening monetary policy to combat inflation, and additional increases are expected at its December and February meetings.

Until we see consistent evidence that higher rates are leading to less inflationary pressure, short-term interest rate uncertainty will remain. Although the impact of higher rates on equity markets was muted last month, we've seen how higher rates can hurt markets throughout the year, so continued short-term interest rate uncertainty presents a risk to markets that should be monitored.

Housing Continues to Slow

The housing sector is one area where we have seen direct evidence of a rate-induced slowdown. Existing home sales declined in September for the ninth consecutive month. The annualized pace of existing home sales is at its lowest since Covid lockdowns began in 2020, highlighting the slowdown in housing sales over the past year. Mortgage rates continued to rise, reaching 7.3 percent before retreating modestly to 7.22 percent. In a sign that the slowdown in sales has begun to affect prices, the Case-Shiller 20-City Composite Home Price Index fell 1.3 percent in August.

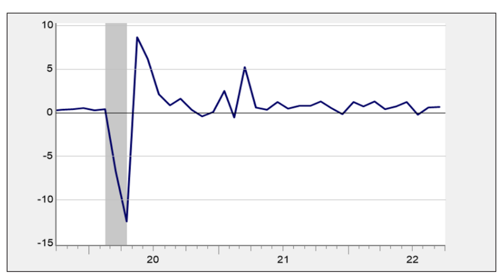
Although prices remain up year-over-year, the slowdown in sales and monthly decline in prices indicate that higher rates are starting to lower inflationary pressure in the housing sector. In the medium to long run, this should help support the Fed's attempts to combat inflation across the economy. At the moment, however, still-high prices on a year-over-year basis signal that further home price declines may be ahead.

Economy Remains Solid

Despite the slowdown for the housing sector, overall economic growth remained on track. The advanced estimate for third-quarter GDP showed that the economy grew at an annualized rate of 2.6 percent, better than economist estimates and an encouraging rebound after two quarters of contraction. This result was supported by better-than-expected personal consumption growth during the quarter, an encouraging sign that economic fundamentals remain solid.

September saw 263,000 jobs added, surpassing expectations. This helped drive the unemployment rate to a pandemic-era low of 3.5 percent during the month. The job market, an area of strength throughout the economic recovery, has helped support gains in personal income and spending this year. September's personal spending report showed that consumer spending held up well. In fact, as shown in Figure 1, consumer spending remained resilient during the month and has been largely consistent this year, other than a decline in July.

Figure 1. Personal Spending, October 2019–Present



Source: Bureau of Economic Analysis / Haver Analytics

Business spending also remained healthy; headline durable goods orders increased in September, and August's results were revised upward. Although business confidence declined modestly, continued spending growth was encouraging.

Risks Cloud Short-Term Outlook

Market and economic updates were largely positive, but there remain risks to monitor. November midterm elections are a source of uncertainty that could lead to market turbulence depending on the outcomes; this uncertainty should be resolved soon, however. The Fed also remains a risk because it could scare investors and cause further interest rate instability if it indicates it plans to raise interest rates higher for longer to combat inflation.

Looking abroad, several risks remain, with the continued Russian invasion of Ukraine a primary risk. Although the market impact of the invasion has diminished, the possibility for an escalation and further instability remains. The slowdown in China and tighter monetary policy globally may also affect the U.S. economy and markets.

Despite these risks to the short-term outlook, market resilience was a positive development that signals many of the dangers may already be priced in. With fundamentals continuing to show signs of improvement, downside risks may be contained. Looking ahead, opportunities exist if fundamental improvements continue for the economy and short-term risks remain muted.

Ultimately, though the potential for short-term turbulence remains, continued growth remains the most likely outcome over the medium to long term. Given the potential for short-term uncertainty, a well-diversified portfolio that matches investor timelines with goals remains the best path forward for most. As always, if concerns remain, reach out to your financial advisor to discuss your plan.

All information according to Bloomberg, unless stated otherwise.

Certain sections of this commentary contain forward-looking statements based on our reasonable expectations, estimates, projections, and assumptions. Forward-looking statements are not guarantees of future performance and involve certain risks and uncertainties, which are difficult to predict. Past performance is not indicative of future results. Diversification does not assure a profit or protect against loss in declining markets. All indices are unmanaged and investors cannot invest directly into an index. The Dow Jones Industrial Average is a price-weighted average of 30 actively traded blue-chip stocks. The S&P 500 Index is a broad-based measurement of changes in stock market conditions based on the average performance of 500 widely held common stocks. The Nasdaq Composite Index measures the performance of all issues listed in the Nasdaq Stock Market, except for rights, warrants, units, and convertible debentures. The MSCI EAFE Index is a float-adjusted market capitalization index designed to measure developed market equity performance, excluding the U.S. and Canada. The MSCI Emerging Markets Index is a market capitalization-weighted index composed of companies representative of the market structure of 26 emerging market countries in Europe, Latin America, and the Pacific Basin. It excludes closed markets and those shares in otherwise free markets that are not purchasable by foreigners. The Bloomberg Aggregate Bond Index is an unmanaged market value-weighted index representing securities that are SEC-registered, taxable, and dollar-denominated. It covers the U.S. investment-grade fixed-rate bond market, with index components for a combination of the Bloomberg government and corporate securities, mortgage-backed pass-through securities, and asset-backed securities. The Bloomberg U.S. Corporate High Yield Index covers the USD-denominated, non-investment-grade, fixed-rate, taxable corporate bond market. Securities are classified as high-yield if the middle rating of Moody's, Fitch, and S&P is Ba1/BB+/BB+ or below..

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