Wealth Enhancement®

# Review of the Markets

Third Quarter, 2023

| Index | 3rd Qtr Return | YTD Return |
|---|---|---|
| S&P 500 | -3.27% | 13.07% |
| MSCI ACWI Ex USA IMI | -3.49% | 5.30% |
| Bloomberg Bond Index | -3.23% | -1.21% |
| Consumer Price Index | 1.20% | 2.84% |

## Market Commentary

The third quarter of 2023 was bumpy for most asset classes. U.S. stocks were among the worst performers, with the S&P 500 falling 3.3% and smaller capitalization stocks generally down more. On a year-to-date basis, however, large cap U.S. stocks remain among the best performing asset classes, with the S&P 500 up 13%.

International stocks held up better in their local currencies, although the MSCI ACWI ex USA index still lost 1.4% in local currency terms. In dollar terms, this index declined 3.5%.

The bond market closed the third quarter at a loss position for the year after a 3.2% selloff during the quarter. Increasing interest rates continue to negatively impact the price of bonds, although credit spreads ended the quarter about where they began, after decreasing during July.

Commodities were positive for the quarter as the price of oil rose substantially.

## Economic Outlook

Rising interest rates are hurting both stock and bond markets. It seems like at least a portion of last quarter's increase might be attributable to increased commodity prices, especially oil, as investors contemplate higher inflation. However, it's likely that the bulk of the increase is a result of the market trying to gain more clarity on where the fed funds rate will ultimately settle over the longer term. While we don't have a strong opinion on the precise level of the Fed's "neutral rate", we think it will likely prove lower than where intermediate-term bond yields are currently suggesting. If this forecast is correct, this should mean that bond yields will decline and bond prices will increase.

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We are mindful that inflationary pressures continue to impact the American consumer, but it appears that the Fed's current restrictive monetary policy continues to moderate price increases. The most recent print of "core PCE", the Fed's preferred inflation measure, dipped below 4% year-over-year for the first time since September 2021. While this can be seen as evidence that the Fed's hiking campaign is working, there is still a challenging road ahead to reach their target of 2%. Real personal income has remained essentially flat for the past few months. A decline in this measure would cause us concern for the health of the consumer. Consumer debt service payments as a percentage of disposable income are above pre-pandemic levels, although this measure has declined from its high in 2022. We are concerned about student loan payments resuming in October, as this has the potential to put a dramatic dent in discretionary spending for consumers with student loans, even with the utilization of income-based repayment plans. Markets have looked to the consumer as a cornerstone of this economic recovery. If the consumer falters, this could be another piece of the puzzle that leads the economy into recession.

Even with the potential for consumer debt to constrain spending, the biggest headwind we see on the horizon for the consumer and the broader economy is a continued softening of the labor market. While absolute levels of unemployment remain low, it's possible that the increases in unemployment we've already seen in 2023 are sufficient to dislodge the robust labor market that has supported the economy in the post-pandemic period. Strikes by labor unions and the potential for a government shutdown – after the last-minute deal that secured funding for another 45 days – may further exacerbate strains caused by rising unemployment.

The tone of the market seems to have shifted from one of optimism over a "soft landing" last quarter to pessimism this quarter as "higher for longer" has become the catchphrase for interest rates. We acknowledge that a recession may not actually develop, even if the economy slows down, but we think that recession is a likely outcome. As always, we encourage clients to maintain their discipline during these periods and remain patient for better opportunities. Please reach out to us with any questions.

Please contact us at fingroup-info@wealthenhancement.com.

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