Wealth Advisory Market Update

November 7, 2023

Market Update

Equities

September was the worst month for the market to date and many were expecting a bounce back in October. That unfortunately did not come to fruition as the S&P 500 fell 2.2% and has now fallen for three consecutive months. This is the longest monthly slide for the index since the pandemic-driven first quarter of 2020. Year-to-date performance is up 10.69%. The index officially hit correction territory at the end of October after falling more than 10% from its high. The market has started off November strong after a weaker than expected Non-farm payroll print and a more dovish tone from the FOMC.

Macroeconomic data continues to point towards slower growth for the economy. Inflation continues to show signs of "stickiness" as core inflation remains well above the Federal Open Market Committees (FOMC) target. Consumer surveys show low confidence in the economy and expectations of higher inflation. Recent Manufacturing surveys in October are indicating stagflation.

The equity market continues to follow the moves of the big seven technology companies. Absent their performance so far this year, the market tells a much different story. The S&P 500 equal-weight index is down on the year; small and mid-caps are flat which is a strong indicator that the underlying economy is weaker than the numbers are showing. The big tech companies are priced to perfection, trading well above their historical valuation on a multiple basis. If we see a continued drawdown in these names expect the market cap weighted indices to follow suit. We are sticking to our discipline of buying companies we believe are trading below intrinsic value while also boasting a strong balance sheet, so they can weather a US recession.

US Economy and Geopolitics

The US economy continues to show signs of slowing and the pace of deterioration has accelerated. Third quarter GDP came in stronger than many expected at 4.9%. Consumer spending was the main driver this quarter, however, the increases was derived from increasing credit card balances which is not sustainable. In fact, the average consumer is carrying a $5,900 balance on their credit card. The figures also show that there has been a decline in investment across the public sector, with Construction falling by 1.6%, a sign of a slowing economy. We have mentioned before that the consumer continues to keep the economy afloat, but in our opinion, this is not sustainable. Headwinds continue for the consumer, as the personal savings rate fell from 5.2% in the second quarter to 3.4% in the third quarter. Auto delinquencies have risen five straight months with the percentage of late payments reaching the highest level in nearly three decades. With the resumption of student loan payments, higher interest rates, continued service inflation, as well as commodity prices rising, the consumer will be tested.

Geopolitical risks have risen to their highest levels of the year thus far. The October attacks carried out by the terrorist group "Hamas" against Israel have elevated these risks to new levels. Israel is launching a full ground invasion of Gaza in which Israeli President Benjamin Netanyahu stated, "this will be a long war." The United States has confirmed their support for Israel, while Iran is backing Hamas. Tensions continue to rise rapidly and could lead to a multi-front war for Israel, and a second conflict that the US is involved in. An escalation in either Ukraine or Israel could lead to a financial flight to safety.

Monetary Policy

The Federal Open Market Committee (FOMC) met in the last week of October, and once again decided to keep the federal funds rate unchanged. This was the consensus opinion going into the meeting, so this was not a surprise. As has been the case with all the live meetings, the market paid careful attention to the press conference afterwards with Fed Chairman Jerome Powell.

As Powell stated in the past few meetings, the Fed is in a data-dependent mode. He reaffirmed that the Fed is proceeding carefully to determine the extent of further tightening and how long to hold rates higher. He made the point that the full effects are still yet to be felt due to the lags that occur during a rate-tightening cycle. When discussing the data, Powell said that they have achieved significant progress on inflation without the labor market falling and that growth has been strong, but it is still the Fed's opinion that slower growth and loosening of the labor market will be required. Mr. Powell also stated that while inflation has moderated and the previous data has been positive, a few months of data is not enough.

The Chairman believes that inflation is still well above the Fed's two percent target. He made it a point to state that the Fed is not confident they are done yet. When touching on the economic data, Mr. Powell said the labor market is still tight and that while nominal wage growth has shown signs of easing there is still strong job creation. Housing sector activity has flattened out and reports from housing effects from rates could be quite significant. Long-term bond yields have also helped with tightening economic conditions but those need to be persistent. Powell doesn't think conditions are tight enough yet. The Fed has indicated that economic growth has been well above their estimates. When asked whether the Fed has put a recession back in their estimates, the Chairman said that they have not, and that recent activity is not indicative of one in the near term. The Committee has not yet discussed when they expect to cut rates.

The overall tone of the meeting was more dovish than others recently. Our opinion differs from the FOMC's with regard to the economy. We sense that the economy has slowed significantly and that a recession is a very likely outcome in the coming quarters. The speed at which this rate hiking has been done will cause a significant impact to the economy despite the lag we've seen. In our opinion, the current growth of the economy is not sustainable with the headwinds facing the consumer. As we mentioned in our last letter, we believe the Fed is lost and just guessing at this point. They have been wrong on every economic forecast for the past decade, and we do not see that changing. We have heard a couple CEOs come out and say nearly the same thing, most recently JPMorgan CEO, Jamie Dimon.

Strategy

A majority of indicators are pointing to a recession in the near term. With that in mind, we have taken a more defensive approach to our equity positions. It is important to be positioned with companies that historically perform well during a recession. We have shifted more monies to companies that have inelastic demand for their goods. A large percentage of our holdings are large cap names that possess a dominant market share and have pricing power. These names are trading at a discount to their historical norms and intrinsic value which provides a favorable entry point.

The fixed income space has continued to present a good opportunity to lock in higher yields. We have been extending our duration in fixed income portfolio's. Recently, we've been adding to the Mortgage-Backed Securities (MBS) space as spreads are attractive and offer the best risk return profile. We are staying in higher-quality debt as high yield instruments present unnecessary risk in a deteriorating economy.

As always, we strive to navigate this challenging environment to the best of our ability. The team at AMB expresses gratitude for your support and the opportunity to collaborate with you in achieving your financial goals.

Matthew J. Roach, CFA®
Chief Investment Strategist

Mike Servetas
Assistant Portfolio Manager