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Market Watch

October 9, 2023

Primary Market Drivers

Inflation

September PPI and CPI reports are on tap this week, so expect both to garner significant attention and move markets. Looking back, August Core PCE came in at +0.1% m/m, below expectations for +0.2% and the smallest monthly increase since November 2020. The soft report was a welcome sign after August CPI and PPI ticked higher than expected earlier in the month. Inflation data is still being closely watched as investors cautiously await the end of the Fed's tightening cycle and wrestle with its "higher for longer" rhetoric.

Fed Policy

No change from last week. The Fed held rates steady at 5.25% - 5.50% at its last meeting. The move was widely anticipated as a foregone conclusion, so there were no surprise regarding the policy decision. What was surprising was the information surrounding the pause. Dot plot projections removed 50bps of easing in 2024 and solidified the notion of an additional hike in 2023, with 12 of 19 Fed officials saying they expect to raise rates once more this year. While the market has anticipated this based on previous dot plot projections, the removal of 50bps of easing in 2024 was a negative surprise. Powell's tone remained cautious as he stressed data dependence and "higher for longer" rhetoric once again. Despite the communicated plan to raise rates again before year-end, CME's FedWatch Tool iscurrently projecting a 74.3% chance of "no change" to the target rate during the next Fed meeting on 11/1, likely in response to the soft August Core PCE data.

Interest Rates, Economic Data, Earnings, & Israel

While inflation and Fed Policy have remained the two constant primary macro drivers for the past 18 months, we suddenly find ourselves with a handful of other significant pieces moving the market. We've covered the historic rise in interest rates in past editions, and we continue to watch yields on the 10-yr as speculation ramps up over the longer-term range that is now in play. Economic data, particularly labor data, has been very impactful in recent weeks. Last Friday, a blowout Nonfarm payrolls report that featured a big beat (+336k vs +161k) and significant revisions higher to previous reports set the stage for a wild session that started down significantly and ended deep green. Earnings season kicks off on Friday with announcements from BlackRock, Citigroup, JPMorgan Chase, PNC Financial Services Group, Progressive, UnitedHealth Group, and Wells Fargo. As has been the case throughout the year, investors will be looking at guidances closely to help set future expectations in a period of significant uncertainty regarding the economy. And finally, over the weekend Hamas launched a large-scale attack on Israel, shocking the global community. It remains to be seen what the geopolitical and market implications will be as the situation is very new. Early indications show a flight to safety in bonds, downward pressure on yields, a spike in energy prices, a spike in defense stocks, and muted weakness in equities. We will continue to discuss the situation and its implications as it progresses in the coming weeks.

Market Returns 10/6/23 (Close)

Category	Ticker	YTD%
Domestic Equity		
S&P 500	SPY	13.58%
Dow Jones	DIA	2.36%
Large-Cap Growth	QQQ	37.56%
Large-Cap Value	IVE	7.00%
Mid Caps	MDY	2.25%
Small Caps	IWM	0.33%
International Equity		
Developed Intl	EFA	6.32%
Emerging Markets	EEM	0.60%
Fixed Income		
Core Bonds	AGG	-2.12%
Corporate Bonds	LQD	-2.22%
High Yield Bonds	HYG	3.22%
ST Treasuries	IEI	-0.59%
LT Treasuries	TLT	-12.72%
International Bonds	BNDX	1.49%

Performance data and stock chart were gathered from eSignal, a paid market screening application provided by Intercontinental Exchange, Inc.

Current Environment Summary

What's Working	What's Not	What's Next
Disinflation	Economic Worries Still Present	**September PPI (10/11) & CPI (10/12)**
Fed Cycle End is Near	Core Inflation Remains Elevated	**Developments in Israel**
Strong Labor Market / Consumer	Yield Curve Inversions Historically Steep	**Earnings Season Begins 10-13: JPM, C, BLK**
Resilient GDP	"Higher For Longer" Fed	Watching Interest Rates
Stable Earnings	Interest Rates Skyrocketing	Assessing Economic Data
FOMC Says "No Recession in 2023"	Israel at War	

Portfolio Manager Commentary

Ken Hartley, CFA

What some observers are calling "the Israeli 9/11" occurred on Saturday morning (10/7) on the anniversary of the Yom Kippur War. Terrorists linked to Hamas breached the border walls of Israel at an estimated 20 locations and began murdering men, women and children in a concerted manner. It is believed that several hundred hostages have been taken (including Americans). What does this mean for financial markets?

So far this Monday morning, not much. US equities are flat-ish and the US government bond market is closed for a federal holiday. The US dollar is higher (flight to safety trade), and oil is up less than 5%. Overall, the financial markets are looking at the situation as contained. So as of right now, we have major conflicts on 2 continents with nuclear armed combatants occupying the headlines. The financial markets are taking it in stride. What could go wrong?

By all accounts Israel will make short work of Hamas. The risk to financial markets is whether some additional players enter the fray. Iran seems to be funding the current incursion by Hamas while Hezbollah waits in the wings on the northern border of Israel. Hezbollah is a terrorist group like Al Qaeda and ISIS. Iran is said to have a hand in financing these two groups as well. It seemed that Arab-Israeli relations were on a peaceful track thanks to the Abraham Accords. The middle east has been a cauldron for hundreds of years. With the US importing oil from this region and the SPR being at 40-year lows, there are some economic risks to an escalation of the conflict.

Last week's economic data had markets scratching their collective heads. Is inflation beaten or just playing opossum? The labor market surprised with unexpected strength. Upon further review, a deeper dive into the numbers showed a spike in low paying service jobs and government hirings. Can the economy sustain lower inflation because people are working longer for less money? The Fed needs productivity to improve before wage inflation subsides.

The inflation hawks will get another look at the data from last month. Now that everyone is data dependent, will the Fed continue to grope along with month-to-month data, or will it keep raising until the economy yells "UNCLE!"? There is a global need for leadership right now. Whether it be in the financial markets or managing regional conflicts. The tyrants call smell weakness and will be emboldened to act. Don't take your eyes off of China. With a troubled economy and domestic unrest, they might be tempted to be aggressive.

It certainly is a challenging time. Our job is to take in the information available and make investment decisions in the best interest of our clients. Unfortunately, current conditions require us to be reactive, not proactive.

Don Moenning

The market's attention is now shifting daily, and there are a lot of moving pieces in this current environment. This week will be an interesting case study on how the market deals with so many different drivers all at once.

At the forefront, we have September PPI (10/11) and CPI (10/12), two significant inflation data points that the market has been picking apart every month as we try to gauge how the Fed's battle against inflation is going in the late stages. Every release has the potential to turn the tide in how we view our progress, and September's data will be no different. Keep in mind that both of these reports will have significant implications regarding upcoming Fed Policy as well as interest rates.

Next, earnings season is back and Friday is the big kickoff. We get important announcements from BlackRock (BLK), Citigroup (C), JPMorgan Chase (JPM), PNC Financial Services Group (PNC), Progressive (PGR), UnitedHealth Group (UNH), and Wells Fargo (WFC), some of the largest banks, insurance companies, and healthcare providers all in one day. As we noted in the section above, guidance continues to be as important as the current figures as investors search for clues about how corporate America is viewing a period of great economic uncertainty moving forward. Friday will be our first look, albeit a bit narrow in scope. Next week, we get a more broad picture with announcements from Goldman Sachs (GS), Johnson & Johnson (JNJ), JB Hunt (JBHT), United Airlines (UAL), Morgan Stanley (MS), Nasdaq (NDAQ), US Bank (USB), Lam Research (LRCX), Netflix (NFLX), Tesla (TSLA), American Airlines (AAL), Dow (DOW), Phillip Morris (PM), AT&T (T), Union Pacific (UNP), CSX (CSX), American Express (AXP), and Slumberger (SLB), among others. Quite a busy schedule, indeed.

Next, the market is still dealing with spiking interest rates as selling in treasuries remains elevated. It's a very touchy space as typically insignificant reports like Weekly Jobless Claims have proven to be the excuse for massive moves in interest rates. I'm not sure if this continues to be the case with so many more significant drivers at play this week, but it certainly has been in recent weeks, which has been a bit odd. Nevertheless, it's something to watch out for as spiking rates put a damper on equities day-to-day.

Finally, and perhaps most importantly, Israel suddenly finds itself at war following a surprise attack by Hamas over the weekend. This situation is loaded with geopolitical tensions and broad-based market implications, though it's difficult to decipher at this time just how far reaching these will end up being. If the situation gets drawn out and extrapolates beyond the current conflict, I could see new themes emerging over the intermediate term. The market's knee jerk reaction has been as follows: Modest dip in equities, big spike in energy prices, big spike in defense stocks, flight to safety in bonds, and lower interest rates. All make sense at the current time, but let's look at the spike in energy and defense stocks – if this situation doesn't eventually involve countries that dictate global supply, do energy prices get driven sustainably go higher? If the US isn't sending weapons and equipment to Israel in short order, do LMT, RTX, NOC, and GD need to trend higher? In a vacuum, probably not. But we won't know until we have more information. Since the situation is so new, these initial reactions are speculative. We all hope this isn't a precursor to a larger global conflict, but all we can do at this juncture is wait, observe, and react accordingly.

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