Convergence Commentary
October 2023 Market Recap

Quick Hits:

- The market is on a three-month losing streak.
- Rising yields continue to headline.
- Geopolitical worries increase.
- The economy remains strong.

Market-Moving Highlights

With 52% of the S&P 500 reported, 78% of companies have surpassed estimates. Earnings beat by 7.5% while sales beat by 0.5%. However, guidance from companies quoted uncertainties, Israel, and geopolitical tensions in commentary more than usual, which spooked investors. Additionally, companies that missed earnings estimates were hit by harsh reactions. While the overall market was not rewarded by the good results, the strong earnings season is still a long-term positive indicator.

In October, inflation met expectations, with headline inflation stable at 3.7% year-over-year and 0.4% month-to-month. A softer-than-expected decline in energy prices offset slowing inflationary pressures in other categories. Core CPI declined to 4.1% from 4.3% year over year, as expected. Prices eased slightly in new vehicles, apparel, and transportation services, while used car prices saw a significant year-over-year decrease of -8%. Forecasts for the next month suggest further moderation in core CPI, but an increase in headline CPI, influenced by concerns surrounding energy prices and geopolitical uncertainties involving Israel. Although inflation progress is slowing, it's encouraging to see core CPI consistently decreasing, albeit at a slow pace.

While the government avoided a shutdown in October, a government shutdown could still happen in November. The House was without a speaker for about 3 weeks, but Mike Johnson was elected at last. It will be interesting to see how the new speaker handles the current environment, and whether he will succeed in approving government budgets by the November 17th deadline.

The Federal Reserve is set to convene for an interest rate decision meeting on November first. Fed Chair Jerome Powell had several speeches in October, and his comments extended the schedule for future rate cuts. He added that, “Inflation is still too high, and a few months of good data are only the beginning of what it will take to build confidence that inflation is moving down sustainably to our [2%] goal.” However, he also mentioned that the fact that treasury bond yields have exploded higher might mean there is less work to do for the Fed. There are also starting to be signs, such as Q4 guidance, that the economy might be slowing faster than expected. In the current uncertain environment, The Federal Reserve will likely pause again in November and reiterate data dependency.

Index Performance

Index	1 Month	YTD	1 Year	5 Year
S&P 500	(2.10%)	10.69%	10.41%	11.01%
Nasdaq Composite	(2.76%)	23.61%	17.99%	12.94%
Russell 2000	(6.82%)	(4.45%)	(8.56%)	3.31%
MSCI ACWI ex US	(4.11%)	1.47%	12.66%	3.96%
Bloomberg US Aggregate Bond	(1.58%)	(2.77%)	0.36%	(0.06%)

Despite the continued strength of the economy, the primary focus has shifted away from its performance. Instead, attention has been predominantly directed at the surging yields and escalating geopolitical tensions. In October, the 10-year Treasury further spiked from 4.61% to 4.85%, while oil stabilized at $84 per barrel, down from $94. As previously mentioned, smaller companies are particularly vulnerable in a high-interest-rate environment, which is why they suffered the most significant declines. The steep downturn underscores the prevailing apprehension and unease in the market. However, towards the end of the month there have been signs of improving sentiment and headlines over potentially oversold conditions.

S&P 500 Sector Highlights & Commentary

Best-Performing Sectors		Worst-Performing Sectors	
Utilities	1.29%	Energy	(5.75%)
Technology	0.05%	Consumer Discretionary	(5.52%)
Communication Services	(1.03%)	Healthcare	(3.26%)

For a surprising sight this year, a defensive sector has topped the list. However, utilities remain the poorest performers, with a -14% return this year. The two strongest performers in 2023, technology and communication services, crept their way to the top again, halfway through the earnings season. On the worst-performing front, oil prices decreased by 10% in October, causing an energy sector decline. There were signs that extra savings that consumers acquired during Covid are depleting, which caused the consumer discretionary sector to suffer. Healthcare went down mostly along with the other sectors. The National Association of Home Builders, the Mortgage Bankers Association and the National Association of Realtors wrote to the Fed “to convey profound concern” about the industry. There is a historic shortage of available homes for sale, and the Fed hikes are not helping. Real Estate was at the bottom of the list until the last day of the month.

What to Watch in November

11/01 – Fed Interest Rate Decision, ISM Manufacturing PMI, Jolts Job Openings
A busy start to the month of November. The Federal Reserve is expected to maintain its pause while reiterating data dependency.

The manufacturing sector is expected to maintain its 49 reading. It will be interesting to see whether the manufacturing sector can come out of the contraction territory with a reading of 50 or higher. Note that the manufacturing sector has been in contraction for one year's worth of data.

The number of job openings rose to 9.61 million in the last reading, well above the market consensus of 8.8 million. The consensus for the next reading is for 9.2 million.

11/03 – Unemployment Rate, Non-Farm Payrolls, ISM Services PMI
The unemployment rate is expected to remain steady at 3.8%, while Non-Farm Payrolls are expected to increase by 190,000. The last report shocked the market with a 336,000 reading (with the forecast at 170,000). The services sector is expected to grow slightly faster at 53.7, up from 53 in September. With expectations calling for consumer spending to slow down, the reading might be more important than usual.

11/10 – Michigan Consumer Sentiment Preliminary

In October, consumer sentiment decreased drastically from 68.1 to 63.8. The decline was attributable to worries over personal finances and negative current events. The next reading will be crucial, showcasing how the consumer views the future after another month of mostly negative headlines.

11/14 – CPI and Core CPI
Inflation remains one of the most important readings of the month, as the main focus of the market is higher yields. The current forecasts expect annual Core CPI to decrease to 4% from 4.1%, while headline inflation is expected to increase from 3.7% to 3.8%.

Market Wrap

In October, the stock market was focused on the near-term uncertainties and negatives. Some parts of the Fed Chair Jerome Powell's Speech were more hawkish than expected. While consumers remain strong, there are reports that might not last. The war in Israel was mentioned frequently, there are fears of a potential widespread conflict, and the war in Ukraine continues. There were also new China export restrictions for AI semiconductor chips. While inflation has moderated, it seems like progress may have slowed.

However, the long-term picture is brighter. The economy is still growing as inflation moderates. The table below argues that inflation is slowing faster than headlines suggest, as Core CPI excluding housing is already below the 2% target. After three months of negative market performance, the question of whether the current level of fear in the market is justified remains uncertain.

Inflation Dashboard (Y/Y %)	Jan.2023	Feb.2023	Mar.2023	Apr.2023	May.2023	Jun.2023	Jul.2023	Aug.2023	Sep.2023
Import Price Index	0.86%	-1.12%	-4.70%	-4.88%	-5.74%	-6.13%	-4.64%	-2.97%	
Producer Prices	5.74%	4.75%	2.71%	2.30%	1.20%	0.30%	1.19%	1.9%	2.15%
Services Prices Index Level	67.8	65.6	59.5	59.6	56.2	54.1	56.8	58.9	58.9
Global Supply Chain Pressure Index Level	1.01	-0.28	-1.18	-1.35	-1.57	-1.11	-0.86	-1.08	-0.69
Gasoline Prices: U.S. Average	3.38	3.42	3.45	3.63	3.55	3.57	3.61	3.84	3.84
Consumer Prices (CPI)	6.41%	6.04%	4.98%	4.93%	4.05%	2.97%	3.18%	3.7%	3.70%
Core CPI Excluding Housing	3.88%	3.69%	3.77%	3.71%	3.40%	2.75%	2.57%	2.32%	1.93%
Rent Prices	8.56%	8.76%	8.81%	8.80%	8.66%	8.33%	8.03%	7.76%	7.41%
PCE Deflator	5.48%	5.19%	4.44%	4.45%	3.96%	3.20%	3.40%	3.48%	
PCE Deflator: Core Services Ex Housing	5.10%	5.11%	4.87%	4.81%	4.70%	4.43%	4.76%	4.43%	

Source: LPL Research, AAA, Bureau of Economic Analysis, Bureau of Labor Statistics, Institute of Supply Management, 10/12/23

Sources

Inflation Losing its Stickiness | LPL Financial Research (lplresearch.com

Your Investment and Research Team

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