Quarterly Insights:
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By Matthew Gaude & Shawn McGuire

Inflation Worries and Higher Bond Yields Pressure Stocks in Q3

Good riddance to what has been a very rough September for stocks. In fact, both August and September saw weakness, living up to their reputation as a potentially troublesome time frame based on seasonality.

The S&P 500 rose to the highest level since March 2022 early in the third quarter, but rising global bond yields, fears of a rebound in inflation, and concerns about a future economic slowdown weighed on the major indices in August and September and the S&P 500 finished the third quarter with a modest loss.

The S&P 500 started the third quarter largely the same way it ended the second quarter—with gains. Stocks rose broadly in July thanks primarily to "Goldilocks" economic data, meaning the data showed solid economic growth but not to the extent that would have implied the Federal Reserve needed to hike rates further than investors expected. That solid economic data combined with a decline in inflation metrics to further boost stock prices, as investors embraced reduced near-term recession risks and steadily declining inflation. The Federal Reserve, meanwhile, increased interest rates in late July but also signaled that could be the last rate hike of the cycle. That tone and commentary further fueled optimism that one of the most aggressive rate hike cycles in history was soon coming to an end. Finally, the second quarter earnings season was better than feared, with mostly favorable corporate guidance which supported expectations for strong earnings growth into 2024. The S&P 500 rose to the highest level since March 2022 and the index finished with a strong monthly gain of more than 3%.

The market dynamic changed on the first day of August, however, when Fitch Ratings, one of the larger U.S. credit rating agencies, downgraded U.S. sovereign debt. Fitch cited long-term risks of the current U.S. fiscal trajectory as the main reason for the downgrade, but while that lacked any near-term specific justification for the downgrade, the action itself put immediate downward pressure on U.S. Treasuries, sending their yields meaningfully higher. The Fitch downgrade kick-started a rise in Treasury yields that lasted the entire month, as the downgrade combined with a rebound in anecdotal inflation indicators and a large increase in Treasury sales stemming from the debt ceiling drama pushed yields sharply higher. The 10-year Treasury yield rose from 4.05% on August 1st to a high of 4.34% on August 21st, the highest level since mid-2007. That rapid rise in yields weighed on stock prices throughout August, and the S&P 500 posted its first negative monthly return since February, as higher rates pressured equity valuations and raised concerns about a future economic slowdown. The S&P 500 finished August down 1.59%.

The August volatility subsided in early September, however, as solid economic data and a pause in the rise in Treasury yields allowed the S&P 500 to stabilize through the first half of the month. But volatility returned following the September Fed decision as the Federal Reserve delivered markets a "hawkish" surprise, despite not increasing interest rates.

Specifically, the majority of Fed members reiterated that they anticipated the need for an additional rate hike before the end of the year and forecasted only two rate cuts for all of 2024, down from four rate cuts forecasted at the June meeting. Then, late in the month, two additional developments weighed further on both stocks and bonds. First, the United Auto Workers labor union began a general strike, a move that would disrupt automobile production and temporarily weigh on economic growth. Second, the U.S. careened toward another government shutdown as Republicans and Democrats failed to agree on a "Continuing Resolution" to fund the government. The shutdown was avoided at the last minute, but the funding extension only lasts until November 17th, meaning there will likely be another budget battle in the coming months. The S&P 500 declined toward the end of the month to hit a fresh three-month low, ending September down modestly.

In sum, volatility returned to markets during the third quarter, as rising bond yields pressured stock valuations, some inflation indicators pointed to a bounce back in inflation and the Fed reiterated a "higher for longer" interest rate outlook.

Third Quarter Performance Review

Rising bond yields were the main driver of the markets in the third quarter as high Treasury yields caused reversals in performance on a sector and index basis, relative to the first and second quarters.

Starting with market capitalization, large caps once again outperformed small caps, as they did in the first two quarters of 2023, although both posted negative returns. That relative outperformance by large caps is consistent with rising Treasury yields, as smaller companies are typically more reliant on debt financing to sustain operations and rising interest rates create stronger financial headwinds for smaller companies when compared to their larger peers.

Following are the returns through 9/29/2023:

Stock Index Performance

Index	Week	YTD	12-mo.	2022	5-yr.
Dow Jones Industrial Avg. (33,508)	-1.34%	2.73%	19.18%	-6.86%	7.13%
S&P 500 (4,288)	-0.71%	13.06%	21.59%	-18.13%	9.89%
NASDAQ 100 (14,715)	0.10%	35.37%	35.31%	-32.38%	15.05%
S&P 500 Growth	-0.37%	18.10%	19.81%	-29.41%	10.42%
S&P 500 Value	-1.13%	7.54%	22.14%	-5.25%	8.38%
S&P MidCap 400 Growth	0.45%	6.83%	16.15%	-19.01%	5.60%
S&P MidCap 400 Value	0.19%	1.53%	14.45%	-7.01%	6.01%
S&P SmallCap 600 Growth	0.69%	2.38%	9.50%	-21.13%	2.85%
S&P SmallCap 600 Value	0.33%	-0.85%	10.19%	-11.09%	3.17%
Russell 2000	0.55%	2.51%	8.87%	-20.46%	2.36%
MSCI EAFE	-1.43%	7.08%	25.65%	-14.45%	3.23%
MSCI World (ex US)	-1.34%	5.34%	20.39%	-16.00%	2.58%
MSCI World	-0.85%	11.10%	21.95%	-18.14%	7.25%
MSCI Emerging Markets	-1.14%	1.82%	11.70%	-20.09%	0.55%
S&P GSCI	-0.15%	7.24%	10.93%	25.99%	5.56%

Source: Bloomberg. Returns are total returns. *5-yr. return is an average annual.* One-week, YTD, 12-mo. and 5-yr. performance returns calculated through 9/29/23. An index cannot be purchased directly by investors. Past performance is no guarantee of future results.

Following is an asset class performance chart with returns going back to 2011:

CREATIVE PLANNING		Asset Class Total Returns Since 2011 (Data via YCharts as of 9/30/23)													@CharlieBilello	
ETF	Asset Class	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023 YTD	2011-23 Cumulative	2011-23 Annualized
N/A	Bitcoin ($BTC)	1473%	186%	5507%	-58%	35%	125%	1331%	-73%	95%	301%	66%	-65.5%	61.7%	8908509%	144.5%
QQQ	US Nasdaq 100	3.4%	18.1%	36.6%	19.2%	9.5%	7.1%	32.7%	-0.1%	39.0%	48.6%	27.4%	-32.6%	35.1%	640.5%	17.0%
IWF	US Growth	2.3%	15.2%	33.1%	12.8%	5.5%	7.0%	30.0%	-1.7%	35.9%	38.3%	27.4%	-29.3%	24.9%	439.5%	14.1%
SPY	US Large Caps	1.9%	16.0%	32.2%	13.5%	1.2%	12.0%	21.7%	-4.5%	31.2%	18.4%	28.7%	-18.2%	13.0%	332.0%	12.2%
EFA	EAFE Stocks	-12.2%	18.8%	21.4%	-6.2%	-1.0%	1.4%	25.1%	-13.8%	22.0%	7.6%	11.5%	-14.4%	6.9%	72.2%	4.4%
CWB	Convertible Bonds	-7.7%	15.9%	20.5%	7.7%	-0.8%	10.6%	15.7%	-2.0%	22.4%	53.4%	2.2%	-20.8%	6.7%	180.0%	8.4%
HYG	High Yield Bonds	6.8%	11.7%	5.8%	1.9%	-5.0%	13.4%	6.1%	-2.0%	14.1%	4.5%	3.8%	-11.0%	4.1%	64.9%	4.0%
MDY	US Mid Caps	-2.1%	17.8%	33.1%	9.4%	-2.5%	20.5%	15.9%	-11.3%	25.8%	13.5%	24.5%	-13.3%	4.1%	225.4%	9.7%
BIL	US Cash	0.0%	0.0%	-0.1%	-0.1%	-0.1%	0.1%	0.7%	1.7%	2.2%	0.4%	-0.1%	1.4%	3.6%	10.0%	0.7%
PFF	Preferred Stocks	-2.0%	17.8%	-1.0%	14.1%	4.3%	1.3%	8.1%	-4.7%	15.9%	7.9%	7.2%	-18.2%	3.1%	60.5%	3.8%
IWM	US Small Caps	-4.4%	16.7%	38.7%	5.0%	-4.5%	21.6%	14.6%	-11.1%	25.4%	20.0%	14.5%	-20.5%	2.5%	170.1%	8.1%
IWD	US Value	0.1%	17.5%	32.1%	13.2%	-4.0%	17.3%	13.5%	-8.5%	26.1%	2.7%	25.0%	-7.7%	1.7%	212.4%	9.3%
DBC	Commodities	-2.6%	3.5%	-7.6%	-28.1%	-27.6%	18.6%	4.9%	-11.6%	11.8%	-7.8%	41.4%	19.3%	1.3%	-6.2%	-0.5%
GLD	Gold	9.6%	6.6%	-28.3%	-2.2%	-10.7%	8.0%	12.8%	-1.9%	17.9%	24.8%	-4.2%	-0.8%	1.1%	23.6%	1.7%
EEM	EM Stocks	-18.8%	19.1%	-3.7%	-3.9%	-16.2%	10.9%	37.3%	-15.3%	18.2%	17.0%	-3.6%	-20.6%	0.9%	3.4%	0.3%
EMB	EM Bonds (USD)	7.7%	16.9%	-7.8%	6.1%	1.0%	9.3%	10.3%	-5.5%	15.5%	5.4%	-2.2%	-18.6%	0.8%	38.2%	2.6%
LQD	Investment Grade Bonds	9.7%	10.6%	-2.0%	8.2%	-1.3%	6.2%	7.1%	-3.8%	17.4%	11.0%	-1.8%	-17.9%	-0.6%	44.9%	3.0%
TIP	TIPS	13.3%	6.4%	-8.5%	3.6%	-1.8%	4.7%	2.9%	-1.4%	8.3%	10.8%	5.7%	-12.2%	-0.7%	31.9%	2.2%
BND	US Total Bond Market	7.7%	3.9%	-2.1%	5.8%	0.6%	2.5%	3.6%	-0.1%	8.8%	7.7%	-1.9%	-13.1%	-0.9%	22.4%	1.6%
VNQ	US REITs	8.6%	17.6%	2.3%	30.4%	2.4%	8.6%	4.9%	-6.0%	28.9%	-4.7%	40.5%	-26.2%	-5.4%	125.1%	6.6%
TLT	Long Duration Treasuries	34.0%	2.6%	-13.4%	27.3%	-1.8%	1.2%	9.2%	-1.6%	14.1%	18.2%	-4.6%	-31.2%	-9.0%	30.3%	2.1%
Highest Return		BTC	BTC	BTC	VNQ	BTC	BTC	BTC	BIL	BTC	BTC	BTC	DBC	BTC	BTC	BTC
Lowest Return		EEM	BIL	GLD	BTC	DBC	BIL	BIL	BTC	BIL	DBC	TLT	BTC	TLT	DBC	DBC
% of Asset Classes Positive		62%	95%	52%	71%	38%	100%	100%	5%	100%	90%	67%	10%	76%	95%	95%

On a sector level, 9 of the 11 S&P 500 sectors finished the third quarter with a negative return, a stark reversal from the broad gains of the second quarter. Energy was, by far, the best performing S&P 500 sector in the third quarter thanks to a surge in oil prices. Communications Services also finished Q3 with a slightly positive quarterly return on the hopes that integration of advanced artificial intelligence would boost search and social media companies' future advertising revenues.

S&P Sector Performance					
Index	Week	YTD	12-mo.	2022	5-yr.
Communication Services	-0.01%	40.43%	38.48%	-39.89%	7.87%
Consumer Discretionary	-0.27%	26.58%	13.69%	-37.03%	7.16%
Consumer Staples	-1.97%	-4.76%	7.35%	-0.62%	8.50%
Energy	1.31%	5.99%	30.09%	65.43%	8.87%
Financials	-1.55%	-1.65%	11.68%	-10.57%	5.98%
Health Care	-1.10%	-4.09%	8.18%	-1.95%	8.21%
Industrials	-0.44%	4.50%	24.54%	-5.51%	7.25%
Information Technology	-0.08%	34.72%	41.10%	-28.19%	18.37%
Materials	0.24%	2.61%	18.05%	-12.28%	8.60%
Real Estate	-1.41%	-5.51%	-1.90%	-26.21%	4.33%
Utilities	-6.92%	-14.41%	-7.02%	1.56%	5.65%

Source: Bloomberg. Returns are total returns. *5-yr. return is an average annual.* One-week, YTD, 12-mo. and 5-yr. performance returns calculated through 9/29/23. An index cannot be purchased directly by investors. Past performance is no guarantee of future results. On 9/28/18, the Global Industry Classification Standard (GICS) was reconstituted and the Telecommunications Services sector was renamed Communication Services. GICS sector information for periods prior to 9/28/18 may not necessarily be comparable to the reconstituted sectors.

Looking at sector laggards, the impact of rising bond yields was again clearly visible as consumer staples, utilities, and real estate were the worst-performing sectors in the third quarter. Those sectors offer some of the highest dividend yields in the market, but with bond yields quickly rising, those dividend yields become less attractive and investors rotated out of the high-dividend sectors and into less volatile bond funds as a result.

The S&P 500 Index is down 3.56% during the third quarter. Now, the S&P 500 is up about 12% year to date. But that's pretty much offset by the fact that we saw an 18% contraction in 2022. In fact, the market is almost back to where it was in September 2021, two years ago.

In volatile times like today, it's important to take note of the underlying forces driving the market…and what they could mean for investors moving forward.

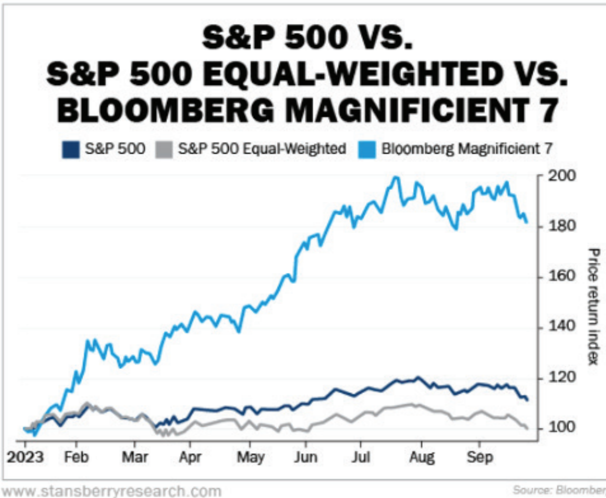
As we discussed during our last quarterly update, the stock market has been dominated by the "Magnificent Seven" tech companies (also referred to as the "S&P 7" or "Bloomberg Magnificent 7") since March. This includes Apple (AAPL), Microsoft (MSFT), Alphabet (GOOGL), Amazon (AMZN), Nvidia (NVDA), Meta Platforms (META), and Tesla (TSLA). The largest companies in the S&P 500, together they account for approximately 27.3% of the S&P 500.

Take a look at their year-to-date performance below:

THE S&P 7

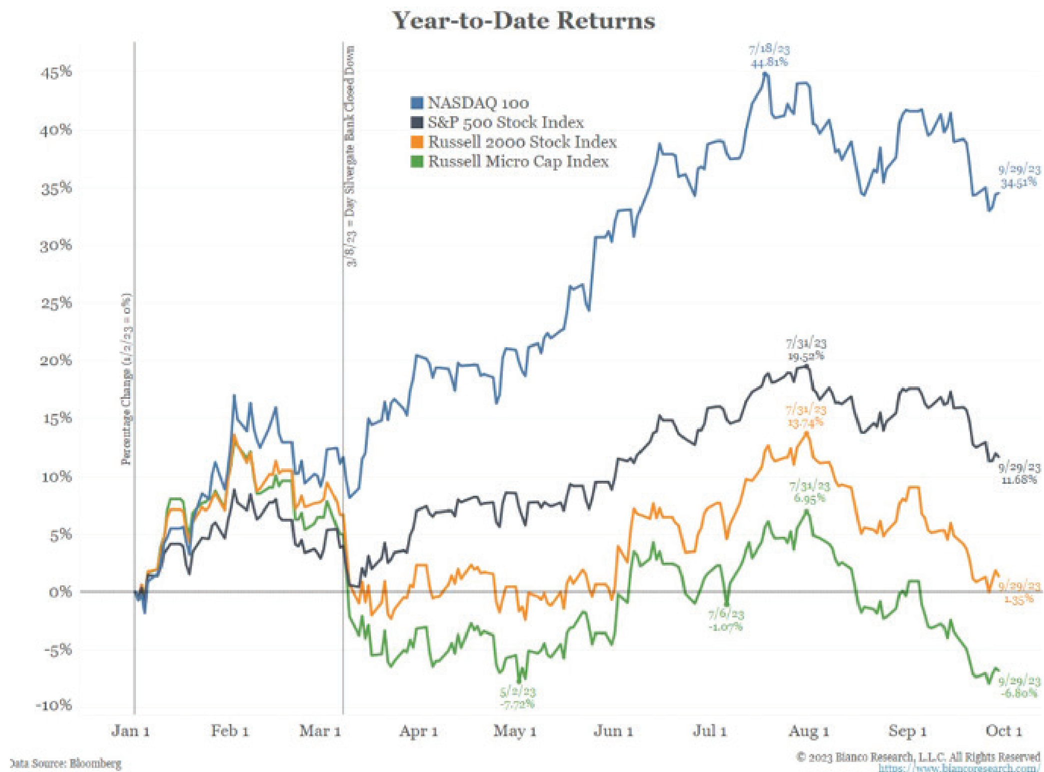
			Weight	Gain YTD
1	Apple	AAPL	7.1%	36%
2	Microsoft	MSFT	6.5%	30%
3	Alphabet	GOOGL	3.9%	45%
4	Amazon	AMZN	3.2%	45%
5	Nvidia	NVDA	2.9%	192%
6	Tesla	TSLA	1.9%	119%
7	Meta Platforms	META	1.9%	134%
	Total		**27.3%**	

On average, these seven companies are up about 81% year to date. The S&P 500 Equal Weight Index—which holds an equal amount of each stock in the S&P 500—just dipped into the red. As of this past Tuesday, it was down 0.2% on the year. That means if you had bought an equal amount of each stock in the S&P 500 one year ago, you'd be about flat on your investment.

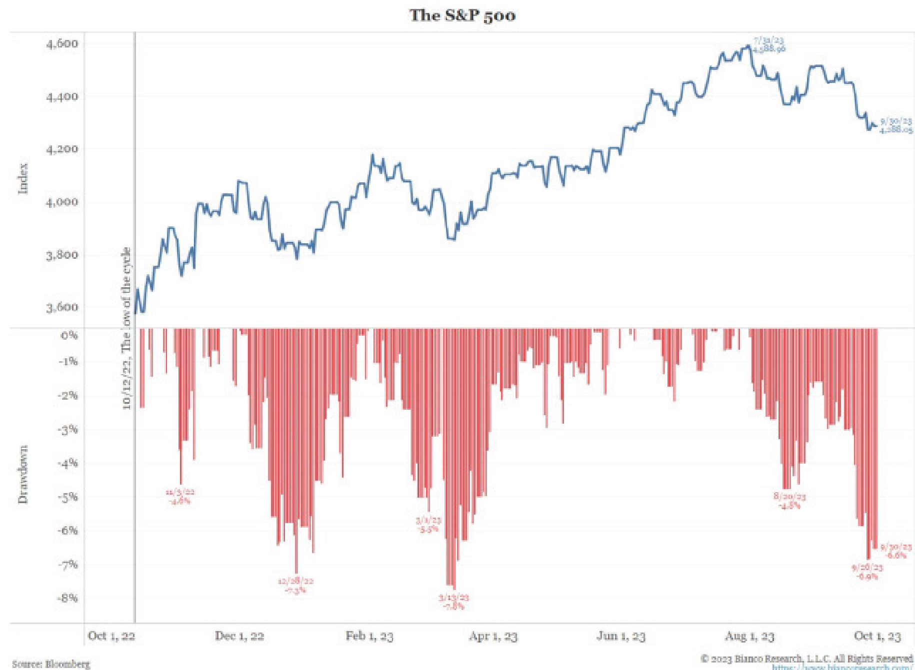


The market's positive returns remain highly concentrated in a handful of stocks. Year to date, the rally has not broadened out to other sectors or asset classes. The small cap Russell 2000 (orange line in the chart below) is up 1.35%. The Russell micro-cap (green line below) represents the bottom 1000 stocks of the Russell 2000 is down 6.80% YTD.

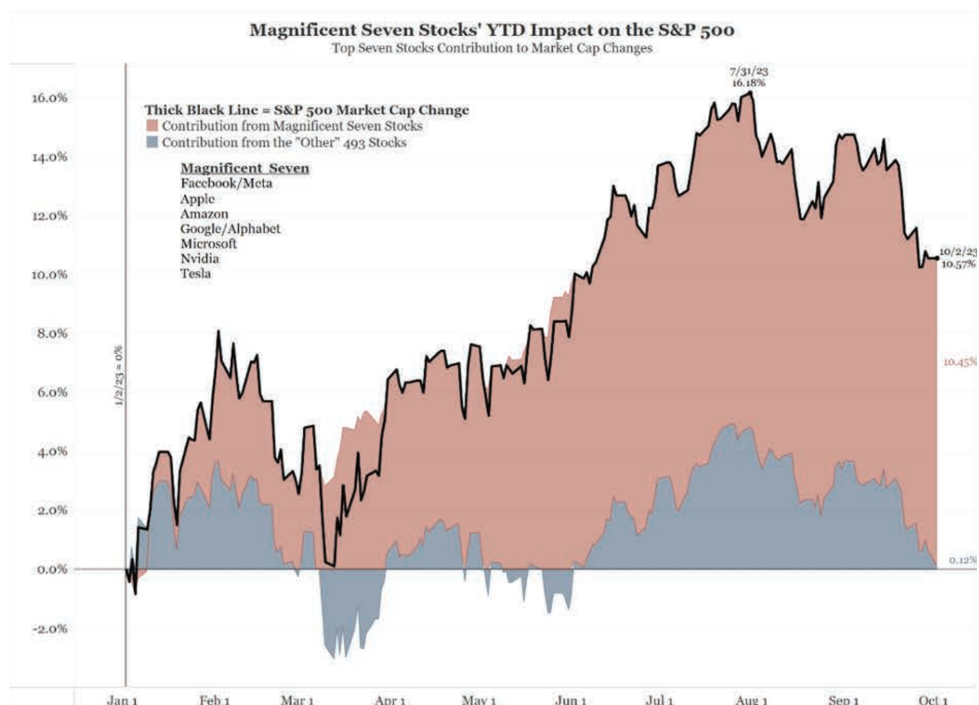
So where do market returns stand after ¾ of the year is done? Long duration bonds are at a loss again YTD while stocks outside the "Magnificent 7" are barely positive for the year.



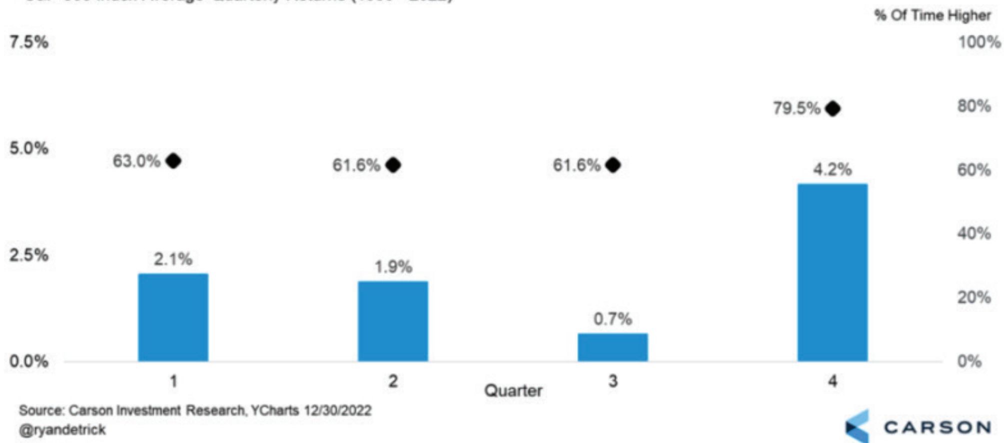
As the fourth quarter starts, the S&P 500's drawdown is near its largest since the market bottomed a year ago (October 12, 2022). The biggest drawdown was -7.8%, ending on March 13, 2023, a week after four banks failed.



Breaking down the market cap change of the S&P 500 below, the "Magnificent 7" stocks (red) accounted for 10.45% of the gain in market cap. The "other 493" stocks (blue) gained just 0.12%.



So, is there any good news going into the end of the year? Yes, there are a lot of negative news events occurring, however, the fourth quarter tends to be the best-performing time of the year historically. According to Ryan Detrick of Carson Group (in his blog "Why Stocks Should Rally in the Fourth Quarter"), the fourth quarter is the best quarter of the year, up nearly 80% of the time and up more than 4% on average, twice as much as the next best quarter.



Breaking it down by months, the upcoming three months tend to be quite strong. October is known as a month for extreme volatility (think 1987 and 2008), but it is usually a pretty decent month overall, with November and December historically very strong.

Here is another example of why we see a late-year rally. Again according to Ryan Detrick, when the S&P 500 is up between 10-20% for the year heading into the normally strong fourth quarter, we can expect an even better fourth quarter, up more than 5% on average and higher more than 84% of the time. In other words, a strong year tends to end strongly.

Don't Bet Against A Fourth Quarter Rally Just Yet

S&P 500 Performance When Up YTD Between 10-20% At the End of September

Year	YTD Return End of September	S&P 500 Index Returns	
		October	Q4
1950	15.8%	0.4%	5.0%
1951	13.9%	-1.4%	2.2%
1961	14.8%	2.8%	7.2%
1963	13.6%	3.2%	4.6%
1964	12.2%	0.8%	0.7%
1976	16.7%	-2.2%	2.1%
1979	13.7%	-6.9%	-1.3%
1980	16.2%	1.6%	8.2%
1983	18.1%	-1.5%	-0.7%
1988	10.0%	2.6%	2.1%
1991	17.5%	1.2%	7.5%
1996	11.6%	2.6%	7.8%
2003	13.2%	5.5%	11.6%
2009	17.0%	-2.0%	5.5%
2012	14.6%	-2.0%	-1.0%
2013	17.9%	4.5%	9.9%
2017	12.5%	2.2%	6.1%
2019	18.7%	2.0%	8.5%
2021	14.7%	6.9%	10.6%
2023	12.8%	?	?
	Average	1.1%	5.1%
	Median	1.6%	5.5%
	% Higher	68.4%	84.2%

Source: Carson Investment Research, FactSet 09/24/2023
@ryandetrick

Adding to reasons to look for a rally, when stocks fall more than 1% in both August and September, a big bounce back in October is normal, as is a great fourth quarter. Turning to the fourth quarter, it has been up 12 out of 13 times and up more than 7.0% on average. In other words, when we see the seasonal August/September weakness, it is also normal to see a strong end-of-year rally.

Down Big In August and September Isn't a Bad Thing

S&P 500 Performance When Down 1% Or More In Both August and September

Year	August	September	S&P 500 Index Returns	
			October	Q4
1952	-1.5%	-2.0%	-0.1%	8.3%
1956	-3.8%	-4.5%	0.5%	2.9%
1957	-5.6%	-6.2%	-3.2%	-5.7%
1959	-1.5%	-4.6%	1.1%	5.3%
1974	-9.0%	-11.9%	16.3%	7.9%
1975	-2.1%	-3.5%	6.2%	7.5%
1981	-6.2%	-5.4%	4.9%	5.5%
1985	-1.2%	-3.5%	4.3%	16.0%
1990	-9.4%	-5.1%	-0.7%	7.9%
2001	-6.4%	-8.2%	1.8%	10.3%
2011	-5.7%	-7.2%	10.8%	11.2%
2015	-6.3%	-2.6%	8.3%	6.5%
2022	-4.2%	-9.3%	8.0%	7.1%
2023	-1.8%	-4.2%	?	?
	Average		4.5%	7.0%
	Median		4.3%	7.5%
	% Higher		76.9%	92.3%

Source: Carson Investment Research, FactSet 09/24/2023
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Fourth Quarter Market Outlook

Markets begin the fourth quarter decidedly more anxious than they started the third quarter, but it's important to realize that while the S&P 500 did hit multi-month lows in September and there are legitimate risks to the outlook, underlying fundamentals remain generally strong.

First, while there are reasonable concerns about a future economic slowdown, the latest economic data remains solid. Employment, consumer spending, and business investment were all resilient in the third quarter, and there simply isn't much actual economic data that points to an imminent economic slowdown. So, while a future economic slowdown is certainly possible given higher interest rates, the resumption of student loan payments and declining U.S. savings, the actual economic data is clear: It isn't happening yet.

Second, fears that inflation may bounce back are also legitimate, given the rally in oil prices in the third quarter. But the Federal Reserve and other central banks typically look past commodity-driven inflation and instead focus on "core" inflation, and that metric continued to decline throughout the third quarter. Additionally, declines in housing prices from the recent peak are only now beginning to work into the official inflation statistics, and that should see core inflation continue to move lower in the months and quarters ahead.

Finally, regarding monetary policy, the Federal Reserve's historic rate hike campaign is nearing an end. And while we should expect the Fed to keep rates "higher for longer," high interest rates do not automatically result in an economic slowdown. Interest rates have merely returned to levels that were typical in the 1990s and early 2000s (before the financial crisis), and the economy performed well during those periods. Yes, we must keep an eye on the risk of higher rates causing an economic slowdown, but for now, higher rates are not causing a material loss of economic momentum.

In sum, there are real risks to both the markets and the economy as we begin the final three months of the year. But these are largely the same risks that markets have faced throughout 2023, and over that period, the economy and markets have remained impressively resilient. So, while these risks and others must be monitored closely, they don't present any new significant headwinds on stocks that haven't existed for much of the year.

Interest Rates

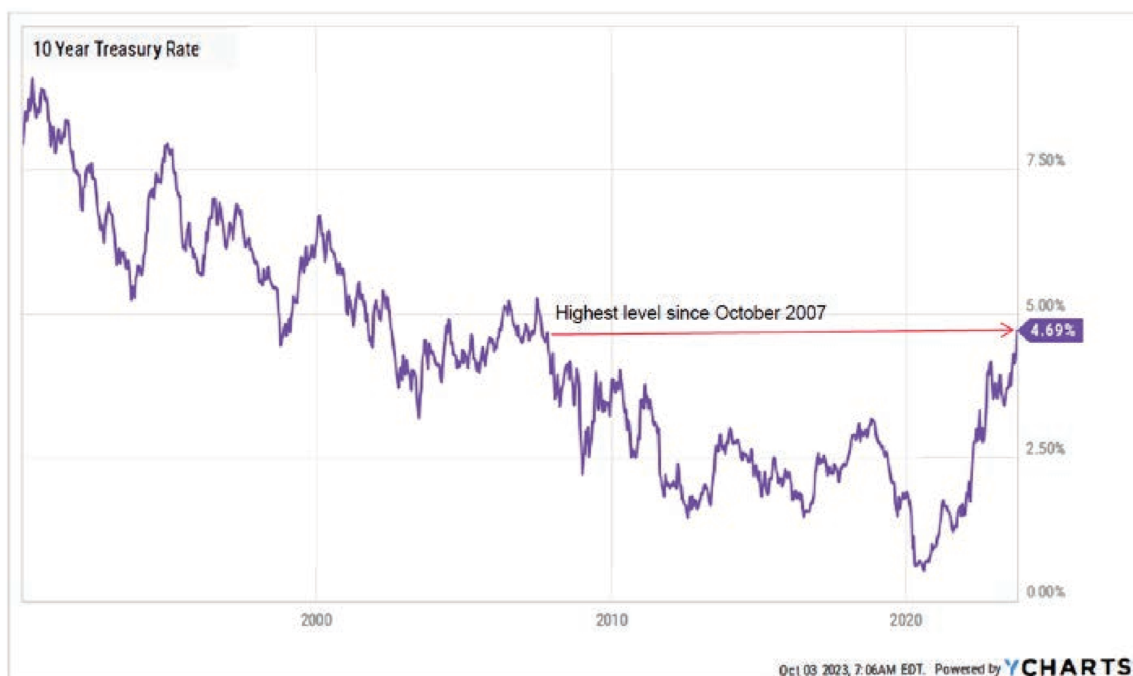
The U.S. bond market has now seen three consecutive years of declines based on the 10-year Treasury bond and the U.S. Aggregate Bond Index, the longest bear market in history. Last year was about markets adjusting to higher rates; this year is about markets adjusting to rates staying higher for longer. Where do the bond market returns stand for 2023? Recall that 2022 was the worst total-return year ever for the bond market. Those hoping for some sort of mean reversion in 2023 have been disappointed so far.

Bloomberg US Aggregate Bond Index: Longest Drawdowns (Monthly Data, 1976 - 2023)			
Start of Drawdown	End of Drawdown	# Months	Max Drawdown During Period (Monthly)
Aug-20	?	38	-17.2%
Jul-80	Oct-81	16	-9.0%
May-13	Apr-14	12	-3.7%
Aug-16	Jul-17	12	-3.3%
Feb-94	Jan-95	12	-5.1%
Mar-87	Nov-87	9	-4.9%
Aug-79	Apr-80	9	-12.7%
Apr-08	Nov-08	8	-3.8%
Feb-96	Sep-96	8	-3.2%
Jun-03	Nov-03	6	-3.6%
Feb-84	Jun-84	5	-4.9%
May-83	Aug-83	4	-3.5%
CREATIVE PLANNING	@CharlieBilello	(As of 9/30/23)	

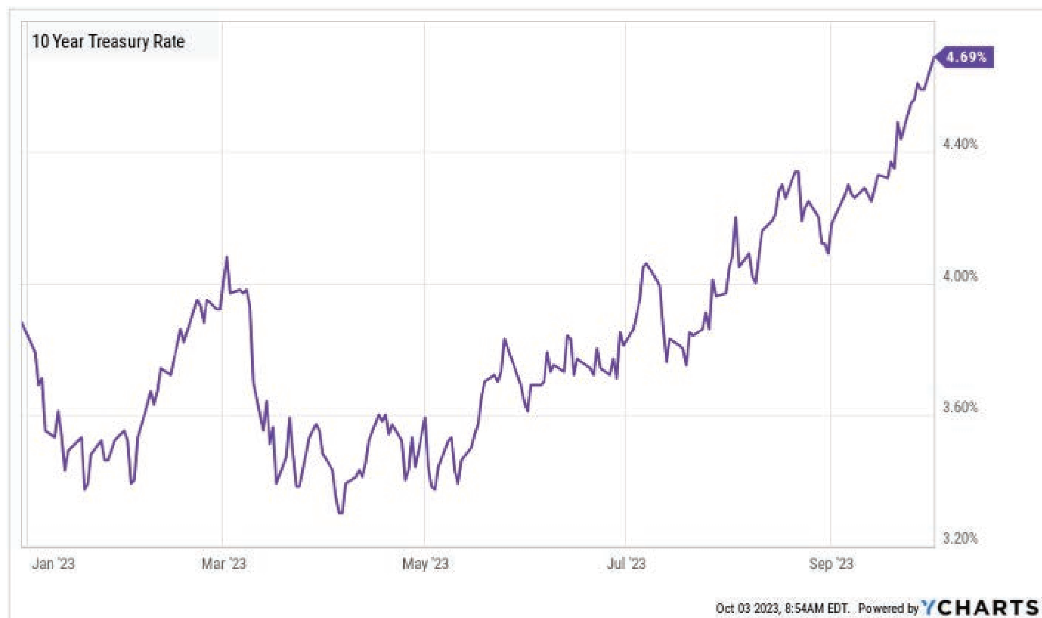
US 10-Year Treasury Bond: Total Returns (1928 - 2023)									
Year	Return	Year	Return	Year	Return	Year	Return	Year	Return
1928	0.8%	1948	2.0%	1968	3.3%	1988	8.2%	2008	20.1%
1929	4.2%	1949	4.7%	1969	-5.0%	1989	17.7%	2009	-11.1%
1930	4.5%	1950	0.4%	1970	16.8%	1990	6.2%	2010	8.5%
1931	-2.6%	1951	-0.3%	1971	9.8%	1991	15.0%	2011	16.0%
1932	8.8%	1952	2.3%	1972	2.8%	1992	9.4%	2012	3.0%
1933	1.9%	1953	4.1%	1973	3.7%	1993	14.2%	2013	-9.1%
1934	8.0%	1954	3.3%	1974	2.0%	1994	-8.0%	2014	10.7%
1935	4.5%	1955	-1.3%	1975	3.6%	1995	23.5%	2015	1.3%
1936	5.0%	1956	-2.3%	1976	16.0%	1996	1.4%	2016	0.7%
1937	1.4%	1957	6.8%	1977	1.3%	1997	9.9%	2017	2.8%
1938	4.2%	1958	-2.1%	1978	-0.8%	1998	14.9%	2018	0.0%
1939	4.4%	1959	-2.6%	1979	0.7%	1999	-8.3%	2019	9.6%
1940	5.4%	1960	11.6%	1980	-3.0%	2000	16.7%	2020	11.3%
1941	-2.0%	1961	2.1%	1981	8.2%	2001	5.6%	2021	-4.4%
1942	2.3%	1962	5.7%	1982	32.8%	2002	15.1%	2022	-17.8%
1943	2.5%	1963	1.7%	1983	3.2%	2003	0.4%	2023	-3.0%
1944	2.6%	1964	3.7%	1984	13.7%	2004	4.5%		
1945	3.8%	1965	0.7%	1985	25.7%	2005	2.9%		
1946	3.1%	1966	2.9%	1986	24.3%	2006	2.0%		
1947	0.9%	1967	-1.6%	1987	-5.0%	2007	10.2%		
CREATIVE PLANNING		@CharlieBilello		As of 9/30/23					

We recently wrote and posted an article updating the Federal Reserve's decision to not raise interest rates at their most recent September 20, 2023 meeting. If you have not read the update, you can read here as it was a comprehensive update and outlined our bond strategy. However, there are a few more updates I will add.

Following is a longer-term chart for the 10-year Treasury bond, showing we are at the highest levels of rates since October 2007:



Here is a year-to-date chart of the 10-year Treasury bond and the relentless increase in rates since July (there are several contributors to rising rates I will detail below):



This is why we have kept our bond allocations to short duration, meaning short maturities between ¼ of a year up to 5-year maturities to help avoid a big drawdown, as longer maturities are experiencing currently.

Treasury sell-off may reflect fears over rising US deficit

A recent Bloomberg article provides some insight to the recent surge in interest rates:

"The slide in Treasuries has been excessive given recent economic data and Federal Reserve policy, suggesting it's instead being driven by fears over the swelling U.S. deficit. Benchmark U.S. yields jumped to the highest levels in 16 years Monday, extending an uptrend that began in May. The latest surge shows Treasuries are detached from their fundamental drivers, according to JP Morgan Chase & Co. The move shows rising alarm at what fiscal policy makers are doing, economist Ed Yardeni says. The worry is that the escalating federal budget deficit will create more supply of bonds than demand can meet, requiring higher yields to clear the market, according to Ed Yardeni. Concerns over U.S. debt levels and large Treasury issuance have prompted investors to demand more compensation for the risk of holding long-term bonds, driving yields higher. We expect a further rise in long-term yields due to those factors."

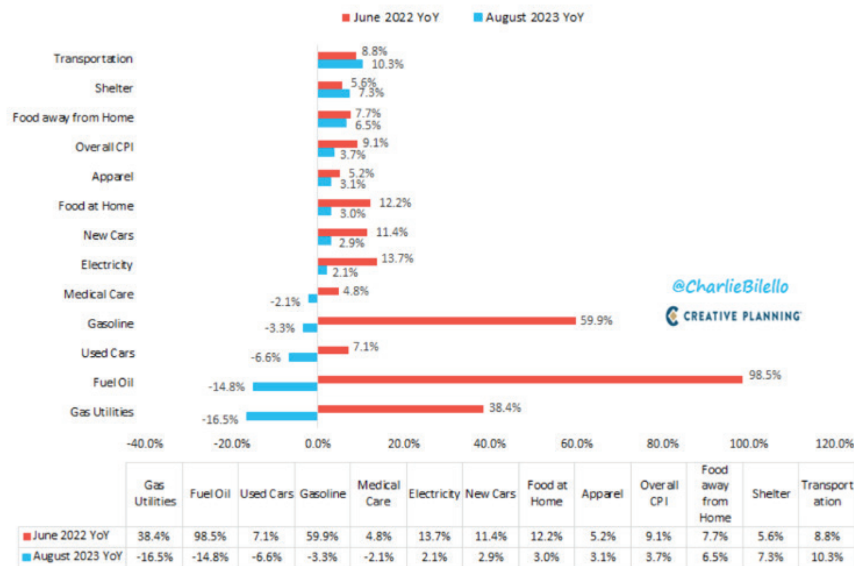
US Inflation

ECONOMY

August core inflation, excluding food and energy, rose 0.3%, hotter than expected

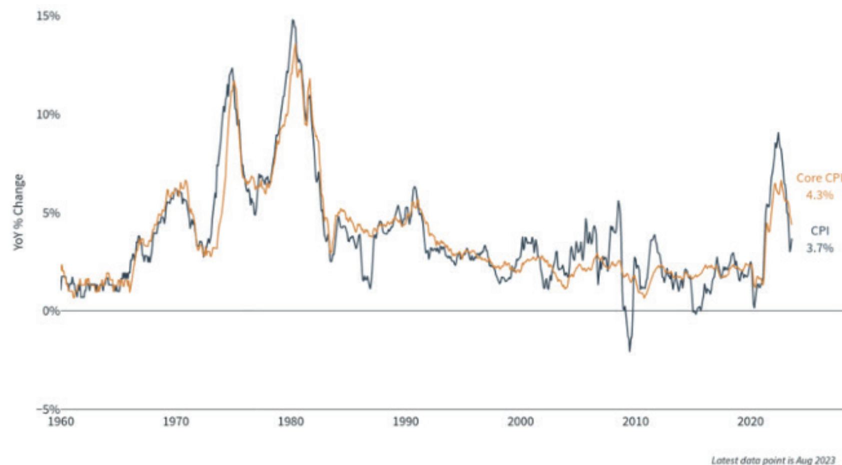
PUBLISHED WED, SEP 13 2023-8:32 AM EDT | UPDATED 35 MIN AGO

U.S. Consumer Price Index (CPI) has moved down from a peak of 9.1% in June 2022 to 3.7% today. What's driving that decline? Lower rates of inflation in Gas Utilities, Fuel Oil, Used Cars, Gasoline, Medical Car, Electricity, New Cars, Food at Home, Apparel, and Food away from Home. Shelter and Transportation are the only major components that have a higher inflation rate than June 2022.

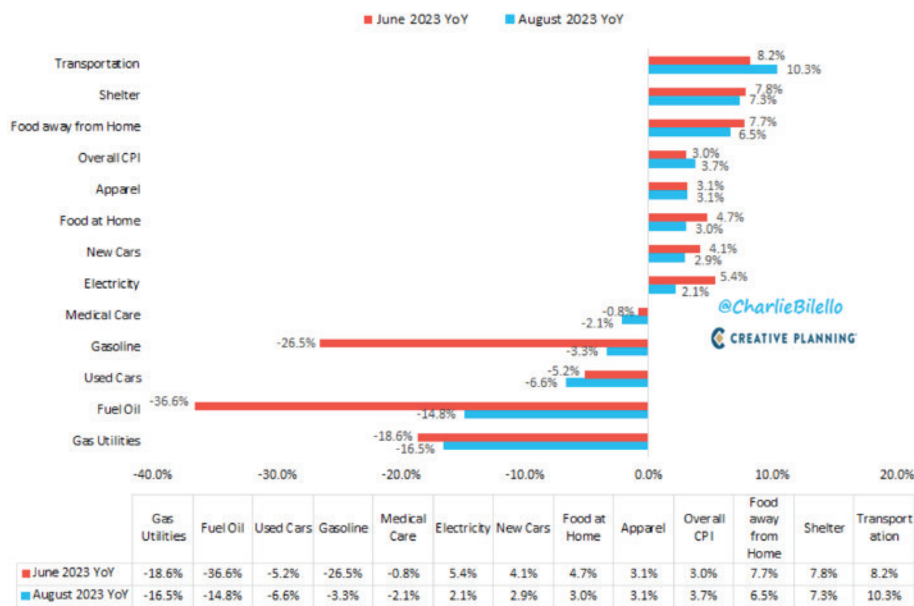


	Gas Utilities	Fuel Oil	Used Cars	Gasoline	Medical Care	Electricity	New Cars	Food at Home	Apparel	Overall CPI	Food away from Home	Shelter	Transportation
June 2022 YoY	38.4%	98.5%	7.1%	59.9%	4.8%	13.7%	11.4%	12.2%	5.2%	9.1%	7.7%	5.6%	8.8%
August 2023 YoY	-16.5%	-14.8%	-6.6%	-3.3%	-2.1%	2.1%	2.9%	3.0%	3.1%	3.7%	6.5%	7.3%	10.3%

U.S. CPI has moved up from a recent low of 3.0% in June 2023 to 3.7% today from the August CPI report.

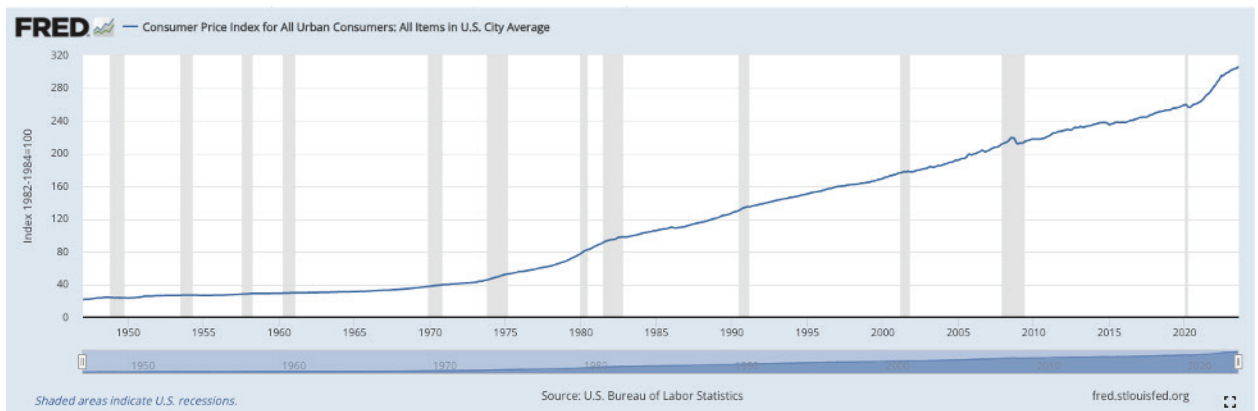


What's driving that increase? Primarily higher energy prices and smaller year-over-year declines in the price of Gasoline and Fuel Oil. Core CPI (core inflation is the change in prices of goods and services, except for those from the food and energy sectors) continues to trend lower, however, with declining YoY increases in Shelter being the biggest contributing factor.



	Gas Utilities	Fuel Oil	Used Cars	Gasoline	Medical Care	Electricity	New Cars	Food at Home	Apparel	Overall CPI	Food away from Home	Shelter	Transportation
June 2023 YoY	-18.6%	-36.6%	-5.2%	-26.5%	-0.8%	5.4%	4.1%	4.7%	3.1%	3.0%	7.7%	7.8%	8.2%
August 2023 YoY	-16.5%	-14.8%	-6.6%	-3.3%	-2.1%	2.1%	2.9%	3.0%	3.1%	3.7%	6.5%	7.3%	10.3%

Even though we have seen inflation decline from 9.1% in June 2022, let's not kid ourselves in the belief that inflation will drop substantially from these levels. All this means is that prices have leveled off and are not rising as much as they were previously. Following is a chart from the St. Louis Federal Reserve you will not see in the mainstream media. This shows inflation, or prices we pay as consumers, going back to 1947. We saw a very slight drop in prices paid in 2020 during COVID, however, since then, we have seen inflation accelerate substantially from previous periods.



The Consumer Price Index for All Urban Consumers is a price index of a basket of goods and services paid by consumers. Percent changes in the price index measure the inflation rate between any two time periods. It can also represent the buying habits of consumers. This particular index includes roughly 88% of the total population, accounting for wage earners, clerical workers, technical workers, self-employed, short-term workers, unemployed, retirees, and those not in the labor force.

The CPIs are based on prices for food, clothing, shelter, and fuels; transportation fares; service fees (e.g., water and sewer service); and sales taxes. Prices are collected monthly from about 4,000 housing units and approximately 26,000 retail establishments across 87 urban areas. To calculate the index, price changes are averaged with weights representing their importance in the spending of the particular group. The index measures price changes (as a percent change) from a predetermined reference date. If you would like to look at different time periods of inflation and prices consumers have paid, visit the St. Louis Federal Reserve's website here.

Stock Market

As we entered 2023, we were confident we would see the stock market rebound, and our initial objective for the S&P 500 was to go up between 4310 and 4375, which we achieved in June of this year. At that time, we started to become a little more conservative and decided to sell some positions to take some risk off the table. 2023 is a year where we could either go up to 4800 on the S&P 500 and possibly make new all-time highs, or the highs from last year could serve as a longer-term top in this market. The key will be if we can hold support in the 4165 to 4185 region of the S&P 500.

Our expectations as we went into the August and September time period, which historically have been two of the weakest months for the stock market, were for a drop down to the 4230 to 4275 region of the S&P 500. So far, the low struck thus far was 4238 as of October 3rd. Yet we are not quite certain we are done with the downside, as we could see a continued decline down to the neck support levels of 4165 to 4230 on the S&P 500. Should we see this decline, then this should be the final test of this decline off the summertime high. As long as the market successfully holds the support, we are maintaining our expectation for a rally to the 4800 region next.

Alternatively, should the market see a sustained breakdown below 4165 and then take us down to the 4000 to 4100 region, the market could be signaling that a long-term top has likely been struck in the market and we are setting up a decline that will likely take us down below the October 2022 low over the next 6 to 9 months.

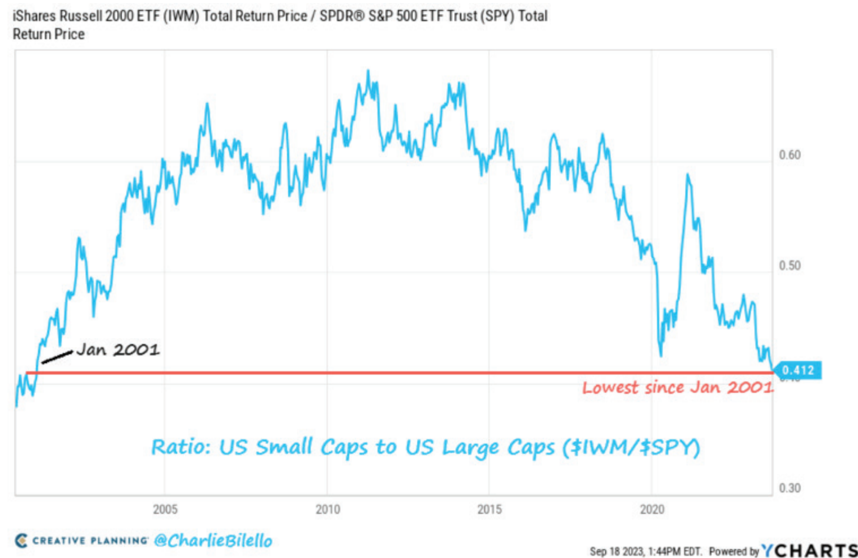
Game Plan

On September 26th, we purchased an initial half position in the S&P 500 ETF (SPY) on the decline to the initial support region of 4265. If the S&P 500 declines to the next support levels of 4165-4230, we will purchase the second half of our S&P 500 ETF position for the potential move higher to 4800.

Opportunities going forward will not be in tech, but in energy, fixed income, and the potential for one more move higher in the S&P 500.

Small-Cap Stocks

Small-cap stocks are flat to slightly negative this year. Following is a chart showing the ratio in price of small-cap stocks compared to large-cap stocks. As the chart shows, small-cap stocks have not been this inexpensive compared to large-cap stocks since January 2001. This alone does not make small-cap stocks an opportunity, however, we are expecting to see a bounce in the Russell 2000 over the next several months.



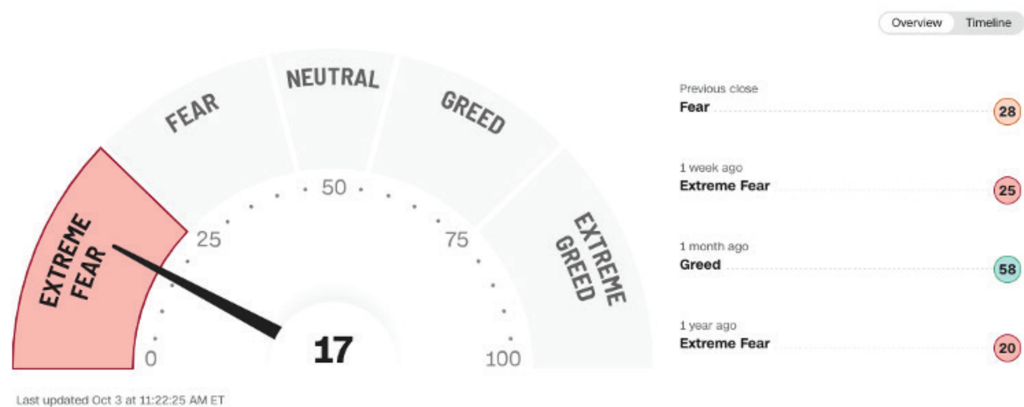
Following is a daily chart of the Russell 2000 to outline my view. Ideally, there is still a lower low to be seen in the coming week or two before the current decline completes, assuming we do not see a move through the 181/182 immediate resistance first. We believe that a lower low that holds the 170/172 region could be a good buying opportunity for a potential rally in the coming months.

What this chart offers is not only a low-risk entry point, but it also suggests that the Russell 2000 may outperform the S&P 500 on the next rally attempt.

Therefore, should we see that lower low in the coming week or two, we should be able to enter between 170-172 and set our stops at 167.46. Again, this gives us a relatively low-risk long attempt, as our stop out potential is approximately 2-3%, which is not a lot of risk to take for what could be a 15%+ potential move higher, as there is potential for the Russell 2000 to rally as high as the 213-225 region.

Taken together, we believe both the S&P 500 and Russell 2000 still suggest that we have one more rally to come in the coming months. But, clearly, if we see a breakdown below the levels of support noted for both these charts, it would open up a potentially large downside move over the coming year in the equity markets. So, we have very strict parameters for looking to the long side in the near term.

Finally, I want to revisit our bull/bear indicator. You can view the CNN Fear & Greed Index here. The current reading is 17, which is indicating Extreme Fear in the market. In other words, there are opportunities being created in areas of the market.

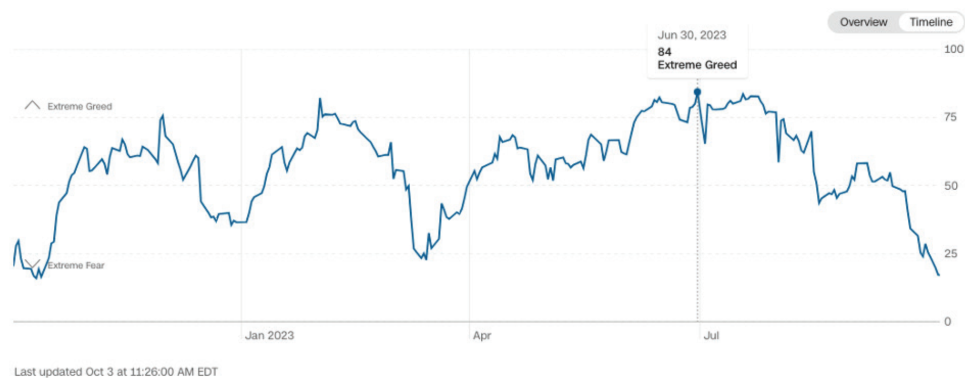


Here is a timeline showing an Extreme Greed reading of 84 in June, which was when we reached our initial objective in the S&P 500 of 4310-4375 and where we started to reduce our exposure to equities. Since then, we have continued lower in market sentiment to the current reading of 17.

And as we've seen throughout history, these moments of extreme pessimism and fear—like what we're seeing right now—make the best opportunities for investors. We saw it back in 2009, when everyone was still too spooked to buy; and yet it turned out to be the greatest buying opportunity in American history.

Of course, we saw it again in mid-2020, when COVID-19 was still casting a long shadow of pessimism over our country's economy. And we all know what happened next...stocks went on to double off their March 2020 bottom. Although we are not expecting the type of performance from the March 2020 bottom, we are still expecting better markets as we get into the remainder of this year.

This chart below shows the few times the Fear & Greed Index has approached extreme fear levels. The last time the Fear & Greed Indicator was at these levels was back in October 2022, where it reached a level of 16.



Energy is another area of opportunity we are allocating to in various areas. We will provide a separate article on the areas within energy we will be purchasing at hopefully slightly lower levels.

That said, as we begin the final quarter of 2023, we remain vigilant toward economic and market risks and are focused on managing both risk and return potential. We remain firm believers that a well-prepared, long-term-focused, and diversified financial plan can withstand virtually any market surprise and related bout of volatility, including "higher for longer" interest rates, stubbornly high inflation, geopolitical tensions, and recession risks.

We understand the risks facing both the markets and the economy, and we are committed to helping you effectively navigate this challenging investment environment. Successful investing is a marathon, not a sprint, and even intense volatility is unlikely to alter a diversified approach set up to meet your long-term investment goals.

Therefore, it's critical we stick to the plan, as we've worked with you to establish a unique, personal allocation target based on your financial position, risk tolerance, and investment timeline.

We thank you for your ongoing confidence and trust. Please rest assured that our entire team will remain dedicated to helping you accomplish your financial goals.

Please do not hesitate to contact us with any questions, comments, or to schedule a portfolio review.

Sincerely,
Matthew Gaude J. Shawn McGuire

About Matthew

Matthew Gaude is an *investment advisor representative and the co-founder of Live Oak Wealth Management, a financial services firm in Roswell, Georgia. He serves the planning and investment needs of corporate employees, those approaching or in retirement, and 401(k) plan sponsors. Working first as a commodity broker and then as a Business Development Manager for a national broker-dealer in previous jobs, he has the insight and experience to help clients understand the complexities of the market and implement strategies to minimize risk. To learn more about Matthew, connect with him on LinkedIn or visit www.liveoakwm.com.

About Shawn

Shawn McGuire is a financial advisor and the co-founder of Live Oak Wealth Management, a financial services firm in Roswell, Georgia. He serves the planning and investment needs of corporate employees, those approaching or in retirement, and 401(k) plan sponsors. He has worked in financial services since 2002 in positions ranging from financial advisor to stock broker and portfolio manager. As a CERTIFIED FINANCIAL PLANNER™ professional, he is trained to help clients with virtually all their financial needs. To learn more about Shawn, connect with him on LinkedIn or visit www.liveoakwm.com.

Live Oak Wealth Management | 10892 Crabapple Rd Suite 100 Roswell, GA 30075 | www.liveoakwm.com
P/Fax: 770.552.5968 | **matthew@liveoakwm.com | shawn@liveoakwm.com**

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