Retirement Market RECAP Q3 2023

HANYS Benefit Services

A tale of two economies

The red-hot rally experienced in the first half of the year, which eliminated most of 2022's losses, has come to a halt. With investors uneasy over nagging inflation and growing concerns over central bank policy keeping rates "higher for longer," risk sentiment appears to have come to a relative standstill. Consumer confidence appears to be waning, and the realization that interest rates could remain elevated for the foreseeable future has clearly influenced market activity. Simultaneously, growing unrest among unions, weaker consumer pockets due in part to the resumption of student loan payments and mounting credit card defaults could provide a fertile environment for volatility in the final months of the year.

While the S&P 500 fared very well in the first half of the year, gaining 16.89%, Q3 showed a stark contrast to this rally. The S&P 500 declined by 3.27%, while the tech-heavy Nasdaq had an even larger decline of 4.27%, as investors attempted to hedge duration bets. Technology companies were a notable bright spot in the first half of 2023, propped up by artificial intelligence boom beneficiaries such as Nvidia and Advanced Micro Devices. However, their long-term share price prospects could be poised to fare poorly with higher interest rates discounting the value of their future cash flows. There also appears to be a bearish trend forming around technology.

As Vildana Hajric and Cristin Flanagan of Bloomberg explain, there appear to be "growing short positions against the technology-heavy Nasdaq 100 Index. Positioning in the Nasdaq 100 is now one-sided short at $8.1 billion, with all long positions unwound, according to Citigroup Inc. strategists."[1] Continued declines in corporate earnings may push the growing short interest on technology-heavy names and indices forward.

While the high-growth technology sector could face immediate pressure, fundamentals across the broader economy also appear bearish. Corporate earnings are expected to decline for the third quarter in a row, with FactSet stating, "Estimated [earning per share (EPS)] year-over-year decline for the S&P 500 is 0.2%... For Q3 2023, 74 S&P 500 companies have issued negative EPS guidance and 42 S&P 500 companies have issued positive EPS guidance."[2]

This dim outlook appears to be shared by the American consumer. In September, U.S. consumer confidence dropped for the second straight month to a four-month low, declining to 103.0 from the upwardly revised 108.7 in August. The index provides a snapshot of how the average American feels about the economy's prospects. While declines with major indices were not severe in Q3, two years of higher inflation has created a more anxious consumer.

As Dana Peterson, chief economist at the Conference Board, explains: "Write-in responses showed consumers continued to be preoccupied with rising prices in general, and for groceries and gasoline in particular. Consumers also expressed concerns over the political situation and higher interest rates. The decline in consumer confidence was evident across all age groups, and notably among consumers with household incomes of $50,000 or more."[3] Consumer confidence may continue to wane in the coming months, with student loan payments resuming for the first time in three years and worker strike shortages becoming more pronounced.

Fixed income struggled in Q3 after experiencing a gain of 2.09% in the first half of the year. The growing expectation rates will remain high and the possibility of a government shutdown led to a major bond market selloff as the yield on the 10-year U.S. Treasury reached 4.80% in late September. Global bonds also struggled in September, experiencing their worst month in a year, with a drop of 2.92%. The risk-off sentiment in equity and fixed income markets has benefited the U.S. dollar, which gained 3.16% in Q3 as investors continue to flock to safe-haven assets as a policy of "higher for longer" becomes a more likely outcome of the Federal Reserve's (The Fed) hiking cycle.

CONTINUED

[1] Hajric, Vildana and Flanagan, Cristin. "Stocks Sink as Bears Take Charge, Dollar Rallies: Markets Wrap." *Bloomberg*. Sept. 25, 2023. Web.

[2] Butters, John. "Earnings Insight." *FactSet*. Sept. 22, 2023. Web.

[3] "US Consumer Confidence Fell Again in September." *The Conference Board*. Sept 26, 2023. Web.

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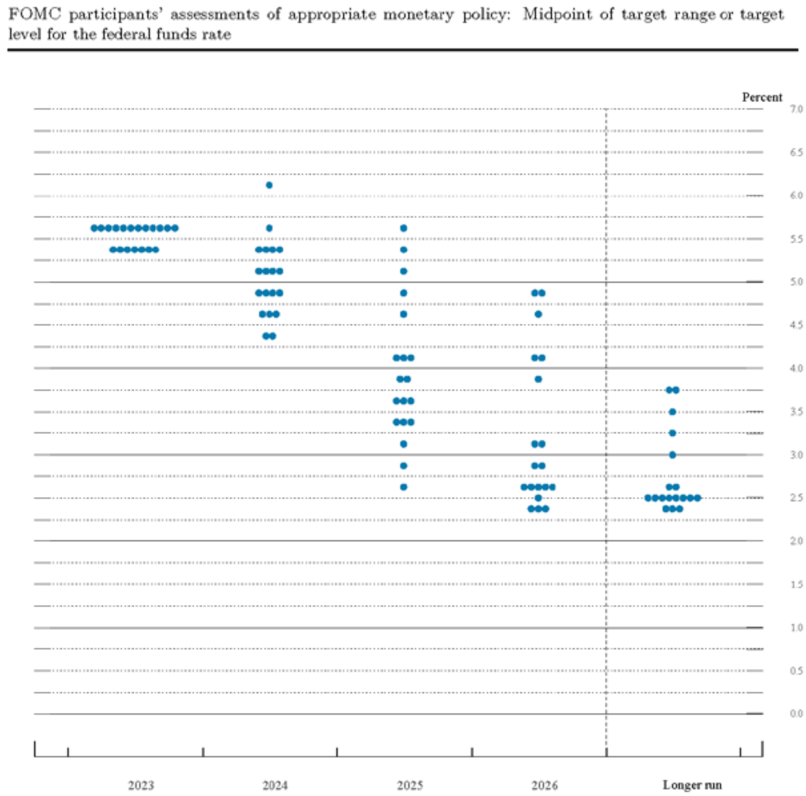
While the first half of 2023 saw strong equity market gains reminiscent of 2021, it appears the second half is shaping up to be much more volatile — possibly creating a "tale of two economies." All eyes will continue to be on the Fed and other central banks, with expectations of one more rate hike this year. The prospect of holding this terminal rate for longer than previously expected (see chart)[4] is discomforting for both investors and consumers. Given the lagging effect tight monetary policy has on an economy, the full effects of keeping rates high in the near-term has yet to be seen. While many economists have referenced a "soft landing" or "Goldilocks" narrative, one in which inflation declines to a normalized level without an economic downturn, the current positioning of interest rate hikes may be merely delaying this downturn rather than averting it. The final months of 2023 should provide a clearer picture of where both the economy and the Fed stand in the fight against inflation.



[4] Federal Open Market Committee. Board of Governors of the Federal Reserve System. Sept. 20, 2023. Press Release, page 4. Web.

EQUITY AND RETIREMENT INDICES	3 MO	YTD	1 YR	3 YR	5 YR	10 YR
S&P 500 TR USD	-3.27%	13.07%	21.62%	10.15%	9.92%	11.91%
Russell 3000 TR USD (Broad Market)	-3.25%	12.39%	20.46%	9.38%	9.14%	11.28%
Russell 1000 TR USD (Large Cap)	-3.15%	13.01%	21.19%	9.53%	9.63%	11.63%
Russell Midcap TR USD	-4.68%	3.91%	13.45%	8.09%	6.38%	8.98%
Russell 2000 TR USD (Small Cap)	-5.13%	2.54%	8.93%	7.16%	2.40%	6.65%
MSCI EAFE NR USD (Int'l Equity)	-4.11%	7.08%	25.65%	5.75%	3.24%	3.82%
MSCI Emerging Markets NR USD (E.M. Equity)	-2.93%	1.82%	11.70%	-1.73%	0.55%	2.07%
S&P United States REIT TR USD (Real Estate)	-7.02%	-1.95%	3.21%	5.76%	2.77%	5.84%
Morningstar Lifetime Mod. TR 2020	-3.70%	2.25%	8.71%	0.22%	3.09%	4.55%
Morningstar Lifetime Mod. TR 2040	-3.95%	4.91%	14.88%	4.59%	4.57%	6.57%

FIXED INCOME INDICES	3 MO	YTD	1 YR	3 YR	5 YR	10 YR
ICE BofA 3M US Trsy Note TR USD	1.25%	3.62%	4.55%	1.73%	1.76%	1.14%
ICE BofA 1-3YR US Trsy TR USD	0.74%	1.72%	2.47%	-0.84%	1.06%	0.81%
BBgBarclays Long Term US Trsy TR USD	-11.83%	-8.55%	-9.09%	-15.73%	-2.78%	0.75%
BBgBarclays US Aggregate Bond TR USD	-3.23%	-1.21%	0.64%	-5.21%	0.10%	1.13%
BBgBarclays US Treasury US TIPS TR USD	0.43%	1.92%	3.24%	1.90%	2.80%	1.71%
BBgBarclays High Yield Corp TR USD	0.46%	5.86%	10.28%	1.76%	2.96%	4.24%
BBgBarclays Global Aggregate TR USD (Global Bond)	-3.59%	-2.21%	2.24%	-6.93%	-1.62%	-0.44%

ICE BofAML – Intercontinental Exchange Bank of America Merrill Lynch; BBgBarc – Bloomberg Barclays; S&P 500 – Standard & Poors; MSCI – Morgan Stanley Capital International.
Sources: Morningstar as of Sept. 30, 2023

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