MARKET COMMENTARY:

THE FALL…. IS IT A SEASON OR A MARKET STORY?

‘*Predicting is very difficult, especially if it’s about the future.’*
Niels Bohr (1885-1962), a Danish physicist/philosopher and recipient of Nobel Prize in Physics

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The Fall is typically an exciting fun time of the year for baseball and football fans. For investors in 2023, not so much...so far anyway.

The recent stock market decline was not entirely surprising given that (i) the month of September has historically been the worst month for the stock market- sometimes called September Effect, and (ii) July and August were good months for the U.S. stock market. <u>The very simple reason markets have decreased recently is that market interest rates have been going up</u>. Back on April 5th 2023, the most widely followed indicator of market interest rates, namely the U.S. government’s 10-year Treasury yield was at 3.27%. In late July, that yield was hovering between 3.75% and 4%. This increase had begun to hurt the fixed income/bond market but was not enough yet to really catch the attention of stock market participants. But an increase in that yield from 3.75% on July 19th to 4.80% on October 3rd was very noticeable, quick and significant in relative terms. It definitely unsettled both the stock market and the fixed income/bond market.

The September Effect referenced above was probably exacerbated by big money traders coming back from their vacations and zeroing in on the higher rates that were likely to harm the economy and the realization that rates were not coming down anytime soon. In a somewhat predictable fashion, initial selling by some traders cascaded into additional selling by other traders, etc… It is hard to predict when this domino effect will end, but it will eventually end since sellers get exhausted, and the selling becomes overdone. Not helping matters is the fact that the U.S. federal government has been selling bonds in order to help finance its debt. The U.S. central bank has also been a net seller of bonds as it unwinds the purchases it did during COVID times. And let’s add China and Japan to the list of bond sellers.

Bottom line: increased supply and reduced demand for bonds have led to an increase in the yields on U.S. government bonds. This might sound boring, but I believe it is the main culprit behind the recent market decline.

Furthermore, let us not forget the efforts by the major government central banks to tame inflation. My personal opinion is that the central banks have dramatically increased their rates, kept them high, and may even increase them a bit more because the <u>central banks would rather be accused of doing too much than too little to fight inflation</u>. So while I believe today’s high rates are hurting most businesses and borrowers, I also think we are now somewhat paying the price for fiscal and monetary policies that, in hindsight, may have been too generous during COVID times.

Investors might now be asking: When will markets turn around? And how will diversified portfolios fare over the next year-and-a-half?

On a very short-term basis, it is difficult to predict (hence the quote at the beginning) the peak for market interest rates, which might also coincide with the low for the markets. That peak in market rates may turn out to be an excellent time to increase one's exposure to risk assets. The likely eventual sequence of events will probably start with data showing a greater-than-expected decline in inflation / leading to lower rates / leading to an increase in bond and stock prices. This sequence of events could take time to play itself out. But it could also happen over a very short period of time. For this reason and many others, most investors should stay fully invested - using an asset mix that matches their investor profile.

<u>I believe diversified portfolios will do well over the next 18 months for two important reasons.</u>

First, over the past 12 years or so, the fixed income/bond part of a diversified investment portfolio was not a significant contributor to overall returns because rates were low, and have been increasing over the past two years. In fact, this portion of the portfolio likely had a negative impact on performance over the past two years. But today's higher rates should help investors earn higher returns - assuming we do not see significant rate increases from here. And an eventual decrease in rates might also increase bond prices, further adding to overall returns for fixed income/ bonds.

Secondly, stocks should benefit from an increase in corporate profits in 2024 along with an eventual decrease in rates. In the long-run, stock prices are mainly influenced by corporate profits, and by both the level and direction of market interest rates. I believe that in one year from now, all of these factors will turn into positive tailwinds for the stock market.

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<u>Insights/Opinions from Experts</u>

In this section, as I often do, I would now like to <u>offer recent quotes/insights/observations from respected market experts</u> that hopefully provide useful perspective during these very uncertain times.

'Rates are back to normal...back to levels before the Great Financial Crisis…The economy on balance is showing itself to be resilient…We are however in a rolling recession…We have excess savings...Things are getting better profit wise for public companies…The economy will be growing next year…real wages will be growing…Productivity will improve…'
Source: Ed Yardeni, Yardeni Research president, CNBC, October 2, 2023

'October is the month of 'bottoms…. somewhere in October, we are going to get a bottom. '
Source: Art Cashin, UBS Financial Services, Floor Director, CNBC, October 2, 2023

'*Bank of America strategist Ritesh Samadhiya noted that since 1950, there have been 15 instances in which the <u>S&P 500</u> rallied more than 15% through July and then dropped an average 8% between August and September.The good news? The broader market index typically rebounds following such sell-offs, averaging a gain of 5% between October and December, the bank said.'*

Source: History shows a September stock sell-off typically begets a fourth-quarter rally, CNBC, September 28, 2023

'Canada's near-term economic struggles will ease next year when growth returns and the Bank of Canada begins cutting its key lending rate, a new forecast from Deloitte Canada said.'
Source: BNN Bloomberg, The Canadian Press, Ritika Dubey, September 28, 2023

'People who tell me bonds are as good as stocks. NO WAY …. when talking about long-term wealth creation.'
Source: Jeremy Siegel, University of Pennsylvania's Wharton School Professor of Finance, CNBC, August 21, 2023

AND FINALLY, A LENGTHY QUOTE THAT OFFERS AN EXCELLENT LONG-TERM PERSPECTIVE
'HISAs (high-interest savings account) have lower expected returns than stocks, even when HISA rates are high. If we take a sample of five-year rolling returns from 1900 through 2022, we see that when short-term rates have been high, stock returns have followed suit …
Looking at historical data from around the world for 38 countries, the estimated probability of losing purchasing power in investments such as HISA funds is about 37% at a 30-year time horizon compared with 13% for domestic stocks and 4% for international stocks.
HISA yields are high right now, and I know this has a lot of people wondering why they would bother investing in stocks, but a HISA has a low unpredictable expected return, leaves you exposed to the risk of falling rates over the long term and it has a lower expected return than stocks in all rate environments. Taken together, HISAs are arguably a riskier long-term investment than stocks even when rates are high – a statement strongly supported by historical data around the world. Long-term investors are best served maintaining exposure to their target asset allocation rather than being enticed by current HISA rates to make tactical changes'.'
Source: Benjamin Felix, PWL Capital, CFP, CFA, (opinion piece) The Globe and Mail, September 15, 2023

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Should you have any questions or concerns, please feel free to reach out. And as always, we encourage you to contact us if there has been an important change in your financial situation.

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October 6, 2023