D|A DAVIDSON
WEALTH MANAGEMENT

The Weekly Market Update – 8/14/23: Elevated Interest Rates Weigh on Equities

Major Indices (Price Returns)	Close	Last Week	Quarter-to-Date	Year-to-Date	Trailing 12-Months	All-Time High	% to High
S&P 500	4,464.05	-0.31%	0.31%	16.27%	8.08%	4,796.56	7.4%
Dow Jones Industrial Average	35,281.40	0.62%	2.54%	6.44%	7.42%	36,799.65	4.3%
NASDAQ Composite	13,644.85	-1.90%	-1.04%	30.37%	10.12%	16,057.44	17.7%
Russell 2000	1,925.11	-1.65%	1.93%	9.30%	2.12%	2,442.74	26.9%
MSCI EAFE (USD)	2,129.23	-0.65%	-0.12%	9.53%	9.91%	2,398.71	12.7%
MSCI Emerging Markets (USD)	997.72	-1.99%	0.83%	4.32%	0.40%	1,444.93	44.8%
Bloomberg Commodity Index	105.59	-0.33%	4.05%	-6.40%	-13.33%	237.95	125.4%
Barclays U.S. Aggregate Bond	88.22	-0.67%	-1.75%	-0.74%	-6.90%	112.07	27.0%

Source: FactSet

Since trending higher in the second quarter, U.S. Treasury yields (interest rates) have remained elevated. This has coincided with a modest decline in major equity indices over the first two weeks of August. A few weeks back (on 7/26/23), the U.S. Federal Reserve Bank (Fed) raised its short-term (overnight) bank lending interest rate target range by 25 bp to 5.25% to 5.50%, where it sits today. Although the Fed resumed hiking rates after pausing (no hike) at its June meeting, we believe that July was likely the last Fed rate increase in this cycle. Despite this expectation, market-driven interest rates remain near 2023 highs as investors consider a “higher interest rates-for-longer” scenario. The U.S. 2-year Treasury note, a widely followed proxy for short-term interest rates, traded at a yield of 4.94%, near the highest level of 2023 (in early July) of 5.01%. We attribute multiple factors to keeping yields near 5.0%, led by a view that the Fed will follow-up on its commitment to keep its fed funds target at a restrictive level (higher) to guard against a resurgence in inflation. Speaking of inflation, despite the July consumer price index (CPI, a measure of consumer inflation reported by the Bureau of Labor Statistics) reflecting inflation of 3.2% year-over-year (Y/Y) compared to 6.4% Y/Y in January, the core CPI (which excludes food and energy prices) was +4.7% Y/Y, suggesting that reaching the Fed’s 2.0% inflation target will take time. In addition, due to ongoing U.S. federal budget deficits and debt issuance delays earlier this year during Congressional debt limit negotiations, the U.S. Treasury increased its planned issuance of new Treasury securities, including $103 billion at various maturities that were priced last week. The Treasury expects 3Q23 borrowing to exceed $1.0 trillion. As the supply of new Treasury bonds increases, we expect modest upward pressure on interest rates, which might already be built into expectations. As interest rates remain elevated, equity markets have moved lower in August; through 8/11/23, the S&P 500 and Nasdaq Composite indices had month-to-date declines of -2.7% and -4.9%, respectively. We continue to expect higher market volatility in the second half of 2023 compared to the first half, and interest rates remaining higher than expected creates valuation uncertainty (the present value of future cash flows is lower as interest rates move higher).

Earnings season winds down with earnings lower Y/Y, but modestly better than expected. Through early Monday, 8/14/23, 91% of S&P 500 constituents had reported financial results for the second calendar quarter of 2023. According to FactSet, reported earnings were down -6.4%, modestly better than -7.4% estimated as of 6/30/23. While the percentage decline is larger than -2.0% in 1Q23, more companies have exceeded estimates than the average over the past five years. In addition, large earnings declines in the Energy sector due to higher oil prices one year ago have masked better underlying earnings than the headlines suggest. Excluding the Energy sector, S&P 500 2Q23 earnings have increased 0.3%. With the earnings reporting season nearly complete, full-year 2023 estimates have trended higher (modestly) for the first time this year. In 3Q23, earnings growth is expected to resume following three quarters of declines. Despite lower earnings, however, the Energy sector has led market gains in August.

Key economic data is scheduled this week, providing light on economic growth trends. July retail sales (consumer trends), housing starts (homebuilding investment), and industrial production (manufacturing) will provide diverse data on the pace of U.S. economic growth, which exceeded expectations in the first half of 2023. While the FactSet consensus for U.S. 3Q23 growth in gross domestic product (GDP) is 0.7%, the July data so far has trended higher.

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Please refer to page 2 of this report for detailed disclosure information.

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