The Weekly Market Update – 10/23/23: October Weakness Extends Equity Pullback

Major Indices (Price Returns)	Close	Last Week	Quarter-to-Date	Year-to-Date	Trailing 12-Months	All-Time High	% to High
S&P 500	4,224.16	-2.39%	-1.49%	10.02%	17.81%	4,796.56	13.6%
Dow Jones Industrial Average	33,127.28	-1.61%	-1.13%	-0.06%	15.32%	36,799.65	11.1%
NASDAQ Composite	12,983.81	-3.16%	-1.78%	24.05%	22.77%	16,057.44	23.7%
Russell 2000	1,680.79	-2.26%	-5.84%	-4.57%	0.97%	2,442.74	45.3%
MSCI EAFE (USD)	1,960.40	-2.60%	-3.49%	0.85%	17.99%	2,398.71	22.4%
MSCI Emerging Markets (USD)	925.58	-2.70%	-2.85%	-3.22%	5.69%	1,444.93	56.1%
Bloomberg Commodity Index	105.82	0.50%	0.93%	-6.20%	-5.09%	237.95	124.9%
Barclays U.S. Aggregate Bond	84.51	-1.72%	-2.10%	-4.91%	-3.65%	112.07	32.6%

Source: FactSet

Equity markets turned cautious last week, driving major indices lower in October. Following three days of declines, the widely followed, large-company S&P 500 equity index dropped -2.4% last week (ended 10/20/23), which was notable as it reversed two weeks of gains to begin October. Through 10/20/23, the S&P 500 decreased -1.5% month-to-date, adding to index declines in August and September. Since 7/31/23 (the date of the highest closing price of 2023), the S&P 500 declined -8.0% (not including dividends). Factors contributing to recent equity market caution include a "wait-and-see" position on S&P 500 third quarter (3Q23) earnings reports (expected to turn positive on a year-over-year, Y/Y, basis for the first time in four quarters), ongoing rhetoric from the U.S. Federal Reserve Bank indicating that inflation remains above long-term targets, and geopolitical uncertainty (due to the global response to the terror attacks in Israel and dysfunction in the U.S. Congress). But the larger issue creating market weakness, in our opinion, is the continued rise in long-term interest rates as measured by the yield on U.S. 10-year Treasury bonds. The 10-year yield traded above 5.00% on 10/19/23, before closing at 4.99%. Not only was this the highest closing yield of 2023, but the highest since July 2007 (16 years). On 7/31/23, the 10-year Treasury yield was 3.95%. The S&P 500 pullback since that date correlates with the rise in long-term interest rates. While the rate increase can be partially attributed to better-than-expected economic data in recent months, other factors include ongoing U.S. budget deficits causing increased supply of U.S. Treasury debt issuance. The higher rates create challenges for equity valuations (the present value of future cash flows is lower as rates move higher), but also pressure economic growth potential as higher interest expense can weigh on consumer spending, corporate earnings, and government outlays. We see the potential for near-term equity market weakness to abate if the recent surge in interest rates reverses and/or 3Q23 earnings reports exceed expectations.

Nearly one-third of S&P 500 constituents are scheduled to report 3Q23 financial results this week. As of Friday, 10/20/23, just 17% of the S&P 500 had reported earnings, but that will change this week as 159 index companies will report. While the early trend of results has reflected revenue and earnings growth of +5.8% and +4.9%, respectively, the blended FactSet estimate (from Wall Street analysts), which combines already reported results with remaining unreported estimates, sits at +1.5% and -0.7%, respectively. This suggests that for overall earnings growth to turn positive in the quarter, better-than-expected reported results over the next several weeks are needed. On a sector basis (using the 11 MSCI Global Industry Classification Standard, GICS, sectors), eight of the 11 sectors are expected to show Y/Y earnings growth. Excluding Energy and Health Care, 3Q23 estimated earnings growth is +7.0%. In addition, through 10/20/23, just 8% of Information Technology (the largest sector comprising 27.8% of the S&P 500 market value) had reported 3Q23 results. Many of the largest companies by market capitalization will report financial results this week.

The first look at 3Q23 gross domestic product (GDP) growth is due Thursday. The FactSet consensus for GDP (the value of goods and services produced, as measured by the Bureau of Economic Analysis) growth has surged to +3.7%. As recently as 8/31/23, the consensus estimate was just +0.9%, but healthy consumer data in September (retail sales and jobs growth) revealed stronger trends. We expect the data to show growth in consumer spending, business investment, housing construction, and government spending. Despite positive recent trends, expectations for 4Q23 remain muted.

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