The Weekly Market Update – 10/30/23: S&P 500 Pullback From Highs Deepens

Major Indices (Price Returns)	Close	Last Week	Quarter-to-Date	Year-to-Date	Trailing 12-Months	All-Time High	% to High
S&P 500	4,117.37	-2.53%	-3.98%	7.24%	14.83%	4,796.56	16.5%
Dow Jones Industrial Average	32,417.59	-2.14%	-3.25%	-2.20%	12.85%	36,799.65	13.5%
NASDAQ Composite	12,643.01	-2.62%	-4.36%	20.80%	19.55%	16,057.44	27.0%
Russell 2000	1,636.94	-2.61%	-8.30%	-7.06%	-1.67%	2,442.74	49.2%
MSCI EAFE (USD)	1,945.35	-0.77%	-4.23%	0.07%	17.09%	2,398.71	23.3%
MSCI Emerging Markets (USD)	919.78	-0.63%	-3.46%	-3.83%	5.02%	1,444.93	57.1%
Bloomberg Commodity Index	105.63	-0.18%	0.75%	-6.36%	-5.25%	237.95	125.3%
Barclays U.S. Aggregate Bond	85.04	0.62%	-1.49%	-4.32%	-3.04%	112.07	31.8%

Source: FactSet

The widely followed, large-company S&P 500 equity index closed Friday, 10/27/23, down -10.3% from its 2023 high (on 7/31). With two days remaining in October, the index had decreased -4.0% for the month and a monthly decline would extend a 3-month drop following monthly gains from March through July 2023. We attribute equity market weakness since July to higher long-term interest rates (as measured by the yield on the U.S. 10-year Treasury bond). The 10-year Treasury yield moved to 4.99% on 10/19/23, up from 3.95% on 7/31/23, raising concern that as borrowing rates adjust, higher interest expense can constrain consumer spending, corporate earnings, and government expenditures. For the week ended 10/27/23, however, stocks declined (the S&P 500 decreased -2.5%) despite lower long-term interest rates (the 10-year Treasury yield was 4.83% on Friday), better-than-expected third quarter (3Q23) earnings reports, and strong data on U.S. 3Q23 economic growth. As of 10/30/23, 50% of S&P 500 constituents had reported 3Q23 financial results; reported earnings were up +6.5% (according to FactSet), trending above the -0.5% estimate as of 9/30/23. The revised estimate (which incorporates already reported earnings with those still to report) is now +2.4%, indicating expected year-over-year (Y/Y) earnings growth after lower S&P 500 earnings for the three prior quarters. In addition, U.S. gross domestic product (GDP), which reflects the value of goods and services produced as reported by the Bureau of Economic Analysis (BEA), increased +4.9% in 3Q23, outpacing FactSet consensus estimates. Despite this series of perceived good news, equity indices moved lower, indicating to us that other factors have contributed to elevated negative investor sentiment. This includes heightened geopolitical concerns as wars in Israel and Ukraine continue, as well as ongoing U.S. budget deficits that create the need for higher debt issuance by the U.S. Treasury. We continue to see the potential for U.S. equities to rally from recent lows in the fourth quarter, but remain cautious as we look to 2024 due to expected slowing growth and tightening credit conditions.

3Q23 U.S. GDP growth was paced by consumer spending, housing investment, government outlays, and higher inventories. Real GDP growth of +4.9% (annualized rate from the prior quarter, adjusted for inflation) was the highest growth rate in eight quarters (since 4Q21) and outpaced the +3.8% FactSet consensus estimate. Consumer spending, which comprises 69% of real GDP, contributed 2.69% to the 4.9% total number, also its strongest contribution to economic growth in eight quarters. While housing investment remained weak by historical standards, it recovered from nine consecutive negative quarters, and added 0.15% to the GDP growth. Further strength came from government spending (added 0.79%) and the quarterly inventory adjustment (added 1.32%). We expect growth to moderate from these levels as consumer spending strength appears partially driven by credit, and rising inventory is likely to retreat at some point. But recession (a steep decline in economic activity) signals are not evident either, at least for late 2023 and early 2024. The 4Q23 FactSet consensus GDP estimate is +0.6%.

Another heavy schedule of S&P 500 earnings this week (162 constituents scheduled to report) will be overshadowed by the U.S. Federal Reserve Bank's (Fed) November meeting. Despite strong economic growth trends in the third quarter, we expect the Fed to hold its overnight bank lending fed funds interest rate target unchanged at 5.25% to 5.50% when its Open Market Committee meets for the 7th time in 2023 this week. We expect the Fed to say that rates should remain high to fight inflation, but to also discuss economic headwinds created by higher long-term interest rates.

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