Week in Review

Equity Markets:

The S&P finished the week -1.6%, despite the 4%+ intraday swing in the S&P on Thursday. Following the higher-than-expected CPI report, the futures market took a significant swing downward, only to end the day significantly in the green. Inflation has remained higher than expected all year and the market's initial reaction was a sell-off.

Earnings season really kicked off this past week with some of the major banks reporting on Friday. There were mixed results, but earnings calls revealed that further economic slowdown is a heavy consideration for them. So far, approximately 7% of S&P companies have reported. 69% have beaten earnings expectations. This is below the 5-year average of 77%, according to FactSet data. Also, companies that have beaten earnings have only beaten expectations by 0.1%. This is well below the 5-year average of 8.7%. Depressed earnings are likely to continue and if the trend continues, the earnings growth rate will be the lowest since the pandemic period.

Fixed Income Markets:

The 10-year treasury ended the week slightly above 4% on the heels of Thursday's inflation report. An important yield spread tightened significantly on Thursday before returning to ~0.25%. Many financial commentators focus on the 2-year/10-year spread, but academics prefer the significance of the 3-month/10-year spread. When this portion of the yield curve inverts, the statistical significance of predicting recessions increases greatly. This spread, intra-day following the CPI report, was lower than 0.2%.

Economic:

Inflation was the headline for the past week with September's PPI and CPI reports. CPI came in at 8.2% year-over-year. On a monthly basis, CPI was higher than anticipated by 0.1%. Inflation appears to have peaked but is dissipating much slower than most are comfortable with. Despite moderation in broad inflation, core inflation (which excludes food and energy) has continued to rise. Core CPI rose 0.6% compared to the Dow Jones estimate of 0.4%. Components of core CPI have historically been more difficult to control. Food and energy prices encompass factors that are out of policy control. Inflation and fiscal policy have been major movers of the market. A key point to watch will be the core number. This factor will likely be a key point for a policy pivot point.

Looking Ahead

Equity Markets:

Bad news has been priced in, but the real question is how much has been priced in? That question is nearly impossible to answer. As long-term investors, we have to absorb the information that has been put in front of us. What we do know is that assets are selling at a 25%+ discount to what they were nine months ago, bond yields are as attractive as they have been in over a decade, and at a minimum, we are seeing an economic slowdown.

As an investor, this is the type of period that will test your resolve. Investors are experiencing a bear market in fixed income not seen in decades, in the midst of what feels like a never-ending equity bear market. But markets have a tendency to revert to an average. So far, there are only a few 100% truths in the market. They go up and down in the short run but over the long term, they go up. Historically this has held true. A popular Warren Buffet quote keeps repeating in our heads:

"Be fearful when others are greedy and greedy when others are fearful".

In an environment where nothing seems to work, it is likely very opportunistic from a long-term perspective, as bottoms are impossible to predict. We are not saying the bottom is in, but we do believe that equities are selling at a discount if an investor can ride out the volatility and wait for prices to normalize.

Fixed Income Markets:

The 10-year closing above 4% is a welcomed sight for fixed-income investors but high yields have weighed on equity markets. We believe we are nearing, if we have not already seen, the high end of the current rate cycle. With the current rate structure, we believe we are better buyers of bonds than sellers. Our view is that secular deflationary pressures remain. This includes demographics, disruptive technology, and debt. As long as these remain, we believe we will see rates trend back lower.

Economic:

Housing will be the focus this week after consecutive months of the market cooling. We will see readings from the NAHB Housing Market Index, new home starts and permits, existing home sales, and mortgage applications.

Other notable reports this week are the Leading Economic Indicators Index and the Fed's Beige Book. We will also see regional manufacturing reports from New York and Philadelphia.

**** *See Important Disclosures on following page*

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