Weekly market wrap

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‹ Weekly market wrap

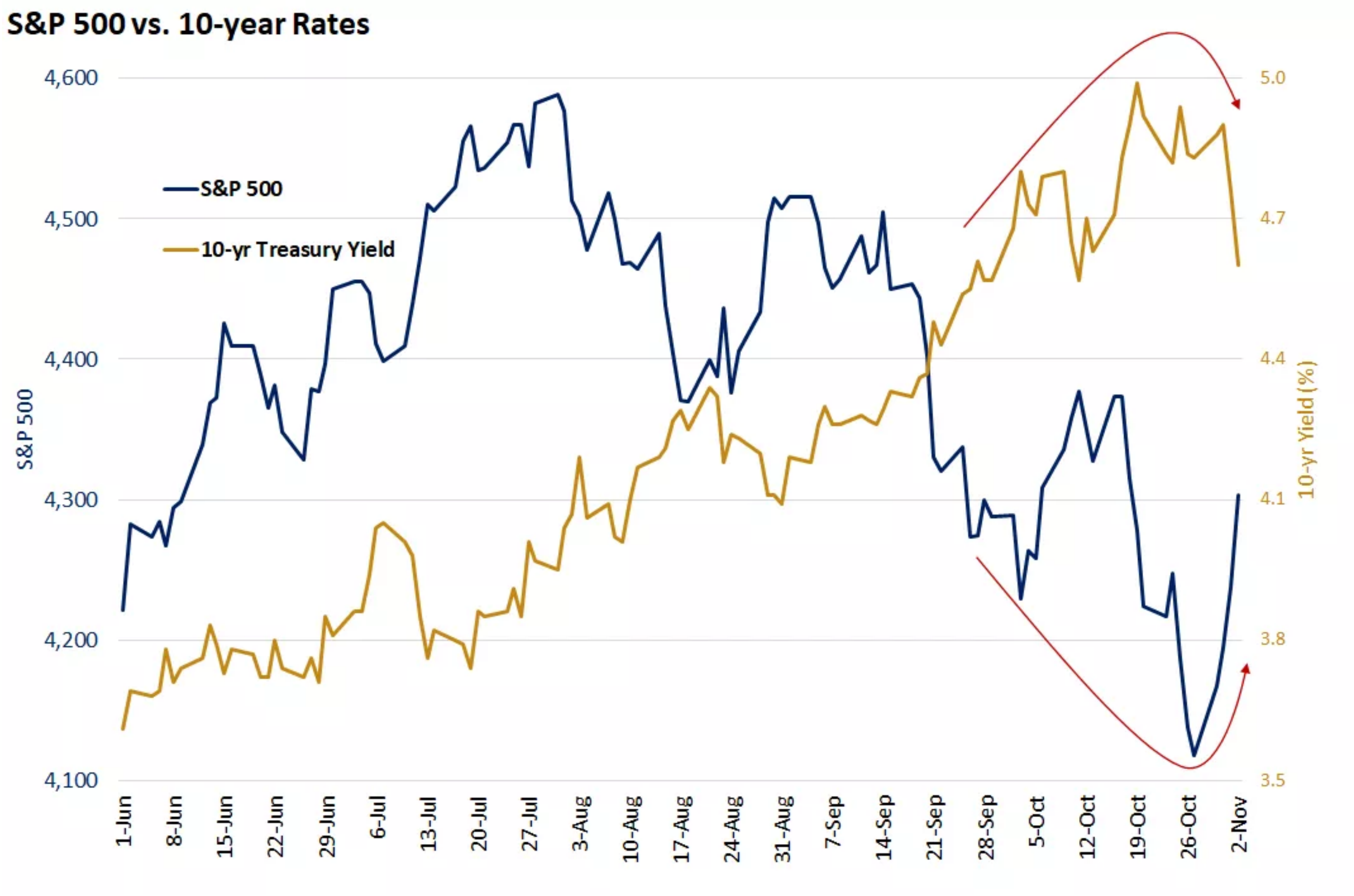
Good Start to a Big Finish?

Key takeaways:

- Stocks rallied sharply last week, as economic data and Fed commentary spurred a decline in interest rates.
- The outlook for monetary policy remains firmly behind the wheel for financial markets. The Fed held rates steady at its meeting last week (as expected), but it struck a more balanced tone around its outlook for upcoming rate decisions, which we think supports our view that the Fed rate-hiking cycle can be complete.
- The latest employment report further supported optimism that the Fed can move to the sidelines, with labor-market conditions cooling enough to help inflation continue its trend lower, while remaining sufficiently healthy to support the consumer and avoid a more severe recession.
- We doubt it will be smooth sailing from here, but with markets having gone through a corrective phase over the last few months, and with economic data supporting an outlook for both ongoing growth and a Fed that can remain on pause for a while, as well as a seasonally favorable period for equities, we think there is a compelling case for markets to find some momentum as we close out 2023 and turn the page to 2024.

Halloween decorations were replaced by Starbucks' beloved holiday cups last week, an annual shift that ushers in the holiday shopping season. Another shift transpired as well, with the recent surge in interest rates giving way to a notable pullback in yields that cleared the path for a healthy (and welcome) rally in the stock market.

Equities rallied sharply on the back of falling rates last week.



Source: FactSet. S&P 500 index and U.S. 10-year Treasury yield.

Chart description

The catalysts for last week's shift were

- a Fed meeting that produced another pause in the policy rate, accompanied by commentary that suggests policymakers aren't convinced more rate hikes are preordained;
- Fresh data offering additional evidence that the economy is cooling enough to bring down inflation, but not so much that a material downturn is imminent or inevitable; and
- Earnings announcements that have generally come in "better than feared," signaling some hope that corporate profits can hold up despite macroeconomic headwinds.

Stocks have been under pressure for much of the last two months, as resurgent rates soured the market's mood. We're not surprised by last week's turn, as we've noted in our last several Weekly Market Wraps that 1) the recent jump in rates looked to be driven by more temporary factors ("higher for longer" message and Treasury bond issuance) versus a structural change in the inflation outlook, and 2) a peak and pullback in 10-year yields would be the spark needed to provide footing for the stock market.

We don't think we've seen the last of interest-rate worries spooking equities, but we continue to hold the view that the recent market correction was more of a compelling opportunity than the beginning of something more sinister or prolonged. While we can't set our watch to a year-end market rally in the same way we can for holiday decorations and that "all I want for Christmas…" tune that will soon be on loop in our heads, we do think there is a credible case for both stocks and bonds to round out the year on a more favorable path than we experienced through September and October.

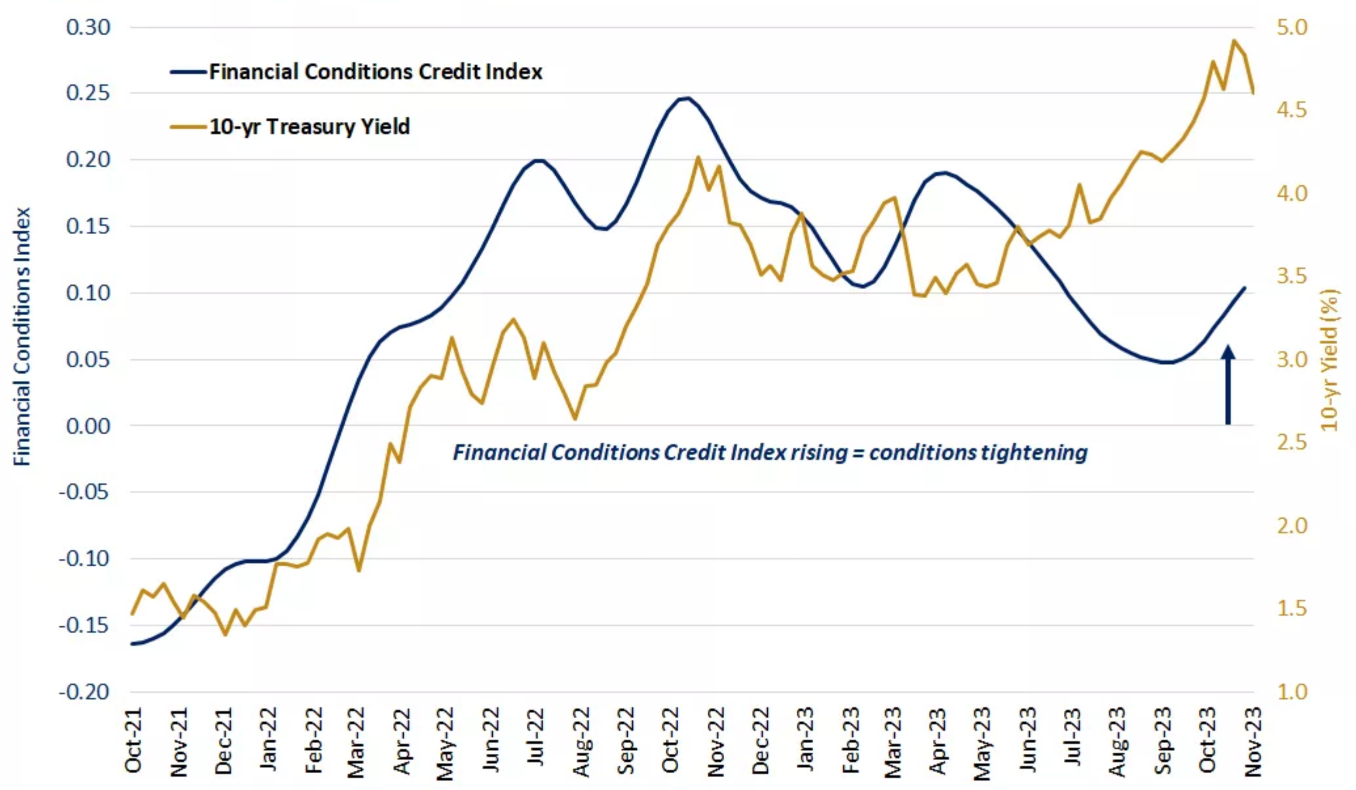
What's the recipe for a rally?

The latest Fed meeting and jobs report were the headliners last week, each offering something for this market, which is eager for any evidence that monetary policy will not have to get more restrictive ahead. We doubt the steepness of last week's move higher in stocks or move lower in rates will proceed uninterrupted, but we don't think the positive trend has a one-week shelf life either. For markets to mount a durable rally, we think the following ingredients will be important:

- **Bond yields need to avoid another surge higher.** After topping 5% just a handful of days ago, 10-year Treasury yields dropped materially last week, falling below 4.6%, arresting the primary headwind to stocks of late. We don't think a repeat of the drop in rates is the only way for equities to maintain strength, but a round trip back toward 5% would not be helpful. At the same time, as odd as it may sound given rising rates have been the source of downward pressure on stock prices, it may also not be particularly favorable for longer-term interest rates to fall sharply from here in the near term. The increase in rates has helped tighten financial conditions recently, effectively doing the Fed's tightening for it and strengthening the case that the Fed won't need to raise rates further from here. We think some stability in yields for the time being would be a positive influence on upcoming equity-market performance.

Higher rates have tightened financial conditions and helped the Fed's efforts to fight inflation.

Financial Conditions and 10-yr Rates



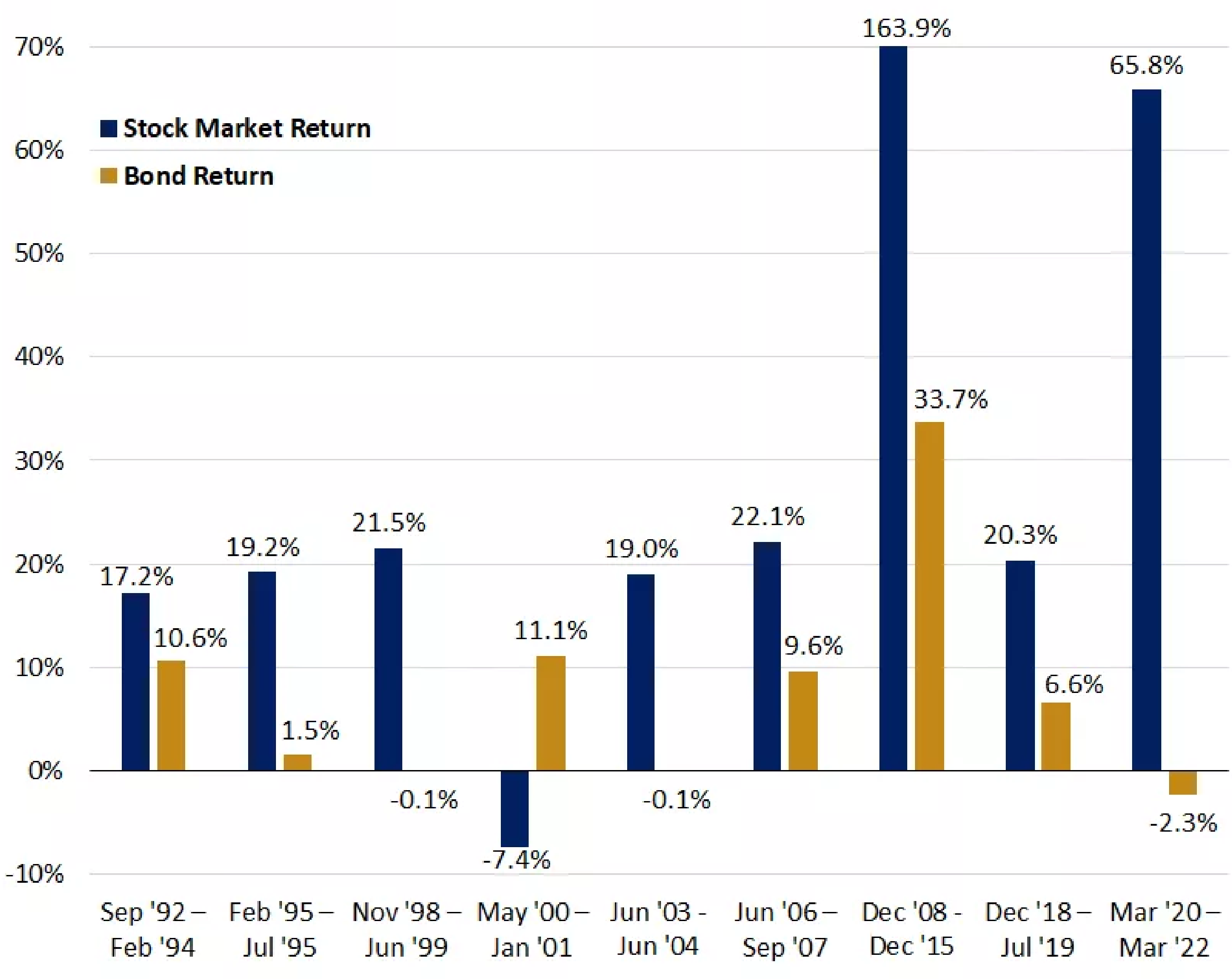
Source: Chicago Fed Financial Conditions Credit subindex, FactSet.

Chart description

- **The Fed needs to remain on the sidelines.** Last week's Fed meeting provided the primary fuel source for stock- and bond-market gains. The policy rate (fed funds rate) was held steady for the second straight meeting, with Chair Powell striking a more balanced tone around future policy decisions. In our view, there is a sufficient case for the Fed to be done with rate hikes. However, we expect Fed officials to continue to use commentary that emphasizes their willingness to hike further as a way of preventing markets and financial conditions from getting too far ahead of themselves in anticipating looser policy ahead. We think the continuation of this equity bull market will ultimately become more tethered to the outlook for rate cuts (which we don't expect until later in 2024). But for now, confidence that the Fed can remain on pause will be a key element of support for financial markets. Over the last 30 years, periods in which the Fed has kept its policy rate unchanged have largely been accompanied by strong gains in both stocks and bonds.

Markets have typically performed well when the Fed was on the sidelines.

Stock and Bond Market Returns During Fed Rate Pause Periods

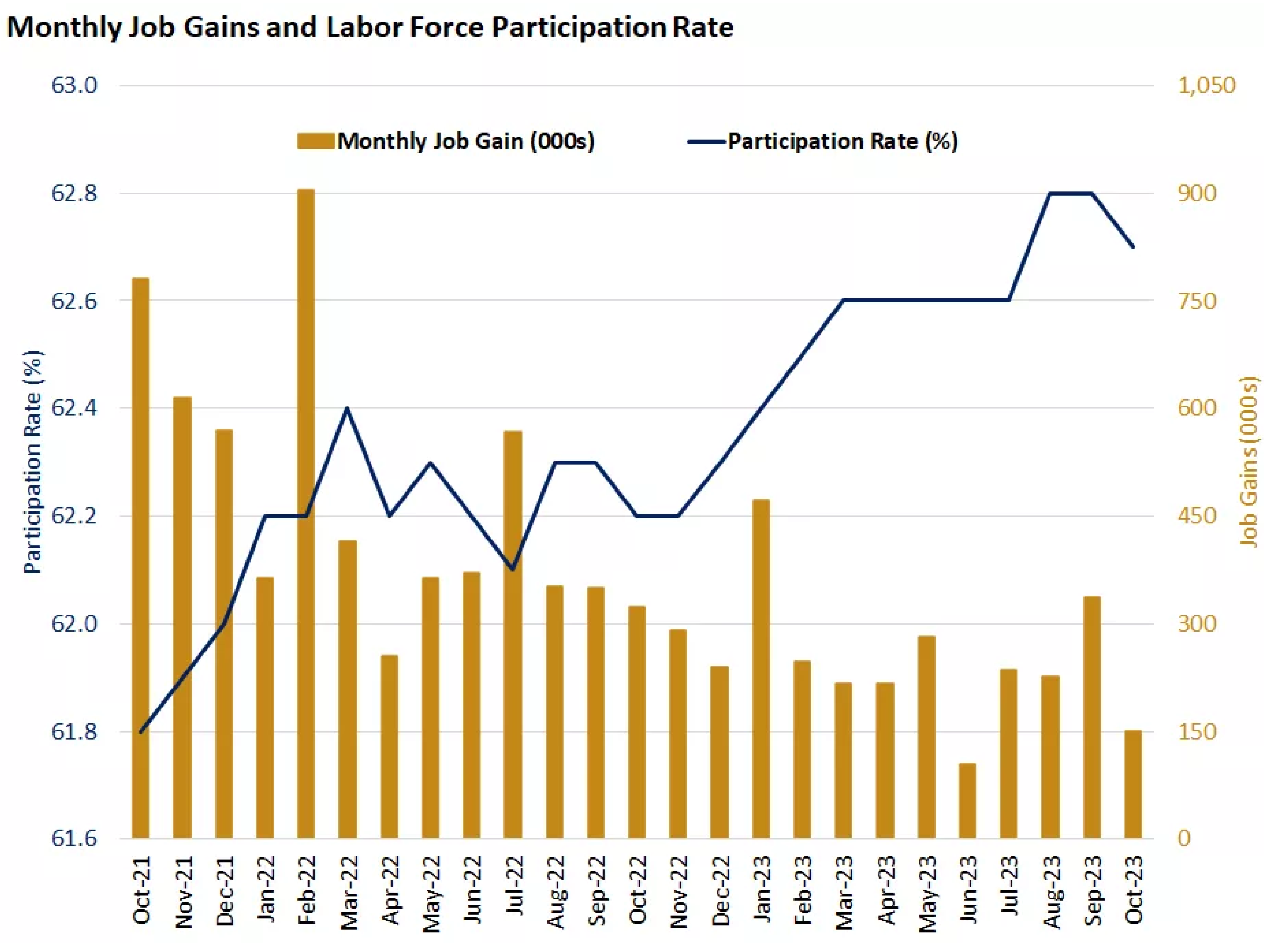


Source: Bloomberg. Total return of the S&P 500 index and Bloomberg U.S. Aggregate Bond index.

Chart description

- **The labor market needs a Goldilocks chapter** – The latest read on employment conditions appeared to hit the sweet spot within last week's Fed policy-outlook narrative, insofar as it signaled the labor market is not too hot to re-stoke rising inflation pressures, and not too cold to undermine consumers and economic growth. The October jobs report showed the economy added 150,000 jobs last month. It's positive to see that hiring gains continue, while at the same time it's clear that some softness is emerging in the labor market, as October's payroll gains were half that of September and down from the 216,000 average over the last six months. The coincident trends of ongoing job gains and moderating wage growth is the zone that the market will likely cheer as we advance, as that combination would be consis with hopes for a soft landing in the economy. The rise in the labor-force participation rate is encouraging, as it reflects a growing supply of labor, which can enable hiring growth and low unemployment to persist while allowing wage pressures to moderate. The October report revealed that average hourly earnings rose by a modest 0.2% from the prior month and are up 4.1% on an annual basis – the slowest since June 2021. Data earlier last week showed that the job quit rate continues to decline, offering another signal that wage growth, and thus inflation, should continue to moderate ahead.

Rising supply of labor could support consumer spending while reducing wage pressure on inflation.

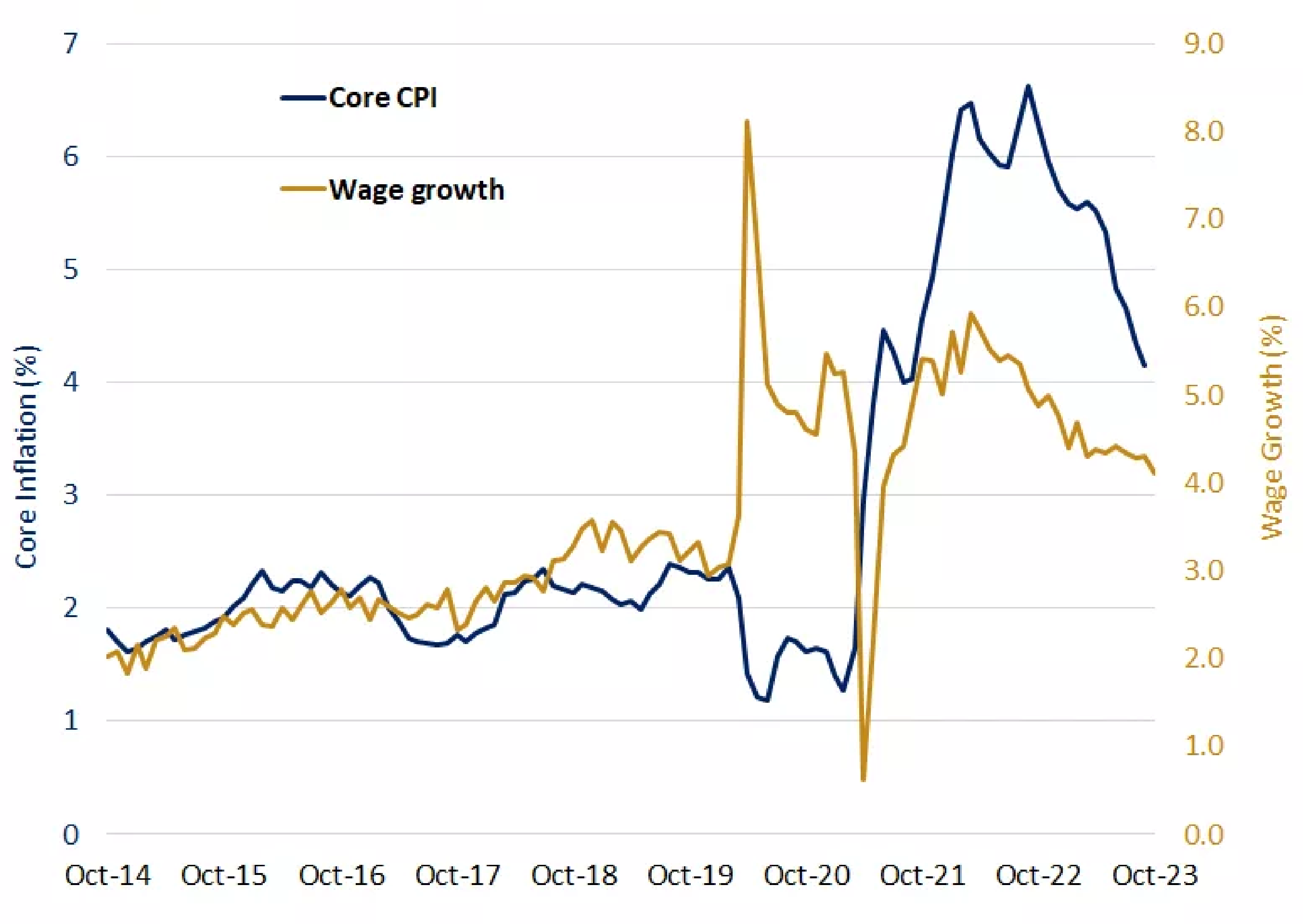


Source: FactSet.

Chart description

Given their historical relationship, slowing wage growth bodes well for lower inflation.

Wage Growth vs. Inflation



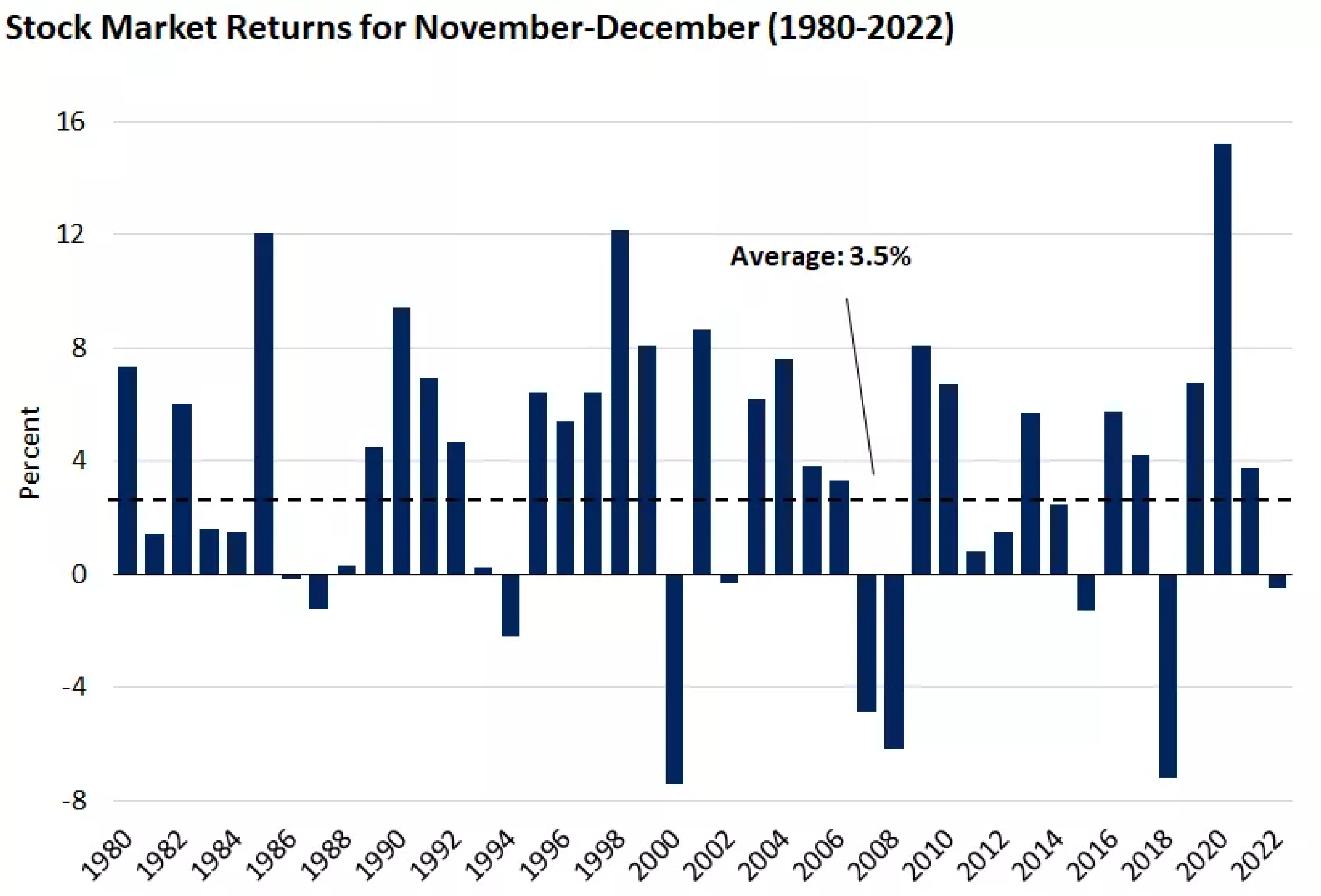
Source: FactSet. U.S. Core CPI and wage growth.

Chart description

What might a rebound look like?

- **'Tis the season.** We don't endeavor to predict short-term market moves, but our view has been that the pullback in equities and recent surge in interest rates was creating an attractive opportunity within both stocks and bonds. If history is a guide, the calendar could be tilted in investors' favor, as stocks have typically enjoyed strong returns in the November-December time frame. Since 1980, the stock market has delivered a gain in the final two months of the year 79% of the time.

The final two months of the year have been favorable for stock-market returns.



Source: Morningstar Direct, Edward Jones. Total return of the S&P 500 index.

Chart description

- **Corrections require correct decisions.** There's no guarantee that the 10% pullback we saw through October was the end of the soft patch for equities, but with think it tipped the risk-reward balance in investors' favor. As the table below highlights, prior corrections have averaged a 14% decline, followed by an average two-month gain of 10% and a one-year return of 28%. This highlights both the opportunity created by short-term declines as well as the importance of disciplined, longer-term portfolio decisions during spates of market volatility.

Market pullbacks can create compelling buying opportunities.

Correction	Pullback	Stock Market Return Over Following: 2 months	1 year
4/23/10 - 7/2/10	-16.0%	7.0%	33.6%
4/29/11 - 10/3/11	-19.4%	13.7%	35.0%
4/2/12 - 6/1/12	-9.9%	7.9%	30.5%
7/17/15 - 8/25/15	-12.2%	11.5%	18.9%
11/3/15 - 2/11/16	-13.3%	12.1%	29.3%
1/26/18 - 2/8/18	-10.2%	1.3%	7.0%
9/20/18 - 12/24/18	-19.8%	19.2%	39.9%
7/31/23 - 10/27/23	-10.3%	?	?

Source: Bloomberg. Total return of the S&P 500 index.

Chart description

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Investment Strategist

Weekly market stats

INDEX	CLOSE	WEEK	YTD
Dow Jones Industrial Average	34,061	5.1%	2.8%
S&P 500 Index	4,358	5.9%	13.5%
NASDAQ	13,478	6.6%	28.8%
MSCI EAFE*	2,031.06	4.4%	4.5%
10-yr Treasury Yield	4.52%	-0.3%	0.6%
Oil ($/bbl)	$80.92	-5.4%	0.8%
Bonds	$94.16	1.7%	-0.9%

Source: FactSet, 11/3/2023. Bonds represented by the iShares Core U.S. Aggregate Bond ETF. Past performance do guarantee future results. *Source: Morningstar Direct, 11/5/2023.

The week ahead

Important economic data being released this week includes consumer credit data for September and the Michigan Consumer Sentiment index.

Review last week's weekly market update.

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Market Data

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S&P 500 4,382.63 ↑ (+35.28)

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