Weekly Market Insights

October 23, 2023

The Four Horsemen

Financial Markets

There is a great sense of unease, even malaise, around the world, and it is being reflected in financial markets. This past week, the Dow fell by 1.61%, the S&P 500 by 2.39%, and the NASDAQ by 3.16%. A case can be made that it is not any one or two problems giving investors distress, but, rather, a series of four—hence the reference to the Four Horsemen.[1] The horsemen we refer to here are not quite as terrifying as their biblical counterparts, but they are troubling nonetheless. The horsemen investors may see galloping their way are inflation, recession, foreign wars, and, perhaps most damaging to the U.S., political mayhem at home.

Economics

There are many fears about the future, which were reflected in the stock and bond market sell-offs this past week. Fed Chairman Powell's remarks in New York did not help to sooth these fears. Both equities and long-maturity Treasuries fell.

At first glance, it did not appear that Chairman Powell's speech should be particularly bearish for financial markets. He implied that the Fed would likely hold off on raising interest rates in the short-term, but that they would maintain their data dependent stance. Looking at recent economic reports, although a bit contradictory, one could feel somewhat confident that the Fed's past efforts are bearing fruit. This past September's employment report and last week's Retail Sales report were both strong, and inflationary pressures have continued to decline. Supply chains have healed, and demand for goods and services seems to be moderating. The Fed's preferred inflation gauge, Core PCE, has been falling. At the end of last year, it stood at 4.9%, and, in August, it was 3.9%, with September's reading likely to come in a bit lower.

A recession, at the moment, is hard to call. Statistics don't say one is around the corner, but so much depends on the Fed and where they go with interest rates. If there is a recession in the future, it is likely to be mild.

The most troubling issue presently is domestic political mayhem. At this point, no one knows how it will turn out. Unless temporary measures are taken, we must first figure out who will be chosen as the next House Speaker.

As for Ukraine and the Middle East, the situation is impossible to predict. The war in Ukraine most likely will drag on with no real end in sight. The question in the Middle East is, will the conflict spread? Informed people will argue that Arab leadership wants a more active role in the region. Alas, a great number of their citizens share this sentiment, and many current Arab leadership positions are somewhat tenuous. So, watch the "Arab Street." If there are huge demonstrations, the likelihood of the war expanding grows exponentially.

[1] English Standard Version Bible, Book of Revelations.

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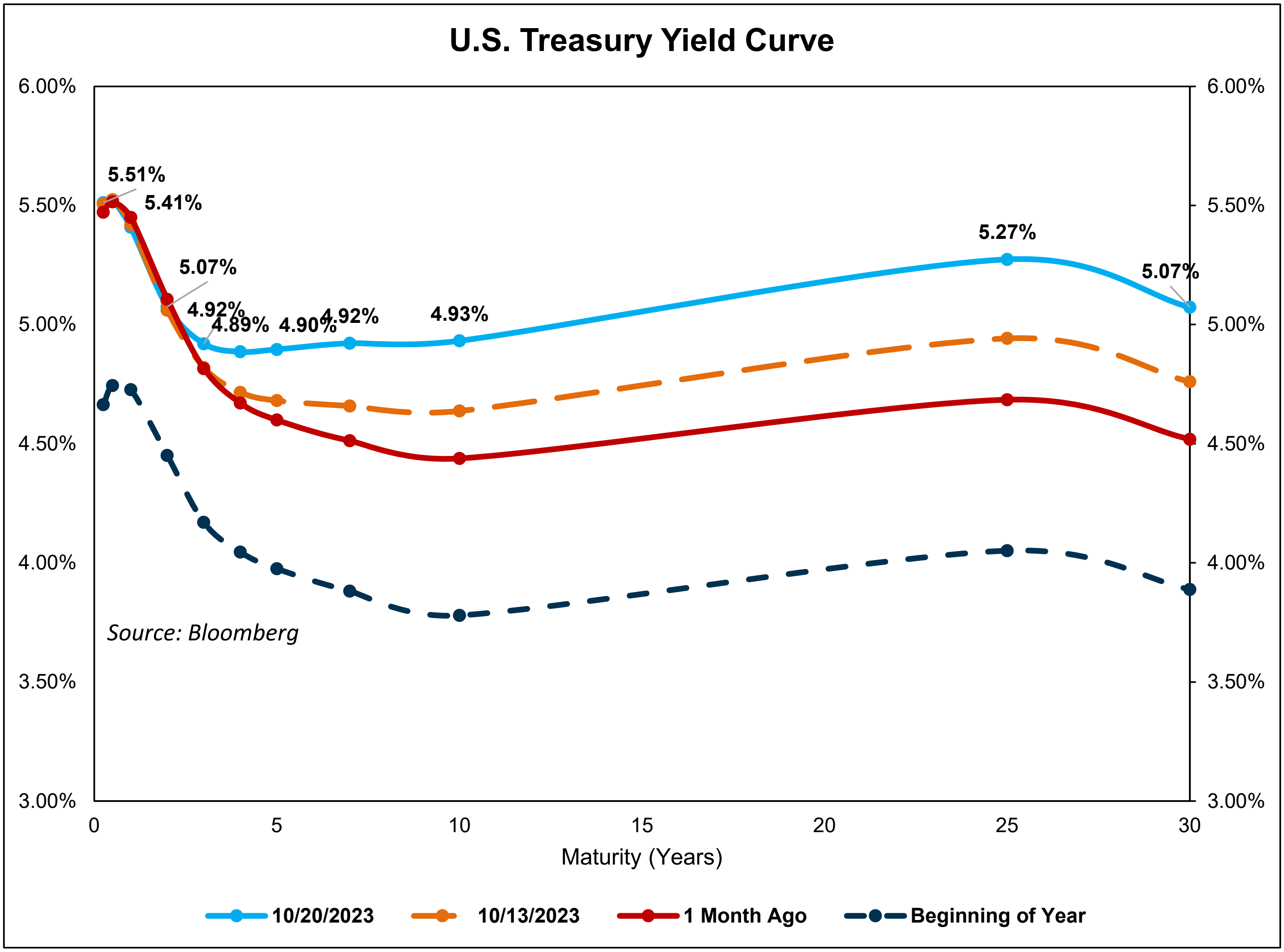
Yield Curve Update



The United States Treasury yield curve shows the yields of Treasury securities with maturities ranging from 30 days to 30 years. The light blue line is the yield curve as of last Friday. The green dashed line is the yield curve as of one week ago. The red line is the yield curve as of the prior month's end. The dark blue dashed line is the yield curve as of the beginning of the year.

The Treasury yield curve inversion lessened significantly this past week, steepening by around 25 basis points relative to one week prior. While the curve shifted higher across all maturities, the increase in longer-dated yields outpaced the increase in shorter-dated yields. The first notable move came on Tuesday when Treasuries sold off sharply after September retail sales came in much stronger than anticipated (bond prices and yields are inversely related). The rise in yields was attributed to investor fears that hotter consumer demand figures could incentivize the Fed to hike again before year-end. Yields made another move higher on Thursday, with the 10-year yield briefly touching 5% following Fed Chairman Powell's comments at the Economic Club of New York. While Powell acknowledged the tightening of financial conditions driven by the recent rise in yields, he added that it "remains to be seen" whether higher yields could actually substitute for additional hikes. The Chairman also left the door open for more tightening should above-trend economic growth, labor market tightness, and inflationary pressures continue. While Powell's speech was largely consistent with the Fed's communicated policy stance, his comments further reinforced the "higher for longer" message that has been a major driver of the recent rise in rates.

Conclusion

There is no easy way to write a conclusion to the problems noted in this week's paper. In the United States, it is imperative that we see a political resolution to the Republican stand-off in the House. Only then will it be possible to make some predictions. At the moment, we see no immediate catalyst for a dramatic market move. Investors should take a close look at fixed income opportunities. Next week, if we have some idea as to who the Republicans will choose as a Speaker, we can make some intelligent guesses for the direction of future U.S. problem solving.

Michael Olin Clark
Senior Advisor
moclark@1919ic.com

Ryan Schutte, CFA, CFP®
Senior Investment Associate
rschutte@1919ic.com

Abigail McKenna
Portfolio Administrator
amckenna@1919ic.com

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