September 2023: Market Review

Global equity and bond markets slumped in September as the Federal Reserve's hawkish comments and 'higher for longer' interest rate projections resulted in a sharp rise in bond yields on the longer end of the yield curve. Longer term yields, both nominal and real, reached levels not seen since before the 2008 recession. The Dow Jones Industrial Average Index returned -3.4% in September, while the S&P 500 Index (-4.8%), and the NASDAQ Composite (-5.7%) tumbled further. The Fed rate decision at their meeting on the 16th of September went as investors expected: Fed Funds rates were held at their current level of 5.25% – 5.50%. However, the hawkish views stemming from the Fed's "dot plot" caused yields to further climb and bond prices to drop. The Fed reduced previously projected rate cuts in 2024 and 2025 by 0.5% each. The Consumer Price Index was up 0.6% for the month of August with gasoline being the largest contributor to the increase. Energy costs reached new peaks in September with crude oil spiking to $94 per barrel, surpassing its recent high in August 2022. While headline inflation has been trending higher in recent months, core inflation (ex-food and energy) has been slowly moving lower, providing the Fed some flexibility to pause again at their November meeting. In addition, the labor market began to show modest softening, with unemployment levels rising to 3.8%.

Domestic equity markets were negative for the month with the S&P 500 Index down -4.8%. Larger cap companies outperformed smaller cap companies on the market capitalization spectrum with the Russell 1000 (-4.7%) topping the Russell Mid Cap Index (-5.0%) and the Russell 2000 Index (-5.9%) in September. Value-style equities (Russell 1000 Value -3.9%) outperformed growth equities (Russell 1000 Growth -5.4%) in the month. However, growth equities maintained a huge performance advantage year-to-date (+22%).

Developed international equities outperformed U.S. equities as the MSCI ACWI ex USA Index was down just -3.2% for the month. This outperformance came despite a stronger dollar, which is a general headwind for overseas investors. Similar to domestic markets, larger cap names outperformed small cap names as the MSCI ACWI ex USA Large Cap Index (-3.1%) outperformed the MSCI ACWI ex USA Small Cap Index (-3.8%). Emerging market countries (-2.6%) collectively outpaced developed markets by 0.8% for the month. China declined -3.4% in September taking its year-to-date loss down to -7.5%, making it one of the worst performing countries for the year.

The Bloomberg US Aggregate Index declined -2.5% for the month, bringing the cumulative drawdown from its peak in the summer of 2020 to -15.6%. As of month end, the 10-year treasury yield reached 4.57%, up from 4.09% at the end of August. Shorter duration bonds performed better than longer duration bonds for the month as intermediate duration paper fell by just -1.1%. The negative spread between the U.S. 10-year and 2-year treasuries continued to un-invert and narrowed in September to end at -0.44%. The Bloomberg High Yield Index (-1.2%) and lower credit rated bonds outperformed investment grade bonds (Bloomberg Investment Grade Index -1.8%) this month. Decade-high yield levels continue to make bonds a more attractive alternative to equities relative to eighteen months ago.

The 'higher for longer' narrative reinforced by the Fed provided a headwind for both stock and bond investors waiting for signs of a Fed pivot to a lower rate regime. Higher rates, coupled with resumption of student loan payments and higher gas prices, seem to imply the consumer will be stretched in the coming quarters. However, stepping back and looking at the whole economic picture, corporate earnings have stabilized and are expected to grow 8-12% in each of the next two years, while unemployment remains near historic lows. Many of these variables are premature to call whether the U.S. economy is entering a recession as the Fed tries to pave the way for a 'soft landing' with two meetings remaining in 2023.

See footnotes on the following page.

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