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Economic & Market Summary
October 2023

The economy has performed better than expected this year. Annualized economic growth net of inflation was 2.1% in the second quarter. Consensus third quarter forecasts predict 3% growth. The labor market shows signs supply and demand realigning as evidenced by a decline in the number of jobs available per worker and a rise in labor force participation. While job creation has decelerated from its peak, demand for workers remains steady. Consumer spending has held up with core retail sales growth ahead of inflation. However, sectors related to the production and shipment of goods have been weaker as spending shifts away from goods and towards services post-pandemic. So far, this weakness has yet to impact overall economic growth. While the economy has been resilient, it's still possible growth may slow or turn negative. Not all the Federal Reserve's interest rate hikes have filtered into the economy. Assuming a one-year lag, about 40% of rate hikes have yet to be felt. Other concerns to monitor include rising energy prices, commercial real estate weakness and the potential impact on banks, and the resumption of student loan payments and its effect on consumer spending.

The downward trend in inflation should continue. Leading inflationary indicators like prices paid by producers and surveys of purchasing managers suggest that many prices are rising at slower rates or declining. This implies monetary policy is already tight. Future rate hikes should be modest and spaced further apart if inflation continues cooling. However, this does not mean interest rates will come down soon. In our view, the Fed will not cut rates until inflation tracks closer to 2% which could still take several months. With strong economic growth, low unemployment, and declining inflation it's feasible the Fed will stick the "soft landing." However, the cumulative effect of rate increases, a policy error, or one of the aforementioned concerns could lead to a recession. The Fed should move cautiously from here.

Outside the US, global economic growth will be challenged by weakness in China. The post COVID-reopening boom has failed to materialize, and the country grapples with an ailing property sector, high debt, and an aging population. To us, the main risk to the US economy is the geopolitical tension between Beijing and Washington. For much of the 21st century, China was a major low-cost manufacturing hub and global supply chains evolved accordingly. If political or security reasons drive manufacturing to a higher-cost locale, it could prove inflationary.

Long-term bond yields have risen to their highest level in 20 years, finally giving investors a return above inflation. However, the outlook is mixed. Large US budget deficits and the Fed's reversal of quantitative easing could drive long-term yields higher, but moderating inflation and economic weakness may temper that rise. The S&P 500 was down in the third quarter but is up 13% year-to-date including dividends. The market rally has mainly been a function of prices rising faster than earnings, but earnings are finally turning a corner. Estimates for the third quarter call for growth after three consecutive quarters of declines. Full year estimates for 2023 and 2024 are finally rising, likely driven by a better-than-expected economy. Performance has been driven by a handful of growth stocks whose weights dominate the S&P 500. The equal weight version is up only 1.8%, trailing the main index by about 11 percentage points. In the near-term, stocks could remain under pressure if interest rates continue rising and the economy weakens. However, we would view a broader market pullback as a buying opportunity. We believe owning high-quality companies over long timeframes and through periods of temporary disruptions is the best way to build and sustain lasting wealth.

Mark J. Sprtel, CFA

If your financial situation has materially changed or you would like to discuss your accounts in detail, please contact your investment manager. To request our SEC Form ADV Part II, please contact Mark J. Sprtel, Chief Compliance Officer, at the address above.