Quarterly Market Commentary

October 2023

Performance Returns YTD

S&P 500 Index:	11.68%
S&P/TSX Composite Index	0.81%
Dow Jones Industrial Average:	1.09%

As of September 29, 2023

The third quarter came to a close last week as economic tailwinds from the first half of the year seemed to shift into headwinds. Although economic growth has been better than expected coming into the year, the recent rise in rates, consumer pressures (via higher energy prices and student loan repayments), and union strikes have weighed in on consumer sentiment during the third quarter.

US Federal Reserve Policy developments also dominated the headlines. Earlier in the year, many investors expected the US Federal Reserve to not only stop raising interest rates, but to also open the door for cuts in 2024. The messaging from Chairman Jerome Powell in late September could not have been further from the truth. Instead of cuts, the message was “higher for longer.” Although inflation is starting to moderate, I think we must keep a couple of points in mind:

1. **No one wants to be the Arthur Burns of this decade** – Arthur Burns was the Chairman of the Federal Reserve during the tumultuous period of the 70s. During this time, inflation rose quickly, and the central banks acted by raising rates. As soon as inflation started to moderate, they cut interest rates. The result - a return of inflation, even higher than it was before. This exercise of raising rates to fight inflation and then cutting them when inflation declined went on for a decade and culminated in 18% inflation in the late 70s.

   It wasn’t until the new Chairman, Paul Volker, took over in 1979 and raised rates to over 20% and kept them elevated for almost two years that the cycle was broken. Like Chairman Powell, many leaders of central banks around the world are familiar with this story, and they don’t want to repeat it.

2. **Interest rate cuts may be off the table for now** - Although we are seeing some moderation in inflation, strikes and wage increases are not abating. Combine that with higher energy prices and there is a good chance that inflation will continue to edge up even if the economy starts to slow. The rate hikes may be close to an end, but unless something drastic occurs, interest rate cuts likely are not on the horizon.

The sentiment going into this quarter was that the economy will slow (not to the point of recession) and declining interest rates will provide a stimulus for equity markets. Now, it has shifted, and not only will rates be higher, making it more expensive for companies to borrow, but the odds of a recession have also increased. This narrative of "higher for longer" has sent the equity markets reeling.

When we are thinking about the current environment, we must remember that this is different than what happened in 2008 and in 2020. In both those times, equity markets fell because growth completely collapsed, and a deflationary environment was created. The tool that was used to stimulate demand and revive equity prices was to reduce interest rates and keep them low as long as they had to.

Today it's the opposite problem. The central bankers are trying to bring down inflation by curbing demand for goods. The tool they have is to raise interest rates. They will keep rates higher until they have their desired outcome, even if it means job losses and a recession.

For now, bonds offer a compelling risk/reward opportunity over stocks. We are ready to pivot if stock prices drop and offer the better opportunity.

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Source: https://ycharts.com/indicators/sp_500_monthly_return.