

## ECONOMIC OUTLOOK

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### *Summary*

In one of the rare economic misfires of late, non-farm payrolls for October disappointed in nearly every facet. Monthly job growth fell 30k short of consensus at 150k and the unemployment rate was 0.1% higher than anticipated at 3.9%. While the labor force participation rate also decreased unexpectedly, the biggest downside surprise of the entire report was the two-month payroll net revision, which decreased prior employment totals by more than 100k jobs. These revisions erased the large positive employment gains that excited market participants just one month ago.

However, it is important to remember there may be some distortion in October's payroll numbers due to the United Auto Workers (UAW) strike. Workers on strike are not considered as "on the payroll" for the establishment survey, or as "part of the labor force" in the household survey. Additionally, there were likely second-order effects related to the closed plants, where related businesses may have needed fewer employees, at least temporarily. For example, food establishments near auto plants may not have needed as many servers per shift, particularly during lunch. When you factor in the timing of the weak jobs report, which came only days after third-quarter GDP increased by an astounding 4.9% and Core PCE continued to gradually decline, it is by no means alarming.

Despite the disappointing job numbers, we are still not ready to declare the Fed will pivot from a hawkish to a dovish bias, especially as the economy appears less rate-sensitive than it has been in prior cycles. Perhaps the ultra-low interest rates of 2020

convinced businesses and consumers to lock in borrowings for a longer time than they typically would have, but it's surprising to see the highest level of GDP in nearly two years after the Federal Reserve increased the overnight rate by 5.25%. It will take significantly more disappointing data before the Fed is even "thinking about thinking about" rate cuts, but the odds are increasing that we have already seen the last rate hike.

### *Positives*

Federal Reserve leaves overnight rate unchanged for the second consecutive meeting

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Both durable goods and factory orders surpassed expectations for the month

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Consumption remained elevated in Q3 at 4.0%

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### *Negatives*

CPI (year over year) failed to decrease for the third month in a row

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ISM manufacturing unexpectedly dropped to 46.7

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Job openings (according to Job Openings and Labor Turnover Survey data) increased for the third consecutive month

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## EQUITY OUTLOOK

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### *Summary*

The late summer/early fall slide in equity markets continued into October with the S&P 500 declining another 2.1% during the month. Losses were once again widespread based on style, size and geography. The Russell 1000 Growth Index and Russell 1000 Value Index dropped 1.4% and 3.5% respectively. The Russell Midcap Index fell 5.0% and the small-cap Russell 2000 Index dropped 6.8%. Looking abroad, the developed MSCI EAFE Index fell 4.0% and the MSCI Emerging Markets Index lost 3.9%.

Much as the equity markets appeared to be overbought prior to the recent declines, stocks now appear to be oversold. There are many potential catalysts that could cause the market to resume the year's uptrend. First, and perhaps most importantly, the Federal Reserve is likely nearing the end of its rate-hiking cycle. While inflation remains stubbornly higher than the Fed's target, the path of core inflation is still trending in the right direction and the Fed seems to be more comfortable with that path as well as other softening economic data points.

Earnings season is now in full swing and with the majority of S&P 500 companies having already reported, results have largely been better than expected. A resolution of the auto workers strike has been welcome news for equity investors.

When legislators eventually reach a more permanent agreement on the federal budget, that should help propel markets forward.

Several risks remain for equity investors. Inflation is still higher than the Fed would like and geopolitical tensions are elevated. Markets are likely to remain volatile but don't be too surprised if we get a holiday rally to close out the year.

### *Positives*

Federal Reserve paused again

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Strong corporate earnings results

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Equity markets are oversold

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### *Negatives*

Recession still a possibility

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Higher interest rates

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Growing geopolitical tensions

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## FIXED INCOME OUTLOOK

### *Summary*

Following a rough September, bond investors looking for a change in sentiment were disappointed as yields increased again, especially in the longer end of the yield curve. With short-maturity yields relatively stable, investors apparently shifted their attention away from future Fed hikes and towards the length of time rates will remain elevated as well as supply concerns. Even as Fed Chairman Powell says the Federal Reserve's Open Market Committee (FOMC) has yet to determine how much additional monetary tightening may be necessary, the markets have become incrementally convinced they have reached their terminal rate for this cycle. As measured by the Fed Funds futures market, the small chance of a November 1 hike gradually evaporated with the probability of a December or January rate increase trending lower as well. For the month of October, the 2-year Treasury yield increased by only four basis points (bps) to 5.09% while the 5-year added 25 bps to end at 4.85%. On the longer end of the curve, the 10-year increased by 36 bps to 4.93% and the 30-year bond increased by nearly 40 bps to end at 5.09%. Both of those benchmarks reached the highest yield level since the summer of 2007. For the broad bond market indices, returns were negative for the sixth consecutive month. Returns were negative for all sectors of the market except for the very shortest in maturity. Intermediate-maturity Treasury note returns turned negative for the 10-month, year-to-date period following the tails of the longer-duration indexes that turned negative in September. After two months in a narrow trading range, credit spreads broke slightly higher and ended up about five bps. While underperforming Treasury notes for the month, intermediate-maturity, investment-grade corporate bonds continue to post a slightly positive return so far this calendar year.

With two consecutive calendar years of negative returns, we are still holding onto some optimism a third can be avoided as the risk/reward profile is skewed in favor of bond investors. Unlike during the past decade or so, today's starting yield provides a substantial cushion to absorb price declines if rates were to increase further. From month-end levels, the 2-year Treasury

note yield would have to increase to over 11% before its 12-month return would become negative. The 10-year Treasury note would have to increase by another 70 bps before becoming negative over a one-year period. An intermediate-maturity portfolio would have to see a parallel shift over 2% higher from October's levels before becoming negative over a 12-month investment period. With the Fed either at or near the end of their rate-hiking cycle, there is little reason to expect short rates to increase materially. The long end of the curve could move somewhat higher as investors seek a term premium for owning longer maturities, but even that should be short lived with the consensus expecting Fed rate cuts to commence sometime in 2024. While it is possible we will experience a third negative-return calendar year, going forward, bond math favors investors. We believe we will see buyers emerge as they begin to increase portfolio duration and reallocate from riskier markets.

### *Positives*

The Fed rate hike-cycle is likely complete

U.S. investment-grade credit spreads widen to 3-year average

### *Negatives*

Substantial government issuance with no declining foreign interest

Slowing path to 2% inflation with robust economic growth

### *Unknowns*

Timing of Fed rate cuts

Russia/Ukraine war. Israel/Hamas war