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Market Update: September 2023

Global stocks closed down just over 4% in September, while global bonds were off nearly 3% for the month. After delivering strong returns through July, stocks have been on the decline for the past two months. Still, global stocks remain up nearly 10% year-to-date and 14% over the past 12 months. These strong returns, initially driven by the excitement over artificial intelligence, have more recently been fueled by the hopes that inflation would subside without recession … an outcome otherwise known as a *soft landing*.

> **It seemed like nothing could stop the 2023 market rally.   Then the third quarter arrived.**
>
> **Karen Langley – WSJ 9/29/23**

Oil prices have climbed almost 30% over the summer, while gasoline prices jumped over 10% in August alone. Not surprisingly, energy stocks were the only one of eleven S&P 500 sectors to show a gain during September.

> **There was a lot to dislike about the past month. Over those 30 days, stock investors have had to contend with a *hawkish pause* by the Fed, a looming federal government shutdown, a jump in bond yields, and rising oil prices.**
>
> **Nicholas Jasinski – Barron's 9/30/23**

The Federal Reserve held rates steady at its September meeting. The benchmark fed-funds rate remains in a range between 5.25% and 5.5% … the highest rate in 22 years. Most central bank officials forecast the rate to settle in at around 2.5% over the longer run. That is considered the "neutral rate", and it is expected to coincide with a 2% inflation rate.

The personal-consumption expenditures price index, the Fed's preferred inflation measure, rose a seasonally adjusted 0.4% in August from the previous month. Core prices, which exclude food and energy, rose 0.1% for the weakest monthly increase since 2020. Over the past three months, core prices have risen at just a 2.2% annual rate, which is only slightly above the Fed's inflation target.

> **This is all good news as far as the Fed is concerned: The chances that it won't be raising rates again this year are looking even stronger. But steep fuel costs, so long as they persist, still will make it harder for it to take the next step and ease.**
>
> **Justin Lahart – WSJ 9/29/23**

Earlier in the year, investors thought the Fed would soon cut rates. Now investors are worried it will keep rates higher for longer, increasing the potential that the resilient U.S. economy could run off the rails.

> **Investors are struggling to make peace with a new reality: Interest rates are likely to remain higher for longer.**
>
> **Hardika Singh – WSJ 10/1/23**

The yield on the 10-year U.S. Treasury note ended September at 4.572%, up from 4.090 at the end of August. (Remember, bond prices fall as rates rise.) While stock valuations look stretched in this backdrop of higher bond yields, they may look more reasonable when (and if) bond yields decline.

> **It's hard for the 10-year yield to rise much higher, but there is a lot more room for it to fall if the economy slows down.**
>
> **Priya Misra, J.P. Morgan Asset Management – WSJ 9/29/23**

Higher rates on cash have given investors the opportunity to earn meaningful returns with little potential risk. Tech stocks, in particular, are hurt by rising rates. Their high valuations are based on growth far in

to the future, and higher current rates reduce the present value of that anticipated growth.

According to FactSet, before rates began to rise, there were 379 stocks in the S&P 500 index that had a better yield than the six-month Treasury bill. Now there are fewer than thirty!

> **Equities are competing with 5% returns on cash, which is basically no risk. They used to say TINA, "there is no alternative". There are alternatives now for equities.**
>
> **Saira Malik, Nuveen – WSJ 9/29/23**

Now that investors and savers can earn a decent return on cash and short-term Treasuries, speculative activity has been on the decline. Meme stock activity is hardly mentioned anymore, while crypto values are well off their highs. When is the last time you heard someone talk about *nonfungible tokens*?

> **Where have all the weirdos gone? Higher interest rates have washed away much of the wackiness … Suddenly, it costs real money to convert interest-earning deposits into something speculative.**
>
> **Jack Hough – Barron's 9/25/23**

Overall, the Fed appears to be pretty much done hiking rates. There may be another quarter-point hike, but that should be it. Inflation continues to decline, as recent measures approach the Fed's target. With the job market starting to cool off, real yields on bonds are starting to look very attractive.

> **Stocks are stories. It's about a company that did something, made something, was successful. Bonds are math, and for most people math is hard.**

Financial advisors tell us it is the best yield opportunity in years and the best return opportunity in bonds in 15 years. Low interest rates had been a headwind for retirees, in particular. That has now changed.

Dave Goodsell, Natixis Center for Investment Insight – Barrons' 9/21/23

China's economy showed some signs of life in September, with factories reporting the first expansion of activity since the spring. However, real estate remains the big problem. Evergrande Group, the enormously indebted property developer, just announced that its chairman is under criminal investigation.

The overall real-estate risk is still gradually being released, and its negative impact on China's economy will continue to exist in the long term.

Zhaopeng Xing, ANZ China Strategist – WSJ 9/29/23

As we have been reporting for some time, China's economy has a host of issues, including record-high youth unemployment, declining exports, and poor demographics. Their access to technology is also hampered by escalating tensions with the U.S. and other Western economies.

China's economy is in the worst shape in decades as financial and geopolitical pressures mount and policy makers struggle to persuade consumers and businesses to spend their way out of a slowdown.

At the same time … Those ready to write off China underestimate the resources of Chinese policy makers and the power of an $18 trillion economy that is home to 1.4 billion people.

Reshma Kapadia – WSJ 9/21/23

A soft landing is extremely difficult to pull off. Investors are now wondering how long interest rates will remain elevated, and how long the economy can remain strong under the pressure of elevated rates. While the U.S. economy is supported by consumer spending and a strong labor market, spending is expected to eventually decline as pandemic savings run out, and student loan repayments resume.

> **Over the next six to 12 months, you have to say, "Okay, how does *consumer spending* continue at this rate?" It needs to moderate.**
>
> **Simona Mocuta, State Street Global Advisors – WSJ 9/29/23**

Consumers are facing many headwinds as of late. Consider the following three major challengers to U.S. households:

- Inflation-adjusted median household income for Americans declined to $74,580 in 2022, according to the Census Bureau. That is 2.3% below the 2021 estimate of $76,330. Overall, inflation-adjusted household income is down 4.7% since its peak in 2019.
- For families that need to borrow money, higher rates are having a material impact. Americans have collective credit-card debt of over $1 trillion, a milestone recently reached for the first time. Interest rates on credit card balances are now over 20% … up from around 15% in early 2022.
- Mortgage rates are now well over 7%, up from 3% just two years ago, and car loan rates are on the rise. The National Association of Realtors calculates that the typical American family can't afford to buy a median-priced home. In addition, the average American household now needs 42 weeks of income to buy a new car, up from 33 weeks just three years ago.

Buying a home or car right now is completely unaffordable for the typical American household because you're mixing the higher borrowing costs with the high prices.

Mark Zandi, Moody's Analytics – WSJ 9/26/23

If the Fed is nearly done raising rates, why are rates continuing to rise? The answer: There are three major sellers increasing the supply of government securities.

Besides raising rates, the Fed is also selling securities (quantitative tightening) at the rate of nearly $100 billion each month. Also, due to troubles in the commercial real estate market, U.S. banks are selling securities to raise liquidity. Finally, the federal government has been engaged in massive stimulus projects and operating a current budget deficit that now measures 6.3% of GDP … spending that must be funded by increasing the supply of Treasury bonds.

With rates still on the rise, it looks like 2023 will be the third year in a row that bond returns will be in negative territory. Many investors are undoubtably becoming frustrated with this asset class. On the other hand, the bond market has effectively been repriced, and real Treasury yields are at their highest levels since 2008. Patient investors should be rewarded in the long run.

Daniel G. Corrigan, CPA/PFS, CFP®