OREGON PACIFIC WEALTH MANAGEMENT

*A Registered Investment Advisor*

# Q3 2023 Market Update

**THE QUARTER IN BRIEF**

As the weakest seasonal period for equities historically, September did what September does. The S&P 500 was down -4.8%. This was a stressful quarter for investors with few places to hide amidst the market pullback that weighed on all size and style boxes and most sectors. Noteworthy developments in the quarter include the sharp rise in interest rates to new multi-decade highs and a nearly 30% increase in oil prices. This combination reignited concerns about the health of the US consumer and the possibility of an upcoming recession. Quality focused equities continued to outperform amidst economic uncertainty.

| | 1M | QTD | YTD | 1-YR | 3-YR | 5-YR | 10-YR |
|---|---|---|---|---|---|---|---|
| S&P 500 | -4.77% | -3.27% | 13.06% | 21.59% | 10.13% | 9.90% | 11.90% |
| NASDAQ | -5.77% | -3.94% | 27.11% | 26.13% | 6.64% | 11.46% | 14.59% |
| Dow Jones Industrial | -3.42% | -2.10% | 2.73% | 19.18% | 8.62% | 7.14% | 10.79% |
| MSCI EAFE | -3.38% | -4.04% | 7.63% | 26.37% | 6.37% | 3.84% | 4.42% |
| MSCI EM | -2.61% | -2.85% | 2.07% | 12.06% | -1.40% | 0.89% | 2.44% |
| U.S. Barclays Agg. | -2.54% | -3.23% | -1.21% | 0.64% | -5.21% | 0.10% | 1.13% |
| Investment Grade Bonds | -3.40% | -4.30% | -0.44% | 3.70% | -5.90% | 0.89% | 2.38% |
| High Yield Bonds | -1.22% | 0.37% | 5.30% | 9.84% | 1.30% | 2.45% | 3.62% |

*Source: Bloomberg. Data as of 9/30/2023. Returns include Dividends. Returns over 1YR are Annualized.*

The sharp recent increase in Treasury yields has weighed on the valuations of the largest seven mega-cap tech stocks (AAPL, MSFT, AMZN, GOOGL, NVDA, TSLA, META) that collectively account for 27% of the S&P 500 index. While consensus sales and earnings expectations for the largest tech stocks have been upgraded since the start of August, the group has underperformed the other 493 S&P 500 companies by 4% over that time (-7% vs. -3%).

**DOMESTIC MARKETS**

US equities were weaker in Q3. Investors entered the quarter optimistic that the Federal Reserve (Fed) had orchestrated a soft landing for the economy, and that the era of policy tightening rates would soon end. That enthusiasm withered over August and September, however, as the prospect of a sustained period of higher rates sank in. This followed a revised Fed “dot plot” (the dot plot is a chart showing each Fed policymaker’s forecast for interest rates).

Overall, the US labor market remains very strong. However, according to the Bureau of Labor Statistics the unemployment rate rose by 0.3 percentage point to 3.8% in August. The number of unemployed persons increased by 514,000 to 6.4 million. The US composite flash purchasing manager’s index (PMI) fell marginally to 50.1 in September, down from 50.2 in August, emphasizing the US economy is cooling. (The PMI indices are based on survey data from companies in the manufacturing and services sectors. A reading below 50 indicates contraction, while above 50 signals expansion.)

Inflation, while ticking up in August, remains on a downward trend. Comments from Fed policymakers suggest a further rate hike is to come before the end of the year, while the dot plot now illustrates a higher median rate for 2024 (5.1% vs 4.6%).

Energy stocks were relatively resilient over the quarter, and one of few bright spots in a quarter where few sectors avoided falls. Most of the so-called “Magnificent Seven” - Apple, Microsoft, Alphabet, Amazon, Tesla, Nvidia and Meta – declined, weighing on the overall market. The IT sector overall was one of the weakest areas over the quarter, along with the less influential sectors of real estate and utilities.

In fixed income markets, government bond returns were negative across developed markets as yields rose over the quarter. UK Gilts remain the major laggard year to date, but did enjoy a relatively better few months, returning -0.7% over the quarter as weaker growth data forced investors to dial down their expectations for where interest rates will peak in this hiking cycle. High yield bond markets remain the top performing sector this year, with the US and European benchmarks returning 6.0% and 6.1% respectively so far in 2023. In a rising yield environment, the shorter-dated profile of high yield bond benchmarks has been a source of resilience, with spreads broadly flat over the quarter.

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**LOOKING FORWARD**

The smooth sailing for risk assets in the first half of the year is unlikely to continue indefinitely in the face of a slowing global economy. Despite the resilience witnessed in economic activity year to date, recession risks remain elevated and not all parts of the market appear appropriately priced for such a scenario. The reset in fixed income yields suggests that core bonds should perform their job as a diversifier if weaker growth helps to break the back of inflationary pressures, but the positive correlation between stocks and bonds in the third quarter is a timely reminder of the importance of alternative assets that can diversify against different risks.

## CoreSat Model Update

### Core Allocation

Overall, there were very few changes to the allocations. Our equity allocation continues to focus on Quality for both domestic and foreign equities. With the increase in yields over the past month, growth equities have corrected, which is good in-light of their high valuations.

**For domestic equities,** we continue to focus on Quality names.

**Outside of the U.S.**, Similar to domestic equities, we have reduced our allocation to value in favor of quality for both foreign developed and emerging markets, while reducing exposure to China.

**Fixed income**, we remain focused on short duration, taking advantage of the sweet spot with regards to yields.

### Satellite Allocation - Tactical

During the quarter both global equities and bonds detracted from absolute returns. Managed futures – as measured by the returns of the Société Générale CTA Index ("SG CTA Index") – posted a 2.00% return. While global equities and U.S. Bonds make up the core of the portfolios, the managed futures overlay contributes the majority of the portfolios active risk. Given the return of the SG CTA Index this quarter, this helped boost overall returns for the portfolios. Risk management continues to be the focus; however, we also want to focus on strategies that provide positive returns vs. their benchmark. We prefer using tactical strategies due to their all-weather go-anywhere approach, which will typically produce better risk adjusted returns over time. The combination of core and satellite allocations are designed to provide a robust approach that diversifies across geographic regions, asset classes, and investment styles.

Andrew Corradetti, CMT
Chief Investment Officer

CITATIONS: Newfound Research, JP Morgan Asset Management, YCharts, Bloomberg

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