RIDING THE UPTREND

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Welcome to September! Every month, we like to impart some perspective on the financial markets or shed light on a current headline or two, all in an attempt to help our clients sift through the noise and become slightly more educated investors. We welcome your comments and suggestions, and as always, we invite you to share this piece with anyone you believe may find it of interest.

Back at the end of July, with the S&P 500 at its highest level in 16 months and 28% above its October's lows, we wrote that the easy money for 2023 may have already been earned and that returns in the months ahead would likely become somewhat choppy. August, as it turns out, was exactly that. And after five consecutive months of gains, August was the black sheep, refusing to continue the upward climb.

With stocks down a few percent in the last month or so, whispers in financial circles are suggesting that we might be entering a correction phase, and we very well may be. While this may make some squirm, we'll let you in on a secret – we aren't losing sleep over it. Corrections come and go like the changing seasons and obsessing over them, or worse – trying to outsmart them – is often a futile endeavor. Our strategy: it's all about the big picture and enduring trends. So despite August's breather, we believe we remain entrenched in a bull market that kicked off last October and that the S&P 500 is still riding the uptrend.

Of course, skeptics abound, as they always do. They point to a mix of slowing economic growth, rising interest rates, and a Federal Reserve that seems oddly content with risking recession to cool inflation. Valuations are another hot topic. Just recently, one of our most respected economists - Brian Wesbury with First Trust Advisors – made headlines by proclaiming the S&P 500 to be more than 25% overvalued according to his Capitalized Profits Model. And the Price/Earnings ratio – the most traditional of all valuation metrics – currently stands at 22.9, considerably above its five and ten-year averages[1].

But don't be fooled into thinking these indicators tell the whole story. The ten largest S&P 500 companies, which include the "Magnificent 7" of Apple, Microsoft, Nvidia, Tesla, Meta Platforms, Alphabet & Amazon, collectively sport a P/E ratio of nearly 50 while the median P/E ratio of the other 490 companies is significantly lower, hovering around 17[2]. This broader perspective paints a very different valuation picture.

And don't mistake us for blind optimists either. We are acutely aware of several issues that demand our attention, any one of which could potentially derail the market's current trajectory:

Inflation and the Fed: Despite our belief that the Fed is in the ninth inning of its tightening cycle, inflation remains above the Fed's target. In his annual speech at Jackson Hole last month, Fed Chairman Jerome Powell warned investors that "we are prepared to raise rates further." Anything beyond expectations could spell trouble.

Corporate Earnings: Corporate earnings are the mother's milk of stock prices. S&P 500 companies reported their third consecutive quarter of negative year-over-year earnings growth in the second quarter and the largest earnings decline since the third quarter of 2020[3]. The way companies guide future earnings bears watching.

Student Loan Payment Restart: The restart of payments on $1 trillion of outstanding student loans on October 1, especially when coupled with higher household interest expenses, could exert pressure on consumer spending, which accounts for over 68% of GDP[4].

Seasonal Trends: While we don't put too much weight on seasonality, it's hard to ignore the fact that September has historically been the worst month of the year for U.S. stocks, with the S&P 500 averaging a -1.1% decline in September going back to 1928[5].

Yet none of these issues will deter us nor divert us from our long-range investment plans. In a world filled with excuses to abandon even the most well-designed strategy, we firmly believe that sticking to our plans will forever trump reacting to current events. Remember the recession that was practically guaranteed this year yet never materialized? It confirms quite conclusively that the economy cannot be consistently forecast, nor the markets consistently timed.

And in the big picture, perhaps that's the only thing we really need to remember.

Onward.

[1]FactSet Research [2]Bespoke/MFS [3]Forbes [4]US Bank [5]DataTrek Research

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