A PAUSE AND CONSOLIDATION

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Welcome to October! 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.

Well, that all changed fast.

Just a mere month ago, we were confidently Riding the Uptrend that began last October, although we cautioned that Septembers have a nasty reputation when it comes to stock market performance. Well, turns out seasonality had a say as the S&P 500 took a -4.9% dip last month[1], quite the bitter pill after a smooth ride for the past year.

Originally, we had exciting plans for this month's Check-In - something fresh and topical. But given the current state of affairs, we thought it best to switch gears.

Today, the burning questions on everyone's mind are: Is September's dip the beginning of something more serious? Have we altered our outlook? The only honest response, of course, is that only time will tell. However from our vantage point, we see the current weakness as simply a pause and a consolidation of recent gains.

Despite the S&P 500 rising as much as 28% over the last year[2], it's been a quiet climb against a skeptical and pessimistic backdrop. But strangely enough, we find comfort in this lack of investor enthusiasm. History has taught us that bull markets often fade when investors are excessively optimistic, so we interpret this recent downturn as more of a necessary consolidation than anything. Some are now saying the markets are setting up for a year-end rally – something not without precedent – but as much as we want to climb on that bandwagon, we're not quite there yet.

Yes, we remain constructive regarding the overall market, but we also believe that investors' individual results may be challenged due to what we anticipate will be continued concentration and the relative underperformance of the equal-weighted averages. In other words, we believe that a handful of stocks may disproportionately contribute.

We're also mindful of misinformation, something we've addressed here quite often. Investors are inundated with inaccurate data, flawed research, and frightening narratives.

One troublesome notion is the fear of an impending crisis due to interest rates reaching their highest point since before the 2008 Financial Crisis. Yet a closer look reveals a significant difference between then and now. In 2008, rates were on a downward trajectory in a "flight to quality" whereas today they're headed higher. Even a cursory review of previous bull markets will find that rates typically increase in the first year of a bull market; in fact, seven of the last eleven bull markets were accompanied by rising rates[3].

Another issue that troubles us is the claim that recent market gains are solely due to expanding Price/Earnings ratios without any substantial underlying earnings growth. While there may be some truth to this, it's not unusual and is typically what happens in the first year of a bull market. Beyond that, and contrary to popular belief, operating earnings for the S&P 500 have actually grown by 5.4% in the last twelve months[4].

We should also note that at the beginning of this bull market, the prevailing view was that the Federal Reserve's efforts to combat inflation would likely stall the economy into recession. Yet with unemployment now at its lowest level in 55 years, core inflation decreasing, and third-quarter economic growth projected at an annualized rate of 3%[5], most Wall Street analysts now believe the Federal Reserve might actually achieve a "soft landing", with a significantly reduced probability of near-term recession.

So after weathering this rough stretch, our stance remains cautiously optimistic. While we acknowledge the challenges causing market turmoil and investor unease, our glass remains half-full, at least for now. We foresee looming structural issues that will need addressing, and we will get to those later, but our mindset today is optimistic - this too shall pass. Importantly, we remind our clients that markets rarely, if ever, move in a straight line; they're regularly interrupted by five- and ten-percent declines, just like the one we're working our way through now.

Onward.

[1]Wall Street Journal [2]Thomson Reuters [3]Birinyi Associates [4]Birinyi Associates [5]Yardeni

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