October 2, 2023

MARKET SIGHT LINES

Headwinds Push the Stock Market Lower

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The year-to-date return on the S&P 500 peaked on July 31 at 20.6%. Since then, the market has fallen 6.0%, and the year-to-date return has fallen to 13.4%. Numerous headwinds are pushing stocks lower, with some investors worried that these headwinds may intensify and lead to further weakness.

In this Sight|Lines, we discuss numerous headwinds putting real pressure on stocks.

THE TAKEAWAY: HIGHER RATES, CONSUMER WORRIES, POLITICS, AND A STRIKE WEIGH ON THE MARKETS.

Each of the following headwinds, especially taken together, can increase stock market risk. In summary:

- Bond market data like the Treasury yield curve is signaling rates are expected to be higher for longer.
- The consumer has driven the strong economy in 2023, but with excess savings exhausted, student loan payments resuming, and cracks in the labor market forming, consumer confidence is wavering.
- While U.S. lawmakers passed late-night legislation to extend funding through mid-November, the risk of a government shutdown weighs on investors.
- We experienced the "summer of strikes," with the United Auto Workers (UAW) strike adding to worker unrest that is higher in 2023 than in recent years.

Stocks have been driven lower by headwinds that may influence markets further for the remainder of the year and into the next.

IN-DEPTH: THE PROSPECT OF HIGHER FOR LONGER RATES, SIGNS OF CONSUMER WEAKNESS, THE CONTINUED RISK OF A GOVERNMENT SHUTDOWN, AND THE UAW STRIKE WEIGH ON THE MARKETS.

Each of the following headwinds can increase stock market risk. Together they are a more powerful force that may push markets lower. Going deeper:

- Higher for longer interest rates influenced by Federal Reserve (Fed) Fed policy are designed to slow the economy, which may hurt company earnings:
  - The Fed's Summary of Economic Projections (SEP) now signal the funds rate will remain about 5% until 2025, significantly longer than in its last forecast.
  - The Treasury yield curve infers 10-year Treasury forward rates above 4.5% for the next 20 years.
- We can thank the consumer for the strong economy in 2023, but trouble is brewing:
  - Excess savings of almost $2 trillion have been spent down, with only $0.2 trillion remaining, and one Fed study estimates that some Americans have less cash today than before the pandemic.

- Student loan payments are resuming, diverting approximately 0.3% of disposable income.
- Interest costs on about $1 trillion of credit card debt are increasing as rates have risen.
- Mortgage rates are also up, with the average rate hitting 7.7%, up from the low of 2.8% in February 2021, a significant move higher.
- We've seen cracks in the strong labor market, including a higher unemployment rate and a fall in job openings.
- The Conference Board's recent report was more negative than expected:
  - The Conference Board Consumer Confidence Index fell in September to 103.0 from 108.7 in August, below market expectations.
  - The Conference Board anticipates a recession in the first half of 2024.
  - Consumers are concerned with higher gas and grocery prices, higher interest rates, and the political situation.

- The risk of a government shutdown has been weighing on investors:
  - At the last minute, U.S. lawmakers passed legislation to extend funding through mid-November.
  - While the bipartisan effort delayed the issue six weeks, the negotiations showed how difficult it may be to reduce spending in the future, a key issue given the new higher rate environment.
- Including a "summer of strikes," 362,000 workers have gone on strike in 2023, compared to only 36,000 two years ago:
  - 25,000 UAW members are striking at dozens of locations in numerous states.
  - Analysts estimate that GM, Ford, and Stellantis have lost production of more than 16,000 vehicles since beginning of the strike.
  - The strike is estimated to cause $1.6 billion in economic damage.
  - UAW has issued aggressive demands, including a 40% hourly pay increase, a shortened workweek, and the restoration of cost-of-living adjustments.

CONCLUSION

The S&P 500 peaked in July, but since then, the market has fallen 6.0%, bringing the 2023 year-to-date return down to 13.4%. As we enter the final stretch of the year, we maintain a cautiously optimistic outlook and remain focused on the potential challenges. We believe equity market volatility will be elevated as investors continue to assess the prospect for a soft landing, the path of inflation, and future monetary policy. There is a strong possibility that the market will end the year lower from here. However, there are also some positive forces supportive of the equity market: momentum, broadening participation, and improving earnings. How these headwinds resolve will be important to the economy and market performance going forward.

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