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Investment Institute

Market Commentary

Weekly perspective on current market sentiment **September 7, 2023**

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Last week's S&P 500 Index: +2.5%

A few simple concepts

Key takeaways

- Keep in mind that in the latter stages of an economic cycle, it is typical for investors to be concerned over numerous issues, most of them centering around inflation and the Federal Reserve (the Fed).
- We believe investors should focus on what will likely drive the economy and markets in the coming 12 – 15 months and block out all the noise.

The good news is we have some volatile weeks in our rear-view mirror that have translated to equity market upside. The bad news is we will likely have downside to deal with over the coming six to nine months as we expect the economy to slow and earnings expectations to reset. While it won't make you feel any better, keep in mind that in the latter stages of an economic cycle, it is typical for investors to be concerned over numerous issues, most of them centering around the Fed and what the near-to-intermediate future might hold in terms of its policy directions. Much of the ebb-and-flow of the economic cycle has almost always been dictated by Fed monetary-policy decisions (or some would say, policy mistakes).

But granted, we currently have other unusual and less common issues that are also bothering equity-market participants. In cycles there are commonalities that have come into play nearly every time, but each cycle also has unique characteristics that may allow them to "rhyme" and not be exactly like any other. So, what is the story with this particular cycle?

In our opinion, you can break the bulk of the forward-looking concerns down into just a few simple concepts:

1. The market is worried about the level of core inflation and the Fed pushing rates higher still. A common killer of economic expansions in the past has been a Fed that raises rates too high and leaves them there for too long given the underlying level of economic activity. Higher rates discourage borrowing and spending and slow the economy. Granted, that is the goal of most rate-hike cycles, but it is hard to fine-tune a $22+ trillion economy under any circumstances.
2. The market is also concerned about potential wage inflation and its typically negative effect on margins. Wages are the largest expense item for almost every company. Right now, corporate margins are off their highs but still well above their long-term average looking back to the early 1990s. The labor market remains tight in many industries. We believe higher wages are clearly a margin problem.
3. The Technology sector has led equities higher for the bulk of this year, but now there are concerns as earnings growth has slowed, interest rates have risen, and valuations sit at far less-attractive levels. In addition, when the equity market gets nervous and investors want to take a little money off the table, the most liquid stocks have often been the victims.

We expect inflation to continue to gradually slow and force the Fed to hike rates one more time this year, wage pressure to likely continue, and Technology to participate in the market upside we anticipate in the second half of next year. We believe investors should focus on what will likely drive the economy and markets in the coming 12 – 15 months and block out all the noise. Keep it simple.

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