Market commentary notes

Monthly call notes
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Eric A. Stubbs
Senior Vice President – Financial Advisor
Senior Portfolio Manager – Portfolio Focus
1211 Avenue of the Americas
Suite 3300
New York, NY 10036
(212) 703-6165
eric.stubbs@rbc.com

Summary: Key issues last month and this month

The federal shutdown—rinse and repeat

We have a new Speaker of the House. However, so far, the new speaker appears less inclined than the last to compromise to pass a bill that keeps the government open past Nov. 17. The historical average for stock market declines in a shutdown might be helpful: There have been 20 shutdowns since 1976 and on average the S&P declined 0.01% with the deepest drop being in 1979 at -3.7%. [RBC, “Navigating Stock and Bond Crosscurrents,” Oct. 2023]

The Fed

At the November meeting, the FOMC didn’t raise rates. That was mostly expected. The press release acknowledged that the economy was growing well but that more time was needed to determine whether enough had been done to bring inflation under control. As I’ve said before, my sense is that most of our inflation is due to post-COVID supply problems and mis-coordination of logistics. I don’t think the Fed had much impact on inflation, but I do think that we have a far healthier investment environment when bonds pay 5% or more.

The yield curve has been very undecided about our future. We ended September with the 10-year Treasury at around 4.6%. It shot up to 5% in October and has now settled back around 4.6%. My sense is that fair value is somewhere in the 4.7–5% range under current conditions and inflation expectations. The other interesting element of yields is that 10-year TIPS are now yielding inflation-plus-2.3% or more. That’s looking pretty attractive for IRAs and tax-exempt accounts that want bonds. [https://home.treasury.gov/resource-center/data-chart-center/interest-rates/TextView?type=daily_treasury_yield_curve&field_tdr_date_value_month=202309, Nov. 4, 2023]

Maersk

Last week global shipping giant Maersk reported that it is cutting about 9% of its workforce, about 10,000 people. The reason is a 47% drop in 3Q revenue to $12.1 billion due to heavy price competition. The company’s Ocean segment posted a $27 million loss compared to 3Q 22 profits of $8.7 billion! The company saw shipping rates fall by 58% from a year ago and believe that there is significant overcapacity in the industry. This is a sea change (pardon the pun) from the situation a year or two ago when ocean shippers could charge up to 10 times the pre-COVID rates. [Louis Goss, “Maersk to cut 10,000 jobs as shipping firm revenue slides,” MarketWatch Nov. 3, 2023]. The importance to us is that this story supports the proposition that much of the global inflation last year

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was the result of logistics constraints and not underlying demand surges. Its resolution is therefore likely to come from unraveling of the shipping knots and not from central bank policy.

Inflation

Core CPI over the last 12 months is now at 1.9%. [https://home.treasury.gov/news/featured-stories/the-us-economy-in-global-context] This isn't the Fed's favorite indicator, which is the PCE (personal consumption expenditures index), but it is nonetheless promising. "Core" excludes food and energy. Core PCE, which weights housing and a few other things differently from CPI, is still up 3.4% from a year ago in September. [https://www.bea.gov/data/personal-consumption-expenditures-price-index, Nov. 5, 2023]

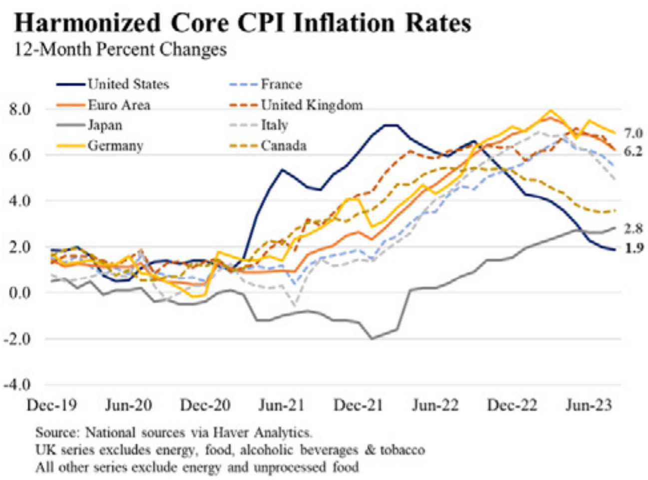


Image source: https://home.treasury.gov/news/featured-stories/the-us-economy-in-global-context, Nov. 5, 2023

I'm including a chart of CPIs from Europe and major market economies. One observation that I'd make is that not only is U.S. CPI running below that of the other countries, but also it contradicts the argument that money supply growth drives inflation.

Earnings

According to FactSet's latest Earnings Insight report, the blended earnings growth rate for Q3 S&P 500 EPS currently stands at +3.7%. That's up from the expected reading as of the end of September, which was (0.3%). The blended revenue growth rate is 2.3%. Of the 81% of S&P 500 companies that have reported for Q3, 82% have beaten consensus EPS expectations, better than the 74% one-year average and the five-year average of 77%. In aggregate, companies are reporting earnings that are 7.1% above expectations. This is telling me that we're starting to see a post-inflation upswing in earnings and the better-than-expected growth should be good for the stock market.

October/November—Not great is great!

Major stock and bond indexes were down again in October. All-in that's a dip of about 8.6% for the S&P over three months. Small caps are down around 15%. Why? Probably largely fears of either the Fed continuing to raise rates and/or a recession. However, recently we saw the 3Q GDP growth print of an astounding 4.9%. So, recession fears ought to fade. And then, we had a mediocre October jobs' report of +150,000 with the prior three months adjusted down by about 100,000. Still an okay report, just nothing that would motivate the Fed to raise rates—so another positive result. Our old friend, "Rosy Scenario," may be back.

International stock indexes were down less than domestic ones and indeed ACWI x U.S. was up only 1% YTD at the end of October. (Some of that is due to USD appreciation.) However, bonds were also down about 1%, which puts them underwater for the year. Gold perked up several percentage points, probably due to the Israel-Hamas war, and is now up 9.2% YTD. Oil on the other hand is in the $82's, which is about where it started the year.

Global stock indexes

Total Index	October %	YTD %	1 yr %	2022 Est PE Trailing/ Projected
S&P 500	-2.10	10.69	10.14	19.17/17.57
S&P Mid Cap	-5.34	-1.30	-1.06	14.17/13.17
S&P Small Cap	-5.74	-4.97	-7.65	14.94/12.45
FTSE All REIT	-3.12	-8.56	-7.89	
MSCI All Country xUS	-4.13	0.99	12.07	
MSCI Emerg Mkt	-3.89	-2.14	10.80	

Source: Morningstar as of October 31, 2023. Estimated PEs are 12-month values from S&P Dow Jones Indices. Trailing PEs are as of September 30, 2022. Projected PEs are as of December 30, 2022. Figures are provided for comparisons over time.

Fixed income and alternatives

Total Return Index	October %	YTD %	1 yr %
Bloom Agg Intermed	-0.98	-1.28	1.22
ICE BofA US Convertibles	-4.36	2.37	-0.03
S&P GSCI	-4.18	2.75	-0.39
Bloom US Corp HY	-1.16	4.63	6.23

Source: Morningstar as of October 31, 2023.

Sector performance

In October, all sectors but one, utilities, were down for the month. On a three-month, all sectors of the S&P 500 were down by percentages ranging from -1.75% (energy) to -12.5% (real estate). On a YTD basis, the best sectors were still: communications (+37.9%), IT (+34.7%) and consumer discretionary (+21.0%). The fourth best and only other sector to come in positive for YTD was industrials at +1.4%. The bottom three were utilities (-13.3%), real estate (-8.1%) and health care (-7.2%) So for the most part, we are still seeing dividend stocks falling, probably due to the higher yields on bonds competing with these stocks for investment dollars. [www.spglobal.com/spdji/en/documents/performance-reports/dashboard-us.pdf, Nov. 5, 2023] [https://digital.fidelity.com/prgw/digital/research/sector, Nov. 5, 2023]

Commodities

Commodity and food price changes, current month and YoY.

Total Index	October %	YoY %
Copper	2.5%	-0.3%
Lumber	2.1%	-5.7%
Cotton	-8.2%	-8.4%
Sugar	7.1%	48.4%
Coffee	16.8%	-2.8%
Wheat	2.2%	-34.0%
Corn	-1.7%	-30.4%
Oil	-2.5%	-12.0%
NatGas	4.8%	-48.5%

Source: https://tradingeconomics.com/commodities, Nov. 5, 2023

Only three of these nine major commodities saw prices decline in October. Compared to a year ago, eight experienced price declines. Looking more broadly at commodities, when we look at 22 categories of agricultural commodities and 26 categories of industrial commodities, 18 of the 48 saw price declines in October, compared to 25 in September and 19 in August. So that indicates that some price declines are still occurring. Then, 33 saw lower prices than a year ago. It was 30 last month and in August. That suggests to me that price declines are still happening but that the rate is slowing. Remaining inflation may be a little more stubborn going forward.

Also, where commodities are concerned, the price level is generally higher now than it was pre-COVID. If we compare current price indexes to their levels in 4Q 2019, we see: The overall commodity index is up just under 50%. The food price index is up about 40%. Energy is up about 40%. Commodity metals are up 35%. [www.indexmundi.com/commodities/, Nov. 5, 2023]

The U.S. economy

The U.S. economy keeps growing . . .

GDP estimates: [www.bea.gov/data/gdp/gross-domestic-product, Nov. 5, 2023] [www.atlantafed.org/cqer/research/gdpnow, Oct. 1, 2023] No changes yet to advance GDP estimates of +4.9% real growth in the last quarter. Personal incomes rose by $200 billion in the quarter, while fixed nonresidential investments fell a little. Consumer spending and increasing exports were the drivers. Other data suggest that corporate profits are trending upward.

The Atlanta Fed's GDPNow model to estimate 4Q GDP growth is estimating a 1.2% growth rate for the quarter we're currently in. I'm guessing that we'll come in a little better than this—maybe +2% to 2.4%—by the time the quarter's over and the numbers start coming out.

Jobs

In October, new payrolls were up 150,000, although the prior couple of months' estimates were reduced by about 100,000 after being bumped up by a similar amount in the last reading. Jobs were created in health care and government. Unemployment ticked up to 3.9%, which isn't a bad thing. Coupled with the jobs' number it indicates that some more people are getting off the sidelines and looking for work, although they haven't found jobs yet. Hourly wages are up 4.1% from a year ago. Long-term unemployed (more than 27 weeks) numbered 1.3 million or 20% of all unemployed. That compares to 40% two years ago when we were recovering from COVID-19. [www.bls.gov/news.release/pdf/empsit.pdf, Nov. 5, 2023]

U.S. PMI statistics

The U.S. manufacturing PMI for October rose to an even 50. It has been in the 46 to 49 range for six months now, so this is the first increase above that range since April. The services PMI—80% of our economy—is still in positive territory and about where it has been, at 50.6, up slightly from last month. [Trading Economics, PMI statistics, Oct. 1. 2023] [Trading Economics, https://tradingeconomics.com/country-list/services-pmi, Nov. 4, 2023]

International

Manufacturing PMI

Every month I look at global Purchasing Managers Index (PMI) statistics. This month only 10 of our 38 countries came in with manufacturing PMIs above 50. That included the U.S. at 50 even, up from 48.9. China dropped back to 49.5 and the EU is at 43.1, still well in contraction territory. The EU's services PMI is also a little underwater at 47.8. Overall, our weighted world index was at 47.5, the same as the previous month. Germany appears to be slowly working its way out of a deep manufacturing downturn, posting a 40.8, up two points from July. [https://tradingeconomics.com/country-list/services-pmi, Nov. 4, 2023]

Here's our updated graph of manufacturing PMIs:

Source: Author's calculations based on published PMI statistics, as of Nov. 4, 2023.

Table summary

Region	Manu PM	Last Month	12 mo. Ago
US	50	48.9	50.4
19 majors	47.8	48.0	49.3
38 world	47.5	47.6	48.9
EU	43.1	43.4	46.4
China	49.5	50.6	49.2

Source: Author's calculations based on published PMI statistics, Nov. 4, 2023.

Investment strategy

So what do we do in terms of investing?

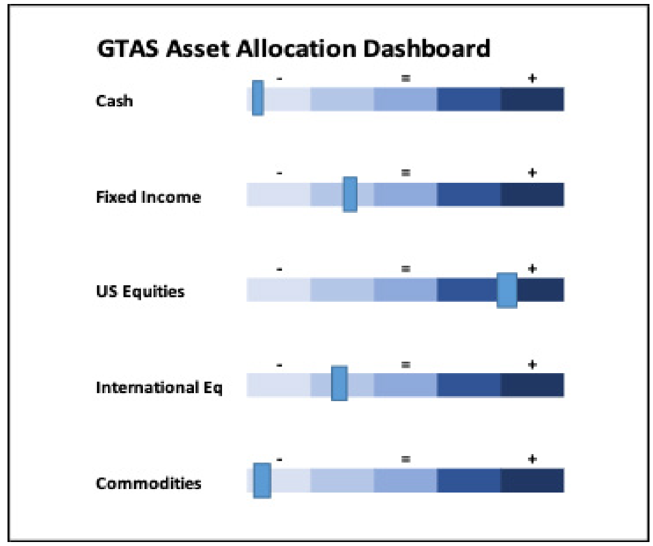
Overall, I'm optimistic about the investment environment right now. I don't think we'll see a recession in the next six months. I also don't think the Fed will change rates in either direction. Europe is a harder call. I'm guessing that it will slowly crawl out of the current malaise. Likewise for China.

From the investment standpoint, the issue is, what is priced in? Earnings at home are exceeding recent expectations, and I don't think better earnings are fully priced in so I think we have upside in our stock markets for the next three or four months. Perhaps even more so in mid- and small-cap than in large cap.

Europe is a harder call both in terms of divining what is or isn't priced in and also due to the currency component. My sense is that a recovery from a dip isn't priced in fully but that you want mostly to invest there with the currency component hedged back into USD. There are ETFs that do that.

On the bond side, you can make 5% or more in treasuries for doing not much of anything. That creates a better base for investing than we've had in over a decade. If you're skeptical of the stock market, I'd say take advantage of these rates.

Commodities as a group might be out of upside. Oil though is impossible to call with the threat of escalation in the Middle East/Gaza. Gold is reacting to the political uncertainty (and, allegedly, Central bank buying) by appreciating.



(+/=/-) represents our group's views over a 6 to 18 month time horizon concerning tilts relative to our strategic positions.

\+ implies an overweight in that asset class.

= implies a weighting similar to our strategic weight.

\- implies an underweight.

Index definitions

Past performance is no guarantee of future results. You cannot invest directly in an index.

Bar Agg Intermed – Bloomberg Barclays US Aggregate Intermediate Total Return index is composed of the BarCap Government/Credit Index, the Mortgage-Backed Securities Index, and the Asset-Backed Securities Index. The returns for the index are total returns, which includes the daily reinvestment of dividends.

Bar US Corp HY – Bloomberg Barclays US Corporate High Yield Total Return index includes all fixed income securities having a maximum quality rating from Moody's Investor Service of Ba1, a minimum amount outstanding of $100 million, and at least one year to maturity.

FTSE All REIT – FTSE Nareit All Equity REITs Total Return index is an index of publicly traded Real Estate Investment Trusts (REITs) that own commercial property. All tax-qualified REITs with common shares traded on the NYSE, AMSE or NASDAQ National Market List are eligible. Additionally, each company must be valued at more than $100MM USD at the date of the annual review.

ICE BofA US Convertibles – ICE BofA US Convertible Bonds Total Return index tracks the returns of U.S.-traded convertible debt issued by companies with a significant presence in the United States. The index is composed of various combinations of convertible structure and credit quality, e.g. it includes investment-grade, speculative-grade, and non-rated issues. The returns for the index are total returns, which include reinvestment of dividends.

MSCI All Country xUS – MSCI All Country World Index Ex USA NR is a free float-adjusted market capitalization index that is designed to measure equity market performance in the global developed and emerging markets. The index consists of 48 developed and emerging market country indices. The returns for the index are total returns, which include reinvestment of dividends.

MSCI Emerg Mkt – MSCI Emerging Markets NR index consists of 26 developing economies including Argentina, Brazil, Chile, China, Colombia, Czech Republic, Egypt, Greece, Hungary, India, Indonesia, Korea, Malaysia, Mexico, Pakistan, Peru, Philippines, Poland, Qatar, Russia, Saudi Arabia, South Africa, Taiwan, Thailand, Turkey, and the United Arab Emirates.

S&P 500 – S&P 500 Total Return index is a market capitalization-weighted index composed of the 500 most widely held stocks whose assets and/or revenues are based in the US; it's often used as a proxy for the U.S. stock market. Total Return (TR) indexes include daily reinvestment of dividends.

S&P GSCI – S&P GSCI Total Return index is a composite index of the commodity futures. It represents unleveraged, long only investments in commodity futures that are broadly diversified.

S&P Mid Cap – S&P MidCap 400 Total Return index is comprised of stocks in the middle-capitalization range, and includes approximately 10% of the capitalization of U.S. equity securities. Total Return (TR) indexes include daily reinvestment of dividends.

S&P Small Cap – S&P SmallCap 600 Total Return index consists of 600 domestic stocks chosen for market size, liquidity, and industry group representation. Total Return (TR) indexes include daily reinvestment of dividends.

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