

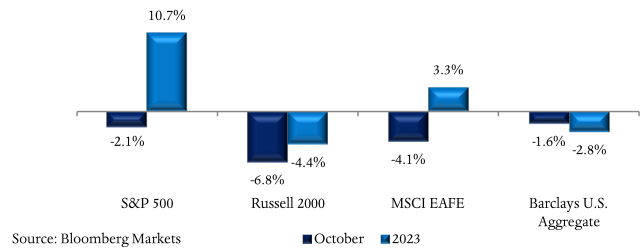


MARKETS

The prospect that interest rates would remain 'higher for longer' hurt global stocks in October. Valuation concerns were further compounded by the resurgence of conflict in the Middle East, triggered by Hamas' attack on Israel and the subsequent counter-offensive. The S&P 500 index proved to be the most resilient, dropping -2.1% during the month (+10.7% ytd). This brought the benchmark more than 10% below its July high, entering correction territory. Growth stocks were relatively firm, declining -2.4% versus their value counterparts which dropped -3.4%. Smaller capitalization stocks bore the brunt of the damage, with the Russell 2000 index plummeting -6.8% in October (-4.4% ytd) to a multi-year low. Overseas, the MSCI EAFE index fell -4.1% (+3.3% ytd), as cracks continued to emerge in the global economic outlook. Asian equities also declined, with the Shanghai composite down -2.9% last month (+0.3% ytd) on the back of continued poor market sentiment despite some positive economic surprises. While still the top performing regional market in 2023, Japanese equities struggled to maintain momentum in October. The Nikkei 225 index fell -3.1% (+20.5% ytd), despite meaningful weakness in the yen.

Government bonds also dropped in October, as yields rose to multi-year highs. The US 10-year Treasury Note yield pushed above 5% for the first time since 2007, driven by a combination of buoyant economic data and concerns around the sustainability of government finances. The Barclays US Aggregate index dropped -1.6% during the month (-2.8% ytd). In corporate credit, widening spreads dented monthly returns of both investment grade and lower quality bonds. The US High Yield index pulled-back -1.2% in October (+4.7% ytd).

Commodities retreated -4.2% in October (+2.8% ytd), as energy and base metals softened, while select agricul-



tural products and precious metals rallied. Initially, there were concerns that a regional Middle Eastern conflict could disrupt oil supply. Nevertheless, by month-end the price of WTI crude oil (\$81.02/bbl) had retraced -10.8% from its September peak (+0.9% ytd). In a flight to safety, investors piled into gold which rallied +7.3% in October, briefly surpassing \$2,000/oz (+8.7% ytd) exhibiting safe haven status amid the geopolitical stress.

GEOPOLITICS

Israel and Hamas went to war after the Palestinian militant group launched surprise cross-border raids into Israel, from Gaza, on October 7. The initial attack was unprecedented in scale, killing more than 1,400 Israelis and taking hundreds of hostages. Hamas's assault resulted in the single deadliest day in Israel's history. In response, Israel ordered a "complete siege" of Gaza commencing with air strikes that have killed several thousand Palestinians and injured multitudes more. Many in the already cramped and impoverished territory are in dire need of aid, which has resulted in a humanitarian crisis. The Israeli military subsequently started staging ground incursions into the Hamas-controlled enclave, with fighting ongoing. Massive demonstrations have erupted globally, airing the grievances of both the Palestinians and the Israelis.

Events-to-date raise concern of a broader war in the Middle East. Lebanese militant group Hezbollah has begun attacking Israel from the north, and unrest is in-

creasing in the West Bank. Iran, a long-time supporter of Hamas, or its proxies, may also become involved militarily. The US and Europe have expressed staunch support for Israel.

UNITED STATES

October saw a flurry of data signaling the resilience of the US economy, including strong retail sales data and a blowout GDP print of 4.9% (annualized) for the third quarter. Inflation showed stickiness, with the headline CPI flat at 3.7% year-over-year in September. However, hiring slowed sharply, a sign the economy is cooling. Employers added 150,000 jobs in October, down from the previous month's revised gain of 297,000, with the caveat that automakers had approximately 33,000 fewer workers on payroll because of the United Auto Workers strike. The unemployment rate rose to 3.9% from 3.8% the prior month. Wage growth cooled as employers hired less, with average hourly earnings up 4.1% from a year ago, a deceleration from 4.3% in September. Economic activity in the manufacturing sector contracted in October for the 12th consecutive month following a 28-month period of growth. The associated PMI came in at 46.7%, compared to 49.0% in September.

The Federal Reserve is on pause from its rate hiking campaign of the past year and a half, but resilient data suggests the central bank may have to hold interest rates at current elevated levels for an extended period of time. In the meantime, the Fed continues to reduce the size of its balance sheet, withdrawing liquidity from the financial system. The central bank's balance sheet currently holds \$7.9 trillion of assets, a decline of approximately \$1 trillion since the start of the quantitative tightening program. Persistently higher yields will affect many segments of the economy, especially those that need to refinance debt or that are exposed to variable rates of interest. From a fiscal perspective, the US National Debt has reached \$33.7 trillion, an \$11 trillion jump (nearly 50%) over the past four years. This trend, along with much higher interest expense, will place a

October 2023 Economic Statistics

	Oct-23	Dec-22	Dec-21
Federal Funds Target Rate	5.25 - 5.50%	4.25 - 4.50%	0 - 0.25%
Consumer Confidence Index	102.6	108.3	115.8
Manufacturing PMI Index	46.7%	48.4%	58.7%
Unemployment Rate	3.9%	3.5%	3.9%
JPY / USD	151.67	131.11	115.08
USD / EUR	1.0576	1.0702	1.1368
Gold / oz.	\$1,982.71	\$1,824.40	\$1,828.39
Oil (WTI)/bbl	\$81.02	\$80.26	\$75.21

Sources: see disclosure *

significant burden on government finances, further affecting fiscal deficits for the foreseeable future.

EUROPE

Bank surveys from the European Central Bank (ECB) showed a contraction in the supply of credit to households and businesses in the third quarter. Meanwhile, the eurozone composite purchasing managers' index (PMI) fell 0.7% to 46.5% in October, well into contractionary territory. Higher interest rates appear to be biting, as shown by the euro area's sizeable drop in consumer confidence, to a seven-month low, and the ongoing decline in retail sales. It was therefore not surprising that the ECB decided to pause its rate hiking plan. Commentary from the central bank's president Christine Lagarde described the euro area economy as "weak." Q3 GDP is expected to decline by -0.1%.

ASIA

China revealed positive surprises in third quarter GDP, showing growth of 4.9%, as well as industrial production and retail sales. Nonetheless, continued weakness in the real estate sector, and reports of new US restrictions on AI chip exports dampened the outlook.

Japanese government bond yields moved higher throughout October as persistent price pressures led the market to justly question the sustainability of the Bank of Japan's (BoJ's) yield curve control (YCC) policy. Despite efforts to defend its accommodative stance, the BoJ tweaked its YCC policy at its October meeting, indicating that the 1.0% upper yield limit for 10-year

government bonds would be considered a “reference.”

OUTLOOK

The summer and early-fall period has been a challenging one for investors, with declines across both equities and fixed income. Despite the continued resilience seen in economic activity, it seems only a matter of time before a slowdown, driven by higher interest rates and tighter financial liquidity, materializes. Mortgage rates recently touched 8% and, when coupled with still high home prices, has resulted in the lowest housing affordability on record. In turn, mortgage applications have fallen to 28-year lows, and existing home sales to the lowest level in 13 years. While US auto sales have remained resilient, the cost of ownership is rising due to price increases (the average price of a car is now \$45,500), and record 9.9% average financing costs. These and other constrictive events have begun to drain the US consumer of its excess savings.

The third-quarter corporate earnings season kicked off with more of a whimper than a bang. The blended earnings growth of 2.8% has come in just slightly ahead of expectations. Moreover, investors have been punishing earnings misses more harshly than in previous quarters, while profit beats have been greeted with skepticism. Forward-looking financial guidance has also been less forthcoming. The more economically sensitive small capitalization stocks in the US fell to a new multi-year low in October, signifying both the fragility of the cohort (many of which hold significant levels of debt), as well as the much lower valuations now on offer. In summary, our research calls for modest medium-term economic growth, a fair amount of which is being discounted by markets. This is ushering in a period where select equities are becoming increasingly attractive for long-term oriented investors.

Bond markets are setting up for the third consecutive year of negative returns, exhibiting elevated volatility, as global central banks tighten monetary liquidity. The pendulum has swung from one extreme: zero interest rate policies amid disinflation, to the other: elevated interest rates across the yield curve to compensate for high inflation.

The Fed has presided over one of the most rapid and steepest increases in short-term interest rates ever, in an effort to re-balance the hot post-pandemic economy which featured pent-up demand, labor shortages, supply chain bottlenecks, fiscal stimulus and excess savings. Looking ahead, investors should be concerned about the sources of demand for US Treasury bonds. The Fed, which was the largest purchaser of bonds during Covid is now a net seller. Other large holders, including Japan and China, are reducing their exposure, with the latter at an accelerated (\$200 billion per year) pace as its relationship with the US cools. On the corporate bond side, concerns are starting to surface surrounding refinancing events, as well as the stress resulting from higher interest rates on floating rate debt. While volatility is sure to persist over the intermediate term, circa 5% 10-year Treasury yields begin to offer reasonable risk adjusted returns to investors. High-yielding credit is discounting the potential for some financial stress and a pick-up in defaults, resulting in the promise of near-equity type returns, while residing higher in the capital structure.

The positive correlation between stocks and bonds has reminded investors of the importance of alternative assets, including commodities and gold. Such exposure should provide ballast to traditional portfolios through diversification and non-market correlation. At long last, government bonds and certain credit opportunities offer investors reasonable risk-adjusted returns. Natural resources stand to benefit from cyclical tailwinds stemming from underinvestment and the potential for scarcity and supply shortages, amid geopolitical instability. Notwithstanding the emerging stress in commercial real estate, we are seeing interesting special situations due to scarcity and secular regional growth. Finally, we see opportunities stemming from disruptive technology trends in the healthcare, defense, edu-tech and cybersecurity sectors.

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*Sources: Reuters, Bloomberg, Bureau of Labor Statistics, Conference Board, Federal Reserve, Institute for Supply Management, MSCI, Russell, Standard & Poor's, Financial Times and the Wall Street Journal.