A View from the Bevy – 3Q23

Market Review

It was a difficult quarter for stocks, as the headwinds facing the market derailed what had been an impressive global rally. August and September, as usual, were tough months in the market, with September becoming the worst month of the year so far for the S&P 500 and Nasdaq Composite.

There were a few negative developments weighing on markets since hitting a 2023 high on July 31. The U.S. Federal Reserve (Fed) released projections showing one more interest rate increase this year and a smaller-than-expected reduction in interest rates in 2024. Additionally, oil and gasoline prices have risen strongly, and looming concern of a government shutdown added uncertainty.

Rising interest rates did not help either, as the bond market's selloff over the past few months has unnerved many investors. In September, yields on the 10-year Treasury rose to the highest level since 2007, and even a pause in Fed-imposed interest rate increases did not stop yields from continuing to climb.

Positively, weaker-than-expected economic data near quarter-end pushed Treasury yields lower across the curve, raising some hopes that the Fed may not raise interest rates again this year. Second-quarter GDP was revised downward, and both the August pending homes sales numbers, and the Kansas City Fed's September manufacturing index came in below estimates. August's personal consumption expenditures index, excluding food and energy, also rose less than expected.

Stock Market Indices	3rd Quarter 2023	Year-to-Date
S&P 500	-3.27%	13.07%
S&P 500 (Equal-Weight)	-4.90%	1.79%
Dow Jones Ind. Avg. (DJIA)	-2.10%	2.73%
NASDAQ Composite	-4.12%	26.30%
Bloomberg US Aggregate Bond	-3.23%	-1.21%
Russell 2000	-5.13%	2.54%
MSCI World	-3.46%	11.10%
MSCI World ex U.S.	-4.10%	6.73%
MSCI Emerging Markets	-2.93%	1.82%

Source: AJO. Data supplied by FactSet Research Systems.

While downturns can be unsettling, it is important to remember that the market was probably due for a modest pullback in the face of the S&P 500 having its best 7-month performance to start a year since 1997. In fact, since 1980, the S&P 500 has had an average of three to four pullbacks of more than 5% per year. So far in 2023, the only other pullback occurred in March during the regional banking crisis.

Market Outlook

We enter the fourth quarter with a mixed outlook that is sure to keep the markets on edge, at least for the short-term. While there is still hope for a seasonally strong end to the year, uncertainty is certain to abound until there is more clarity around how the Fed will act through 2024. Additionally, the development around several macro issues will be weighing on investors' minds and will likely play a large role in determining if we get a year-end rally.

While a government shutdown was averted with the signing of a 45-day spending bill, this now means that the drama of passing a budget will likely last until at least mid-November. Without an agreement then, it could drag on far longer. While Moody's has not formally placed the U.S. on watch for a credit downgrade, the rating agency has announced that it is closely watching developments. Moody's is the only one of the three big rating agencies that maintains a AAA rating on U.S. government debt. Any downgrade would not be received well in the markets and would likely be reflected with higher interest rates.

The magnitude of the strikes against the big three automakers has increased, as the unions are not happy with the progress that has been made. A long and protracted strike could negatively impact economic growth, while large wage gains by the union members may create anxiety around wage growth across the job market. The Fed has pointed to wages and the strength of employment as reasons to raise interest rates and keep them high.

On the bright side, weaker economic data would actually bode well for markets, as it would result in a more dovish Fed and a faster stock market recovery. But the recent spike in interest rates, along with the Fed's more hawkish view are raising questions over whether the Fed will indeed be able to engineer a soft landing, or if there will be a recession early next year.

Consumer sentiment has become more negative, with student loan payments re-starting October 1st, excessive savings from the pandemic nearly depleted and softening labor market conditions. Lower discretionary spending resulting from these developments could precipitate a recession despite the Fed's best efforts. But even if there is a recession, we don't think it will be long or deep.

Even given all these continuing uncertainties, it is important to remember that the fourth quarter is typically the strongest quarter of the year for stocks. The S&P 500 has averaged a return of 4% in the fourth quarter since 1957, and even in 2022, when the S&P 500 had its fourth-worst year since 1957, the S&P 500 was up 7.6% in the fourth quarter.

Remember, it is really a market of stocks, more than a stock market, and we are always evaluating companies to add to portfolios that are positioned for success whatever the overall market conditions. Client portfolios also remain diversified to mitigate risk. Let's hope as the weather turns cooler stocks turn higher and end of the year as they started, with positive momentum.

Of Interest: A Look at Generative Artificial Intelligence

Generative Artificial Intelligence (AI) is a broad label that is used to describe any tool that processes and organizes data to identify patterns, summarize information or make suggestions, such as creating new text, images, video, audio, or code.

Although a relatively new concept to many, it has become more mainstream over the past year, led by Microsoft's ChatGPT and Google's Bard, two of the largest language model chat tools. The question and debate today is, is it the technology of the decade or an inflated promise?

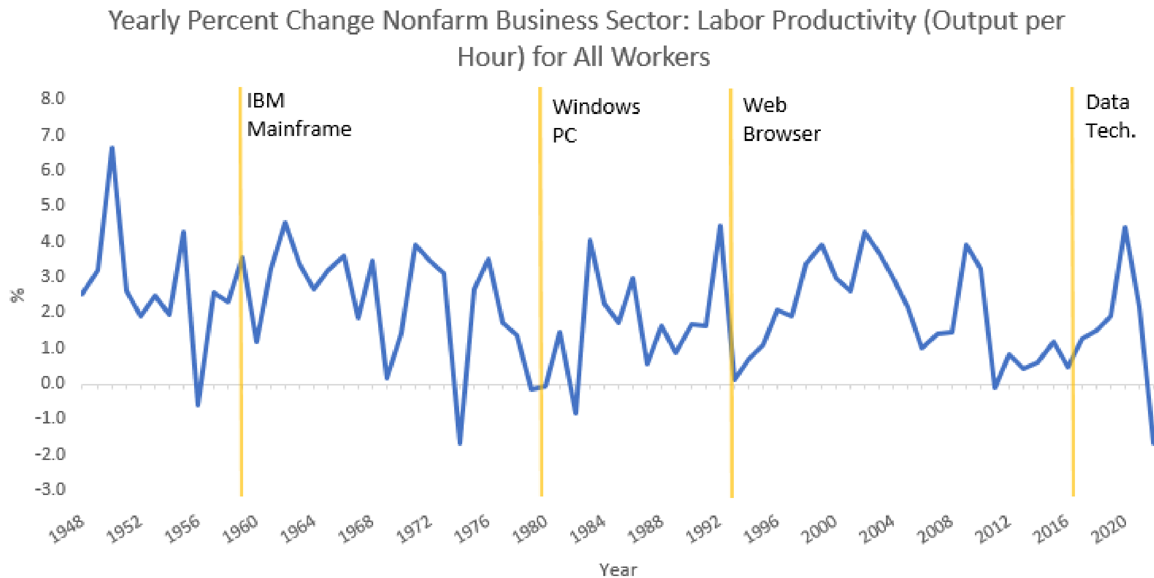
AI proponents are confident that productivity enhancements offered by AI will be the next economic revolution. For example, Goldman Sachs projects that AI could help drive more than $7 trillion in global economic growth over the next 10 years. They view AI as much more than just a chat bot, citing evidence supporting the impact of integrating AI across all sectors of the S&P 500, from optimizing logistical efficiency to advancing medical devices.

Technological advancements can be lifesaving tools, but they often come at a cost. Sceptics argue that the current investment craze has created a bubble, driving the price of these stocks above intrinsic value. Companies involved in AI are in large part fueling the hype, with Alphabet, Meta, and Microsoft each mentioning AI approximately 50 times each in recent earnings reports.

Skeptics also argue that the existing technology cannot deliver on these exaggerated expectations, and there may be far more losers than winners, much like during the Dotcom Bubble. Even some of the staunched proponents of AI are calling for a slowdown to assess the positives and negatives, and additional governmental oversight seems likely.

The growth of AI may also result in substantial labor force disruptions. Historically, for example with the introduction of personal computers and web browsers, labor force disruptions were short-lived, as obsolete jobs were replaced by new ones tied to the emerging technology. Telegraph operators became computer operators, and so forth. But the jobs AI is capable of replacing may not offer realistic substitutes.

Wendy's recent announcement concerning the use of AI for drive-through orders serves as an example. If successful, competitors are likely to follow suit, leading to the displacement of over a million workers. As illustrated below, productivity increases resulting from past technological advances have resulted in reduced payrolls, and what's ahead may be no different, if not worse. While some new job opportunities will emerge in relation to the rise of AI technology, those positions will remain out of reach for many of the displaced workforce.



Source: Dimensional Fund Advisors.

Groundbreaking emerging technology, such as AI, can boost gross domestic production and improve livelihoods, but may also prove to be disruptive to the economy. Risks exist with all investments, yet history shows us that failing to invest in emerging technologies like personal computers in the mid-80s or data technologies in 2018 would have been a costly mistake. Managing risk effectively to capture upside and hedge against downturns continues to be the imperative strategy to ensure you don't miss the proverbial boat while protecting yourself at the same time.

Cygnus Asset Management, LLC is not a registered broker/dealer and is an independent of Raymond James Financial Services. Securities are offered through Raymond James Financial Services, Inc. Member FINRA/SIPC. Investment Advisory Services are offered through Raymond James Financial Services Advisors, Inc.

Any opinions are those of Cygnus Asset Management and not necessarily those of RJFS or Raymond James. The information contained does not purport to be a complete description of the securities, markets, or developments referred to in this material. There is no assurance any of the trends mentioned will continue or forecasts will occur. The information has been obtained from sources considered to be reliable, but Raymond James does not guarantee that the foregoing material is accurate or complete. Any information is not a complete summary or statement of all available data necessary for making an investment decision and does not constitute a recommendation. Investing involved risks and you may incur a profit or loss regardless of strategy selected. The Dow Jones Industrial Average (DJIA) commonly known as "The Dow" is an index representing 30 stocks of companies maintained and reviewed by the editors of the Wall Street Journal. The NASDAQ composite is an unmanaged index of securities traded on the NASDAQ system. The S&P 500 Index is an unmanaged index of 500 widely held stocks that is generally considered representative of the U.S. stock market. The MSCI EAFE (Europe, Australia and Far East) is a free float-adjusted market capitalization index that is designed to measure developed market equity performance, excluding the United States and Canada. The EAFE consists of the country indices of 22 developed nations. The Russell 2000 Index measures the performance of the 2,000 smallest companies in the Russell 3000 Index, which represents approximately 8% of the total market capitalization of the Russell 3000 Index. The Bloomberg Barclays US Aggregate Bond index is a broad-based flagship benchmark that measures the investment grade, US dollar-denominated, fixed-rate taxable bond market. Inclusion of these indexes is for illustrative purposes only. Indices are not available for direct investment. Any investor who attempts to mimic the performance of an index would incur fees and expenses which would reduce returns. Investing in commodities is generally considered speculative because of the significant potential for investment loss. Their markets are likely to be volatile and there may be sharp price fluctuations even during periods when prices overall are rising.