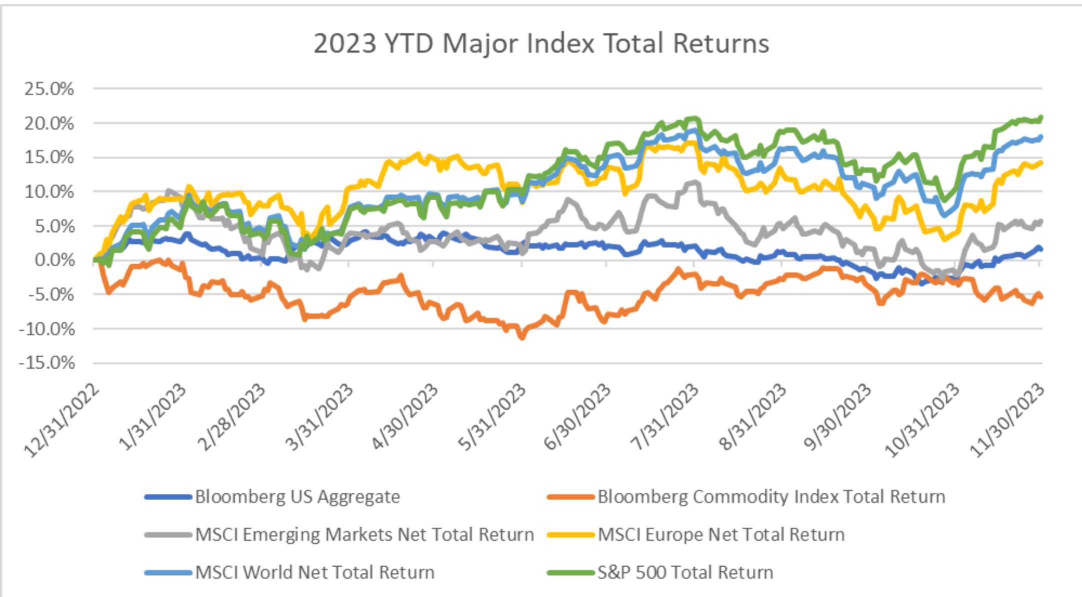
ENCORE INVESTMENT ADVISORS

NOVEMBER 2023 MARKET REVIEW

Market Recap: Just as it seemed stocks were tumbling towards a bear market, equities delivered historically strong returns in November. After a three-month losing streak, US equities jumped 9.1% and global equities fared slightly better, increasing 9.4%. The rally in November was accompanied by a significant uptick in bond markets as well, with US bonds increasing by over 4.5%. This was the largest monthly return for US bonds in over 35 years! Better than expected inflation readings spurred interest rates lower and equities higher from oversold positions in both asset classes. For much of the year, investors were wagering that a soft-landing would be the most likely outcome, and after three months of economic worries, markets again appear to be pricing in a euphoric state of normalized inflation and steady positive growth. And speaking of lower inflation, US CPI inflation for October came in at 3.2% and US PCE inflation read 3.0%. Both figures are down significantly from their peaks; however, the Fed is still tightening the economy to reduce these levels further. The inflation picture is improving in Europe and the UK as well, yet another positive sign for the global economy.

When markets whipsaw like they have in the second half of the year, it is important to examine what changes have driven these outsized moves. The stock market volatility in the fall was preceded by an increase in year-over-year inflation readings in headline measures of inflation during each month of the second quarter, after declining sequentially from the peak in June of 2022. The lower October readings reaffirmed that inflation continues to trend lower, although inflation may not move lower in a straight line. Without getting overly technical, investors are able to bet on upcoming Fed interest rate decisions via the futures market, and through the pricing of various futures contracts, we are able to determine a consensus view of where interest rates are expected to be in 2024. Only three months ago, markets were expecting the Fed to essentially hold rates steady for much of 2024. Today, however, the expectation is for approximately two rate cuts through July 2024, and a total of four for the entire 2024 calendar year. Lower interest rates buoy the value of stocks, and equities have taken the expectation of more rate cuts in 2024 as an opportunity to inflect higher, thus driving the large gains in November.

How does this impact our perspective? Inflation continues to be the most important variable when analyzing the global economy. Although, as we near central bank inflation targets, we believe that much more attention will be placed on how the broader economy is faring and whether some form of recession will occur in 2024. Forecasting recessions, and everything else in the financial world, is obviously quite difficult to do consistently. As such, we believe our portfolios are positioned for success in good times and resilience in bad times. The current risk is that equities have priced in a goldilocks scenario and that either inflation remains far stickier, or the economy is much closer to recession than investors believe. In those scenarios, the Fed would likely cut rates significantly more than four times in a recession, or less than four times if inflation remains sticky. For equities to continue to move higher, any rate cuts will be driven by easing inflation rather than a weakening economy, and the equity rally will need to broaden from the handful of tech companies that have driven the majority of return so far in 2023, to the rest of the market in the US and abroad.



Data Source: Y Charts

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