INVESTMENT STRATEGY UPDATE

MARKET REPORT
OCTOBER 2023

ASCENTIAL WEALTH ADVISORS

MARKETS RECONSIDER RALLY

The rally in equity markets lost steam in the third quarter, after a strong first half in 2023. While equity markets remained in positive territory year-to-date, they posted quarterly losses as concerns about higher interest rates again became the focus. While core inflation continued to abate, headline inflation increased due to energy prices rising significantly as West Texas Intermediate crude oil prices increased 28.5% for the quarter. Additionally in the US, a strike by the United Auto Workers Union threatened to pressure inflation by further tightening supply in the automotive market.

With this data in mind, the Federal Reserve indicated that it is likely to keep interest rates higher for longer than markets had previously anticipated. A premature reduction in rates could allow inflation to rebound in an economy underpinned by a surprisingly resilient labor market. This strong labor market has thus far kept the US economy out of recession but has also made inflation difficult to mitigate by keeping consumers flush with income. The negative sentiment in equity markets in the past quarter was enhanced by a variety of risks that could derail the possibility of a "soft landing," including waning consumer savings, slower than expected growth in China, and a potential for a government shutdown in the US.

Bonds struggled alongside stocks, with the Bloomberg US Aggregate Bond Index falling into negative territory for the year as the market digested the new higher rate outlook. Short term bond yields rose slightly from already elevated levels, but the more significant change in yield came from longer duration bonds. The yield on the 10-year US Treasury reached its highest level since 2007, climbing from 3.8% on June 30th to 4.6% at the end of September. The 10-year Treasury serves as a benchmark for longer term lending and this move is likely to drive mortgage rates and other borrowing costs higher.

Index	*2023 (through 9/30)*
S&P 500	+13.1
Dow Jones Ind. Avg.	+2.7
MSCI EAFE	+7.1
BC US Aggr. Bond	-1.2

Dow Jones Relative Risk Benchmarks	
Conservative	+2.1
Moderate	+3.2
Aggressive	+7.1

OUR VIEW

FIXED INCOME:
The Federal Reserve increased rates by another .25% in July and then paused again in September, and indicated one more increase may occur in 2023. The Fed Funds rate now stands at 5.25%-5.5%, up from 0%- 0.25% at the beginning of 2022. Recent guidance suggests that rates could remain high for some time in response to mixed inflation data and continued strong employment. Bond prices fell and yields rose as markets digested this outlook. The yield curve began to flatten in the third quarter, with long term yields moving up closer to short term yields. While short term rates remain attractive, we are in favor of extending bond maturities to lock in some of these higher yields as they approach peak. Historically, bonds have consistently delivered strong returns after a rate hike cycle concludes. Even if rates remain elevated for a while before receding, bonds are now offering attractive yields and should provide more stability to portfolios to help offset equity volatility.

US EQUITY:
Enthusiasm over artificial intelligence and the potential for a "soft landing" was tempered in the third quarter with stocks giving back gains from the first half. The broad earnings outlook was little changed, but stock prices fell, lowering valuations and leaving the S&P 500 trading slightly above its long-term average. The communications and technology sectors remain the best performers year-to-date, however, the top sector for the third quarter was energy, which rallied double digits as oil prices spiked.

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US EQUITY (CONT.):

The most interest rate sensitive areas were hit hardest, particularly small cap companies which lost the most for the quarter. We remain in favor of a somewhat defensive approach in equities. We are recommending less exposure to small and mid-size companies in favor of larger names which should be better able to withstand higher interest rates or an economic slowdown if it should materialize.

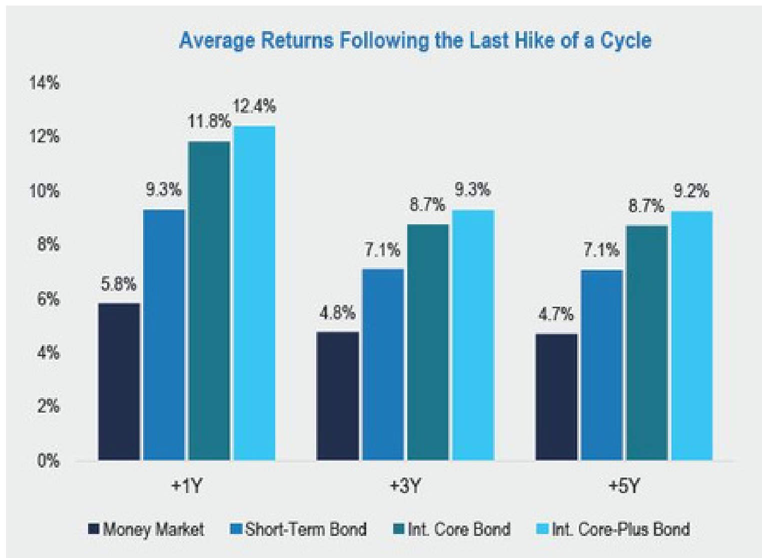
INTERNATIONAL EQUITY:

International equities posted declines in line with US markets for the quarter, while both foreign developed and emerging markets remained in positive territory year-to-date. However, emerging markets are the laggards for the year so far, up only 1.81%. Fears weighing on foreign stocks include persistent inflation, higher energy costs, ongoing trade tensions between the US and China, and slower than anticipated growth in China's economy. After a period of decline in the US dollar a recent rally in the currency further weighed on foreign markets. Foreign stocks remain much cheaper than US stocks on a price/earnings basis and are generally trading below their 25-year average valuations. We feel there is room for recovery in foreign stocks, particularly in developed international markets.

OPPORTUNITY IN PEAK INTEREST RATES

Current rates on short-term fixed income such as money market funds, high yield savings accounts and CDs are incredibly tempting. Offering yields in the 5% range, these options could be better than holding cash or excess funds in typical low-rate bank accounts and can put cash to work while maintaining liquidity for shorter term needs. Investors should take advantage of the current yield on cash alternatives but not lose sight of the opportunity that lies ahead in longer term fixed income.

When interest rates peak, history suggests that longer duration fixed income is likely to outperform short-term bonds and cash alternatives. This chart illustrates how various types of fixed income have performed after the Federal Reserve stops raising interest rates. With the Federal Reserve seemingly approaching the end of this interest rate cycle, we believe opportunity lies ahead in longer duration fixed income and investors who stay in cash and short-term bonds could miss out.



(PGIM Investments, 2023)