CETERA® INVESTMENT MANAGEMENT

COMMENTARY

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Stocks Enter Correction Territory

- After a strong start to 2023, market headwinds have pushed the S&P 500 into a correction.
- A robust economy, improving corporate earnings, and a Fed on hold may shift investor sentiment.
- As volatility picks up, diversification and staying focused on your goals are even more important.

The S&P 500 finished last week in correction territory, meaning it is now down more than 10% from its most recent high set this past July. Corrections are a normal part of investing but can lead to increased volatility. However, they can also present investment opportunities. Regardless of the direction of the stock market, diversification remains one of the most important investment strategies you can utilize in your portfolio.

After a strong start to the year in which the S&P 500 had its best first half in 22 years, the most recent three months have been a struggle for the index. Today, this index has fallen back to April levels. While there are many culprits of this recent weakness, the three primary headwinds to stocks have been the following:

- **Rising Bond Yields** – Last week, the 10-year U.S. Treasury yield breached 5% for the first time since 2007. Equities do not like rising bond yields as this leads to higher borrowing costs and creates asset class competition. Higher yields make bonds more attractive, and investors may be less inclined to buy equities.

- **Geopolitical Concerns** – The ramifications of escalating tensions in the Middle East have weighed on investor sentiment.

- **Mixed Earnings Season** – According to Factset, 49% of S&P 500 companies have reported third-quarter earnings. While 78% of these companies have reported a positive surprise, investors have focused on the lackluster forward guidance as companies are uncertain about the business ramifications of a potential recession and any further escalations in the Israel-Hamas war.

We expect these market overhangs to weigh on investor sentiment for some time. However, there are some potential positives that may reverse this sentiment:

- **The U.S. Economy Remains Robust** – Last week, third quarter U.S. GDP growth came in at an astonishing 4.9% powered by the strength of the consumer. This reading exceeded both expectations and the second quarter reading of 2.1%. Given that a lot of economic strength was seen in the latter part of the quarter, this momentum should flow into the fourth quarter. Furthermore, areas of the economy in recession today, such as manufacturing, autos, and housing, are stabilizing. Taken together, a stronger economy bodes well for corporate earnings.

- **Corporate Earnings Recovery** – Speaking of earnings, we may have just seen the bottom in corporate earnings growth. According to Factset, the blended earnings growth for the third quarter rose from -0.4% to +2.7% last week and is now on pace for the first quarter of year-over-year earnings growth since the third quarter of 2022. Corporate earnings tend to lead stock prices.

- **The Federal Reserve (Fed) is Done** – Inflation is slowing, and higher bond yields are helping the Fed slow growth already. As such, we continue to believe that the Fed is done raising rates. This potentially removes a key market overhang.

With the recent pullback, valuations such as price-to-earnings ratios have fallen. The S&P 500's P/E ratio looking at 12-month forward earnings has fallen quickly from 19.8 to 17.1. Lower stock market valuations, combined with potential shifts to investor sentiment, offer some potentially better market entry points for long-term investors. However, until we get more clarity on these potential positive drivers, we do expect market volatility to remain elevated. But again, market volatility is a normal part of investing. Case in point, as we noted last week, from 1980 – 2022, the S&P 500 has been positive in 35 of these years, yet the average intra-year drawdown was -14.3%. Market volatility is a normal part of investing. Diversification helps to protect against volatility.

Given the current negative sentiment, U.S. equities are now in a correction with volatility starting to pick up. Given the potential positives that we see on the horizon, markets can change abruptly and reverse course quickly. Your financial professional can help you stay focused on your personal financial goals. As always, please contact your financial professional with any questions on tailoring your portfolio to your personal situation.

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