Market analysis

November 20, 2023

**At a glance**

U.S. stocks rose for a third consecutive week and bond yields fell as cooling inflation and moderating consumer spending led investors to price in earlier expectations for Federal Reserve interest rate cuts in 2024.

**Number of the week**

-0.1%

The change in retail sales in October compared to September.

**Term of the week**

**Continuing resolution** – Legislation that continues pre-existing appropriations at the same levels as the previous fiscal year (or with minor modifications) for a set amount of time. Continuing resolutions typically provide funding at a rate or formula based on the previous year’s funding.

“Big-box retailers report cautious consumer spending trends. Home Depot, Target and Walmart all note cautiousness among lower-income consumers, with customer engagement directed toward smaller projects and lower-ticket items. Spending on discretionary items remains soft, albeit largely similar to second quarter levels. Inventories appear in line with expectations, decreasing the likelihood of widespread bargain pricing at year-end.”

- **Terry Sandven**, Portfolio Manager, Chief Equity Strategist, U.S. Bank
Global economy

Quick take: Slowing consumer spending and moderating inflation suggest Federal Reserve (Fed) interest rate hikes are achieving their desired effect. China’s economy continues to struggle to recover from its pandemic shutdowns.

Our view: U.S. job growth is trending lower but remains sturdy, inflation is moderating and consumer spending — while positive — exhibited slowing in October, conditions consistent with a soft-landing, according to U.S. Bank’s Economics Team.

- U.S. inflation cooled more than expected in October. The headline Consumer Price Index (CPI) was unchanged relative to September, with the year-over-year measure slowing to 3.2%. Core inflation, which excludes volatile food and energy items, also decelerated more than analysts’ expectations to 4.0% compared to a year ago, the slowest pace in two years. While core inflation remains twice the Fed’s target rate, inflation’s steady decline suggests the Fed is nearing the end of its tightening campaign.
- Consumer spending slowed slightly in October after three months of strong gains. Total retail sales fell 0.1% after rising 0.9% in September and 0.7% in August. The modest monthly decline from high summer levels suggests consumer spending remains relatively resilient with positive momentum heading into the holiday season. Spending at restaurants and bars rose 0.3% relative to the prior month while furniture and home furnishings declined 2.0% and department store sales fell 1.2%, highlighting the ongoing divergence between services and goods spending.
- The U.S. avoided a federal government shutdown, with Congress passing a stopgap measure before Friday’s deadline. The continuing resolution funds certain government agencies until January 19 while funding others until February 2. The short-term spending bill extends farm subsidies through September but does not include support for Ukraine or Israel.
- China’s October data releases continue to reflect a two-speed economic recovery, with industrial production and retail sales accelerating relative to September while housing construction and sales activity continues to languish. Chinese President Xi Jinping met with President Biden and business leaders in San Francisco and spoke at the Asia-Pacific Economic Cooperation (APEC) summit in his first U.S. visit in six years, with the leaders of the world’s two largest economies hoping to ease geopolitical tensions.

Equity markets

Quick take: U.S. equities are beginning the Thanksgiving-shortened trading week as the third quarter reporting period draws to a close and focus on holiday selling trends begins to ramp.

Our view: Persistent inflation, elevated interest rates and uncertainty over the pace of earnings growth in 2023 and 2024 have remained headwinds to advancing equity prices for much of 2023. Still to be determined is whether the pace of inflation is on a sustained downtrend, which would pave the way for the Federal Reserve to take a more dovish stance while providing valuation support for equities.

- November performance reflects a risk-on (more aggressive) bias. The S&P 500 ended Friday up 7.6%, with 10 of 11 S&P 500 companies posting gains ranging from 2.1% to 11.9%; only Energy, down 1.3%, is in negative territory for November. The favorable broad-based return in November is partially attributable to investors anticipating that the Federal Reserve is close to finished with its rate hikes, thus providing valuation support. The three best-performing sectors in November — Information Technology, Communication Services and Consumer Discretionary — are also the three best performing sectors year-to-date, up 49.5%, 48.9% and 31.7%, respectively.
- Third quarter results are trending in line to modestly above low expectations. As of Friday’s close, 97% of S&P 500 companies have reported third quarter results, with sales advancing 1.7% year-over-year versus expectations for growth of 1.5%; earnings are up 2.7% versus expectations for a fractional increase of 0.1%. Another 2% of S&P 500 companies are slated to release results this week, highlighted by artificial intelligence bellwether NVIDIA, which is scheduled to report on Tuesday.
- Big-box retailers report cautious consumer spending trends. Home Depot, Target and Walmart all note cautioniness among lower-income consumers, with customer engagement directed toward smaller projects and lower-ticket items. Spending on discretionary items remains soft, albeit largely similar to second quarter levels. Inventories appear in line with expectations, decreasing the likelihood of widespread bargain pricing at year-end. Dwindling savings, student-loan repayments, high interest rates and economic uncertainty are among factors noted to be weighing on demand.
Bond markets

Quick take: Slower Consumer Price Index data released Tuesday prompted a fall in Treasury yields as investors priced in the possibility of earlier Federal Reserve rate cuts in 2024. The decrease in Treasury yields boosted bond prices across the fixed income market.

Our view: High-quality bonds remain an integral component for diversified portfolios, typically performing well when growth and inflation are slowing. Higher-than-normal Treasury bond issuance and uncertainty regarding domestic fiscal policy and regional conflict outcomes has led to increased bond market volatility, favoring keeping interest rate sensitivity (duration) close to benchmarks.

- Softer inflation data reduces the odds of additional monetary policy tightening. Falling energy costs steadied headline CPI data, with prices unchanged from September to October. While making good progress toward the Fed’s goal of cooling price growth to average 2% year-over-year inflation, monthly readings can be volatile, and many core inflation measures such as services costs continue to rise at an unsatisfactory pace. The slight increase in unemployment claims since September may cool wage growth and help ease inflation from its current 3.3% year-over-year rate toward the Fed’s target, but Fed officials have been wary of preemptively declaring victory in their fight against inflation. We prefer retaining near-benchmark interest rate sensitivity in bond portfolios, recognizing both the return benefits long-term bonds can offer in periods of slowing growth and inflation as well as the risk of heightened yield volatility from high Treasury bond supply and persistently tight monetary policy.

- Near-normal corporate and municipal bond valuations fairly compensate for credit risks, while esoteric bond categories offer compelling return opportunities with favorable fundamentals. Strong investor risk appetite has supported returns in riskier corporate and municipal bonds, meriting exposure near long-term allocation targets. However, mortgage bonds not backed by government agencies can complement existing high-quality bond exposures. Rising home prices in recent years well-secure the collateral backing mortgage bonds, and delinquencies remain historically low. Meanwhile, low unemployment and strong wage gains support home-owning consumers’ ability to stay current on their inexpensive fixed rate loans.

Real assets

Quick take: Most real asset categories recovered last week as interest rates declined from recent peaks. Real Estate and Infrastructure have notably underperformed this year as interest rates rose but rallied last week as rates declined. Energy led commodity price declines despite falling interest rate expectations fueling dollar weakness.

Our view: We continue to see value in real assets’ defensive sectors. We favor tangible assets with stable cash flows as the market moves into a period marked by decelerating economic and corporate earnings growth. Commodities remain vulnerable if expectations for falling inflation and decelerating growth come to fruition.

- Real Estate outperformed the S&P 500 by 1.7% last week. Cell towers were the top-performing sector, outperforming the broader market by 5.3%. Residential was the worst-performing sector, trading in line with the broader market. Public real estate offers compelling value at current levels and trades at a significant discount to net asset value, but we acknowledge that near-term risk is elevated, and sentiment can change abruptly.

- Infrastructure outperformed the S&P 500 by 1.6% last week. Railroads led performance, outperforming the broader market by 1.9%. Midstream energy was the worst-performing sector but still outperformed the broader market by 0.6%.

- Crude oil prices fell 1.7% last week despite the continuing conflict in Gaza. Friday’s price action was significant, with oil prices recovering by 4.1% as rumors of further OPEC+ production cuts surfaced. (OPEC + is the Organization of the Petroleum Exporting Countries and 10 oil-producing allies, including Russia.) The crude oil market remains undersupplied over a longer time horizon, which should continue to provide price support. However, an emerging solution to regional conflicts or disappointing economic growth represent further downside risks to oil prices.
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Based on our strategic approach to creating diversified portfolios, guidelines are in place concerning the construction of portfolios and how investments should be allocated to specific asset classes based on client goals, objectives and tolerance for risk. Not all recommended asset classes will be suitable for every portfolio. Diversification and asset allocation do not guarantee returns or protect against losses.

**Past performance is no guarantee of future results.** All performance data, while obtained from sources deemed to be reliable, are not guaranteed for accuracy. Indexes shown are unmanaged and are not available for direct investment. The S&P 500 Index consists of 500 widely traded stocks that are considered to represent the performance of the U.S. stock market in general. The Consumer Price Index is a measure that examines the weighted average of prices of a basket of consumer goods and services, such as transportation, food and medical care. It is one of the most frequently used statistics for identifying periods of inflation or deflation.

**Equity securities** are subject to stock market fluctuations that occur in response to economic and business developments. **International investing** involves special risks, including foreign taxation, currency risks, risks associated with possible differences in financial standards and other risks associated with future political and economic developments. Investing in **emerging markets** may involve greater risks than investing in more developed countries. In addition, concentration of investments in a single region may result in greater volatility. Investing in **fixed income securities** are subject to various risks, including changes in interest rates, credit quality, market valuations, liquidity, prepayments, early redemption, corporate events, tax ramifications and other factors. Investment in debt securities typically decrease in value when interest rates rise. This risk is usually greater for longer-term debt securities. Investments in lower-rated and non-rated securities present a greater risk of loss to principal and interest than higher-rated securities. Investments in **high yield bonds** offer the potential for high current income and attractive total return but involve certain risks. Changes in economic conditions or other circumstances may adversely affect a bond issuer’s ability to make principal and interest payments. The **municipal bond market** is volatile and can be significantly affected by adverse tax, legislative or political changes and the financial condition of the issues of municipal securities. Interest rate increases can cause the price of a bond to decrease. Income on municipal bonds is free from federal taxes but may be subject to the federal alternative minimum tax (AMT), state and local taxes. There are special risks associated with investments in **real assets** such as commodities and real estate securities. For commodities, risks may include market price fluctuations, regulatory changes, interest rate changes, credit risk, economic changes and the impact of adverse political or financial factors. Investments in real estate securities can be subject to fluctuations in the value of the underlying properties, the effect of economic conditions on real estate values, changes in interest rates and risks related to renting properties (such as rental defaults).