

## November 6, 2023 – Investment Commentary

### Market Moves

Last week, stock and bonds (price up / yield down) were up. The “risk on” markets helped the S&P 500 outperform the MSCI EAFE (non-U.S developed) and MSCI Emerging Markets indices. Across U.S. Russell style & market cap indices, small cap value outperformed due to their meaningful exposure to financials, REITS, and less profitable companies.

As for fixed income, the 10 yr. treasury yield fell over 30bps on the week to 4.52% and the 2year- 10year treasury yield spread flattened to -34 bps. The best performing parts of the bond market included mortgage-backed securities. For reference, the yield on the U.S Treasury 10-year opened the week at 4.88% and closed the week at 4.52%, and in between, reached a high of 4.93% and a low of 4.48%. This is a tremendous amount of volatility for the “risk free” U.S government bond market.

### Update: What we are evaluating

Last week, we identified a few categories that could move markets. The following is a summary of the developments which individually and collectively helped to pivot the market to a more “risk on” posture.

1. The U.S. Treasury indicated the amount of long-term bonds it's planning to auction would be modestly lower than previously indicated (supply<demand for treasuries), which would suggest price up/yield down;
2. The Bank of Japan further loosened its grip on long-term interest rates by tweaking its bond yield control policy again, but less than expectations, taking another small step towards dismantling its controversial monetary stimulus of the past decade (suggesting foreign demand for U.S debt may largely remain in place);
3. The Federal Reserve offered guidance that it didn't plan any more rate hikes and that its approach is more “strategically patient” rather than “strategically restrictive”;
4. US unemployment data was weaker than expected.
5. Fundamentals Q3 2023 Update:
  - For Q3 2023 (with 81% of S&P 500 companies reporting actual results), 82% of S&P 500 companies have reported a positive EPS surprise and 62% of S&P 500 companies have reported a positive revenue surprise.
  - Earnings Growth: For Q3 2023, the blended (year-over-year) earnings growth rate for the S&P 500 is 3.7%. If 3.7% is the actual growth rate for the quarter, it will mark the first quarter of year-over-year earnings growth reported by the index since Q3 2022.
  - Earnings Guidance: For Q4 2023, 48 S&P 500 companies have issued negative EPS guidance and 27 S&P 500 companies have issued positive guidance.
  - Valuation: The forward 12-month P/E ratio for the S&P 500 is 17.8. This P/E ratio is below the 5-year average (18.7) but above the 10-year average (17.5).
6. Inflation in the eurozone slowed more than expected to an annual rate of 2.9% in October—its lowest level since July 2021—from 4.3% in September.
7. Stocks in China gained as speculation that U.S. interest rates may have peaked offset broader concerns about the country's slowing growth. China's ongoing housing market decline remains a serious drag on its growth outlook for many investors despite recent indicators suggesting a demand recovery after Beijing rolled out a flurry of stimulus measures. Although China is widely expected to attain its goal of 5% gross domestic product (GDP) growth in 2023, many observers appear to believe that the economy remains vulnerable, given insufficient governmental support for the housing sector.

Ironically, the increase in stock prices and lowering of yields lowered the Fed's Financial Conditions Index, which summarizes the combined effects on the economy of several financial variables. The looser financial conditions may create a "feedback loop" and trigger the Fed to keep rates higher for longer to dampen economic growth and tackle inflation. This theory of "reflexivity" that famous investor George Soros embraced may be increasingly discussed between now and year end.

### Portfolio Considerations

The majority of the last market environment from 2009 through 2019 was characterized by a zero-interest rate environment where the "punch bowl" was always full. Investors had little income opportunities available in the broader bond market. Equity capital appreciation (a function of earnings growth and multiple expansion) was the most important driver of returns. Given valuations were very elevated to start this cycle coming out of 2020 with over 20x forward P/E and earnings jumped quickly over 30% from 2020 to 2022, capital appreciation from multiple expansion and earnings growth may be less of a driver of total return from here. However, the bond market now offers yield, and we are not even close to a zero-interest rate environment today. As a result, we believe income/yield will be an increasingly relevant portfolio contributor to total return from here.

Even though bond yields did give back some of the recent rise last week, we are still looking at yields of 6.0% for investment grade corporates, 5.5% for mortgage-backed securities, 5.3% for the U.S. Aggregate Bond index (broad index of U.S investment grade bonds) and high single digit tax-equivalent yields for certain municipal bond investors in high tax jurisdictions. In our view, investors should consider using income/yield to their advantage with the added potential benefit of future price appreciation (price up/yield down) for investors who are patient. We prefer higher quality bonds in public markets and stressed/distressed credit in private markets because we believe we are late in an economic cycle. In other words, we believe unemployment is skewed to go up rather than down, and margins are likely to compress for weaker companies rather than expand from here with a slowing economy. Therefore, income is likely to be an important return driver across portfolios for the next several years.

### Disclosures

*Investment Commentary Sources: Bloomberg. Investment advisory services offered through Robertson Stephens Wealth Management, LLC ("Robertson Stephens"), an SEC-registered investment advisor. Registration does not imply any specific level of skill or training and does not constitute an endorsement of the firm by the Commission. This material is for general informational purposes only and should not be construed as investment, tax or legal advice. It does not constitute a recommendation or offer to buy or sell any security, has not been tailored to the needs of any specific investor, and should not provide the basis for any investment decision. Please consult with your Advisor prior to making any Investment decisions. The information contained herein was carefully compiled from sources believed to be reliable, but Robertson Stephens cannot guarantee its accuracy or completeness. Information, views and opinions are current as of the date of this presentation, are based on the information available at the time, and are subject to change based on market and other conditions. Robertson Stephens assumes no duty to update this information. Unless otherwise noted, any individual opinions presented are those of the author and not necessarily those of Robertson Stephens. Indices are unmanaged and reflect the reinvestment of all income or dividends but do not reflect the deduction of any fees or expenses which would reduce returns. Past performance does not guarantee future results. Forward-looking performance targets or estimates are not guaranteed and may not be achieved. Investing entails risks, including possible loss of principal. Alternative investments are only available to qualified investors and are not suitable for all investors. Alternative investments include risks such as illiquidity, long time horizons, reduced transparency, and significant loss of principal. This material is an investment advisory publication intended for investment advisory clients and prospective clients only. Robertson Stephens only transacts business in states in which it is properly registered or is excluded or exempted from registration. A copy of Robertson Stephens' current written disclosure brochure filed with the SEC which discusses, among other things, Robertson Stephens' business practices, services and fees, is available through the SEC's website at: [www.adviserinfo.sec.gov](http://www.adviserinfo.sec.gov). © 2023 Robertson Stephens Wealth Management, LLC. All rights reserved. Robertson Stephens is a registered trademark of Robertson Stephens Wealth Management, LLC in the United States and elsewhere.*