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CAPITAL MANAGEMENT INC.

MARKET REVIEW

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WATCH EPISODE

MARKET COMMENTARY

Financial markets are recalibrating to a higher interest rate environment with interest rates returning to a more normal level after more than a decade of unusually low rates. The 10-year U.S. Treasury bond yield has risen to its highest level since late 2007, driven by a more resilient U.S. economy, causing investors to scale back expectations on imminent Federal Reserve rate cuts combined with a growing acceptance that the policy rate will be higher for longer to bring inflation back to target. An increasing supply of treasury bonds to fund growing government deficits is also putting upward pressure on yields.

Restrictive monetary policy is working. At the same time, rising long-term treasury bond yields have also been contributing to a significant tightening of financial conditions. High interest rates are having the intended impact of slowing economic growth and easing inflation with more to come in as the lagged impact is fully absorbed. While core inflation remains above the target range, there is good visibility, particularly in the United States, for inflation to recede further as shelter disinflation resumes. The end of the rate hiking cycle is in sight.

Corporate profit growth turns negative when a recession hits. Corporations in the S&P 500 Index are not guiding to a profit recession this year. While year-over-year earnings per share (EPS) growth was negative in the first two quarters this year, EPS is expected to be marginally up in the third quarter and further strengthen in the fourth quarter. The consensus view is that profit growth will continue into 2024, implying a recession will be bypassed. Commentary from management teams in the upcoming earnings season will provide clarity regarding the profit outlook for the next 12 months and should current consensus forecasts hold, provide some valuation support.

Making accurate macroeconomic forecasts is difficult and when combined with unexpected policy changes and/or exogenous events that may occur, nearly impossible. While being cognizant of economic conditions, we focus on what is manageable by staying invested in financially strong, reasonably priced companies to build wealth over time.

Christine Poole, MBA, CFA