HIGHLAND

Multi-Asset Solutions Weekly Commentary

October 30, 2023

Key Observations

- Stocks sold off last week as solid, albeit mixed earnings results led to profit taking in some of this year's mega-cap growth leaders. With earnings season now half over, there are fewer potential catalysts to drive gains into year-end, but many stocks appear oversold, and we are looking to 4,240, the S&P 500's 200-day moving average and 3% above Friday's close, as a key area of resistance for any rally.

- At the halfway point of earnings season, 77% of companies that have reported have topped the consensus estimate for earnings per share, while 65% have bested the consensus sales estimate, evidence that companies continue to do a good job managing costs and maintaining/growing profit margins, broadly speaking. However, we remain concerned that earnings expectations for 2024 remain too lofty and may see significant downward adjustment over coming quarters.

- The 10-year U.S. Treasury yield briefly topped 5% last Monday before buyers stepped in and forced yields lower over the balance of the week. The 10-year yield, specifically, closed at 4.85%, down 8 basis points on the week as fixed income investors yawned at the hotter than expected preliminary reading on 3Q U.S. GDP. A break below Friday's close could bring 4.65% into play in short order, but below that we would expect 4.50% to put up staunch resistance and we would be surprised to see the 10-year yield end 2023 below that level.

What We're Watching

- Eurozone Consumer Price Index (CPI) for October is released Tuesday. Headline CPI is expected to fall sharpy to 3.0% year over year from 4.3% year over year in September, while core CPI is expected to make a more modest move lower to 4.2% from 4.5% the prior month.

- The Federal Open Market Committee (FOMC) kicks off its scheduled two-day meeting on Tuesday with Chair Jerome Powell expected to speak around 1:30 central time on Wednesday. We do not expect the FOMC to hike the Fed funds rate at this meeting, but Chair Powell's remarks will be dissected for any hints as to how the Committee may be leaning leading up to its December meeting.

- The Conference Board's Consumer Confidence survey for October is released Tuesday with a reading of 100.5 expected, which would be a drop from 103.0 in September.

- The October nonfarm payrolls report is released Friday with 189k jobs expected to have been created during the month. The unemployment rate is expected to remain static month over month at 3.8%.

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	Price/Yield			Total Return (%)			
	10/27/23	1 Week Ago	1 Month Ago	Year to Date	1 Year	3 Years	5 Years
Dow Jones Industrial Average	32713.91	-2.14	-3.28	-0.48	3.39	7.84	8.13
S&P 500	4156.78	-2.52	-3.58	9.08	9.95	8.35	11.16
NASDAQ	12825.06	-2.62	-3.41	22.52	18.20	4.25	13.42
Russell 2000 Index	1657.18	-2.60	-7.87	-5.38	-7.99	2.24	3.43
MSCI World ex US	277.41	-0.89	-3.44	1.08	11.76	2.38	4.39
MSCI EM	919.78	-0.61	-2.93	-1.37	10.26	-4.06	2.49
Bloomberg US Aggregate	5.58	0.68	-1.07	-2.82	0.00	-5.59	-0.08
Bloomberg Global Aggregate	4.32	0.42	-0.60	-3.41	0.89	-7.48	-1.67
Bloomberg US Corporate	6.28	0.78	-1.45	-1.82	2.63	-5.59	0.82
Bloomberg 10-Year Muni	4.49	-0.04	-1.13	-2.37	2.71	-2.49	0.95
Bloomberg High Yield	9.35	0.40	-1.25	3.79	6.00	0.85	2.99
				Price/Yield			
	10/27/23	1 Week Ago	1 Month Ago	12/31/22	1 Year Ago	3 Years Ago	5 Years Ago
SOFR (yield)	5.31	5.30	5.32	4.30	3.04	0.09	2.19
30 Year Mortgage (average rate)	8.05	8.10	7.83	6.66	7.10	3.03	4.70
2 Year Treasury (yield)	5.06	5.07	5.14	4.43	4.27	0.15	2.81
10 Year Treasury (yield)	4.88	4.91	4.61	3.87	3.92	0.77	3.08
30 Year Treasury (yield)	5.04	5.08	4.72	3.96	4.08	1.55	3.31
WTI Crude (closing price)	85.54	88.75	93.68	80.26	89.08	39.57	67.59
Brent Crude (closing price)	90.48	92.16	96.55	85.91	96.96	41.20	77.62
Gold (NYM $/oz)	1988.60	1982.50	1872.30	1826.20	1660.70	1908.80	1232.50

Source: Bloomberg (3- and 5-Year Returns Annualized)

What Happened Last Week:

▲ Stocks: Risk-Off Dominates As Profit-Taking Hits Some Mega-Cap Growth Leaders With 'High Bars To Chin;' Relative Strength From Abroad, Despite Weaker Economic Data; Another Rough Week For Crude Oil, But Recent Consolidation Is Reason Enough To Remain Allocated To Energy Stocks.

"Good, But Not Great" Earnings Not Good Enough To Support Valuations For Some Mega-Cap Growth Names. Investors took their cue from earnings last week which proved to be a headwind for equities as the S&P 500 fell 2.5% on the week while the small-cap Russell 2000 index declined 2.6%. Alphabet, Amazon, Meta Platforms, and Microsoft, all members of the 'Magnificent 7,' posted quarterly results which appear solid when viewed collectively but were viewed by investors as sending mixed signals. Alphabet, the parent company of Google, was the biggest loser as the stock fell 9.9% on the week despite topping the consensus estimate for earnings per share and sales. Meta Platforms fell 3.8% after also besting estimates as an initial post-earnings rally fizzled. It's notable that both Alphabet and Meta outperformed the S&P 500 in the 3rd quarter and leading up to earnings season, so these two names appear to be victims of bullish sentiment and their own success. On the other side of the ledger, Microsoft, which had marked time since the end of the 2nd quarter, gained 0.9% as sentiment surrounding the name was less enthusiastic. Rounding out the week, Amazon released earnings after market close on Thursday and the stock rallied 8.5% on Friday, but shares ended the week with a more modest 2% gain. We would characterize earnings reports out of these four companies as impressive and evidence of the strong getting stronger, but with these names up between 36.7% and 139.6% year-to-date, great expectations and lofty valuations made them subject to profit-taking. However, investors may not be able to stay away from these stocks for very long and last week's profit taking could reverse into year-end as performance chasing takes hold.

Relative Strength Abroad Despite Lackluster Economic Data Out Of The Eurozone. The Eurozone Purchasing Managers Index (PMI) for October was released Tuesday, with the Composite reading coming in at 46.5, below the 47.4 estimate, evidence that economic activity in the Eurozone contracted further during the month. Despite

both the manufacturing and services components of the PMI reading coming in below expectations, Eurozone equities, broadly speaking, barely seemed to notice, a sign that investor expectations for the Eurozone and U.K. economies, as well as equities domiciled there are close to rock-bottom levels. The MSCI EAFE developed markets index ultimately ended the week lower by 1.1% as France and Japan outperformed while Italy and Spain were notable laggards. Emerging markets held up better than we might have expected last week given continued U.S. dollar strength and ongoing geopolitical concerns. However, while the MSCI EM index fell just 0.7% on the week, the index was buoyed by China and little else as the MSCI China index rose 2.4%, while country indices tied to South Korea and Taiwan fell by 3.9% and 1.7%, respectively.

A Rough Three-Week Stretch For "Black Gold" As Crude Oil Prices Tumble Again, But M&A Activity In The Oil Patch Remains Hot, A Sign Of C-Suite Confidence. The geopolitical risk premium built into crude oil prices in the wake of Hamas' attack on Israel on October 7 has been all but completely removed and the price per barrel of West Texas Intermediate (WTI) crude oil ended last week at $85.45, just over 3% above where it was trading on October 6. The S&P 500 energy sector has also reversed course and after falling 6.2% last week, is now lower by 6.3% in October, with downside materializing as the Israel/Hamas conflict has failed to spread to other parts of the Middle East which could be more impactful on global crude oil supply. It's notable that the selloff in the energy sector in recent weeks has occurred despite merger and acquisition (M&A) activity heating up in the space with Chevron buying Hess in a $53B all-stock transaction last week, which followed Exxon's $59.5B purchase of Pioneer Natural Resources the prior week. Energy prices and related stocks will likely remain volatile, ebbing and flowing on news out of the Middle East, but with M&A activity likely to ramp up into 2024, we would be more interested in buying weakness in the space as opposed to selling into strength.

U.S. Dollar Strength Representative Of Global Investor Skittishness. The U.S. Dollar Index, or DXY, bounced off key technical support at/around 105.50 and ended the week at 106.56 for a modest 0.3% weekly gain. The dollar's upward trajectory over the balance of last week is notable given the fall in Treasury yields week over week, and a resumption of the DXY's uptrend is evidence that investors globally remain a skittish bunch and continue to seek out safety above all else. Sentiment on stocks, broadly speaking, appears unlikely to improve in a meaningful way over the near-term with geopolitical tensions running hot and earnings unlikely to provide bulls with a catalyst for sizable gains. A Santa Claus rally is still likely in the cards, but it may come from lower levels as bears appear to have control as October wraps up.

▲ Bonds: A Downward Bias To Treasury Yields On The Week Despite A Hot 3Q GDP Reading; European Central Bank Pauses, Joins The FOMC, Bank Of England In Pushing "Higher For Longer" Rates Mantra.

A Round-Trip For Rates After A Volatile Week Of Trading. Bonds have been battered during October, making even last week's modest bounce in prices feel therapeutic. The Bloomberg Aggregate Bond Index ended last week higher by almost 0.7%, as the 10-year yield retreated from a high of 4.95% mid-week to close at 4.83%, the byproduct of core inflation from September coming in in-line with the market's expectations which gave bond investors' increased confidence that there would be no surprises out of the FOMC this week. While Fed funds futures have remained steadfast in the view that there would be no rate hike at the FOMC's meeting, Fed-watchers will be listening closely to the post-meeting press conference for hints of dovishness, or the lack thereof, and any updates surrounding the path and pace of quantitative tightening. Complacency surrounding this week's FOMC meeting could contribute to additional interest rate volatility leading up to and in the wake of the meeting. Given elevated interest rate volatility around recent FOMC meetings, corporate treasurers seeking to float new debt issues are waiting for the dust to settle before issuing debt as deal activity dried up last week with just one coming per day. Modestly wider credit spreads in the past month are another factor crimping supply as issuers across the quality spectrum may be waiting on improved investor risk appetite or are hoping that challenges posed by a weak spot in the calendar dissipate quickly.

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Bonds Yawn At Hot Initial Read On 3Q GDP. The first read on 3Q GDP showed 4.9% quarter over quarter growth which blew the doors off the consensus forecast which called for still lofty 3.8% growth. Looking at the GDP number in isolation, the economy appears impervious to tighter financial conditions, but to us strong 3Q growth appears unsustainable. We suspect that some of 3Q's strength was borrowed or pulled forward from 4Q, and with the current consensus estimate calling for north of 2% GDP growth next quarter, we would lean toward taking the under. Bond market participants appear to agree with this assessment, evidenced by the downward move in yields on the heels of Thursday's strong GDP release as better growth, in theory, should have been supportive of inflation expectations and pushed yields higher. GDP has surprised us and many others on the upside for much of this year, but rather than looking in the rearview at trailing numbers, our sights are set on forward drivers, specifically consumption as spending has increased at the expense of saving over the back half of the year. Personal income data for September furthered this trend as income advanced by just 0.3% while spending jumped 0.7%, which in turn forced the savings rate lower for the fourth consecutive month. Admittedly, savings is coming from a record high base, but if U.S. consumers struggle to rein in spending and average hourly earnings contract, this dynamic will ultimately weigh on economic growth.

ECB Pauses, As Expected, After Tightening At 10 Straight Meetings. The European Central Bank (ECB) joined the multitude of global central banks on the sideline for now, leaving the ECB refinance rate at 4.5% last week as anticipated, likely capping the central bank's tightening cycle that began in July of last year. For those keeping score, the ECB is the last of the four major central banks to go on hold while simultaneously embracing the 'higher for longer' rates message. Like the FOMC in the U.S., the ECB attempted to keep its options open by stating that more rate hikes shouldn't be ruled out, but there appears to be minimal appetite for additional policy tightening given paltry Eurozone economic growth and the fragility of the bloc as winter approaches, which could bring with it higher energy/electricity prices. One point of interest on the other side of the ECB's pause is the admission that inflation will stay higher for longer than it would prefer, describing inflation as a medium-term issue, which generated questions about the length of the pause and when the first potential rate cut could materialize. ECB President Lagarde also let it be known that another policy lever at the ECB's disposal, altering the pace and/or size of quantitative tightening, was not discussed, thus taking any potential changes to the central bank's pace of balance sheet runoff off the table in the near-term. Eurozone bonds rallied after the ECB's meeting, but we question the durability of any move lower in yields as inflationary pressures could be set to reaccelerate over coming months, likely keeping upward pressure on euro area sovereign yields.

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