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September 2023

Quarterly Review and Outlook

The stock market has shown strong gains year to date powered mainly by the move in technology stocks, especially companies with exposure to Artificial Intelligence. Since the highs reached in July, however, the stock market has given up some of its advance. Investors are grappling with U.S. Treasury yields that have surged to their highest level in 16 years and hawkish revisions to monetary policy from the Federal Reserve. The Federal Reserve met in mid-September and decided to pause its rate hikes for now. However, they warned that resumed tightening is possible, sending a clear message that monetary policy will be kept restrictive for longer than investors previously expected and dashing any hopes for possible rate cuts before year end. If economic growth does not slow, and if inflation does not fall toward the Fed's target of 2.0%, the Fed has made it clear that more rate hikes lie ahead, including the possibility of one more hike this year. Fed Chairman Powell also said in his remarks that a soft landing was not a baseline expectation which further dampened investors' spirits.

In addition to the Fed Chairman's sobering remarks and the climb in the ten-year Treasury yield to a 16 year high of ~4.6%, investor concerns were also heightened by the announcement from Saudi Arabia that it would extend its voluntary production cut of 1 million barrels per day through year-end which resulted in a run-up in oil prices. Further weighing on investor sentiment has been the United Auto Workers strike against all three of Detroit's automakers which, depending on how long it lasts, could depress economic growth and drive-up car prices. Whereas the prospect of a US government shutdown had also weighed on investor sentiment, that event has been averted at least for now. With just hours to spare, Congress passed (with bipartisan support) and President Biden signed a stop-gap funding measure which will keep the Federal government open through November 17th. While resolved for the near term, the government funding issue remains an intermediate term overhang. If a shutdown were to occur in mid-November, it could delay the release of economic data on wages, employment, inflation and other output that the Federal Reserve relies on to set monetary policy. The risk of the Fed "flying blind" is no longer a significant concern for its next meeting scheduled to begin October 31st, but it may affect the Federal Reserve's final policy meeting in December. Such an event would cloud the economic outlook and impair the Fed policy-making process, potentially causing officials to postpose any decision on rates until sometime in Q1 2024.

Another worrisome concern is that the consumer, whose spending has remained surprisingly resilient, may begin to slow their spending due to depleted savings (left over from Covid stimulus payments), tighter lending standards and the resumption of student loan repayments. While these factors might result in a slowing in the rate of economic growth, ongoing strength in the job market has served as an offsetting force.

Taking these factors into account, it is fair to say that the outlook for the economy and financial markets is tricky from here. While the economy and corporate earnings have been stronger than expected this year, recent indicators have shown a slowing in economic activity. Third quarter corporate earnings should give investors a better read on the state of the economy. Companies will begin to report their earnings in the third week of October, but right now we are in a quiet period when companies are unable to give guidance to analysts. Historically during this period of uncertainty, the market tends to feel pressure and become choppy. Although stocks have come off their summer highs, valuations have converged closer to their 25-year average. This suggests that stock valuations are not stretched, and if earnings reports come in better than expected, there is likely room for the market to move higher into year-end.

Our investment approach has not changed. We continue to look for companies with competitive advantages, superior growth, solid balance sheets and strong management teams. Our focus continues to be on the technology, healthcare, industrials, specialty financial and consumer sectors.

In the fixed income market, it has been a long time since we could say that we are excited about yields. However, with interest rates rising, we have been finding opportunities to increase income in portfolios by purchasing higher yielding securities with a focus on high quality issues. In some cases, we have also purchased longer dated securities to secure a stream of income should the Federal Reserve start to cut interest rates at some point next year.

As always, we are grateful for the support of our clients, and we encourage you to reach out to us with any questions or concerns you may have regarding your investments.