Market Leadership: A Double-Edged Sword

That's the story of the stock market in 2023. After a stellar first half and a good start in July, riding a wave of upward momentum, both the S&P 500 and NASDAQ have since erased the returns investors had amassed since June. Despite that, they can find solace in their remaining current YTD returns from those indices of roughly 11% and 23% in turn. That compares to their July peak returns of almost 20% and 37% respectively. That dramatic change of the last 60 days can be explained by the continued acrobatics of the eight mega-cap, AI/tech stocks that led the market up through July and then retraced a bit for the remainder of Q3. It's readily apparent the lack of breadth in the market can cut both ways in a cap-weighted index. Illustrating the importance of those stocks to performance, the *unweighted* S&P 500 index dipped briefly into negative territory for the year on Wednesday as other sectors of the market failed to pick up the slack created by the decline in the mega-caps.

While seasonal influences may be a minor factor here, current weakness in the market is more likely the result of concerns regarding valuation of the market leadership as we embark on a Q3 earnings season amid expectations for Q4 that are predicted to put 2023 S&P earnings marginally ahead of those of last year (1-2%). It's generally thought that *key sectors* (Tech, Financials, Consumer, Energy) reporting in Q3 could weigh on investors' expectations (and actions) as the year comes to a close. 2024 earnings are forecast by a few optimistic analysts to improve by 11%. Recently, others have settled into the 8-9% area with their predictions. That range of estimates is the result of continued uncertainty about the ultimate destination of interest rates.

Speaking of the Fed. Having foregone a hike in the Fed Funds rate at this month's meeting, conjecture has escalated once again over the meaning of "higher for longer". A reading of the FOMC Summary of Economic Projections ("SEP") points to the likelihood that the Fed is in the 9th inning of executing policy actions. The SEP encompasses the individual forecasts of both voting and non-voting members on policy actions foreseen as necessary to regaining price stability and maintaining optimal employment for the economy. Those forecasts *lean* toward seeing a *single* hike in one of the two meetings held before year-end. That's a reading of current sentiment. Whether extra innings are required is, of course, dependent on the data that currently points to a *sustainable* though uneven decline of inflation toward the mandated 2% level that appears to be much further down the road. For now, that puts us in the "*little* higher for longer" camp.

Looking ahead, opinion is divided (naturally) over 2023 marking the beginning of a new bull market. We find that call to be premature despite the reemergence of the soft landing narrative in some quarters. Reading between the lines, the Fed cautions against mistaking *resilience* in the economy for early cycle *reacceleration*. The weight of higher interest rates and quantitative tightening on the economy are as immutable as the law of gravity. To what extent remains to be seen. For that reason, we remain cautious. That means playing the long game, broadly diversified and balanced between value and growth, while balancing exposure to risk with liquidity needs. As we've seen in Q3, data dependence for the Fed can spell data confusion for investors playing the short game. Stay tuned.