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OCTOBER 2023

MARKET PERSPECTIVE

Higher for Longer ... for Now

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DASHBOARD

- Business Cycle
- Valuation
- Trend

There was a string of solid economic news for most of the past few months. Core inflation has continued to moderate. GDP growth appears to have accelerated in the third quarter. The Federal Reserve didn't raise rates at its September meeting. And while it left the door open for another hike this year, it appears that the Fed is about done raising rates. It also predicted it would leave its short-term benchmark rate at this higher level for longer.

Adding to the headwinds is the recent spike in long-term rates. As of this writing, the yield on the 10-year Treasury bond touched 4.8%, the highest in 16 years. It had been steadily climbing since the spring, likely from the combination of stronger economic growth and expectations that the U.S. government will need to issue an increasing amount of debt to fund the fiscal deficit. Also, with the Fed attempting to unwind its massive Covid stimulus, it's increasing the supply of Treasurys. It seems the latest move up in rates is from the market embracing the notion that rates will be higher for longer.

Source: StockCharts.com, Clayton Wealth Partners.

Higher interest rates can affect financial markets and the economy in several ways. In theory, higher rates can have an immediate impact on stocks because bonds that now offer a higher payout may compete more effectively with stocks for investor dollars, all else equal. Also, higher interest rates make the value of future corporate cash flows less valuable when discounted back to today's value. (The value of any investment is the sum of all future cash flows discounted back to today's value at an appropriate rate, which is heavily influenced by current interest rates.) And finally, higher rates will weigh on corporate earnings when companies take on new debt or roll over old debt at higher prevailing rates.

But higher long-term rates may not stay as high as some might think. Historically, investors have flocked to Treasurys as a haven when facing economic headwinds or other financial distress, which pushes rates down. We think it's a matter of when, not if, that occurs in this cycle.

Bullish

- The Fed is making progress toward reducing inflation.
- Significant pent-up consumer demand.
- The services sector of the U.S. has remained strong.
- The most attractive yields for fixed income and cash in years.
- Consumer and corporate balance generally remain healthy.

Bearish

- Global inflation remains too high.
- Global central banks tightening.
- Slowing global economic growth with recession pressures mounting.
- Leading indicators of unemployment, such as a lower number of job openings and increasing layoffs and initial jobless claims, are generally trending down.
- Delinquency rates on consumer loans are rising.
- Russia-Ukraine war, Israel-Hamas conflict, and other geopolitical concerns.
- China's post-Covid economic rebound has lost momentum, with deflation fears growing.
- Federal debt and deficits have ballooned.

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As Partner and Chief Investment Officer, James Walden strives to maximize our clients' long-term, risk-adjusted portfolio returns. This includes determining strategic and tactical asset allocations, as well as specific investment analysis and prudent rebalancing. Jim is also a partner and management team member. His expertise includes advanced investment research and valuation, and he is passionate about his role in helping clients reach and exceed their financial goals.

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