Oxford Harriman Market Commentary

September 27, 2023

Oxford Harriman Offices

Astoria, New York

Boston, Massachusetts

Buffalo, New York

Chagrin Falls, Ohio

Cleveland, Ohio

Detroit, Michigan

Kingston, New York

Mentor, Ohio

Newport News, Virginia

Park Avenue, New York

Rhineback, New York

Sarasota, Florida

Saratoga County, New York

Short Hills, New Jersey

Syracuse, New York

Westlake, Ohio

Woodcliff Lake, New Jersey

www.oxfordharriman.com

Last week, the S&P 500 index closed at its lowest level of the current quarter with a decline for the week of nearly 3%. The same index has fallen nearly 6% since its highest close of the year on July 31. What is behind the multi-week decline? If we step back and look at the year overall, investor sentiment has largely remained upbeat. Financial markets have rebounded from their 2022 sell-off, with the S&P 500 gaining more than 14% (inclusive of the most recent decline) and credit spreads have tightened. The U.S. consumer continues to be supported by low unemployment and wage growth, and while data shows the rate of economic activity is slowing, it remains positive despite the rate hiking cycle. GDP growth has exceeded expectations, housing activity is rebounding despite elevated mortgage rates, and the industrial sector remains resilient as the government invests in infrastructure upgrades, renewable energy, and semiconductor production. So, what has changed?

On Wednesday September 20, the Federal Reserve did not increase the federal funds rate, as generally expected, but the tone of his speech and subsequent press conference was more hawkish than previous announcements. Many investors now believe that potential rate cuts will take place later than previously expected in 2024. This has been our concern and a topic we have discussed in these commentaries over the past year. Interest rates are likely to remain higher for longer. Given the recent decline in the stock market and rise in the 2- and 10-year Treasury rates, this theme may be gaining broader acceptance.

Oil prices have been rising and recently, the current economic environment has been drawing comparisons to the 1970s. In the early 1970s, oil prices surged following OPEC's oil embargo, and U.S. fiscal deficits expanded as government spending increased. Today, oil prices are elevated due to supply concerns, and fiscal deficits are expanding as the government invests in infrastructure improvements and renewable energy.

While the 1970s and today share rising oil prices and budget deficits, the most direct link between the two periods is high inflation. The numbers differ, but a similar pattern emerges. In both periods, inflationary pressures began building early when interest rates were low in the 1960s and 2010s, respectively. Inflation subsequently eased as economic activity slowed around the 1970 recession and the 2020 COVID pandemic. However, inflation later reversed higher in both periods, with oil prices spiking in

the early 1970s and supply chain disruptions following the 2020 pandemic. In both instances, the Fed responded by aggressively raising interest rates to ease inflationary pressure.

It is possible the Fed has been hesitant to declare a victory against inflation even though there has been a recent decline. The risk remains that inflation accelerates like it did in the late 1970s. While this is not the Fed's forecast, it is widely discussed as a potential risk.

However, the 1970s serve as a cautionary tale, as inflation reaccelerated to over 13% by the end of the decade. The rapid rise in inflation prompted the Fed to take drastic action and raise the federal funds rate to a staggering 20% in early 1980. It is possible the Fed has been hesitant to declare a victory against inflation even though there has been a recent decline. The risk remains that inflation accelerates like it did in the late 1970s. While this is not the Fed's forecast, it is widely discussed as a potential risk.

The Fed may be determined to avoid repeating its errors from the 1970s. The implication is that the Fed may decide to keep interest rates higher for longer, which could keep the cost of capital high in the coming years.

Consumers are already finding it more expensive to buy homes and vehicles, and to refinance existing mortgages. Additionally, businesses are starting to find it more expensive to fund operations, finance inventory, and reinvest in their business. While the recent rise in rates appears dramatic, with the 10-year Treasury bond yield hitting 4.5% for the first time since 2007, it is important to keep in perspective just how low rates have been in recent years. The 4.5% yield on the 10-year represents the average yield for U.S. government debt dating all the way back to 1790.

We continue to evaluate many data points to determine how interest rates, and expectations of future rates, will drive investor behavior and market direction. Please reach out if you have questions concerning how the current interest rate environment impacts your portfolio and financial objectives.

Have a good week ahead,

Dennis P. Barba, Jr.
CEO & Managing Partner

Michael P. Finkelstein, CFA
Partner

Robert Frenkel, CFP®
Chief Investment Officer

Sources:

cnbc.com

reuters.com

bloomberg.com

barrons.com

Important Disclosures: The report herein is not a complete analysis of every material fact in respect to any company, industry or security. The opinions expressed here reflect the judgment of the author as of the date of the report and are subject to change without notice. Any market prices are only indications of market values and are subject to change. The information contained herein is based on technical and/or fundamental market analysis and may be based on data obtained from recognizable statistical services, issuer reports or communications or other sources believed to be reliable. However, such information has not been verified by us, and we do not make any representations as to its accuracy or completeness. The material has been prepared or is distributed solely for information purposes and is not a solicitation or an offer to buy any security or instrument or to participate in any trading strategy. Index returns are not fund returns. An index is unmanaged and not available for direct investment. Past performance is no guarantee of future results. Yields are given as of 8/2/2023.Bonds are subject to price and availability.

The S&P 500 Index consists of 500 stocks chosen for market size, liquidity, and industry group representation. It is a market value weighted index with each stock's weight in the Index proportionate to its market value.

Additional information is available upon request. PM-03262025-5976307.1.1