Q3 Market Podcast Transcript: Seasonal Trends

Kim Brown:

Hello, I am Kim Brown, President of JNBA Financial Advisors, headquartered in Minneapolis, Minnesota. We are recording this podcast on September 21st, 2023, and joining me are two members of JNBA's Investment Committee, Mark Rosenkranz, an Investment Strategist, and John Foster, Senior Advisor and Investment Strategist. Mark and John, good morning. There's lots to talk about today, so let's get started. Following a difficult year in 2022, this year has seen a bit of a comeback. That's true. Despite bleak economic forecasts, a national debt ceiling debate, fears of a potential banking crisis, and a historic rise in interest rates, 2023 has been a year of some actually positive economic surprises.

Unemployment remains resilient, inflation appears to be in a downward trend, and corporate earnings have appeared solid. Despite a relatively strong year for the S&P, the year to date returns, I think hovering around north of 15%, we have seen some challenges across our more diversified portfolios in both equities and fixed income. John, I'm wondering if you can discuss a little bit about the return environment we've seen across the various asset classes since the market lows in late 2022 and how that has actually impacted returns for more diversified portfolios.

John Foster:

Yeah, good morning, Kim. I think 2022 and 2023, really the last couple of years have at times been challenging for investors. It reminds me a little bit of a Warren Buffet quote where "The market is a mechanism to transfer wealth from the impatient to the patient," is certainly some asset classes here have required more patients than others. Coming off the lows from October last year, we saw everything rally from 5% of bonds off the lows to 15% for many equity markets and international leading the way with 25% returns off the October, 2022 lows.

Starting though in February, we started to see a big divergence across different asset classes, so large cap stocks fueled mostly by the Nasdaq-100 type names, the big mega-cap tech stocks like Apple and Google and Microsoft that really don't need to do any debt financing because of all the cash they have on hand and all the cashflow they generate, so they're not as impacted by higher interest rates.

And so companies like that, continue to power higher into summer while other areas in the market, small-cap stocks, mid-cap stocks, some international equities had a bit of an undertow to them. So small-cap stocks in January rallied about 12%. Well, since then, they've declined about 11%. So small company stocks are only up about 1% on the year. So we've seen this divergence really over the last eight months now between large-cap stocks that continued to move higher into July until stalling out here in mid-July. And that's really not that uncommon either for the market to take a pause into fall, August and September seasonally tend to be two of the worst months. With September, the only month where U.S. markets on average have a negative return.

So that kind of seasonal pattern has certainly held true this year. I think what gives us some optimism though moving forward is some of the areas that have been left behind are relatively cheap. Small company stocks right now have, on average, they've traded at about 19 times earnings over the last decade, and currently they're trading at about 11 times earnings. And so you have small company stocks that are at a significant discount to their historical norm. So some

of these areas that have been left behind are really priced for good returns. But again, that's where some patience is required before those valuations may return to their mean.

Kim Brown:

Right. Patience is a virtue. We've learned that right over these many years. Well, thanks John. I guess that brings us to today, despite what's shaping up to be a good quarter for equities on the surface anyway, we have seen some weakness in August and September. And Mark, I'm wondering if you could walk us through a bit of what may be driving that and how that compares historically to how markets have performed as we work through a calendar year?

Mark Rosenkranz:

Yeah, absolutely. Thanks Kim, and good morning. I'd say on top of some of the trends that John discussed, our investment committee remains cognizant that the current period we're in is historically one of the softest for equities. In these types of stretches, it's often helpful to kind of take a look back at how markets have performed in the past, just following the general path of returns on any given year. We have a couple charts in our written piece that will be distributed along with this podcast that I think do a really good job of highlighting some of the seasonality that we may be currently experiencing.

The first chart shows the average six month returns for global stocks in any given month, and the second shows the same data over three month periods. The takeaway is that we see some of the data align pretty well with what we're experiencing so far in 2023. On average, May and October have been the weakest six month period for global equities, both in terms of the percentage of stocks that are positive over the period, as well as just general overall returns.

While November through April has been the strongest six month period in the past. The three month, that also paints a similar picture with the weakest stretch in August to October before some seasonal strength in October and December. I think the biggest takeaway from these charts is that while the past can never be fully relied on for the future, the history of equity markets does give us a bit of comfort that the pain we're currently experiencing in recent months isn't necessarily outside the norm, and there's reason to believe that we might see some light at the end of the tunnel at the end of the year and entering 2024.

The important thing with looking at historical data is to keep it in the context of the day, these trends just can't be viewed in a vacuum, and I think there's valid reasons that the weakness we've seen could be outside some historic norms. At the same time, we do have some of the strength that we've seen as you highlight in unemployment, corporate earnings and inflation trends, and that could provide a solid basis to see some potentially improved performance in line with other historic trends that we've seen in the past.

Kim Brown:

That'd be great. Thanks, Mark. Taking a step back at the bigger picture, we've seen that a tumultuous past three years have brought a bit more uncertainty into the markets. So John, looking beyond 2023, what is our current outlook on a longer term basis across our diversified portfolios?

John Foster:

Yeah, Kim, I certainly think these higher interest rates will likely provide a little bit of a headwind for equities. We've really been coming out here of a 15 year period where interest rates were more or less at 0 to 1% for a decade and a half, and so investors seeking return really didn't have a lot of other options or other alternatives out there, and so people were putting money into the equity markets seeking out return. And now that added boost or that lack of competition from fixed income, well, that's come to an end. The Feds raise interest rates by 550 basis points from 0 to 5.5%, and that offers alternatives for investors now. So we're really expecting equities to maybe do a little bit less, especially in the U.S. over the next 10 years where maybe you have a 7%, 8% return for stocks given the competition for capital with these higher interest rates. And probably a little bit slower growth too as financing costs for homes and cars and big ticket items comes into play.

Bonds, however, are set up for really good returns. So if you think of the bond market right now, and we'll just call the yield on fixed income, 5%. The Fed yesterday indicated maybe they have one more rate increase yet to do, but they also anticipate that they'll likely be cutting rates. As inflation's come down a lot, we're seeing signs of employment growth slowing a bit, and so that battle or that war against inflation, they've certainly been winning as 12 of the last 13 months we've seen declines in the year over year inflation number.

And so you think about the bond market with a 5% yield, if rates are stable, bond investors should earn about 5%, but if rates drop a half percent to 1% over the next year, there's a chance in 2024 that a bond investor will get both, a good yield of 5%, plus the chance for a few percentage points of capital appreciation, which could push bond returns into the higher single digits to low double digit range. So again, after a rough period for bonds, perhaps patience will again be rewarded.

Kim Brown:

Yeah, that would be great. Mark, anything that you'd like to add?

Mark Rosenkranz:

Yeah, I'd say on top of some of the seasonal weakness that I discussed earlier, I'd say another main area of focus for our investment committee is just keeping a close watch on the overall volatility of the markets. The economy and corporations are still working through various supply challenges, inflation in both supply and wages and unemployment shifts related to the pandemic. There's a lot of headline concern out there as well, from government shutdowns to auto workers

striking, and while these type events may not necessarily impact markets long-term, they can cause a bit more sensitivity on any given week. Combining these factors with the availability of higher yields that John discussed in fixed income, we may start to see a faster shift down towards bonds at the first signs of a recession. So far the forecasts have been pushed further and further out for any event recession as the economy continues to provide upside surprises. This has been a positive for markets this year, but it could make markets respond a little bit quicker to any weakening of the data as we move through the calendar year.

The flip side of that is on the fixed income side, as John discussed, the Fed's rate cycle appears to be reaching a near end, and that has been the main source of poor performance for bonds and adding a little bit more volatility while this cycle is nearing completion. Forward outlook for fixed income appears a bit more stable than we've seen perhaps the previous 12 months. So all in all, there's a lot of dynamics at place, so it'll be certainly interesting to follow along in the next few months and as we approach the end of the year.

Kim Brown:

Thanks, Mark and John for that great update and overview, and thanks to you, our listeners for joining us today. Our written piece accompanies this podcast and it can be found by visiting jnba.com/insights/investment-insights. You can also tune into our other videos and podcasts where we cover both investment and financial life planning topics.

Thank you for your continued trust in JNBA, not only as your financial advisor, but also as your advocate. Please reach out if you need anything at all. You can find our contact information at jnba.com.

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