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OCTOBER 2023 MARKET COMMENTARY

EQUITY & FIXED INCOME MARKETS COMMENTARY

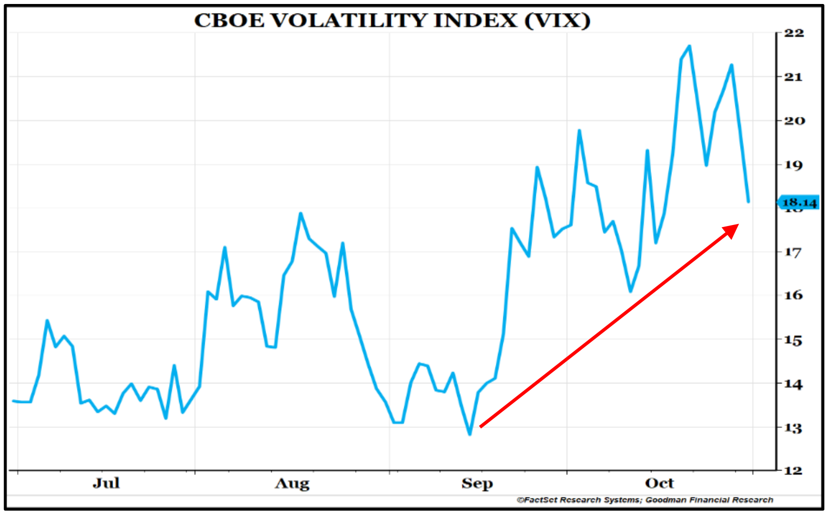
Stocks reached correction territory (a 10% drop from recent highs) in October. The S&P 500 closed down -2.1%, while the Blended Equity benchmark lost -3.8% in October, as the Mid-Cap S&P 400 and the Small-Cap S&P 600 Indices were down -5.3% and -5.7%, respectively. International stock indices also posted losses in October, with developed markets and emerging markets down -4.1% and -3.9%, respectively. Bond indices were mostly lower in October, as the 10-year U.S. Treasury bond yield rose to 4.90%, from 4.57% last month.

ISRAELI-HAMAS WAR

As you know by now, on October 7th, the Palestinian militant group, Hamas invaded Israel and savagely killed over 1,400 Israelis and kidnapped hundreds of others. Israel has responded with a stated intent to destroy Hamas through both a bombing campaign and planned ground invasion of Gaza. Before further discussion, we wish to acknowledge the humanitarian disaster and loss of life as a result of this war. The question posed by this month's commentary is "what does this war mean to financial markets?". Following are some of our thoughts:

- First, we must assess how long this war will last. In looking at the prior five major Israeli-Arab wars, all of them lasted from days to months – none were multi-year in nature (though the conflict has lasted centuries). There are reasons to believe this war will be no different. If right (always a big if when it comes to war), then market impacts should be manageable and short-term in nature.
- A truism is that markets hate uncertainty – and any war is full of geopolitical uncertainties. This would seem to be the case in October as stocks suffered losses (as discussed above) and volatility increased significantly, as seen in the chart below.
- Historically, investors have moved money to bonds in times of uncertainty. That has not been the case so far since the war started, as bond prices and interest rates have hardly budged.
- Given Iran's implicit involvement in the war by supplying and backing Hamas, the wild card is to what extent Iran decides to involve themselves in the war…and the U.S. and Israeli response to such an event. Our base case is that Iran does not directly respond militarily. If they do, then the complexity and risks of the war go up dramatically.
- Because of its proximity to the Middle East, one obvious impact of the war has to do with oil prices. Oil surged 8% in the days following the invasion but has since given up much of those gains. In our base case scenario of a short war, we expect no meaningful, lasting impact to oil prices. But if Iran involves themselves then all bets are off. At a minimum, the U.S. would tighten sanctions on Iran and attempt to once again limit their oil sales…which might result in Iran threatening oil tanker shipments through the narrow Strait of Hormuz. The bottom line is that in such a (hopefully) unlikely scenario, oil prices could easily skyrocket for a while. Of course, this would temporarily put upward pressure on inflation until resolved.
- If the war turned out to be a more protracted and intense one, we would likely see consumers become more cautious and investors lower their appetite for risk taking. This might accelerate and worsen the pending economic recession we have been expecting.

We have no better crystal ball about the outcome of this war than any other market observer, so we cannot predict the future. We will, however, be monitoring events as they unfold and respond if, and as needed, in regard to portfolio management. In the meantime, current events add conviction to our continuing strategy this year to transition client equity portfolios to a more defensive posture from that which we had to begin the year.



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REFERENCED INDICES

You cannot invest directly in an index. Index results assume the reinvestment of all dividends and interest.

- **S&P 500 Index** - a market-cap weighted index composed of the common stock of 500 leading companies in leading industries of the U.S. economy.
- **S&P 400 Mid-cap Index** – a market-cap weighted index composed of the common stock of 400 mid-sized companies reflecting the distinctive risk and return characteristics of the U.S. mid-cap equities sector.
- **S&P 600 Small-cap Index** – a market-cap weighted index composed of the common stock of 600 small-sized companies reflecting the distinctive risk and return characteristics of the U.S. small-cap equities sector.
- **Dow Jones Industrial Average Index** – a price-weighted index composed of 30 U.S. blue-chip companies. The index covers all industries except transportation and utilities.
- **Nasdaq Composite Index** – an index that measures all Nasdaq domestic and international based stocks listed on the Nasdaq Stock Market.
- **Barclays Intermediate Govt/Corp Index** – the index includes investment grade, US dollar-denominated, fixed-rate treasuries, government-related and corporate securities with less than 10 years to maturity.

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