Convergence Commentary

September 2023 Market Recap

Quick Hits:

- OPEC cuts shake oil markets
- Mixed Inflation Data in September
- 10-year Treasury Yields reach 16-year high
- Government shutdown risk on October 1

Market-Moving Highlights

The Organization of the Petroleum Exporting Countries (OPEC) is an economic cartel of the following countries: Algeria, Angola, Equatorial Guinea, Gabon, Iran, Iraq, Kuwait, Libya, Nigeria, the Republic of Kongo, Saudi Arabia, The United Arab Emirates and Venezuela. The organization has tightening ties with Russia, (OPEC partners are referred to as OPEC+) and is often used as an economic/political weapon. The goal of the organization is to maximize the profit of oil exports. OPEC+ produces about 40% of crude oil's output.

In April, OPEC+ unexpectedly announced that they would cut output by about 1.66 million barrels per day, which puts a significant strain on the world's supply of oil. Furthermore, China, a major oil importer, is gradually reopening its economy, potentially driving up the demand for oil. Crude oil is at its highest price in the last 13 months at $94 per barrel, up 10% from the start of the month. Elevated oil prices have significance, as they exert a dampening effect on economic growth.

In September, inflation exhibited a mixed performance, with headline inflation increasing 3.7% year-over-year and 0.6% month-to-month. The expectation was for 3.5% and 0.5%, respectively. The increase in gasoline prices contributed to over half of the monthly increase. However, Core CPI stood at 4.3% year-over-year, against the expectation of 4.4%. The data underscores that the surge in oil prices is the primary driver behind the mixed report. These developments reminded investors that the war on inflation might be far from over, reigniting fears over economic repercussions. While the oil spike is troubling, it is encouraging to see core CPI continuing its decrease.

As we mentioned before, the Federal Reserve is at a point where they must balance risk between doing too much and doing too little. While they kept the federal funds rate at 5.25%-5.5%, they signaled one more hike this year. This move took the market by surprise, as most market participants had not anticipated any further rate hikes this year. The 10-year Treasury currently yields 4.65%, the highest level in 16 years. The reason for the change was the stronger-than-expected economy. Good news might be bad news for the fight against inflation. However, the Federal Reserve's projections are highly uncertain, and Powell reiterated multiple times that they will proceed carefully and remain data dependent. Inflation readings will remain important, and so will the price of oil.

A government shutdown is likely on October 1, as Congress failed to pass 12 spending bills for the 2024 federal fiscal year. While government shutdowns are usually short-lived and do not affect the markets much, they add uncertainty to the equation. Additionally, Moody's, the last credit agency to maintain the US' top credit rating, wrote that the increased political shenanigans may lead to a credit downgrade, as the US's governance strength relative to other AAA-rated sovereigns would decrease. A rating downgrade could in theory increase treasury yields, which could result in a more contractionary monetary policy in the near future. While scary on paper, a government shutdown has historically not had a material impact on the market.

Index Performance

Index	1 Month	YTD	1 Year	5 Year
S&P 500	(4.77%)	13.07%	19.79%	9.92%
Nasdaq Composite	(5.77%)	27.11%	24.21%	11.41%
Russell 2000	(5.89%)	2.54%	8.27%	2.40%
MSCI ACWI ex US	(3.11%)	5.82%	21.38%	3.07%
Bloomberg US Aggregate Bond	(2.54%)	(1.21%)	0.34%	0.10%

September marks the second month in a row where all the indexes fell into negative territory. The 10-year Treasuries spiked from 4.09% to 4.61%, while oil spiked from $84 per barrel to $94 per barrel. Smaller companies are more susceptible to higher interest rates, which is likely why the Russell 2000 Small Cap Index suffered the biggest loss. The Bloomberg Aggregate Bond index suffered from the same issue, as bond prices are inversely related to interest rates. Technology was weak this month after a strong run has caused the Nasdaq to underperform the S&P 500. On the emerging markets front, continuing talks between China and the US are perhaps the reason why the international index had the best performance. While it is discouraging to see negative numbers all across the board, September is known to be a seasonally weak month, and the clouds may clear by year's end.

S&P 500 Sector Highlights & Commentary

Best-Performing Sectors		Worst-Performing Sectors	
Energy	2.40%	Real Estate	(7.23%)
Communication Services	(2.95%)	Technology	(6.48%)
Healthcare	(2.96%)	Industrials	(5.95%)

The energy sector was again top of the list in September, mostly thanks to the further increases in oil prices. The end of the writer's strike strongly benefited the communication services sector. Healthcare is in the top three for the second month in a row, being the defensive sector of choice. On the worst-performing sector front, real estate is facing a lot of pressure due to the unaffordability of houses, with prices and mortgage rates increasing. Unsurprisingly, amidst a lot of negative headlines in September, cyclical sectors that had large gains this year already, have underperformed the market. It is common for a market rally to stall similarly, and more months of cyclical underperformance would be needed for it to be a warning sign.

What to Watch in October

10/02 – ISM Manufacturing PMI

The reading came in at 47.6 in August, up from the previous month's 46.4, and higher than the market consensus of 47. The manufacturing sector contracted for the tenth consecutive month. The forecast for the September reading that comes out in October is 48.1.

10/03 – JOLTS Job Openings

The number of job openings has decreased to the lowest level since March 2021, coming in at 8.827 million in July. The labor market is slowing after months of tightening monetary policy. The Federal Reserve wants to see the labor market slow in its war against inflation. The forecast for the next reading is 8.5 million.

10/04 – ISM Services PMI

The services sector is experiencing an expansion, with the August reading jumping to 54.5, the highest in six months. The forecast for the next reading is 53.7.

10/06 – Unemployment Rate, Non-Farm Payrolls

The unemployment rate rose to 3.8% in August from 3.5% in July, above the market expectations of 3.5%. The forecast calls for a steady 3.8% in September. An unexpected tick in unemployment would emphasize the risks of doing too much for the Federal Reserve, while a decrease could give a green light for an additional hike.

10/12 – CPI and Core CPI

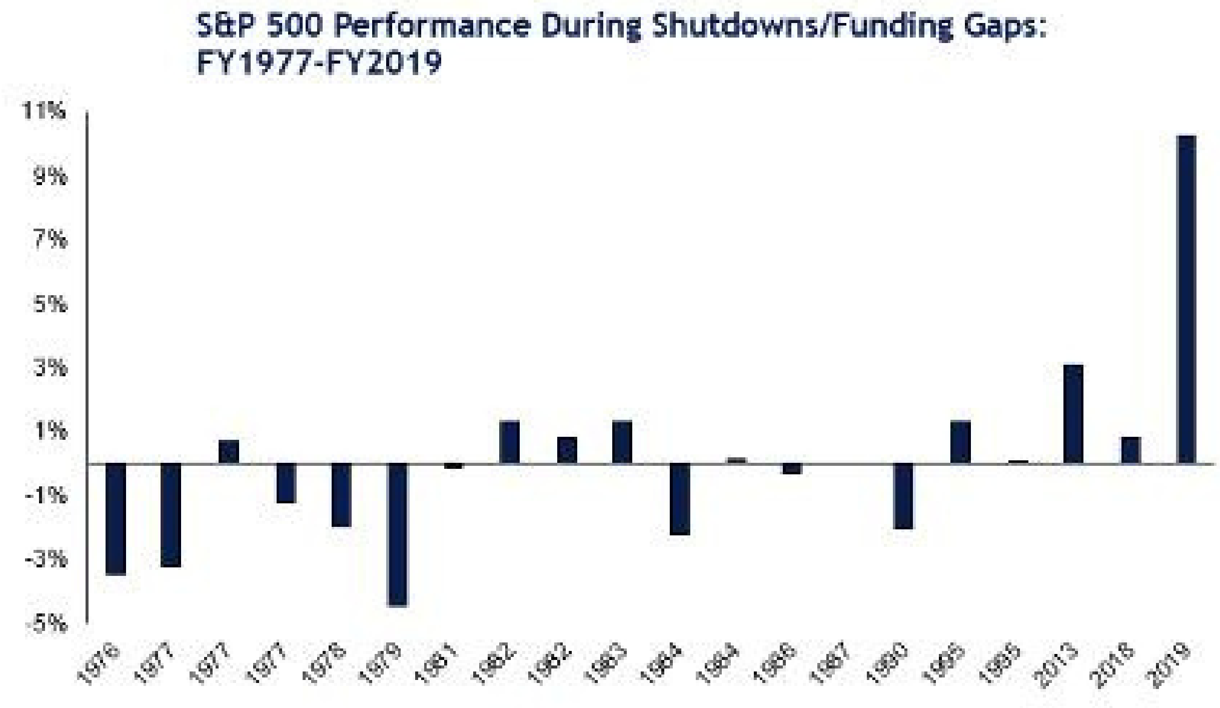
Headline inflation accelerated in August to 3.7% from 3.2% in July. The increase was mostly due to an increase in oil prices. Core Inflation fell to 4.3% from 4.7%.

10/13 – Michigan Consumer Sentiment

Consumer Sentiment fell more than expected in September, down to 67.7 from 69.5 in the previous month. We could be in for another rough reading ahead, after the developments in September.

Market Wrap

In September, oil prices and treasury yields - coupled with the looming government shutdown - influenced market dynamics. The Federal Reserve signaled one more rate hike, reiterating data dependency. As the Fed Chair Jerome Powell candidly noted: “Forecasters are a humble lot, with much to be humble about.” With important inflation data coming up as we enter a new quarter, it is important to remind ourselves that the market has weathered these issues before. Below is a chart of the performance of the S&P 500 during government shutdowns. On average, the return across 20 government shutdowns was a modest 0.04%.



Source: LPL Research, Strategas Research Partners 09/14/23

Indexes are unmanaged and cannot be invested in directly. Past performance is no guarantee of future results

Sources

[Government Shutdown Looms, Stocks Say ‘Been There, Done That’ | LPL Financial Research (lplresearch.com)]

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Jason Buford
President,
Wealth Advisor

Joshua Evans
Vice President,
Wealth Advisor

Dr. John Stansfield, CFA
Director of
Investments

Chris Repka
Assistant Investment
Research Analyst

4700 Belleview Ave, Ste 205, Kansas City, MO 64112
816.737.8526
www.convergencefinancial-kc.com