OCTAVIA
WEALTH ADVISORS

Economic and Market Overview

Third Quarter 2023

Building a Lifelong Partnership

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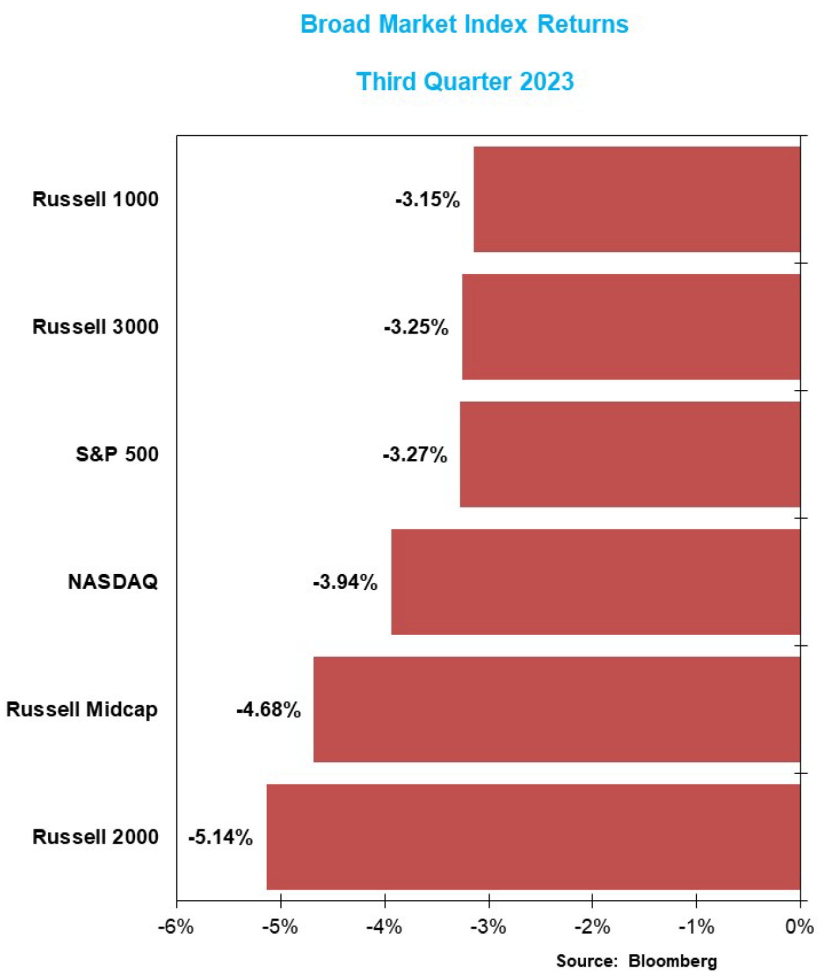
The Economy

The U.S economy has continued to show resilient growth in recent months, surprising many economists who had expected that a recession would have begun by now due to higher interest rates, tighter credit, and still-elevated inflation. The Bureau of Economic Analysis (BEA) released its final revision to second quarter 2023 real GDP, reporting an adjusted annualized increase of 2.1%, a modest decline from 2.2% in the first quarter. Third quarter GDP numbers are scheduled to be unveiled soon, with market participants expecting a fifth consecutive quarter of growth thanks to resilient consumer spending, increased government spending, and a shrinking trade deficit. Consumer spending has been buoyed by a resilient jobs market, as evidenced by September's payrolls report, which showed that employers added 336,000 positions for the month, significantly more than expected. Meanwhile, the Federal Open Market Committee (FOMC) raised its federal funds target rate range once during the third quarter, a 0.25% increase to a range of 5.25-5.50%.



Highlights and Perspectives

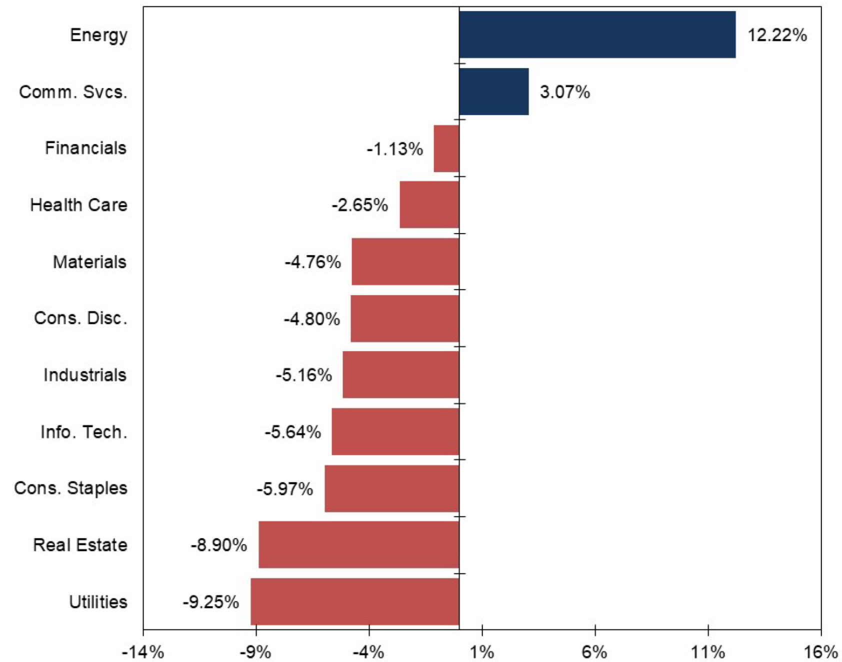
GROSS DOMESTIC PRODUCT (GDP)

According to the BEA's latest revision, U.S. real GDP rose at a seasonally adjusted annualized rate of 2.1% in the second quarter, marking a fourth consecutive quarter of growth in spite of widespread forecasts for a recession in the latter half of this year. However, although a recession has not yet materialized, the risk of one remains substantial as interest rate hikes apply the proverbial brakes to economic activity. In the second quarter, GDP growth stemmed from strength across consumer, government, and private investment spending. Corporate profits rose by 0.2% (not annualized) during the quarter after falling 2.6% in Q1. Inflation expectations were relatively flat across the quarter but remain at elevated levels.

HOUSING

The housing market continues to bear the weight of elevated mortgage rates, with 30-year average rates eclipsing 7% during the third quarter and remaining well above 2022 peak levels. Home affordability remains a significant concern, as rapid increases in mortgage rates have pushed monthly payments higher for new buyers. Homeowners who previously locked in low mortgage rates also have a disincentive to sell, limiting available inventory. Sales of existing homes fell 0.7% in August to an annualized rate of 4.0 million units, down more than 15% from a year ago and near their lowest rate over the past decade. The median price of an existing home sold in August was 3.9% higher than the prior year. In the new home segment, the NAHB Housing Market index, which measures homebuilding activity, ended the quarter at 45, down from 50 the prior month. Any reading below 50 indicates that building conditions are perceived as poor.

U.S Equity Market Returns by Major Sector
(GICS Sectors in S&P 500, Third Quarter 3Q23)



Source: Bloomberg

EMPLOYMENT

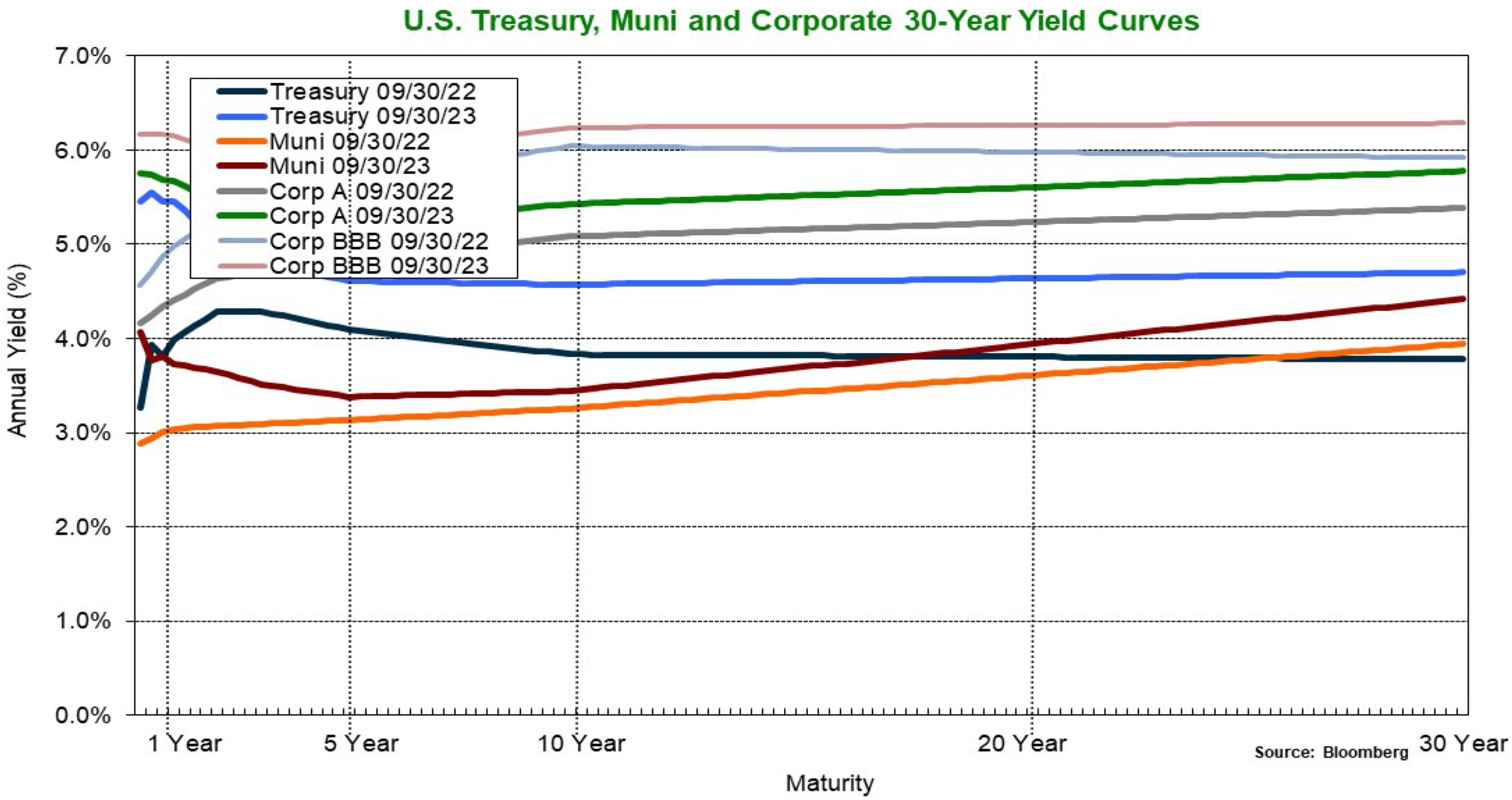
September's non-farm payrolls report showed a sudden acceleration in job creation as employers added 336,000 new positions, far more than 170,000 expected. Additionally, numbers for August and July were revised upward by nearly 120,000 total positions. The economy averaged 214,000 new jobs for the six months from March to August, making September a notable surprise amid expectations for slower hiring. The unemployment rate and workforce participation rate were both flat for the month, at 3.8% and 62.8%, respectively. Unemployment has risen marginally from its recent low of 3.4% in April, but workforce participation has climbed as well, indicating that more people are joining the workforce. Wage growth was once again slow, rising 0.2% for the second consecutive month and 4.2% over the past year. While unfavorable for workers, slower wage growth is a positive for the FOMC, as wage increases are a significant contributor to inflationary pressures.

FEDERAL RESERVE POLICY

The FOMC raised the federal funds rate target range once during the third quarter, with a 25-bps increase at its July meeting, bringing the target range to 5.25-5.50%. The FOMC then chose to make no changes at its September meeting. Economists are split as to whether further rate increases will be required, or whether current interest rate levels are high enough to bring inflation down to the Fed's 2% target. At most, one more rate hike is expected in the near future, while the timeline for rate cuts continues to be pushed out. Projections from the FOMC's September meeting indicated that the median policymaker expects rates to fall by 50 bps in 2024, lower than the 100 bps of cuts that they expected back in March. The biggest current risk to the FOMC's outlook is the recent surge in global oil prices, which may cause inflation to reaccelerate if higher energy costs flow through to the prices of other goods and services.

INTEREST RATES & FIXED INCOME

Fixed income prices were generally lower (and yields higher) during the third quarter as the bond market continues to adjust expectations for interest rates to remain at higher levels for longer than previously expected. Shorter-term yields, represented here by 2-year Treasuries, rose by 25 bps to 5.05% at the end of September. Longer-term yields rose more than short-term, with 10-year Treasury yields climbing by 72 bps to 4.57%, and 30-year yields rising 80 bps to 4.70%. The Treasury yield curve remains inverted, as it has been since the middle of 2022, but flattened significantly during the third quarter as long-term rates have risen faster than short-term.



Total returns on fixed income securities were generally negative during the quarter. The Bloomberg Treasury 5-7 Yr. Index fell 2.2%, while 5–10-year corporate bonds fell 2.7%. High yield securities, which tend to be less sensitive to interest rates, were slightly higher, rising about 0.5%. Municipals fell sharply, with the Bloomberg Municipal Bond Index declining 4.0%. Non-U.S. fixed income securities also posted losses, evidenced by the 4.0% decline in the Bloomberg Global Aggregate ex-U.S. index.

EQUITIES

Stock prices were broadly lower in the third quarter, reversing some of the gains from the first half of the year. The economy's steady growth should provide support for stock appreciation, but recent increases in interest rates may threaten corporate growth, while the corresponding increase in yields provides viable investment alternatives to stocks. The S&P 500 marched higher for the first few weeks of the quarter, peaked on July 31st, then trended lower throughout August and September. The S&P 500's total return for the third quarter was -3.3%.

Energy (+12.2%) and Communication Services (+3.1%) were the only S&P 500 sectors to see positive returns for the quarter, the former lifted by rapidly rising oil prices and the latter buoyed by gains in its two largest constituents, Meta Platforms and Alphabet. Among the nine sectors to see losses, Utilities (-9.3%), Real Estate (-8.9%), and Consumer Staples (-6.0%) were the worst performers.

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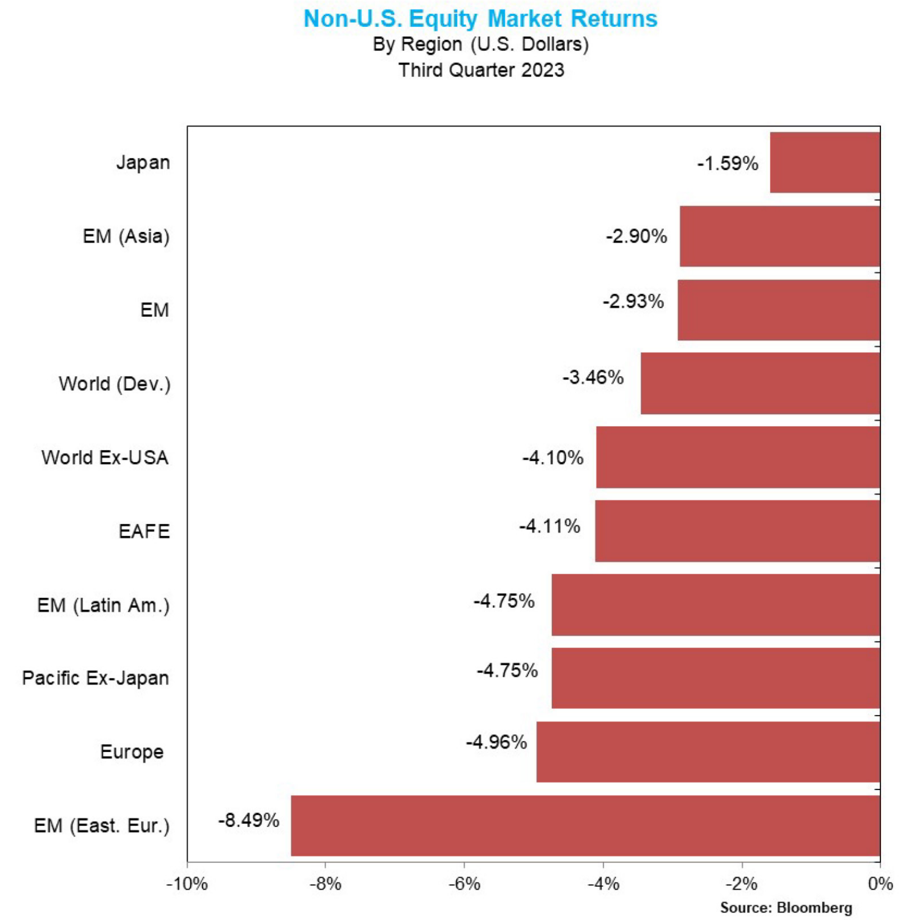
The Russell 1000 index generated a -3.2% total return during the quarter. Large cap value and growth stocks saw very similar returns, a change from the first half of the year when growth massively outperformed value. Small cap stocks, as represented by the Russell 2000 Index, underperformed large cap with a -5.1% return for the quarter. Small cap value outperformed small cap growth. The NASDAQ Composite index, which is dominated by technology stocks, declined 3.9% for the quarter. The Dow Jones Industrial Average fell 2.1%.

Real estate investment trusts (REITs) were sharply lower during the quarter, with the DJ US Select REIT Index returning -7.4%. Commodities posted modest gains, due in large part to increases in oil prices. The Bloomberg Commodity Index gained 4.7%.

International equities saw similar negative returns to those experienced domestically. The MSCI ACWI ex-U.S. index, which measures all markets outside the United States, fell 3.8% for the quarter. The MSCI EAFE index of developed market stocks declined 4.1%. Of all developed markets, Japan was the best performer, with a 1.6% decline in its stocks. European stocks struggled, falling 5.0%. Emerging markets stocks, represented by the MSCI Emerging Markets index, declined 2.9%.



Outlook

The economy has remained resilient in the face of the highest interest rates since before the Global Financial Crisis. Real GDP growth continued in the second quarter and is estimated to have accelerated in the third. Even still, signs of economic weakening abound, and economists expect weakness to continue for the foreseeable future. The threat of government shutdown, ongoing fallout from the banking crisis, a recent surge in oil prices, and slower consumer spending upon reinstatement of student loan payments all pose near-term threats to economic growth. Moving forward, we will be keeping an eye out for signs of further deterioration in major economic indicators, as well as monitoring ongoing political developments, including potential for a long-term government shutdown, the surging federal government debt, and the ever-evolving outlook for the upcoming 2024 elections.

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INDEX OVERVIEW

The **Dow or DJIA** (Dow Jones Industrial Average) is an unmanaged index of 30 common stocks comprising 30 actively traded blue chip stocks, primarily industrials, and assumes reinvestment of dividends. The **NASDAQ Composite** is a stock market index of the common stocks and similar securities listed on the NASDAQ stock market. The **S&P 500 Index** is an unmanaged index comprising 500 widely held securities considered to be representative of the stock market in general. The **DJ US Select REIT Index** is a subset of the Dow Jones Americas Select RESI and includes only REITs and REIT-like securities (The Dow Jones US Select Real Estate Securities Index (RESI) represents equity real estate investment trusts (REITs) and real estate operating companies (REOCs) traded in the US). The **Bloomberg Commodity Index** is a broadly diversified commodity price index that tracks prices of futures contracts on physical commodities on the commodity market, and is designed to minimize concentration in any one commodity or sector. The **MSCI EAFE Index** is recognized as the preeminent benchmark in the US to measure international equity performance. It comprises the MSCI country indices that represent developed markets outside of North America: Europe, Australasia, and the Far East. The **MSCI Emerging Markets Index** is a free float-adjusted market-capitalization index that is designed to measure equity market performance in the global emerging markets. The **MSCI ACWI Index** is a free float-adjusted market-capitalization-weighted index that is designed to measure the equity market performance of developed and emerging markets. The MSCI ACWI consists of 46 country indices comprising 23 developed and 23 emerging markets country indices. The **MSCI Emerging Markets (EM) Eastern Europe Index** captures large and mid cap representation across four emerging markets (the Czech Republic, Hungary, Poland, and Russia) countries in Eastern Europe. With 52 constituents, the Index covers approximately 85% of the free float-adjusted market capitalization in each country. The **MSCI EM (Emerging Markets) Latin America Index** is a free float-adjusted market-capitalization-weighted index that is designed to measure the equity market performance of emerging markets in Latin America. The **MSCI ACWI Ex-US Index** is a market-capitalization-weighted index maintained by Morgan Stanley Capital International (MSCI) and designed to provide a broad measure of stock performance throughout the world, with the exception of US-based companies. The **MSCI China Index** captures large and mid cap representation across China H shares, B shares, Red chips, and P chips covering about 85% of this China equity universe. The **Bloomberg Barclays Municipal Bond Index** is an unmanaged index comprising investment-grade, fixed-rate municipal securities representative of the tax-exempt bond market in general. The **Bloomberg Barclays Global Aggregate ex-US Index** is a market-capitalization-weighted index, meaning the securities in the index are weighted according to the market size of each bond type. Most US-traded investment-grade bonds are represented. Municipal bonds and Treasury Inflation-Protected Securities are excluded, due to tax treatment issues. The Index includes Treasury securities, government agency bonds, mortgage-backed bonds, corporate bonds, and a small amount of foreign bonds traded in the US. The **Bloomberg Barclays US 5-10 Year Corporate Bond Index** measures the investment return of US dollar-denominated, investment-grade, fixed-rate, taxable securities issued by industrial, utility, and financial companies, with maturities between 5 and 10 years. Treasury securities, mortgage-backed securities (MBS), foreign bonds, government agency bonds, and corporate bonds are some of the categories included in the Index. The **Bloomberg Barclays Capital US 5-7 Year Treasury Bond Index** is a market-capitalization-weighted index, and includes Treasury bonds issued by the US with a time to maturity of at least 5 years, but no more than 7 years. The **Russell 1000 Index** is a market-capitalization-weighted benchmark index made up of the 1000 largest US companies in the Russell 3000 Index (which comprises the 3000 largest US companies). The **Russell 2000 Index** is an unmanaged index considered representative of small cap stocks. The **Russell 3000 Index** is an unmanaged index considered to be representative of the US stock market, and measures the performance of the largest 3,000 US companies representing approximately 98% of the investable US equity market. The **Russell Midcap Index** is a subset of the Russell 1000 Index. It includes approximately 800 of the smallest securities based on a combination of their market cap and current index membership. The **Housing Market Index** (HMI) is based on a monthly survey of **NAHB** members designed to take the pulse of the single-family housing market. The survey asks respondents to rate market conditions for the sale of new homes at the present time and in the next six months, as well as the traffic of prospective buyers of new homes. The **JPMorgan Emerging Market Bond Index** (EMBI Global) tracks total returns for traded external debt instruments in the emerging markets, and is an expanded version of the JPMorgan EMBI+. As with the EMBI+, the EMBI Global includes US dollar-denominated Brady bonds, loans, and Eurobonds with an outstanding face value of at least $500 million. The **CBOE Volatility Index** (VIX) is an up-to-the-minute market estimate of expected volatility that is calculated by using real-time S&P 500 Index option bid/ask quotes. The Index uses nearby and second nearby options with at least 8 days left to expiration and then weights them to yield a constant, 30-day measure of the expected volatility of the S&P 500 Index.

DEFINITIONS

The **Federal Open Market Committee** (FOMC) is the monetary policymaking body of the Federal Reserve System. The **federal funds rate** is the interest rate at which a depository institution lends funds maintained at the Federal Reserve to another depository institution overnight. The **European Central Bank** (ECB) is the central bank for Europe's single currency, the euro. The ECB's main task is to maintain the euro's purchasing power, and thus price stability, in the euro area. The euro area comprises the 19 European Union countries that have introduced the euro since 1999. The **Gross Domestic Product** (GDP) rate is a measurement of the output of goods and services produced by labor and property located in the United States. The **Bureau of Labor Statistics** (BLS) is a unit of the United States Department of Labor. It is the principal fact-finding agency for the US government in the broad field of labor economics and statistics, and serves as a principal agency of the US Federal Statistical System. The **Bureau of Economic Analysis** (BEA) is an agency in the US Department of Commerce that provides important economic statistics, including the gross domestic product of the US. It is a governmental statistical agency that collects, processes, analyzes, and disseminates essential statistical data to the American public, the US Congress, other Federal agencies, state and local governments, business, and labor representatives. The **PCE (Personal Consumption Expenditure) Index of Prices** is a US-wide indicator of the average increase in prices for all domestic personal consumption. Using a variety of data, including US Consumer Price Index and Producer Price Index prices, it is derived from personal consumption expenditures, and is essentially a measure of goods and services targeted towards and consumed by individuals. Sector performance is represented by the **Global Industry Classification Standard** (GICS) sectors, developed by Standard & Poor's and MSCI Barra.

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