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SUMMARY

- US market is now officially in a 'correction'.
- We see reasons for optimism into year-end...
- ...due to strength in the economy and earnings, plus seasonal patterns.

We view the next support level at around 4100 (Chart 1, green dotted line), which represents a roughly 2/3 retracement of the recent rally from the March 2023 low, as well as what we view as a zone of meaningful consolidation last April and May. A decisive break below that zone would imply a retest of the March low of around 3800 (see Chart 1, red dotted line).

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Which Way for Markets from Here?

Reasons for Optimism

What Happened Last Week?

At the risk of making a cheesy Halloween pun, last week was 'all trick and no treat' for investors, as markets were spooked by continued interest rate volatility, geopolitical concerns and a US earnings season which has gotten off to an uneven start. As of Friday, the S&P 500 has now pulled back -10% from its' cycle high made in July- the definition of a 'market correction' - for the first time since the rally started roughly a year ago (Chart 1, below). **While the near term may remain dicey, we are starting to see an improving reward relative to risk for both stocks and bonds heading into the end of the year.**

We still believe that the US economy - and the corporate earnings that are powered by it - will prove resilient, and that 10-year treasury bond yields will anchor around their current 5% range. **Pervasive pessimism, along with a still positive technical trend in the US and favorable seasonal patterns soon kicking in, reinforces our belief that it's too early to give up on the stock bull market.**

US Stocks: Pervasive Pessimism, Favorable Seasonality and Earnings Resilience Gives Us Hope

Technicals – Near-term Support broken, watching 4100: From a technical perspective, meaningful support levels were breached last week, with the S&P falling below 4200 and the 10-year yield flirting with 5%. Despite this breach, we are not ready yet to further reduce equity exposure in our balanced portfolios, as we are gauging the magnitude and duration of this pullback to determine if the breakdown is decisive and sustainable.

Chart 1: S&P 500 Index with Support Levels



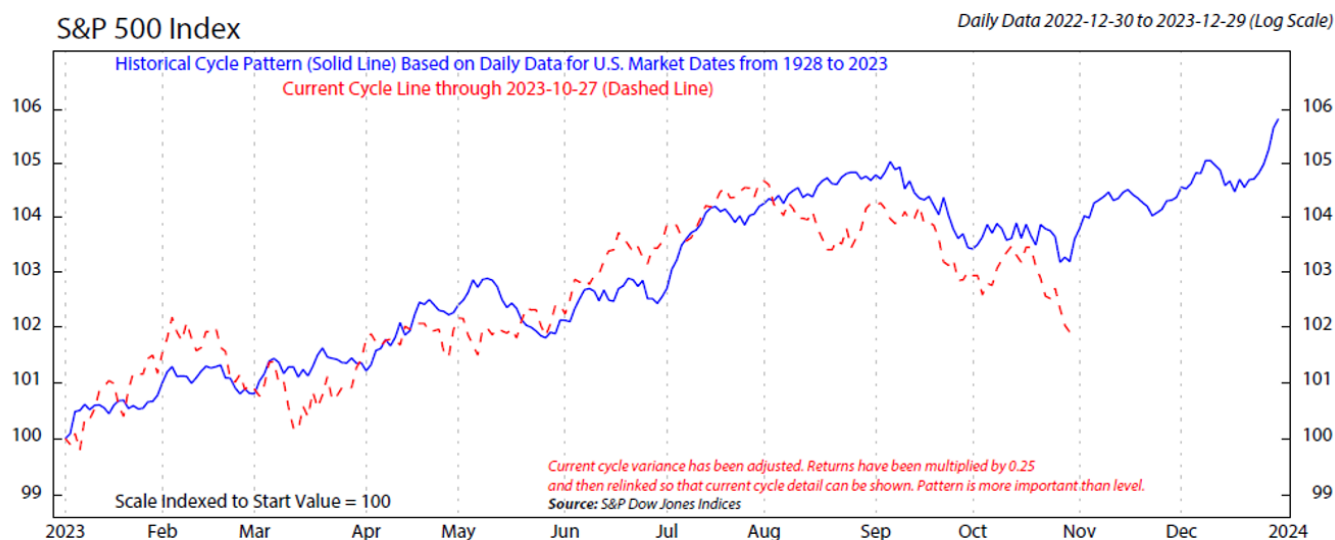
Source: LSEG Datastream, RiverFront. Data daily through October 27, 2023.

Chart shown for illustrative purposes. Past performance is no guarantee of future results. An investment cannot be made directly in an index.

Historical Analysis Suggests Positive Near-Term Returns into End of the Year: It's worth noting that two of RiverFront's [Three Tactical Rules](#) – 'Don't Fight the Trend' and 'Beware the Crowd at Extremes' are still in investors' favor for US markets (see more in our [Weekly View from October 2nd](#)). From the perspective of 'Don't Fight the Trend', the slope of the S&P 500's primary trend (as defined by the 200-day moving average, Chart 1 above, red solid upward sloping line), has decelerated but should remain positive for the foreseeable future. With crowd sentiment bearish, RiverFront's proprietary 'heatmap' analysis (which combines primary trend slope and sentiment data to gauge market probabilities based on history), is still suggesting to us a higher-than-average probability of positive market returns over the next 3 months.

This analysis is supported by seasonal patterns. September historically tends to be the weakest market return month, October is often a month where the market bottoms, and December tends to be the strongest, giving rise to the concept of the 'Santa Claus' rally. So far this year, the S&P has tracked its 95-year historical seasonal pattern relatively closely going back to 1928, according to data from Ned Davis Research (NDR). If history is any guide, this year's 'Santa Claus' rally could start in earnest soon (see NDR chart, below). Some potential catalysts for strength into year-end include continued positive economic and earnings performance, body language from the Fed that the end of the hiking cycle is near, and/or if the war in Gaza does not spread to a wider regional conflict, as we currently expect (see more in our [Weekly View from October 24th](#)).

Chart 2: Seasonality Could Help S&P 500 Returns Into the End of the Year



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Stock Fundamentals: Stronger than Commonly Appreciated, in our View

We believe stock market fundamentals are also generally better than currently appreciated by the market. More specifically:

- The US economy remains in expansion:** The US economy shocked many economic bears by putting up an impressive +4.9% real GDP growth rate for the third quarter. This strength was led by resiliency in consumers; Personal consumption spending – which represents approximately 69% of US GDP– was up almost +4% quarter over quarter, contributing 2.7 percentage points to GDP. Spending on durable goods was up +4.7% month over month in September, suggesting to us a pickup in capital expenditures during Q4. While the downside of this is that the Fed will likely keep interest rates 'higher for longer', longer term interest rates have already reflected this view in our opinion.
- Earnings season thus far has been better than average:** While there have been several high-profile earnings misses thus far in the Q3 earnings season, the overall performance of companies has been generally solid, in our opinion. With roughly half of S&P 500 companies having reported, about 56% of reporting companies have earnings that have 'beat' their Q3 estimate from six months ago. If this holds through the remainder of the earnings seasons, it will represent the highest beat percentage in the last six quarters (source: Factset, RiverFront Investment Group).

US Fixed Income – Improving Picture: We believe Yields Will Remain Close to 5%

In our view, we are now getting to levels in the bond market where investors may need to begin to rethink asset allocation decisions, as fixed income is becoming increasingly attractive in comparison to equities on a risk-adjusted basis. With the 10-year Treasury yielding 4.9% and the S&P500's dividend yield at 1.7%, the 3.2% percentage point differential is compelling in our view, especially for investors needing income.

We expect the long end of the yield curve to start to anchor around 5% as investors begin to lock in higher yields. We see the recent back-up in yields as an opportunity to shift more money to fixed income, taking more interest rate risk, less credit risk and generally lowering portfolio volatility over longer timeframes due to the cushion of greater income. This is especially true for investors in the [‘distribute’ phase](#) of their investment journey. Furthermore, investment grade corporate bond spreads are now 1.3 percentage points above equivalent maturity Treasuries, yielding 6.34%. The sector continues to show no signs of any credit issues, as companies have adapted their operating strategies to reduce costs and overall leverage.

Conclusion

We still believe that the US economy – and corporate earnings – will prove resilient, stocks will survive the current pullback, and bond yields will anchor around 5%. **Pervasive pessimism, along with a still-positive technical trend and favorable seasonal patterns kicking in, reinforces our belief that it's too early to give up on the stock bull market.** We continue to prefer US stocks over international, and favor the investment themes of large-cap, high cash flow technology and energy companies. We are also advocating for alternative yield strategies that can help generate additional income in volatile markets, in keeping with our PATTY (‘Pay Attention to the Yield’) theme.

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All charts shown for illustrative purposes only. Technical analysis is based on the study of historical price movements and past trend patterns. There are no assurances that movements or trends can or will be duplicated in the future.

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Principal Risks:

Stocks represent partial ownership of a corporation. If the corporation does well, its value increases, and investors share in the appreciation. However, if it goes bankrupt, or performs poorly, investors can lose their entire initial investment (i.e., the stock price can go to zero). Bonds represent a loan made by an investor to a corporation or government. As such, the investor gets a guaranteed interest rate for a specific period of time and expects to get their original investment back at the end of that time period, along with the interest earned. Investment risk is repayment of the principal (amount invested). In the event of a bankruptcy or other corporate disruption, bonds are senior to stocks. Investors should be aware of these differences prior to investing.

In general, the bond market is volatile, and fixed income securities carry interest rate risk. (As interest rates rise, bond prices usually fall, and vice versa). This effect is usually more pronounced for longer-term securities). Fixed income securities also carry inflation risk, liquidity risk, call risk and credit and default risks for both issuers and counterparties. Lower-quality fixed income securities involve greater risk of default or price changes due to potential changes in the credit quality of the issuer. Foreign investments involve greater risks than U.S. investments, and can decline significantly in response to adverse issuer, political, regulatory, market, and economic risks. Any fixed-income security sold or redeemed prior to maturity may be subject to loss.

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Technology and internet-related stocks, especially of smaller, less-seasoned companies, tend to be more volatile than the overall market.

Index Definitions:

Standard & Poor's (S&P) 500 Index measures the performance of 500 large cap stocks, which together represent about 80% of the total US equities market.

Definitions:

The 200-day moving average is a popular technical indicator which investors use to analyze price trends. It is simply a security's average closing price over the last 200 days.

Don't Fight the Fed – 'Supportive' means the Fed's monetary policy regarding inflation and employment is in what we believe based on our analysis to be the investors' best interest; 'Against' means the Fed's monetary policy, in our view, is going against the investors' best interest; 'Neutral' means the Fed's monetary policy is neither supportive or against the investors' best interest in our view. Don't Fight the Trend – Terms correlate to the 200-day moving average as it relates to the equity indexes: 'Positive' means that the trend is rising, 'Flat' means the trend is flat, 'Negative' means the trend is falling. Beware the Crowd at Extremes – Terms correlate to the NDR Crowd Sentiment Poll and its measurement of Extreme Optimism (Bearish), Neutral, or Extreme Pessimism (Bullish).

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