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Q3 2023 Newsletter

Economy & Market Valuation

The US stock market as measured by the S&P 500 dropped by approximately 3% in Q3 2023. Despite high interest rates, the US economy is growing at a healthy pace and is showing no signs of a recession. Higher interest rates are having an impact on the economy. The inflation rate has been coming down, although it is still not at the Federal Reserve Bank's (Fed) target of 2%. House sales have almost come to a standstill as people are not moving and not much housing inventory is coming to the market. People who have mortgages at 3% or less, have to take on new mortgages at 7% or higher, if they move. The big question is - what will the Fed do? Will they raise interest rates one more time in 2023? Our view is that interest rates are already high enough to slow down inflation and the economy. The Fed should not raise interest rates anymore and inflation will come down on its own with time. Economic indicators are lagging and do not capture the slowdown already happening in the economy. Over-tightening could do more harm than good. If the Fed does not raise interest rates on Nov 1, it would be positive for the market. We expect that the Fed will start cutting interest rates in 2024. The timing will depend upon the state of the economy.

We are almost fully invested in the market, with around 6% cash in the portfolio. US companies are still able to grow earnings and a recession is not in sight. We are invested in high quality companies that are able to grow earnings, buy back shares and have a high Return on Invested Capital (ROIC). These are the kind of companies that you do not have to worry about on a daily basis. This is not the time to increase risk and go into high growth companies.

Risks to the US economy remain. If interest rates stay high for a long (er) time it could take the US into recession. Escalating war between Israel and Palestinians could result in spike in oil prices. We are keeping an eye on the risks and will act accordingly.

2023 investment strategy:

As we stated earlier, we are almost fully invested in the market. We do not see a reason to change it as we are only invested in quality companies. If the Fed does not increase interest rates any more in 2023, and indicate a cut in interest rates in 2024, we could see a mini rally in Q4 2023. On the other hand, if we see worsening signs, we will act accordingly.