ROBERTSON STEPHENS®

October 23, 2023 – Investment Commentary

Geopolitical concerns, Federal Reserve "high for longer" commentary, and a rise in long-term bond yields to new 16-year highs appeared to weigh on sentiment and drive the S&P 500 Index to its biggest weekly decline in a month. The Nasdaq Composite Index, with long duration growth dynamics, are being impacted by the rebound in the 10-year Treasury yields. For the end of last week, this index is 19.9% below its early-2022 intraday highs. The yield on the 10-year U.S. Treasury note nearly touched 5% in intraday trading at the end of the week, reaching its highest level since July 2007. (Bond prices and yields move in opposite directions.) While higher yields put pressure on stocks, a robust economy has supported earnings and equities in the interim.

European government bond yields broadly climbed as investors weighed the prospect that interest rates could remain higher for longer due to sticky inflation. Germany's benchmark 10-year government bond yield rose, ending the week just shy of 2.9%. Italian bond yields also advanced, with the yield differential between German and Italian 10-year debt increasing above 200 basis points. The wider differential begins to signal that investors are more concerned about the higher rate regime, which is placing relatively disproportionate stress on more indebted countries such as Italy.

Fedspeak

Richmond Fed President Thomas Barkin told a real estate conference in Washington that he was "still looking to be convinced" that demand was slowing and cooling inflation. In comments before the Economic Club of New York on Thursday, Fed Chair Jerome Powell seemed to give a brief boost to sentiment after acknowledging "a clear tightening in financial conditions," but *The Wall Street Journal* reported that markets pulled back sharply after Powell stated that he saw no signs that the current stance of Fed policy would push the economy into a recession.

Some upside economic surprises (more resilient economy than prior expectations) may have reinforced worries that rates would remain "higher for longer." The recent string of positive economic surprises will keep the Fed on high inflation alert, and although we don't think it won't tilt the FOMC toward another rate hike at the November meeting, the December meeting will very much remain a "live" one. The recent barrage of Fed communication indicates policymakers' focus is shifting from "how high" to raise the policy rate to "how long" to maintain it at restrictive levels. We believe the Fed tightening cycle is close to complete. However, we do not foresee massive rate cuts for the next several months in the absence of something breaking in the U.S. financial system, sudden material recessionary slowdown or substantial geopolitical escalations.

Portfolio Considerations

With more persistent higher rates, we expect investors will continue to focus on balance sheet strength and avoid companies that are most vulnerable to increased borrowing costs, especially small capitalization companies, which are susceptible to variable rate debt and less profitability. For companies with strong balance sheets, we expect investors will reward those firms committed to growing dividends and returning cash to shareholders while being more concerned about companies making large capex investments at this late stage of the economic cycle.