Peregrine asset advisers

3RD QUARTER 2023 MARKET OVERVIEW

BEND BUT NOT BREAK

The stock market retreated in Q3, succumbing to pressure from higher interest rates. The decline broke a three quarter win streak for the broad market. The month of September held true to form as consistently being the weakest seasonal period of the year. The S&P 500 fell 4.74%. Last year, by comparison, the market fell 9.3% in September, so it could always be worse.

We are reminded that periodic market setbacks are needed to remove frothy conditions that elevate the risk of investing. Pullbacks create the best opportunities to buy low and sell high. The important aspect, from our perspective, is that our collective asset account values remain close to their best levels in preparation to make a transition when the stock market will be more favorable. Thus, "Bend but not break."

Higher long term interest rates grabbed center stage in Q3 as the chief worry. Even though interest rates are on a steady course higher over the past 18 months, it was the spike in long term rates that created the main disturbance. In the last two months, the ten year Treasury bond rate moved from 4.25% to 4.80%. The 20 year rate rose from 4% to 5.2% and the rate on a fixed 30 year fixed mortgage moved from 6.7% to a recent high of 8.5%. These higher interest rates are almost certain to have a dampening effect on the US economy.

In addition, inflation, which was slowing dramatically by June, turned higher in the latest quarter, led by oil prices, which moved from $65 per barrel to $95. Food prices also surged over the last three months. Bespoke Investments created the term, "Mortgas", as a misery index, representing the combined cost of fuel prices and the mortgage interest rate. As suspected, this index is at the highest level since 2007.

Rising interest rates and inflation are mortal enemies of the stock market. People are less willing to commit money to the stock market when they can secure a guaranteed 5% return on safe investments.

Higher interest rates prove "There IS an alternative to stocks".

At the high point near the end of July, the S&P 500 retreated over 8% by the early days of October. The bad news is that this decline in the indexes took a heavy toll on individual stocks, many of which we own. Many prominent names throughout the index have pulled back over 15% in 2023, including Nvidia, Microsoft, Home Depot, Bank of America, Pepsi, and Boeing.

Cagey investors know that horrible, no good, markets, typically lay the groundwork for the best prospects for a rally to materialize. We are counting on the corrective phase of the third quarter to usher a rally in the fourth quarter. *The good news is most stocks have all pulled back and are cheaper today than in July, so this makes investing in them less risky.*

For a meaningful rally to take shape, the bond market needs to cooperate, however. At a bare minimum, long term rates must halt their sharp rise. We expect this to happen as interest rates typically fall in response to detrimental economic news or a flight to safety. This could come in the form of a new war outbreak like in the Middle East, an impasse in congress over the budget, or any form of slackening in the labor market.

DEATH OF DIVIDEND PAYING STOCKS

At the outset of 2023, there was widespread agreement that this year would be the year dividend paying stocks would shine. 2022 was a dreadful year for most of the market but many dividend paying stocks were outliers and performed surprisingly well. Stocks like General Mills, Genuine Parts, Coca Cola, McDonalds, and Lockheed Martin, all gained in 2022, which was extraordinary, given last year. Traditional dividend payers like utility stocks also rose in 2022.

Moving into 2023, the general belief held that dividend paying stocks in safe, defensive companies, would continue to perform well. Instead, just the opposite occurred. Most stocks in this category have seen steep slides. The broad I Shares Select divided fund is down over 10% in 2023. The Utilities Select SPDR fund is down 16%. The individual names mentioned above are all in deeply negative territory for this year.

Unexpectedly, these dividend paying stocks met their demise from higher interest rates. Again, stocks face competition so that a 3% or 4% dividend pay rate looks much less attractive when money markets yield 5%. As a consequence, investors fled these kinds of stocks.

PEREGRINE STRATEGY

- Since high interest rates promise to contain rallies within a trading range, we continue to employ a tactical trading strategy. We do see a rally in the fourth quarter of at least 5% on the S&P 500 regaining most of the loss from Q3.
- Cash and TBills paying above 5% will continue to be emphasized in client accounts.
- If the economy falters, we will likely lock in on the two year Treasury, currently yielding 5%.
- We substantially departed from our defensive, dividend paying stocks like General Mills, Proctor Gamble, and Oneoke.
- We reduced our holdings in industrial stocks like Caterpillar, and General Electric, due to heightened risk of recession and a sense that these investments may see lower prices before bottoming.
- We have used the latest decline in the market to invest in stocks that we gauge to be at important support levels.

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