George McAuliffe – Third Quarter 2023 Commentary

Dear Clients,

If the market was a bit optimistic in July and August in looking beyond a period of rising rates, then in September, historically the worst month of the year, the market had second thoughts. As employment and housing markets refused to fade, good news was now bad news when viewed through the lens of fighting inflation, and what the Fed might next do, and how high and for how long interest rates might go. If rates need to go higher, that probably threatens equities. And if bond yields still need to reflect interest rates that may be kept higher for longer, then the risk premia there remains too low. This made for a third quarter where few investors were rewarded.

At the ends of the past two quarters, I had been trying to determine if markets might be nearing a turning point, whether in terms of simple sentiment, or interest rates, or global events. More recently, however, I have been thinking that maybe the notion of an "intermission" might be more appropriate. Interest rates may thus be "higher for longer" while we see what happens with wage and housing pressures. The economy still seems okay, and employment remains healthy. Russia/Ukraine does not seem to have changed much, save that Europe is perhaps slightly more self-sufficient at this point, but that is just one of multiple potential knock-on topics. And of course, the rapid spread of AI continues to empower new areas. It therefore looks like this Fed will stay higher for longer until either more elements of inflation start to ease, or until something further breaks (maybe commercial/office real estate?), but until such time things could well continue to putter along.

And then there is the new war in Gaza and the atrocities committed by Hamas. In the very short term, it looks like it will be a toll on Israeli company productivity as reservists are called up. But if this conflates to something involving Iran, or more of the region, affecting oil and shipping, then that of course is another story. I don't think anyone really knows what will happen here, nor do I feel there is much point trying to hedge unknowable things. Much of the global economy navigated through the Covid pandemic mostly okay, demonstrating the world can deal with large-scale global disruptions, and I believe the companies we own are resilient.

As investors, we always try to have a view to what is coming in the world. But forecasting the short term is hard, and has recently become harder. Confidence, whether with investors or consumers, has taken a hit. Uncertainty is of course always there, but it would seem to have grown recently. Corporate earnings, the economy, and the consumer have been fairly resilient, but for how much longer? Some sort of economic landing will in all likelihood occur, but exactly when and how hard is not evident, nor what area(s) might crack first. Therefore, as investors, what we can more profitably stay focused on is the longer term — and here I see a fair number of good things coming. As markets "climb the wall of worry" over time, things are never smooth, but I do feel today is not that bad a time to be an investor.

As always, I would be happy to discuss further with anyone interested.

Thank you -

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