Ropes Wealth Addresses What Keeps Us Up At Night

Another week has brought another all-time high for key market indices like the S&P 500 Index and Dow Jones Industrial Average. We are only a week in but so far earnings season has exceeded expectations with continued strong results from many of the banks and asset managers (Goldman Sachs, Bank of America) as well as from the likes of Netflix and Taiwan Semiconductor Manufacturing. On the latter, the largest chipmaker in the world reported a 54% climb in annual profit, better than analysts had expected, driven by accelerating AI demand. As for Netflix, they too exceeded forecasts with their results and guided for higher earnings. Notably, their operating margin climbed, and ad-tier membership increased 35%. However, in contrast to the optimism shown by stock prices, the 10-year Treasury note yield reached 4.11% in this week's trading and gold has hit a record high of $2,714 as anxiety mounts with the election nearing and geopolitical risk rising.

This week I had the pleasure of traveling to Chicago to join some fellow investors and speak on a panel discussing the topic of "what keeps us up at night." The list was not short and not unexpected, and I think speaks to some of the same worries we have heard from you in our recent meetings together.

The first group of worries related to interest rates and inflation. There is a growing argument that we are oversimplifying the conventional wisdom that interest rates are going to fall. Sure, short-term interest rates will decline in line with cuts to the Federal Reserve's target, but what about longer-term interest rates? As we have seen over the last few weeks, a combination of persistent inflation fears and rhetoric from both candidates about deficit spending has the bond market spooked. Today the 10-year U.S. Treasury bond yield is 4.11%. Some experts on this panel predicted a 10-year Treasury note yield as high as 6% in the coming 3-5 years as inflation persists and more deficit spending is pursued. You can imagine a yield curve that steep for those reasons would cause sleeplessness. I should also note that worries over our debt and deficit spending had more urgency than I have ever seen, not surprising as both candidates and Congress seem unable and unwilling to address the topic even as the national debt has reached an all-time high of $35.46 trillion, the debt-to-GDP ratio is 126.30%, and our budget deficit is just shy of $2 trillion.

There was also discussion around geopolitical risk which is a recuring concern but in the current environment seems more heightened. Of note was concern that there is growing alignment and coordination between Russia, China, Iran, and North Korea that could create a new "axis of evil" of the sort that should keep us up at night. There are just too many examples of collaborative efforts that demonstrate a mutual diplomatic and ideological joint anti-U.S. and anti-western strategy. Under Obama, Trump, and Biden, fear of global escalation on so many fronts and in so many places has restrained and paralyzed responses, even as these unfortunate alliances seem to grow stronger. It would seem we may have to rely on the Cold War prospect of mutually assured destruction to deter rash actions, and it is disappointing and demoralizing to consider that is our present and future.

And while geopolitical risk was more urgent, there was also a very clear and present danger noted in the extreme polarization between our political parties and amongst everyday citizens that only compounds the tightrope we are walking.

The last grouping of risks we focused on was the income inequality and how to consider intergenerational equity, climate change, cybersecurity, and valuation bubbles. On the last point, most panelists agreed that stock market performance would not be as robust as it has been the last decade but were sanguine about future returns given the strong conviction that expectations for a near term U.S. recession are low and corporate earnings growth is on a steady and positive trajectory. There was also a strong view that market broadening to companies beyond the technology sector, including value-oriented companies, small caps, international, and others would prove a tailwind for diversified investors at last.

To talk of some better news, recession risk was identified as a low probability, and this week's economic data underscored that judgment. For example, September retail sales climbed 0.4%, and excluding automobile sales, were even stronger with growth of 0.5%. One extraordinarily strong category in retail sales was restaurants and bars, which saw a 1.05% monthly increase. Gas station sales fell sharply, thanks to lower gas prices, prompting consumers to spend more willingly on other items last month. Less positive were reports on housing starts and building permits for industrial production, which showed slowdowns. Also, initial weekly jobless claims fell to 241,000, down from 260,000 the prior week and under expectations but above the four-week average of around 236,000. Continuing claims of 1.867 million rose from the prior week and were the highest since late July. Hurricanes might explain the recent jump in claims.

Overseas, there were two notable developments. First, the European Central Bank (ECB) cut its key interest rate another 25bps for the third time this year, taking the deposit facility rate from 3.50% to 3.25% in response to declining eurozone inflation. Analysts expect another cut in December. The other big news was Chinese GDP growth was just 4.6% according to official data, returning to the lows of 2023 thanks to a tumbling property sector. A barrage of stimulus announcements has blunted some of the fears around this slowdown, but it remains to be seen if the world's second largest economy will be able to get into high gear again.

The sum of all these points for you is that the market outlook has an abundance of risks to overcome even as recession fears have faded. Will our monetary and fiscal policymakers and global leaders be able to mitigate those risks? You can see why we are all feeling a little sleepless. That said, if it is any consolation, markets are well known to climb over walls of worry about risks such as these, and we see that pattern continuing as rightfully the focus remains on earnings and corporate profits rather than on risks outside of CEOs control.

Thank you for your interest in our weekly investment commentary. If you would like to speak personally with a member of our team at any time, please click **here**.

Ropes Wealth Advisors
800 Boylston Street Boston, MA 02199-3600