IRONWOOD
Investment Counsel, LLC

Ironwood Investment Counsel, LLC constructs and manages customized investment and wealth management programs designed to meet our clients' unique goals and objectives. Our distinctive process maximizes performance through return enhancement, risk reduction, tax efficiency, and cost containment.

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Third Quarter 2023 Market Commentary

The third quarter of 2023 was marked by volatile markets and shifting economic data. A U.S. debt downgrade, fewer job openings, talk of another government shutdown, and higher interest rates were departures from some of the more supportive economic conditions in prior quarters. While some elements of the economy have modestly deteriorated, jobs growth remains strong and inflation is moderating as investors move into the final quarter of 2023. Following is a summary of markets and notable events from the three-month period ending September 30, 2023:

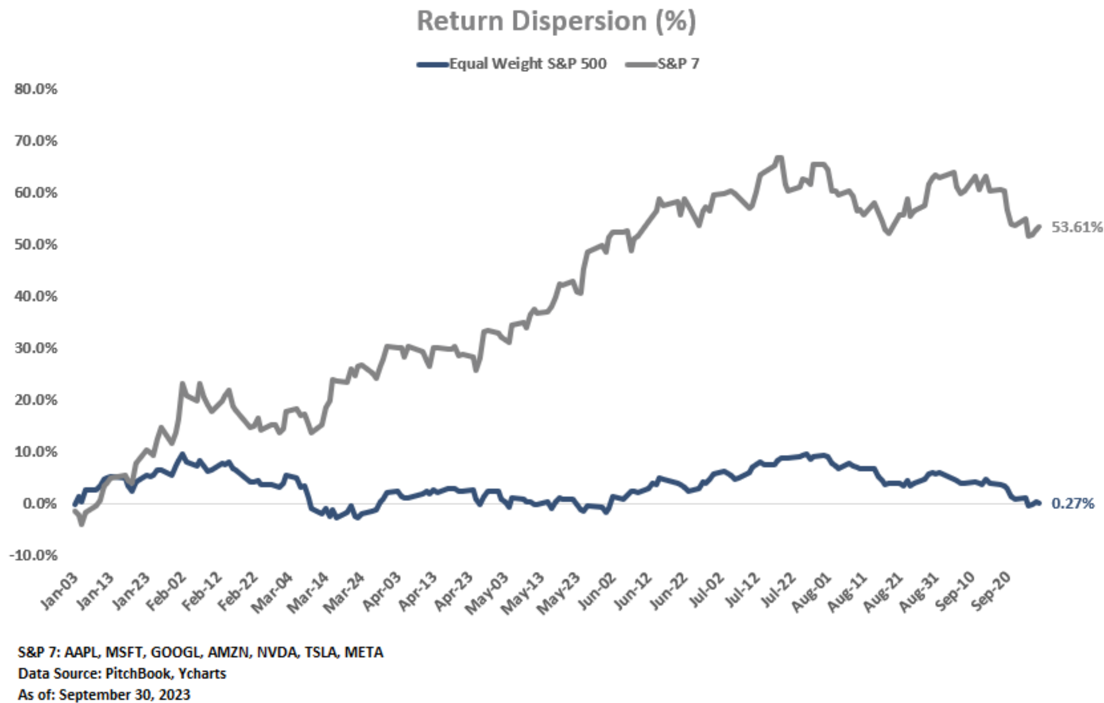
Equity and Fixed Income Markets

After surprisingly strong returns for the first half of the year, equity markets ultimately gave way to the above-referenced "headline risks" and shed much of their gains during the third quarter. The S&P 500 Index, which lost -3.27% over the quarter, was actually one of the better performing areas within equities. Other stock indices posted larger declines. Considered the benchmark for small-cap stocks, the Russell 2000 index was down -5.14%, holding the asset class in an almost two-year bear cycle with its last peak in November 2021. The MSCI EAFE, which measures larger international stocks, was lower by -4.94%. Lastly, the S&P Dividend Aristocrats Index, which measures long-time dividend paying U.S. companies, was down -5.44% for the third quarter.

With regard to fixed income, the Bloomberg U.S. Aggregate Bond Index declined by -3.23% as the quarter came to an end. While rate increases cause short-term shocks to fixed income, we are encouraged by the future returns on our client's fixed income holdings. Currently, the annualized yield on a five-year Treasury bond offers more than 5%. Further, to the extent a mild recession played out and short-term interest rates declined (i.e., money market yields), our clients will have locked in higher returns over a multi-year time period with their fixed income assets.

Throughout much of 2023, U.S. equity market performance has been driven by a concentrated group of companies. Dubbed the "Magnificent Seven" earlier in the year, shares of Apple, Amazon, Meta, Alphabet, Nvidia, Tesla and Microsoft have traded higher on hopes of future profits derived from Artificial Intelligence or "AI". Notwithstanding the year-to-date performance of these seven companies, this year's market results have been lackluster.

The chart below indicates the large return dispersion this year between an equally weighted index of the S&P 500 versus the "Magnificent Seven", showing that most of the market has been relatively flat through the third quarter of 2023. While we have exposure to some of the "Magnificent Seven" companies, we currently see value in a number of other businesses outside of this concentrated group.



Fitch Ratings Downgrade

On August 1st, Fitch, one of the three major credit rating agencies, downgraded the United States Long-Term Rating from AAA to AA+. According to Fitch, some of the key drivers of the ratings downgrade included the reflection of the expected fiscal deterioration in the coming three years, a high and escalating government debt burden, and the erosion of governance relative to AA and AAA rated peers over the course of the last two decades. According to Treasury data, the gap between spending and revenue widened by 170% during the first nine months of the fiscal year. Two elements driving deficits are higher interest costs and lower tax revenue. According to the Wall Street Journal, in 2023, tax revenue declined by 11% and interest costs increased by more than $131 billion.

Job Market

The U.S. Labor Department reported job openings, typically an indicator of labor demand, declined to a seasonally adjusted 9.6 million as of August 30th. While this reading was one of the lowest levels since March of 2021, it was still well above pre-pandemic levels and equivalent to approximately one and a half jobs for each person seeking employment. By comparison, job openings were 12 million only 18 months ago. We are hopeful that the slight downtick in open positions can support slowing wage growth which would further reduce inflationary pressure. Still, overall U.S. job growth remains on firm footing as employers added 336,000 jobs in September, a sharp revision upward from the Labor Department's prior estimate of 227,000. Ultimately, job growth is a supportive element for the economy and consumer spending.

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Interest Rates
Borrowing costs continued to climb throughout the third quarter as the Federal Reserve Open Market Committee (the "Fed") lifted the benchmark Federal Funds rate again in July by a quarter point to a range of 5.25% to 5.5%. This 22-year high was matched by another 22-year high for mortgage rates. In August, the 30-year fixed rate reached 7.23%. Following suit, to no one's surprise, applications for purchase mortgages dropped to the lowest level since 1995, according to the Mortgage Bankers Association. Thus far, the economy has been able to weather this sharp increase in rates.

Looking ahead to the fourth quarter, we are encouraged as inflation is moderating. Further, consumer spending has held its ground remarkably throughout 2023 despite higher borrowing costs. It will be interesting to see if the consumer and jobs market can continue to push the economy forward. Only time will tell. As numerous market pundits weigh in on their economic predictions and recession calls, we maintain our emphasis on quality and long-term investments, rather than trending ones, as well as our careful, disciplined, and thoughtful strategies. We believe this approach will continue to best serve our clients' portfolios and their financial well-being into the future.

As always, we thank you for the ongoing trust you have placed in our team and we appreciate your partnership. Should you wish to review your portfolio and wealth management goals at any time, we invite you to schedule an appointment at your convenience.

We hope to speak with you soon and wish you and your loved ones an enjoyable holiday season.

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