



## “RATES” OF CHANGE



### MARKET INSIGHTS

#### Global Financial Markets

The level of interest rates impact every asset class, but the velocity of the change in rates and the range of possible outcomes are also very important. Higher than expected interest rate volatility typically reduces visibility, rattles confidence, and slows decision making for companies, governments, and consumers. Persistently elevated interest rate volatility, coupled with rising geopolitical tensions could keep markets volatile for a while.

#### U.S. Economy

Relatively strong economic data has eased fears of a deep recession but fueled worries that interest rates may remain elevated. The job market and consumers have remained resilient despite rising gas prices and mortgage rates pushing 8%<sup>1</sup>. Inflation has been trending down, but the Fed will remain vigilant until the data indicates that inflation is more comfortably under control.

#### Portfolio Implications

The recent rise in interest rates should give us more options to provide income and liquidity. It has been difficult to generate income from bonds without taking on excessive risk since the financial crisis. More sectors of the bond market are now palatable. We remain focused on generating income and returns without taking on excess risk.

### A CLOSER LOOK

Concerns about persistent inflation and rapidly rising interest rates pressured most markets in the third quarter. The S&P 500 slipped 3.27%<sup>2</sup>, the tech-heavy Nasdaq fell 3.94% and the Barclays Aggregate Bond market dropped 3.32%. International stocks also suffered with the MSCI All World ex-US index losing 3.77%. The FTSE Emerging Market index supported by rising oil and commodity prices dipped only 1.64%.

While domestic equity market returns have been solid year-to-date, the rally has not been as broad as it may appear. As of August 31st, according to Bloomberg Global Investors, the largest ten companies in the S&P 500 accounted for roughly 82% of the return<sup>3</sup>.

The S&P 500 is a market-capitalization index which means that larger companies carry more weight. When the value of these companies rise so also does their weighting. The so-called “Magnificent Seven” currently make up 27.5% of the index!

This phenomenon is known as concentration risk, and it can be especially dangerous when many of the largest companies in an index are highly correlated. In the case of the S&P 500, the high correlation comes from an abundance of large technology companies with exposure to artificial intelligence. Apple, Microsoft, Amazon, Alphabet, Meta, Tesla and Nvidia have carried the broader markets this year. The market would be nearly unchanged without their huge rallies<sup>4</sup>. Our portfolios have exposure to each of these companies, but we do not chase their recent performance.

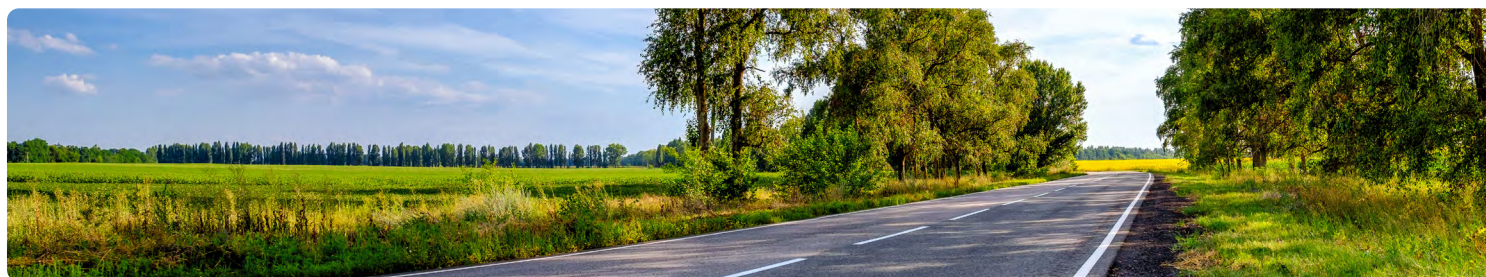
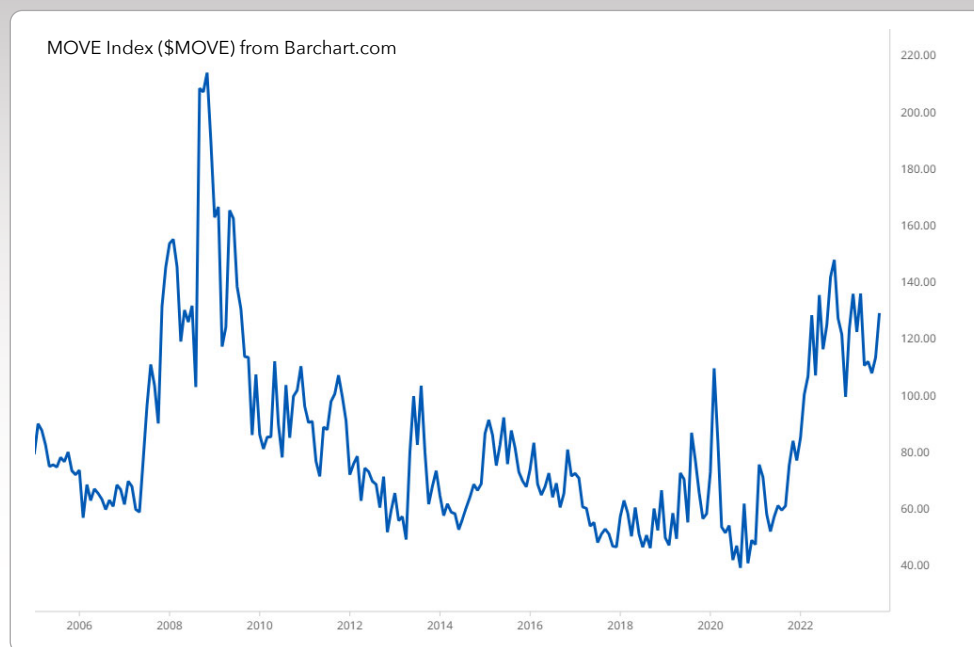
History tells us that the late 1990s dotcom bubble was led by Microsoft, Cisco, Oracle, and Intel. Similarly, the “Nifty Fifty” propelled the market higher in the 1970s, but their subsequent decades of underperformance is a cautionary tale about excessive optimism by investors in growth companies and the dangers of overly concentrated portfolios. As the Spanish philosopher George Santayana once said, “Those who cannot remember the past are condemned to repeat it.”

Our broadly diversified strategy has the potential to provide more protection from the downside than portfolios focused on recent outperformers. Market cycles and investment fads will come and go, but our portfolios will evolve without sacrificing discipline.

The recent rise in interest rates has made holding cash a more attractive alternative than it has been in many years. A slightly increased cash position also adds valuable liquidity and flexibility should market volatility persist or increase. Thus, in most models, we have reallocated some of the short-term bond positions into cash. We have also rebalanced other holdings back to target by trimming growth stock, buying small-cap and adding to real estate (REITs).

The recent volatility is not surprising, because markets cannot be expected to smoothly adapt to wild swings in interest rates and economic data while still pondering the long-term effects of unprecedented pandemic-related stimulus. High rates may deflate bubbles in some areas of the market while also increasing the attractiveness of holding more cash and bonds.

The MOVE index, a widely accepted measure of interest rate volatility, has often spiked during periods of increased uncertainty and market volatility. Most recently, it rose during the global financial crisis and the onset of the pandemic. The recent rise in interest rate volatility highlights both the importance of the Fed's battle with inflation and the rate of change in interest rates.



## GAINING PERSPECTIVE

**International Equities:** Understanding our international exposure

### Market Composition

The largest tech companies in the world have seen enormous growth over the last decade and those types of companies tend to be headquartered in the United States. However, many international companies, especially those based in emerging markets, tend to be concentrated in more value-oriented sectors like financial services, utilities, industrials, and materials.

### Foreign Currency

Strength in the U.S. dollar has muted returns from international investments, but during periods of dollar decline, like in the mid-2000s, the foreign currency exposure in these positions will likely boost returns.

### Economic Growth

PWC estimates that by 2050 the largest economies in the world ranked by GDP will be China, India, United States, Indonesia, and Brazil. Global economic growth is most likely to be fueled from abroad over the next several decades.

**In the long run, we believe our international investments increase diversification, reduce risk, and provide opportunities for growth as these markets evolve.**

**Our portfolios are designed to meet our clients needs and help them achieve their long-term goals.  
Please contact your advisor to discuss how we balance risk and reward in your personalized plan.**

*- NorthLanding's Investment Direction Committee*

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<sup>1</sup> <https://www.reuters.com/markets/us/us-mortgage-rates-soar-highest-more-than-23-years-2023-10-25/>

<sup>2</sup> Investment index information and performance data through 9/30/2023 is provided by Morningstar

<sup>3</sup> <https://www.forbes.com/sites/greatspeculations/2023/09/05/the-concentration-risk-lurking-in-your-401k/?sh=4cf76e074022>

<sup>4</sup> <https://finance.yahoo.com/news/guide-magnificent-seven-stocks-etfs-130000486.html>