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Weekly Commentary

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What's on our Radar for the Fourth Quarter of '23

The warm weather seems to be behind us and we find ourselves firmly in the final quarter of 2023. In Q3 we saw a mild correction in financial markets as investors remained focused on a plethora of issues. Looking ahead, we've identified what investors will be most focused on as we wind down the year (already!). In fact, the issues at hand haven't changed much from earlier this year. Perhaps the most hotly debated question is "are we headed for a recession?" The answer, of course, is that nobody knows. However, economic indicators that we rely on for guidance have been sending mixed signals. We've highlighted below the four issues we'll be most focused on.

Interest rates: Since the Federal Open Market Committee's (the "Fed's") initial interest rate hike in the recent cycle (March 2022), the central bank has raised its benchmark interest rate 11 times. Measures taken at the July meeting brought the Fed's target rate up to 5.25% to 5.50% from a low of 0.00% to 0.25% in March 2022. Historically low rates, which resulted from extreme stimulative measures taken by central bankers to support the global economy during the pandemic, led to the unintended consequence of rampant inflation. The Fed's aggressive policies over the last 18 months were intended to counter inflationary pressures by intentionally slowing down the economy.

Interest rate policy remained unchanged at the Fed's September meeting and this has fueled speculation that the Fed's aggressive rate hikes are showing signs of successfully slowing down the economy. Despite commentary from Fed Chairman Jerome Powell continuing with the rhetoric that rates will remain "higher for longer", many are convinced that the fed is "done" with raising rates. The Fed's next policy meeting is scheduled for November 1. Market observers will be monitoring the event closely for key indicators on Fed policy forward; some heighted volatility in markets can be expected.

Inflation: This has arguably been the most followed story over the last year. Well documented is the fact that the accommodative fiscal policies that began in 2020 and were designed to lessen the economic impact of the pandemic, culminated in "easy money" being the culprit of the highest inflation rates in decades. To battle rapidly rising inflation, central banks began aggressively raising interest rates with the objective of slowing down the economy and taming inflation. In the U.S., the Federal Open Market Committee (Fed) raised rates ten times between March 17, 2022 and May 3, 2023. The Fed's "target rate" rose from 0.25% to 0.50% in March 2022 to 5.00% to 5.25% at the most recent meeting. In Canada rates rose in similar fashion.

Q2 quarter earnings results: Earnings continued to show resiliency in the first quarter and were broadly better than analysts' expectations. However interest rates continue to rise, and this has implications for businesses and consumers

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alike. The longer rates remain elevated, corporations will face increasing financing costs which in turn should eventually impact capital investments and corporate profits. Companies with stretched balance sheets will face stronger headwinds than companies that have strong balance sheets. Third quarter earnings season kicked off with food and beverage company PepsiCo Inc. (PEP:NYSE) reporting this morning. The company reported a strong quarter with "resilience across geographies and categories". Management issued full-year 2023 guidance for an earnings per share (EPS) increase of 13% (12% previously) and included expected organic growth of 10%.

Shares in PEP were higher by 1.9% following earnings although the year-to-date share price was lower by 11.3% leading into the numbers. Bank earnings in the U.S. are traditionally amongst the first groups to report. Later this week we'll get a glimpse at how the banks performed in Q2 with **JPMorgan Chase & Co. (JPM:NYSE), Citigroup Inc. (C:NYSE), Wells Fargo (WFC:NYSE) and PNC Financial (PNC:NYSE)** reporting on Friday. Earlier this year, the U.S. banking industry was reeling from the failures of several large regional banks including Silicon Valley Bank, Signature Bank and First Republic. The market reaction will give us a glimpse of "where we are" with regards to an "earnings recession" in North America.

Geopolitical Risk: The war in Ukraine has entered its 18th month and we are no closer to a resolution. In fact, with the outbreak of violence in the Middle East we are seeing an increased level of geopolitical upheaval. In addition, an escalation of the violence in the Middle East could distract Western Nations from assisting Ukraine. The situation is complex and while we certainly do not wish to overlook the terrible suffering of innocent civilians, we must consider the economic impacts and investing implications. Should the tensions in the Middle east persist or expand, there is potential for a disruption in global oil supplies which would have an economic impact at a time when OPEC+ and sanctions on Russian supplies are already having an impact.

While returns in both bond and equity markets were comparatively weak in the third quarter, indicators based on investor sentiment, oversold conditions and positive data points on the economy and inflation are encouraging; we have begun to see some encouraging signs. We'll be monitoring Q3 earnings closely for signs of economic resiliency.

Markets often react emotionally and irrationally to fearful media headlines and economic uncertainty. Along with uncertainty and volatility comes opportunity and as always, we'll be monitoring upcoming events for attractive opportunities to invest. Historically, the best returns are achieved when markets are depressed. Smart investors act when prices are cheap.

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Chart 1: Palos Domestic Funds versus Benchmarks (Total Returns) [1]	FundServ	NAVPS	YTD Returns
Palos Income Fund L.P.	PAL100	$7.77	1.29%
Palos Equity Income Fund - RRSP	PAL101	$6.47	0.48%
Palos WP Growth Fund - RRSP	PAL213	$10.18	-18.22%
Palos-Mitchell Alpha Fund [3]	PAL300	$9.86	25.30%
S&P TSX Composite (Total Return with dividends reinvested)			1.94%
S&P 500 (Total Return with dividends reinvested)			14.36%
S&P TSX Venture (Total Return with dividends reinvested)			-6.26%
Chart 2: Market Data [1]			**Value**
US Government 10-Year			4.80%
Canadian Government 10-Year			4.16%
Crude Oil Spot			US $82.79
Gold Spot			US $1,849.50
US Gov't10-Year/Moody BAA Corp. Spread			185 bps
USD/CAD Exchange Rate Spot			US $0.7320

[1] *Period ending October 6th, 2023. Data extracted from Bloomberg*

[2] *Fund is priced annually*

[3] *Fund is priced weekly on Tuesdays*

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