CETERA® INVESTMENT MANAGEMENT

COMMENTARY

August 21, 2023

Rising Bond Yields Sting Equities

- Bond yields have risen dramatically, increasing equity market volatility.
- Stronger economic data and supply-demand imbalances have been the key causes.
- With our expectation that the Fed pauses, we think this could be an opportunity to buy bonds.

The stock market's mood has changed since early August. After ending the first half up around 16%, the S&P 500 struggled in August primarily due to rising bond yields. Since July 19, the yield of the 10-year U.S. Treasury bond has jumped from 3.74% to 4.34%, largely due to economic resilience and supply/demand imbalances for U.S. Treasury bonds. Consequently, U.S. equity markets have struggled for direction. With rising yields becoming more attractive to income- seeking investors and the Federal Reserve (Fed) likely on hold for the foreseeable future, we do not expect yields to rise significantly higher from current levels and would incrementally add exposure based on your objectives.

Economic data over the past month, such as retail sales, industrial production, 2nd Quarter GDP, and early 3rd Quarter GDP indications, all suggest the U.S. economy is resilient. If the economy is stronger than expected, investors begin to anticipate inflation pressure and sell fixed- income securities consequently pushing higher bond yields. Further pressuring yields higher has been a supply/demand Treasury bond imbalance. On the supply side, the Treasury Department has been issuing more treasury bonds for funding needs and rising budget deficits due to slower tax receipts. On the demand side, the Fed continues its Quantitative Tightening program, where they have been selling treasury bonds each month. The Fed has been very adamant, through comments and last week's FOMC meeting minutes, that they will maintain higher interest rates for longer. Higher interest rates reduce the incentive for investors to buy U.S. treasury bonds to lock in these higher yields. On the other hand, if yields were poised to move lower, investors would likely jump in to buy U.S. treasury bonds to lock in higher yields. Supply and demand of U.S. treasury imbalances have pressured yields higher. These considered, stronger economic data will likely cause the Fed to not cut interest rates anytime soon.

With bond yields moving higher, equity investors are worried for two primary reasons. First, higher yields equal higher borrowing costs for companies and consumers. Higher corporate borrowing costs may hurt profit margins and increase costs for new projects or other expansion plans. Higher consumer borrowing costs, such as mortgage rates or auto loans, may reduce consumer spending. Therefore, higher borrowing costs impacts economic growth and possibly corporate earnings.

The second reason why higher yields worry equity investors has to do with investment fundamentals around valuation. When an investor values a company, one common way is to look at future cash flows or earnings and attempt to determine what they are worth today. Because this valuation methodology relies on current interest rates to determine the present value of these future cash flows/earnings, higher interest rates or bond yields reduce stock valuations. Technology stocks usually struggle in a rising rate environment because rapid growth assumptions are usually built into their valuations. This explains why the Technology sector is the worst performing sector this month in the S&P 500.

Rising bond yields have been pressuring equities and driving a rise in market volatility. While uncertainty persists around Fed interest rate policy, we continue to believe that the Fed has paused and will no longer need to raise interest rates. With the economy likely to begin feeling the full effect of an over-5% jump in the Fed Funds Rate, inflation continuing to slow, and signs that higher yields are impacting borrowing, yields will likely be lower next year. Diversification remains prudent.. Please continue working with your financial professional to help you align your portfolio with your long-term investment objectives. Creating a financial plan that you can monitor and follow helps to avoid distractions and to stay focused on what you can control.

This report is created by Cetera Investment Management LLC. For more insights and information from the team, follow @CeteraIM on Twitter.

Cetera®

About Cetera® Investment Management
Cetera Investment Management LLC is an SEC registered investment adviser owned by Cetera Financial Group®. Cetera Investment Management provides market perspectives, portfolio guidance, model management, and other investment advice to its affiliated broker-dealers, dually registered broker-dealers and registered investment advisers.

About Cetera Financial Group
"Cetera Financial Group" refers to the network of independent retail firms encompassing, among others, Cetera Advisors LLC, Cetera Advisor Networks LLC, Cetera Investment Services LLC (marketed as Cetera Financial Institutions or Cetera Investors), and Cetera Financial Specialists LLC. All firms are members FINRA / SIPC. Located at 655 W. Broadway, 11th Floor, San Diego, CA 92101.

Disclosures
Individuals affiliated with Cetera firms are either Registered Representatives who offer only brokerage services and receive transaction-based compensation (commissions), Investment Adviser Representatives who offer only investment advisory services and receive fees based on assets, or both Registered Representatives and Investment Adviser Representatives, who can offer both types of services.

The material contained in this document was authored by and is the property of Cetera Investment Management LLC. Cetera Investment Management provides investment management and advisory services to a number of programs sponsored by affiliated and non-affiliated registered investment advisers. Your registered representative or investment adviser representative is not registered with Cetera Investment Management and did not take part in the creation of this material. He or she may not be able to offer Cetera Investment Management portfolio management services.

Nothing in this presentation should be construed as offering or disseminating specific investment, tax, or legal advice to any individual without the benefit of direct and specific consultation with an investment adviser representative authorized to offer Cetera Investment Management services. Information contained herein shall not constitute an offer or a solicitation of any services. Past performance is not a guarantee of future results.

For more information about Cetera Investment Management, please reference the Cetera Investment Management LLC Form ADV disclosure brochure and the disclosure brochure for the registered investment adviser your adviser is registered with. Please consult with your adviser for his or her specific firm registrations and programs available.

No independent analysis has been performed and the material should not be construed as investment advice. Investment decisions should not be based on this material since the information contained here is a singular update, and prudent investment decisions require the analysis of a much broader collection of facts and context. All information is believed to be from reliable sources; however, we make no representation as to its completeness or accuracy. The opinions expressed are as of the date published and may change without notice. Any forward-looking statements are based on assumptions, may not materialize, and are subject to revision.

All economic and performance information is historical and not indicative of future results. The market indices discussed are not actively managed. Investors cannot directly invest in unmanaged indices. Please consult your financial advisor for more information.

Additional risks are associated with international investing, such as currency fluctuations, political and economic instability, and differences in accounting standards.

A diversified portfolio does not assure a profit or protect against loss in a declining market.

Glossary

The **S&P 500** is a capitalization-weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries