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Both September and the third quarter have well-earned reputations for being the most challenging periods of the calendar year for investors, and both continued that trend in the third quarter of 2023 as all major equity indices posted losses. The encouraging news is that most equity benchmarks are still carrying handsome year-to-date gains.

As is typically the case with disappointing quarters, multiple interconnected culprits were to blame, though the Federal Reserve continues to be the strongest market influence. During the third quarter, the Fed introduced the concept "higher for longer." Earlier this year, an overwhelming majority of investors expected the Fed to begin easing interest rates in 2024. The Fed is now hinting that they may keep interest rates near their current levels through 2024. Higher interest rates place downward pressure on the valuation multiples investors are willing to pay for stocks and create competition for the allocation of capital. The benchmark 10-year U.S. Treasury note is at its highest yield since 2007. A risk-free Treasury instrument that yields around five percent is a formidable competitor for equities.

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Investors also continue to worry about inflation and consumer spending. Inflation has subsided but troublesome pockets remain–most notably the price spike in oil in the third quarter. Brent Crude rose nearly 30 percent in the quarter to close at $95.31 a barrel. Petroleum-based inputs are present in myriad products and have an inflationary impact that reaches far beyond the gas pump. Several forces are also testing the resilience of the American consumer. Mortgage rates have surged, with the average 30-year fixed mortgage now over eight percent. Credit card debt has hit record highs as consumers are exhausting their COVID relief funds. Lastly, the moratorium on student loans has expired, and payments will resume in October. These factors may create conditions which place liquidity pressure on the consumer.

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We believe the Riverbridge portfolio companies are relatively well positioned to confront these economic challenges. Most of our companies are less economically sensitive as they have high degrees of recurring revenue and offer their customers mission-critical products or services. While this does not make them immune from the effects of economic softening, it does provide a buffer from a slowdown. Our portfolio companies are also internally financed, meaning their growth is not dependent on the ability to borrow money to finance their operations. Consequently, they are less impacted by rising borrowing costs.

Barring unforeseen developments, we believe it is likely that interest rates, inflation, and signals from the consumer will continue to be the primary influencers of the market's mood as we head toward the end of the year. While much of the financial media focuses on the short-term implications of these catalysts, our investment team remains focused on identifying and investing in companies that are well positioned to thrive over the next decade. This long-term perspective is crucial in less certain times.

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