2023 Q3 IN REVIEW

The third quarter of 2023 began with a promising rally that pushed the S&P 500 to its highest levels since March 2022. July was particularly buoyant for stocks, spurred by positive economic data and diminishing inflation metrics. Yet, as August and September returns showed, concerns about rising global bond yields, a potential inflation rebound, and the specter of an economic slowdown cast a shadow over the major indices. Several economic indicators suggested potential headwinds. New home sales tapered off, consumer confidence ebbed, and the S&P 500 index retreated. Despite these indicators and the Federal Reserve's recent rate hike, market participants are bracing for another potential rate increase in 2023. Specific market indices, such as the Russell 1000 Growth and Value indexes, declined by about 3.1% in Q3, while the Russell 2000 index dipped by 6%.

The Federal Reserve's decision to hike interest rates in late July was a significant market mover. While this move was anticipated, the central bank's hint that it might be the cycle's final hike and update to its Summary of Economic Projections were widely watched by market participants as the median rate projections hinted towards a target rate of 5% by the end of 2024. This uncertainty of when the Fed will begin to ease up was exacerbated when Fitch Ratings downgraded U.S. sovereign debt in August on the back of spiraling fiscal deficits and unnecessary political brinksmanship in the debt ceiling debate, propelling Treasury yields to levels unseen since mid-2007.

In the equity market, large-cap stocks maintained their dominance over their small-cap counterparts, a trend consistent with the first half of 2023. On the style side, value stocks outperformed growth stocks during this period. Commodities broadly witnessed significant activity, with oil prices surging. In contrast, gold prices, often a barometer of economic uncertainty, declined due to the strengthening U.S. dollar.

The bond market mirrored the uncertainties of the broader economy. The U.S. bond market shrank by 3.2% in Q3, and the 10-year yield surpassed the 4.5% threshold for the first time since November 2007. A significant challenge for investors this quarter was the positive correlation between stocks and bonds, which posed diversification challenges. The market rally, while robust, was narrow in its focus. The 10 largest stocks in the S&P 500, primarily from the tech and communications sectors, drove most market gains, as has been the case for the whole calendar year.

Economic resilience, be it a byproduct of stronger than expected consumer spending or a result of increasing fiscal dominance was the key word for Q3 2023, much as it has been for the whole calendar year. As we move to Q4, where financial conditions may tighten, all eyes will be on bonds, as we wait to see if their historic route continues.

RECOMMENDED PORTFOLIO WEIGHTINGS

AS OF SEPTEMBER 30, 2023

EQUITY SECTORS

OVERWEIGHT

- Energy
- Industrials

NEUTRAL

- Utilities
- Technology
- Materials
- REITs
- Communications
- Consumer Discretionary

UNDERWEIGHT

- Financials
- Health Care

ASSET CLASSES

OVERWEIGHT

- Short-Term Investment Grade Bonds
- Intermediate-Term Investment Grade Bonds
- Precious Metals
- Resource Commodities
- U.S. Mid Cap Equities
- U.S. Small Cap Equities

NEUTRAL

- Cash Alternatives
- High Yield bonds
- Agriculture Commodities
- International Developed Fixed Income
- U.S. Large Cap Equities

UNDERWEIGHT

- International Developed Equities
- Long-Term Investment Grade Bonds
- Emerging Market Equities

FIXED INCOME

OVERWEIGHT

- Agency Securities
- Bank Loans
- TIPS

NEUTRAL

- Municipal Bonds
- Corporate Bonds
- U.S. Treasuries
- Mortgage-Backed Securities

UNDERWEIGHT

- Preferred Securities

INDEXES

DATA POINT	CURRENT	YEAR-END PROJECTION
S&P 500	4,288	4,400-4,500
NYSE	15,398	16,500-17,000
10-Year Treasury Rate	4.57%	4.25-4.50%
WTI Crude Oil	$90.77	$95-100
Gold Priced in Dollars	$1,871	$2,000
Trade Weighted Dollar Index	128.30	115-120
Effective Fed Funds Rate	5.33%	5.33%

2023 Q4 ECONOMIC & MARKET OUTLOOK

01. Equities

Growth continues its retreat.

Since its inception, the S&P 500 has consistently posted positive performance in the fourth quarter, with an average gain of 4%. This trend persists even in years that have shown strength through the first three quarters. With the economy still robust and the labor market displaying unexpected resilience, there remains some room for upside into year-end. Due to flow dynamics, when equities enter the fourth quarter in positive territory it's likely you get follow through to the upside.

The past quarter witnessed a sell-off predominantly focused on growth-oriented names, a trend we believe will persist through the end of the year. Given that roughly 70% of the market's returns this year have been driven by a select few stocks, there also appear to be opportunities for medium-term excess positive returns in the mid-cap segment. Breadth, which has been largely absent this year, might begin to emerge in pockets of the market leaning more toward value.

However, markets are also showing warning signs. The tight labor market offers little flexibility to maintain our current growth trajectory without risking a resurgence of inflation. The consumer, who has been resilient so far, might face challenges as dwindling savings could curb their spending, potentially impacting corporate profits.

Nevertheless, the theme for Q4 should shift away from the future promise of Artificial Intelligence to more traditional business models that have historically provided stable revenues and manageable costs. As such, we are emphasizing Energy, which has experienced a surge that might soon label it as "overvalued," and Industrials, the foundation of economic output. Technology, having pulled back significantly, might now offer better value, and there could be attractive opportunities in some utilities given their Q3 performance

02. Fixed Income

A flurry of treasury issuance slams bonds.

Early in the third quarter, the Treasury published its plans for bond issuance in the second half which totaled more than $1 Trillion in notes and bonds. Obviously, this is a large number that had to be digested by the market and private balance sheets. This drove bond yields higher throughout the quarter and thus bond market volatility. We see this dynamic of higher deficits and increasingly dysfunctional treasury markets as a trend, rather than an acute problem. There simply is not enough private balance sheet room to handle the level of capital needed to fund our debt issuance.

Ultimately the Fed will be forced to pivot and ease policy in order to stave off this dysfunction which builds with each passing day of QT and each issuance. This is why we expect to be close to a cyclical peak while being clear-eyed that rates will likely run higher longer term. Near term, however, there may be a trade in duration assets, but with the notion that the trade will be unlikely to be fruitful beyond a couple of years.

The credit markets have started to price in the higher likelihood of a recession in 2024, but there has only been a moderate widening of credit spreads, not a precipitous drop that would signal a major credit event. Overall, we like pockets of the fixed-income markets right now, especially TIPS and parts of the corporate credit markets in the sectors that benefit from an inflationary environment.

No matter the subsector of fixed income, it is important to know your duration risk and be ready to migrate to shorter durations over time. During inflationary times, your biggest risk is duration, not credit risk. You should always be monitoring both, but this environment is new and should be treated as such.

03. Commodities

A strong dollar and geopolitical unrest brings crosscurrents.

The most interesting market in Q3 was the commodity space, as the dollar was surprisingly strong, yet the Bloomberg Commodity Index was higher. This bodes well for prices if the dollar can show any weakness into year-end.

The rising geopolitical tensions and tight supply dynamics are creating tailwinds for material and energy prices worldwide. The lack of CAPEX investment during the 2010s is manifesting in tight supply and rising prices in most commodities. We are especially bullish on green metals that have long lead times to new production, like copper.

Oil prices remain volatile, but in an uptrend as tensions in the Middle East and Europe continue to rise. This is also leading to strength in gold as a safe haven asset. We see this decade characterized by a rolling set of geopolitical and budget crises throughout the developed world, which should keep hard asset prices well bid.

CONCLUSION

As we close out the year, odds favor a rally into year-end, but with the higher cost of capital and rising geopolitical risk are starting to change the tenor of sector leadership. Tech stocks are starting to act a lot like they did in 2022 and the resurgence in energy is likely to bleed into 2024.

Asset prices are being weighed down by hawkish monetary policy, but that should abate as we enter next year due to an increasingly dysfunctional treasury market and weakening economic outlook. The recession ahead is unlikely to be major, but the ultimate impact of any policy response is highly uncertain as we deal with structurally higher deficits and ultimately the popping of the first major sovereign debt bubble in any of our lifetimes.

As the fiat system becomes ever more leveraged and stressed by the day, the need to monetize those debts increases and thus hard assets will become more valuable. The road ahead is treacherous, but with the right mindset and outlook, there will be plenty of opportunities for savvy investors. Anyone using the playbook of the 2010s will likely find themselves in tough waters.

DISCLAIMER

There is no assurance that any of the target prices or other forward-looking statements will be attained. Any market prices are only indications of market values and are subject to change. Past Performance is a no guarantee of future results.

The prices of small and mid-company stocks are generally more volatile than large company stocks. They often involve higher risks because smaller companies may lack the management expertise, financial resources, product diversification and competitive strengths to endure adverse economic conditions.
Technology and internet-related stocks, especially of smaller, less-seasoned companies, tend to be more volatile than the overall market.

There are special risks associated with investing in preferred securities. Preferred securities generally offer no voting rights with respect to the issuer. Preferred securities are generally subordinated to bonds or other debt instruments in an issuer's capital structure, subjecting them to a greater risk of non-payment than more senior securities. In addition, the issue may be callable which may negatively impact the return of the security. Preferred dividends are not guaranteed and are subject to deferral or elimination.

Income from municipal securities is generally free from federal taxes and state taxes for residents of the issuing state. While the interest income is tax-free, capital gains, if any, will be subject to taxes. Income for some investors may be subject to the federal Alternative Minimum Tax (AMT).

Bond prices fluctuate inversely to changes in interest rates. Therefore, a general rise in interest rates can result in the decline of the value of your investment. Investing in fixed income securities involves certain risks such as market risk if sold prior to maturity and credit risk especially if investing in high yield bonds, which have lower ratings and are subject to greater volatility.

All fixed income investments may be worth less than original cost upon redemption or maturity.

Although Treasury Inflation-Protected Securities (TIPS) are considered free from credit risk, they are subject to other types of risk. These risks include interest rate risk, which may cause the underlying value of the bond to fluctuate, and deflation risk, which may cause the principal to decline and the securities to underperform traditional Treasury securities. TIPS have special tax consequences, generating phantom income in the "inflation compensation" component of the principal. A holder of TIPS may be required to report this income annually although no income related to "inflation compensation" is received until maturity.

The yield, average life and the expected maturity of mortgage-backed securities are based on prepayment assumptions that may or may not be met. Changes in prepayments may significantly affect yield, average life and expected maturity.

Investing in foreign securities presents certain risks not associated with domestic investments, such as currency fluctuation, political and economic instability, and different accounting standards. This may result in greater share price volatility. These risks are heightened in emerging markets.

Investments in the energy sector are subject to the adverse economic events within that industry. A downturn in the energy sector of the economy, adverse political, legislative or regulatory developments or other events could have a large impact on a portfolio's investments in this sector.

Exposure to the commodities markets may subject an investment to greater share price volatility than an investment in traditional equity or debt securities. Products that invest in commodities may employ more complex strategies which may expose investors to additional risks.

Real Estate investments have special risks, including possible illiquidity of the underlying properties, credit risk, interest rate fluctuations, and the impact of varied economic conditions.

Additional information available upon request.

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