Market Commentary

As of September 30, 2023

Economy & Market Review

Third Quarter 2023

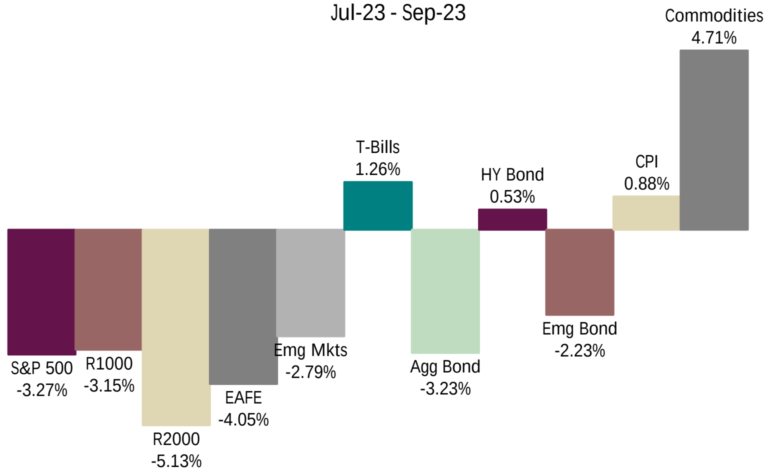
Autumn is a time of transition; the days shorten, temperatures decrease, leaves fall and crops are harvested. In the fall, plants and animals prepare for winter as some take refuge and others relocate to more temperate climates. The economy may be observing a time of transition as well. Certainly, the bond market is going through the most challenging transition ever. Even though the Federal Reserve (Fed) has paused increasing short-term rates in the near term, rates on the longer end of the yield curve are moving up fairly aggressively. This increase in rates is currently producing a third consecutive year of negative bond performance based upon the Bloomberg Aggregate Bond Index. Although there has been a long and variable lag (Fed speak), the economy might just be starting to feel the effects of higher rates. The 30-year mortgage rate is near 8% which makes homeownership very difficult given home prices remain quite elevated. Average credit card rates are much higher than previous years. When companies must refinance debt, this cost has risen as well. Until recently, the stock market has been oblivious to any negative news instead anticipating a "soft landing" as the S&P 500 large cap stock index increased 13.1% year-to-date (YTD), but fell 3.3% during the quarter. YTD S&P 500 performance was lifted by a few large cap growth companies, the vast majority of the US stock market hasn't performed nearly as well. For instance, US small caps increased only 2.5% YTD and declined 5.1% for the quarter. Internationally, developed non-US stocks decreased 4.1% for the quarter and lagged US performance. Geopolitical events from China, Israel, and the Ukraine will continue to provide sparks for future market volatility.

US economic data remains resilient. The September jobs report surged above expectations adding 336,000 jobs, the most since January. Historically, adding that many jobs might be good, but not when the Fed is trying mightily to fight inflation. Although the jobs report looks strong, the full time employment has declined over the last 3 months while part time employment has soared. This could be indicative of a softer employment market than headlines suggest. The unemployment rate rose from 3.5% to 3.8%. September data showed annual wage growth drifted lower up 4.2% but still stronger than the Fed desires. The Fed needs just the right amount of labor market softness, but not enough to push the economy into a major recession.

Global Market Performance

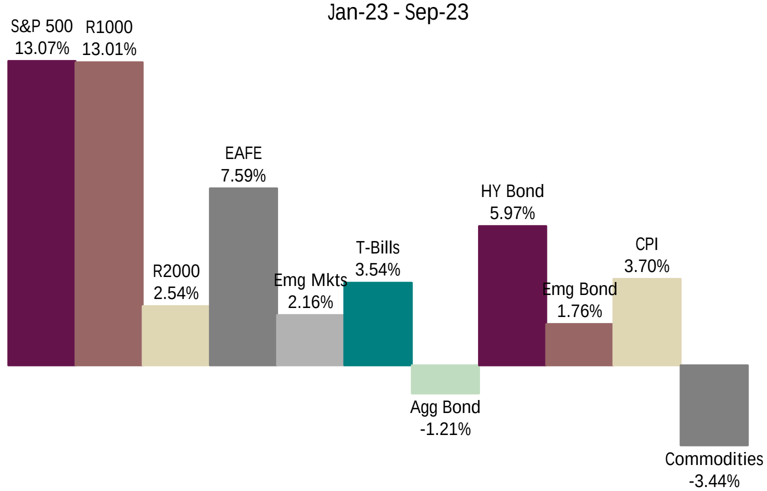
Quarter Performance

Jul-23 - Sep-23



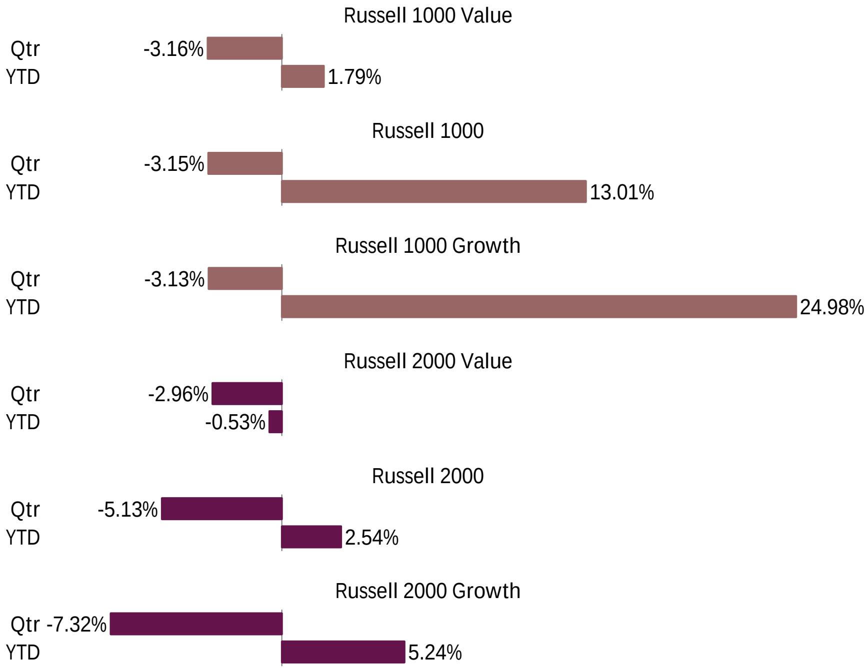
Year to Date Performance

Jan-23 - Sep-23



U.S. Equity Markets

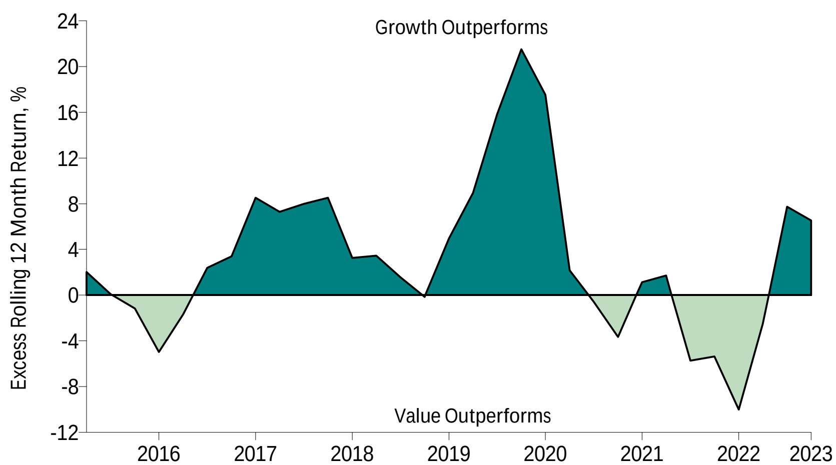
U.S. Equity Style Performance



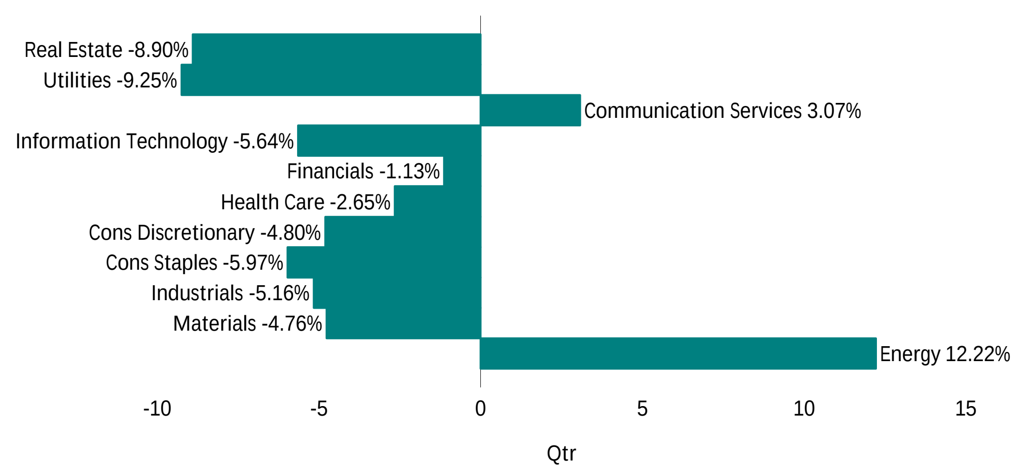
Only commodities, T-bills (cash), and high-yield bonds were positive in the quarter. Commodities benefited from higher energy prices and high-yield bonds' shorter duration impacts them less negatively in a rising interest rate environment. Large cap growth and value stocks performed nearly identically for the quarter, but small cap stocks told a different tale. Small cap value (Russell 2000 Value Index) decreased 3.0% and small cap growth (Russell 2000 Growth Index) was down 7.3% during the quarter. Large growth stocks are still really expensive relative to their 20-year averages. Only small cap value and small cap blend represent a somewhat meaningful discount to each one's historical average. From an overall equity market valuation, the S&P 500's current Price-to-Earnings ratio (P/E) of 17.8x is above the 25-year average of 16.8x but has decreased that premium throughout the year.

Only two sectors had positive performance for the third quarter, with Energy easily representing the best quarterly performer. The worst performing sectors were Utilities and Real Estate both for the second quarter in a row. Utilities many times are a bond proxy with high dividend yields, but react unfavorably to rate increases. Real Estate continues to be impacted by higher lending costs and slow demand for some sectors of that market.

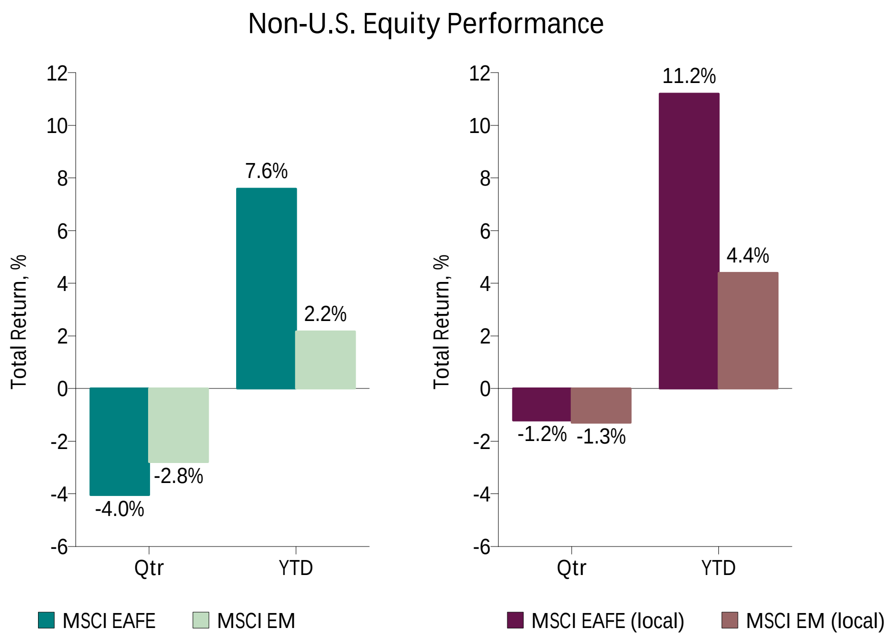
Growth Relative to Value (Russell 1000)



U.S. Equity Sector Performance (S&P 500)

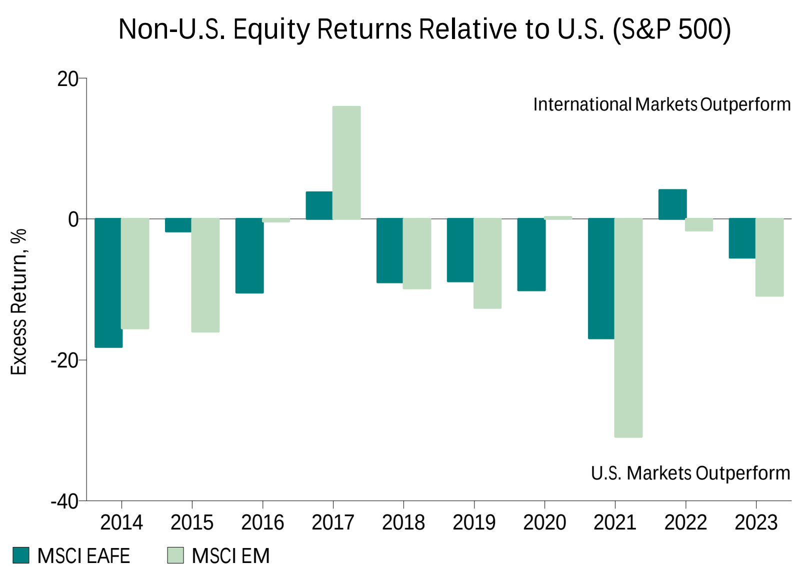


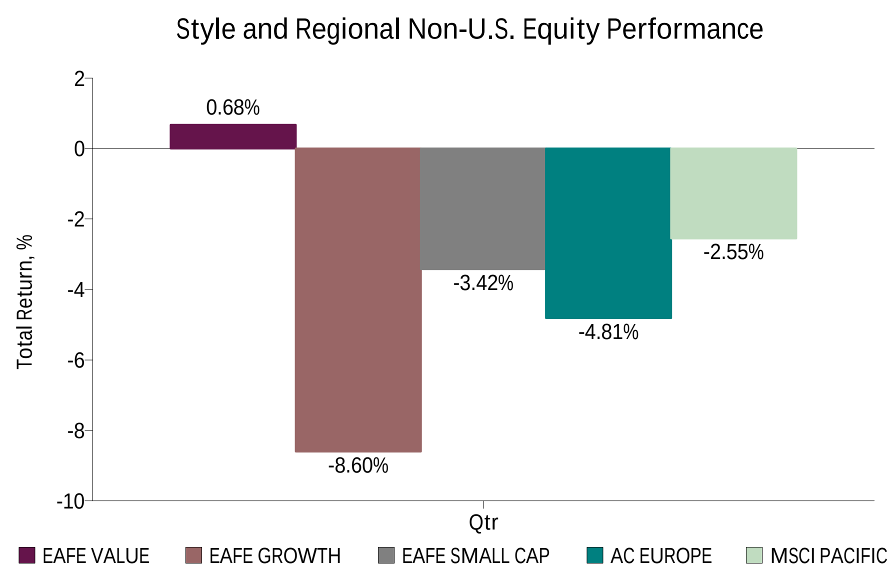
International Equity Markets



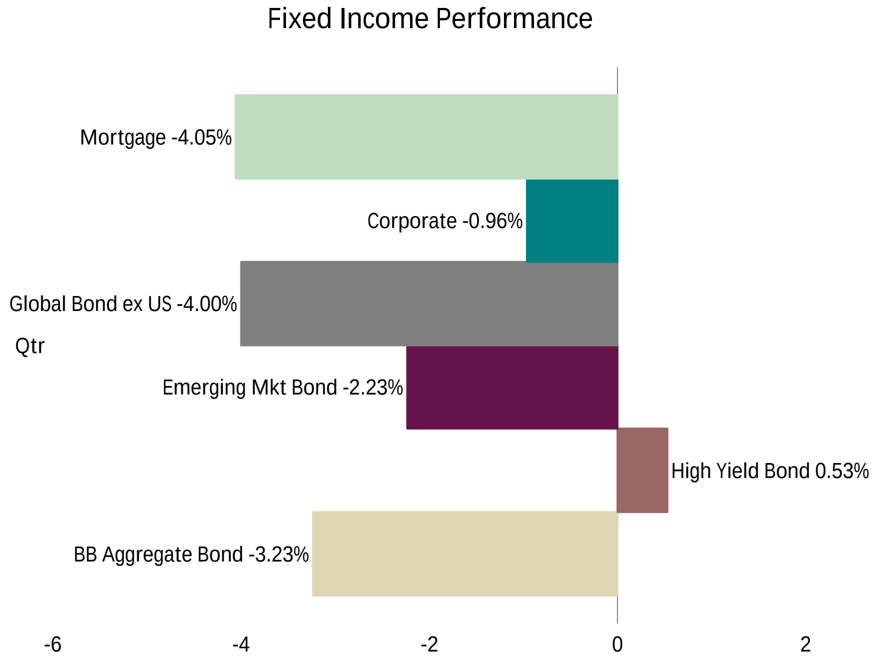
The MSCI EAFE (Europe, Australasia, and Far East) Index, a proxy for large international developed equity markets, was down 4% during the quarter with performance negatively impacted by the strong dollar versus foreign currencies. The eurozone fell as well in Q3 amid concerns over the negative effects of interest rate increases on economic growth. Data produced at the end of the period showed eurozone inflation slowed to a two-year low of 4.3% in the year through September, down from 5.2% in August. Potentially, this could lead to an end of European Central Bank (ECB) rate increases. The ECB raised interest rates twice in the quarter. Purchasing Manager Index (PMI) data showed that the eurozone private sector was in contraction, although the composite reading edged up to 47.1 in September from 46.7 in August.

The MSCI Emerging Markets Total Return Index was down 2.8% which was better than the rest of the world in quarter three. China's stock saw improved performance for the quarter, but has easily lagged the world YTD. China's reopening process has been disappointing and policymakers' piecemeal approach to stimulus has made it difficult to stabilize the property market and broader economy.



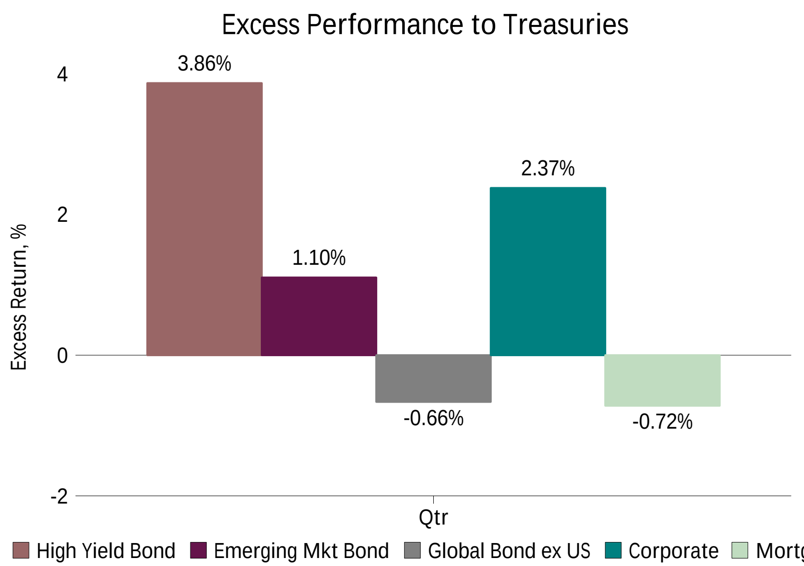


Fixed-Income Markets



As mentioned previously, longer term rates continued higher adding more volatility to the fixed income markets. Many believe this is due to rising inflation, too much treasury supply, foreign central bank selling, a possible credit event, or some combination. Possibly, it might just be economic growth continues to limit the likelihood of impending Fed rate cuts and bond market vigilantes are requiring a higher yield. The Bloomberg US Aggregate Index was down over 3% during the quarter as interest rates continued to rise. Just like last quarter, high-yield bonds were one of the few bright spots with a positive return of 0.5% for the quarter as recession hasn't surfaced and credit default rates remained relatively low. Mortgage securities were a lagging sector as spreads over treasuries increased. Bond spread or yield spread is the difference in the yield on two different bonds.

The US 10-year Treasury yield recently reached 4.81% and set a 16 year high. This dramatic move, especially late in the quarter, pushed the yield curve closer to flat. Although the yield curve is still inverted (higher yield on shorter term treasuries than longer dated treasuries), it isn't nearly as inverted as it was earlier this year. The 10-year minus 2-year yield curve was inverted over -1% in July and now is only -0.3%.



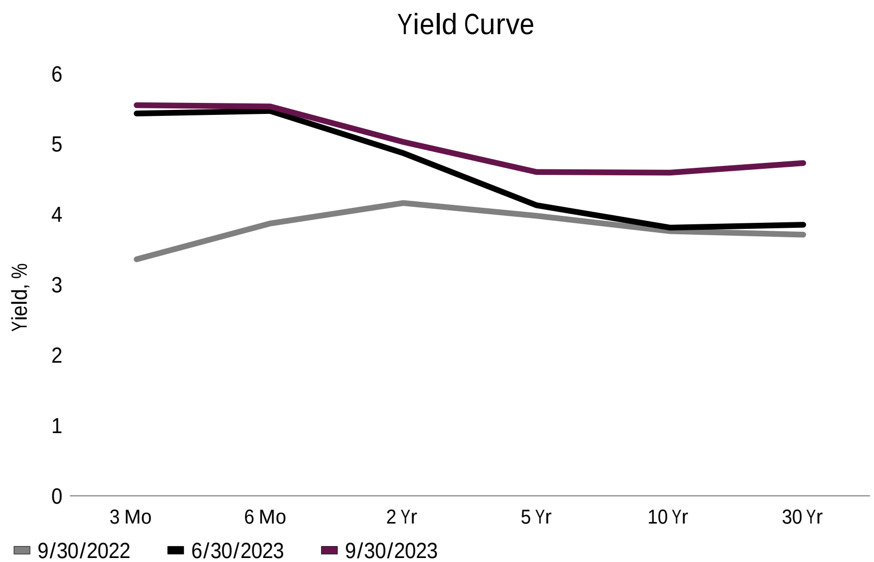
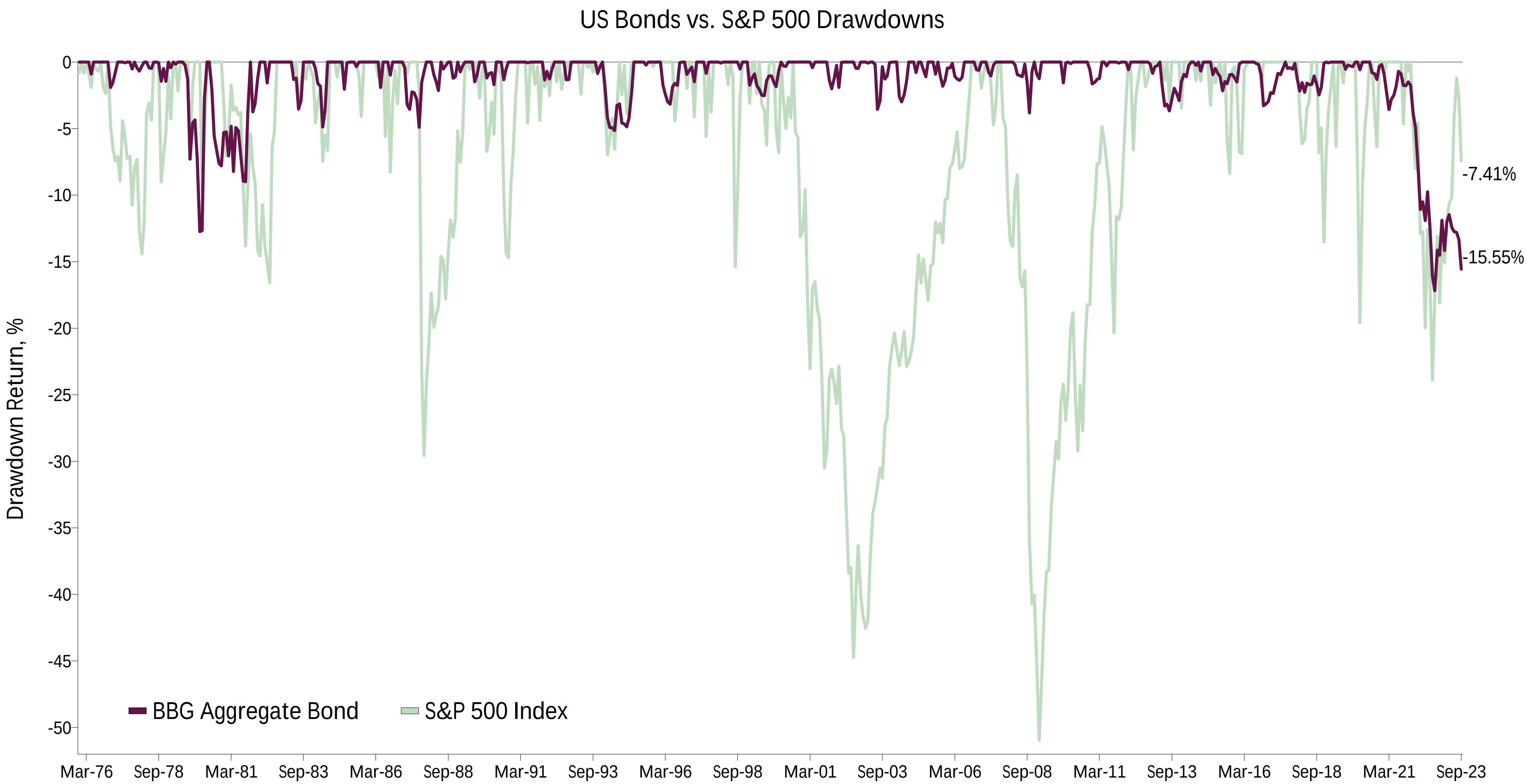


Chart of the Quarter



Back in 1972, a children's book called Alexander and the Terrible, Horrible, No Good, Very Bad Day was published. The chart of the quarter looks like the Terrible, Horrible, No Good, Very Bad Chart. As drawdowns go, the recent bond drawdown is worse than the late 1970s and that speaks volumes. Bonds are a complement to stocks, not competition. Over 560 rolling 12-month time periods since 1976, bonds and stocks both declined only 2% of the time. Bonds had a negative 12-month return only 12% of the time when stocks fell. This makes bonds well-suited to help mitigate stock market risk.

2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	Annualized Return
			Small Cap Stocks 21.31%	Emerging Mkt Stocks 37.75%		Large Cap Stocks 31.43%					
			High Yield 17.49%	International Stocks 27.77%		Small Cap Stocks 25.52%	Gold 24.61%				
			Large Cap Stocks 12.05%	Large Cap Stocks 21.69%		International Stocks 22.13%	Large Cap Stocks 20.96%				
	Large Cap Stocks 13.24%		Commodities 11.77%	Small Cap Stocks 14.65%		Emerging Mkt Stocks 18.90%	Small Cap Stocks 19.96%				
	Real Estate 12.49%		Emerging Mkt Stocks 11.60%	Gold 12.66%		Gold 18.43%	Emerging Mkt Stocks 18.69%	Commodities 27.11%		Large Cap Stocks 13.01%	12.74
Small Cap Stocks 38.82%	US Bonds 5.97%		Real Estate 8.76%	60/40 Blended Index 12.07%		60/40 Blended Index 16.50%	60/40 Blended Index 12.24%	Large Cap Stocks 26.45%		High Yield 5.97%	4.23
Large Cap Stocks 33.11%	60/40 Blended Index 5.51%		Gold 8.10%	Intl/EM Bonds 10.41%		High Yield 14.41%	International Stocks 11.13%	Real Estate 22.18%		International Stocks 5.82%	4.53
International Stocks 15.78%	Small Cap Stocks 4.89%	Real Estate 15.01%	60/40 Blended Index 7.85%	Real Estate 7.62%		Intl/EM Bonds 9.98%	Intl/EM Bonds 7.90%	Small Cap Stocks 14.82%		60/40 Blended Index 5.15%	6.12
60/40 Blended Index 14.85%	High Yield 2.50%	Large Cap Stocks 0.92%	Intl/EM Bonds 5.77%	High Yield 7.48%		US Bonds 8.72%	US Bonds 7.51%	60/40 Blended Index 10.05%	Commodities 16.09%	3-month T-Bills 3.54%	1.04
Real Estate 13.94%	Intl/EM Bonds 2.08%	US Bonds 0.55%	International Stocks 5.01%	US Bonds 3.54%	Real Estate 8.35%	Commodities 7.69%	High Yield 6.17%	International Stocks 8.29%	Real Estate 7.46%	Gold 3.13%	1.13
High Yield 7.42%	Gold 0.12%	60/40 Blended Index 0.11%	US Bonds 2.65%	Commodities 1.70%	3-month T-Bills 1.87%	Real Estate 5.35%	Real Estate 1.17%	High Yield 5.36%	3-month T-Bills 1.46%	Small Cap Stocks 2.54%	8.61
3-month T-Bills 0.07%	3-month T-Bills 0.03%	3-month T-Bills 0.05%	3-month T-Bills 0.33%	3-month T-Bills 0.86%	US Bonds 0.01%	3-month T-Bills 2.28%	3-month T-Bills 0.67%	3-month T-Bills 0.05%	Gold 0.44%	Emerging Mkt Stocks 2.16%	1.89
2013	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**	
US Bonds (2.02)%	Emerging Mkt Stocks (1.82)%	Intl/EM Bonds (2.42)%			Gold (0.93)%		Commodities (3.12)%	US Bonds (1.54)%	High Yield (11.22)%	Intl/EM Bonds (0.72)%	-0.05
Emerging Mkt Stocks (2.27)%	International Stocks (3.44)%	Small Cap Stocks (4.41)%			High Yield (2.26)%			Emerging Mkt Stocks (2.22)%	60/40 Blended Index (11.35)%	US Bonds (1.21)%	0.87
Intl/EM Bonds (4.13)%	Commodities (17.01)%	High Yield (4.64)%			Intl/EM Bonds (3.17)%			Gold (4.33)%	US Bonds (13.01)%	Commodities (3.44)%	-1.52
Commodities (9.52)%		International Stocks (5.25)%			60/40 Blended Index (3.71)%			Intl/EM Bonds (4.44)%	International Stocks (15.57)%	Real Estate (7.64)%	8.55
Gold (27.33)%		Gold (12.11)%			Large Cap Stocks (4.78)%				Intl/EM Bonds (18.17)%		
		Emerging Mkt Stocks (14.60)%			Small Cap Stocks (11.01)%				Large Cap Stocks (19.13)%		
		Commodities (24.66)%			Commodities (11.25)%				Emerging Mkt Stocks (19.74)%		
					International Stocks (13.78)%				Small Cap Stocks (20.44)%		
					Emerging Mkt Stocks (14.25)%						