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You may be aware of the following, but we just want to make sure. We are able to consult on planning on many investment and retirement issues and there is no cost to you. Furthermore, we would not be trying to sell anything to you. These issues include income in retirement, Social Security, and many others. We can also implement a complete financial plan for you. We have two CFPs (Certified Financial Planners) on staff and one CPA (Certified Public Accountant). There is no cost for these services. They are included with the management of your money and can be part of what we do for you if you need it.

Year end is coming. If you have taken any unusual gains this year from real estate transactions or other areas, and you need tax losses, we may have positions that would assist in providing offsetting losses. Please do not hesitate to call to discuss this or any issues.

Markets Review and Forecast. Well, it does seem that the world is a mess. There are wars in Ukraine and Israel, as well as threats from China, Russia, and Iran. On the home front, we are plagued by poor fiscal policy, excessive spending (that seems to have always been with us), a massive National Debt, and so many other things.

As you read down our 3rd quarter report here, you will note the broad stock and bond markets are flat to negative, just a narrow group of stocks are rising. That said, the old adage, "The market climbs a wall of worry," seems appropriate.

We have allocated portfolios relatively defensively in a period of rising interest rates. The bond decisions of shortening maturities have been quite good. However, due to the anticipated historically negative effect of rising interest rates on technology stocks, we have been a bit underweight there while the AI (artificial intelligence) boom has been significant.

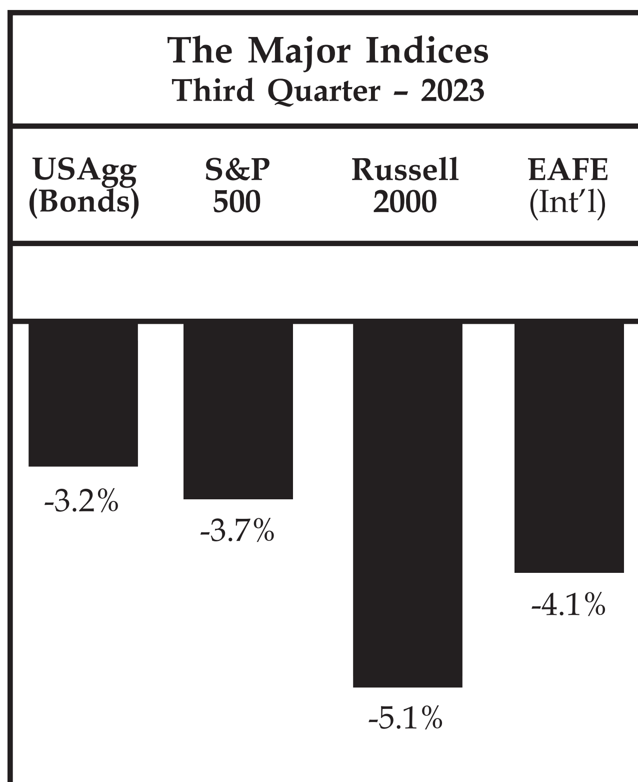
Regarding world events, we can't know the unknown and therefore will continue to manage with a historical perspective towards our economic expectations and traditional asset allocation for the present time. Below we will note some positives and negatives we perceive ahead.

Not to repeat our message from the end of the 2nd Quarter 2023 word for word, but here in the 3rd Quarter, interestingly the year-to-date numbers are nearly identical to June 30, 2023. However, early in the 4th quarter, the Dow Jones Industrial Average and the S&P Equal-Weighted Index slipped further down and both went negative year-to-date, before rallying somewhat.

When you combine the broad stock market decline with the bond market decline (Barclays Aggregate Bond Index also being negative) this has been a challenging year

so far. Well, that is, with the exception of the 6-7 stocks (technology stocks) that constitute 85% of the performance in the S&P 500. When you hear how good the economy is on the news, please note that many sectors and markets are completely unaware of that questionable "fact." That also includes weak performance by both smaller capitalization U.S. stocks and international stocks.

Our message last quarter noted that only a handful of stocks have provided nearly all of the S&P 500 performance, and they are largely connected to the emerging artificial intelligence industry ("AI"). The standard S&P 500 Index is a capitalization weighted index, i.e., larger companies like Microsoft constitute a greater weighting and consequently a larger impact on index performance. Indeed, six companies comprise more than 20% of the value of all 500 stocks in the S&P index. The S&P 500 was up 11.68% YTD at the end of the 3rd Quarter.



There is another S&P 500 index that "equal weights" all 500 of the underlying company stocks. This index was up a modest 1.69% for the year at 3rd quarter end. The Dow Jones Industrial Averages (DJIA) was up just 1.09% at 3rd quarter end. Of note, early in 4th quarter, 70% of all stocks were down for the year.

Historically, technology stocks often underperform in rising interest rate environments, and rates have been rising. The "AI" boom changed that for a few of the technology companies as discussed above, and they are those heavily weighted issues in the S&P 500, such as Microsoft and Nvidia. Hence, there has been an outperformance of that index relative to the broader market.

We have been anticipating a market consolidation here in early October and we are getting it. We plan to rebalance towards the S&P weightings as we feel interest rates will soften next year creating a better environment for technology as a whole.

Fixed income is taking it "on the chin" again this year. While the longer maturity bonds have not performed as poorly as last year, they are not doing well. The Barclays Aggregate Bond Index fell 3.2% in the third quarter. Anticipating the rising rates in 2023, we have reduced duration and maintained a predominantly short-term exposure to fixed income. Consequently, our clients have not been hurt by the rising interest rates and declining bond values to the extent of the Barclay's Aggregate. We are holding our own and harvesting a nice yield in the 5% range.

Over the next 12-18 months, we expect several factors to slow the rise in rates. In

fact, short-term rates may decline modestly and the yield curve may normalize. With the election year coming up, we expect it will be difficult for the Federal Reserve to raise rates. Politicians in power don't like it when they do that. Furthermore, we believe there is the distinct possibility of an economic downturn following the 2024 elections. Therefore, we expect rate hikes will soon come to an end and may even decline. Consequently, we anticipate reallocating toward intermediate term paper, extending maturities to both lock in higher yields and garner appreciation from declining rates.

In the economy longer term (24-36 months out), we expect that we may see a different story. We feel it is likely in the coming years, yields will again rise. Past the 2024 elections and a very possible economic downturn following the elections, we have serious concerns and they are as follows.

First, rampant government spending and the rising debt will cause an increased supply of U.S. bonds as we finance that debt and spending. In the future, we expect decreased demand for U.S. bonds from many foreign buyers, most especially China. Increased supply and reduced demand will cause rates to rise. China has its own set of difficulties and economic issues, in addition to being a bit less than friendly to the U.S. So that if the Chinese stop buying our bonds and our supply of bonds continues apace (i.e., rampant government spending financed by excessive borrowing), then yields would of necessity rise sharply to attract buyers.

Recall the late 1970's and early 1980's when Federal Funds rates hit 21%, the inflation rate hit 13%. The National Debt in 1980 was a modest $870 billion. Today it is over $33 trillion. It was said at the time that there was too much money being printed, too much borrowing, and too much spending. They must have been correct because during that time frame mortgage rates hit 16% and the unemployment rate rose to 12%. Recall it took a number of years in the 70's and early 80's and a lot of pain to finally clear out the mess.

It will likely take something significant and quite some time to fix the problems we face today, if our politicians will at all face it somewhere down the road. It is always easy to spend money, especially someone else's money. We have seen inflation kick in over the past few years in large part due to excessive government spending, initially much of it Covid related. However, spending has been an ongoing problem as far back as we can see and it is difficult to see how it will end.

Interest Rates. The Federal Reserve is currently "on pause" with their recent rate hiking cycle as they monitor inflation in order to determine any future moves. A little over a year ago the U.S. inflation rate (the percentage in which a chosen basket of goods and services in the U.S. increases in price over a year) hit a forty year high of 9.1% on June 30, 2022, but it currently sits at 3.67%. So, progress has been made on the rate of inflation, but prices at the store are still up over 12.24% from two years ago. Not to mention gasoline prices are 32% higher since the Colonial Pipeline was hacked in May of 2021. Funny how the hack at Colonial was resolved in about three weeks, but gas has stayed elevated ever since. This is important because high fuel costs get passed on to the consumer and contributes to inflation remaining "sticky."

Higher rates are reflected in mortgage costs with the 30-year fixed mortgage recently hitting 7.9% and the 15-year fixed rate resting at 7.05% according to the Wall Street Journal. The once popular 5-year adjustable-rate mortgage or ARM is 6.64% while a new 4-year car loan sits at 7.47%. The prime rate is 8.5%. So, it is costing consumers more to borrow money today compared to the last fifteen years. However, looking at rates going back to just after WWII, an argument can be made that rates have been normalizing into more historical ranges. The consumer remains strong although savings accounts are substantially lower and default rates on consumer debt (credit cards, car loans and etc.) are rising.

The Bloomberg U.S. Aggregate Bond Index was down -1.1% YTD at quarter end. It lost about 3% during the third quarter as interest rates continued their climb. The bond market has the potential to finish 2023 in negative territory. If that happens, it will be the third year in a row that bonds have given investors a negative return. The Bloomberg U.S. Agg has a current duration of 6.3 years and a long-term average duration of 4.9 years. As mentioned in previous newsletters, we have been much shorter in our bond durations in order to mitigate and prevent the aforementioned negative returns that have arisen due to a rising interest rate environment.

The 10-Year Treasury closed the second quarter yielding 3.8% and just closed the third quarter yielding 4.572%. It even tagged 4.9% intra-day in early October. The yield started to move noticeably higher in early August after Fitch Ratings downgraded U.S. Treasuries from AAA to AA+. When Standard and Poor's did the same thing in 2011, yields moved lower. However, this time yields have moved higher suggesting the Washington, D.C. dysfunction is beginning to get the attention of investors. It's time to address spending and Federal budget deficits just like consumers and small businesses have been managing their own budgets and finances for decades.

If you have any other questions about your account or any concerns, please give us a call at 336-998-7000. We always enjoy talking with our clients.

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