THE PRIVATE CLIENT GROUP

BALANCING LIFE & WEALTH

ECONOMIC & MARKET INSIGHTS

An Executive Summary for Third Quarter 2023

Global economic growth has remained resilient during this rate hiking cycle. Near term growth, although moderate, is now trending towards an economic slow down as most major economies seek to reduce high levels of inflation. Within the U.S., monthly inflation has nearly returned to trend and job creation continues to support economic growth.

U.S. equity markets, which fell moderately during the quarter, remain ahead for the year but equity returns have been driven by a small group of names. The average S&P stock is reasonably priced, trading at a P/E of 14x.

Fed policy makers are forecasting a *'soft landing'* for the U.S. economy with growth moderating and inflation falling. S&P 500 is priced more opportunistically with valuations and volatility levels implying a *'no landing'* scenario. Fixed income markets are priced for *'no landing'*, given tight credit spreads across corporate and municipal bonds. Though recession talk abounds, no asset category is priced for a *'hard landing'*.

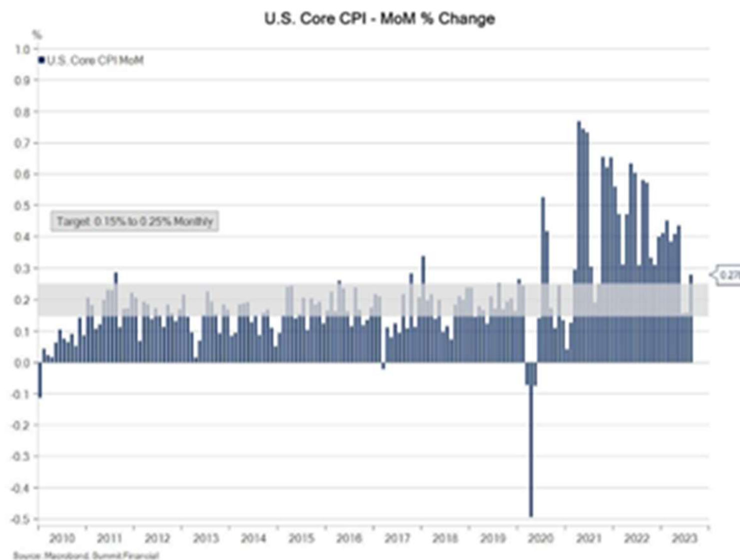
Economic Insights

The U.S. economy, per the GDPNow forecast from the Federal Reserve Bank of Atlanta, is on pace to grow near 5% in Q3 2023. The rate of growth is far in excess of the 0% projection from Wall Street economists at the beginning of the quarter and well above the Fed's target. Growth was driven by strength in retail sales, construction materials, software/AI and investments in renewables infrastructure. However, higher growth today may lessen future growth tomorrow as forecasts for Q4 2023 and calendar year 2024 are being reduced. Headwinds include higher rates for mortgages, resumption of student loan repayments and the expiration of a short-term government funding bill which will likely lead to tighter fiscal policy.

Inflation continues to decline but remains above the Fed's 2% target. Core PCE, the Fed's preferred measure, is running at 3.9%. According to the Fed's internal forecasts, core PCE will fall to 2.6% by calendar year 2024 and return to target by calendar year 2026. The Fed intends to reduce its policy rate from restrictive to neutral in tandem with this decline.

The U.S. labor market remains strong. Nonfarm payroll growth, while slowing, remains supportive of economic growth and initial claims as a percentage of the labor force are running at historic lows. An increase in work stoppages and recent labor settlements are driving wages higher. While too early to worry about a wage-price spiral, the Fed needs to consider medium-term risks to inflation if wage growth accelerates and moves above trend.

Eurozone growth, despite running negative in Germany, has actually held up well given the backdrop though it is now expected to reach 0% for H2-23 and Q1 2024. Emerging markets continue to grow near 6% with India and the Asia Pacific region showing the most strength. China is forecast to grow 4% next year, though only 1% for the upcoming quarters. Japan is forecast to slow from 1.8% growth this year towards 1% next year.



Equity Markets

S&P 500 market breadth remains very narrow with the seven largest names (AAPL, MSFT, GOOGL, AMZN, META, NVDA, TSLA) generating all the returns in 2023. The average stock is flat year to date. The same seven names are driving the sector outperformance in technology, communications and consumer discretionary as well as the style outperformance of growth over value.

VIX remains below average levels and is currently indicating a normal market correction, although equity valuations, relative to cash and bonds, remain richly valued with risk premiums at historic lows.

Looking forward, analysts are forecasting a ‘no landing’ scenario with earnings growth for Q4 2023 estimated at 7.8% and calendar year 2024 at 12%. Given the Fed’s policy stance of higher for longer, margin pressures are likely to increase, driven by higher rates, slower bank lending, rising strike occurrences and wage levels. Under a ‘soft landing’ scenario, earnings are likely to grow closer to 0%, similar to the growth slowdown of 2015/16.

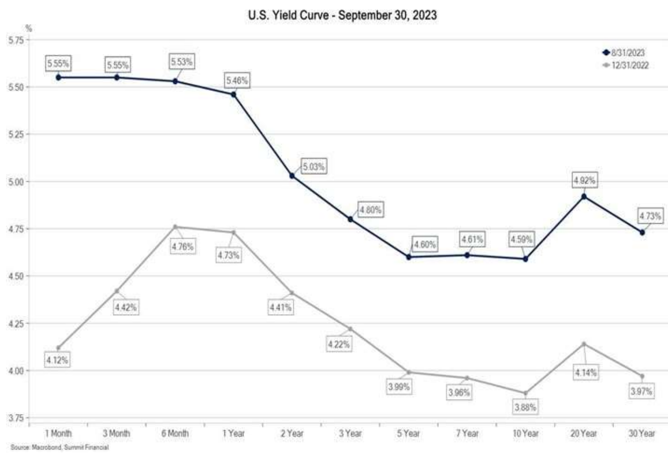
Versus U.S. large cap names, international markets offer lower valuations with higher dividend yields, but also have lower profit margins and returns on invested capital.

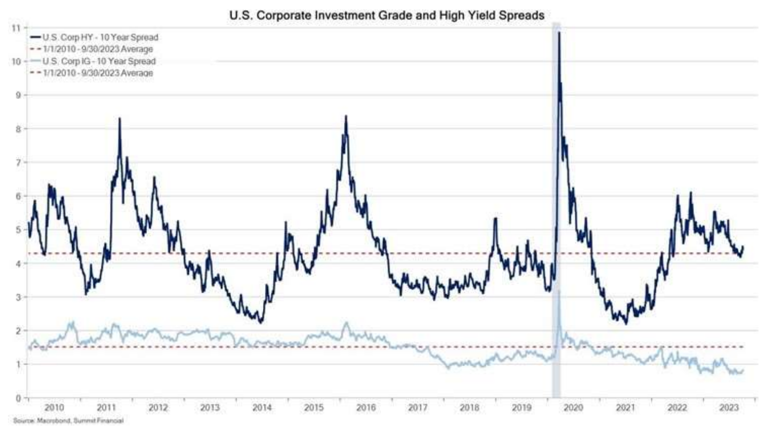
Fixed Income and Alternatives

During Q3, investors repriced the U.S. 10-Year Treasury 90bps higher with yields rising from 3.9% towards 4.8%. In part, this was driven by the Fed (finally) convincing investors that it intends to hold rates in restrictive territory and at higher levels for a longer period of time. This repricing of the term premium further tightens financial conditions and assists the Fed in its battle against inflation. Internal Fed projections indicate that its Federal Funds rate will remain at current levels into Q1 2024 and market forecasts, per the CME, indicate investors are now in general agreement.

Despite rising rates, credit spreads remain in line with historic levels. Credit spreads across municipal, corporate and securitized bonds remain stable and well within normal ranges. Over the past few years, many large firms extended duration and borrowed long-term at very low rates. As a result, they have minimal refinancing requirements and are much less sensitive to higher short-term rates. This is reflected in credit spreads, especially for investment grade bonds, which remain very low and are not indicating any signs of stress. The curve remains inverted as the Fed continues to try and slow down the economy and reduce inflation pressures. The impact is flowing through but with significant lags given how low rates were (at 0%) and how hot the economy was when the Fed began.

At a macro level financial condition indices remain favorable, largely because credit spreads are narrow, equity volatility is low and equity returns remain positive. At a micro level, the tightening effects of the Fed’s aggressive policy hikes are accumulating. The lagged (normally 6 to 18 months) effects will begin to show through widening spreads, followed by delinquencies and ultimately defaults. However, given the high level of policy rates, the Fed now has tremendous flexibility to ease and will be able to adjust as required—assuming inflation remains contained—though this is likely to be a volatile process.





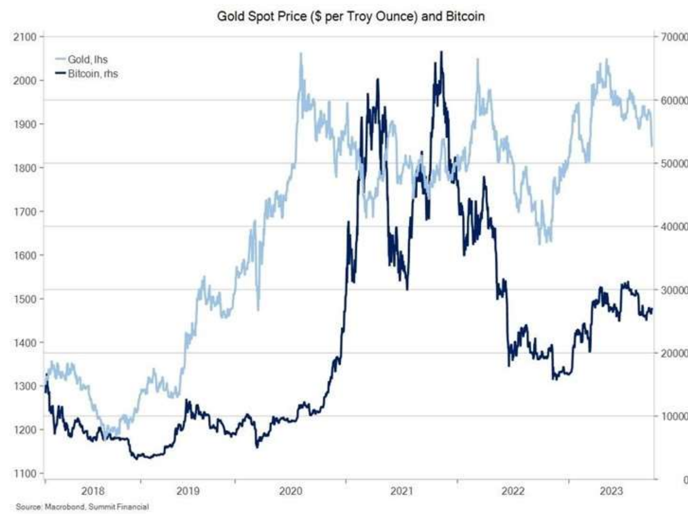
Oil prices rose during the third quarter, including ~12% in September, extending an upward move that began in July. Production cuts by Saudi Arabia and Russia led to tight supply concerns and pushed WTI crude prices above $90 per barrel after oscillating in the $60 to $80 range for most of the year.

Gold is holding strong despite the rising rate backdrop. An extensive run up in cash and bond yields alongside a stronger USD and economic resilience continue as headwinds for gold. However, a worsening geopolitical backdrop, higher global levels of inflation, large U.S. deficits and increased foreign central bank purchases continue to provide support.

Industrial metals achieved a modest gain for the quarter, with price increases for zinc, lead, and aluminum offsetting weaker prices for copper and nickel. Copper prices, commonly seen as a bellwether for the global economy, dropped ~7% over the past two months and are roughly flat on the year.

U.S. REITs fell in Q3, though dispersion among sectors remains high. The sector's sensitivity to rising interest rates and ongoing weaknesses in office and retail properties contributed to the underperformance. However, areas such as data centers, warehousing, multifamily residential continue to be strong and many continue to generate strong cash flows. Certain analysts believe many companies are now trading at favorable discounts given the recent price declines.

Infrastructure securities were dragged down alongside the broader equity markets due to higher interest rates, persistent inflation and weakness globally, despite fundamental and operating trends remaining strong. Current U.S. policies, including the Inflation Reduction Act and the Infrastructure Investment and Jobs Act, have fostered a favorable backdrop for the sector and its long-term outlook remains positive.



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designed to anticipate turning points in economic activity relative to trend, continue to strengthen in most major economies. The MOVE Index measures US interest rate volatility. The index tracks the movement in US treasury yield volatility implied by current prices of 1-month OTC options. The Cboe Volatility Index (VIX) is a real-time index that represents the market's expectations for the relative strength of near-term price changes of the S&P 500 Index. The Consumer Price Index (CPI) is a measure of the average change over time in the prices paid by urban consumers for a market basket of consumer goods and services. Core CPI excludes food and energy, while headline CPI includes all items. The Consumer Confidence Index is a measure based on a survey administered by The Conference Board that reflects prevailing business conditions and likely developments for the months ahead. This monthly report details consumer attitude, buying intentions, vacation plans and consumer expectations for inflation, stock prices and interest rates. A treasury Bill (T-Bill) is a short-term US government debt obligation backed by the treasury Department with a maturity of one year or less. Treasury Inflation-Protected Securities, or TIPS, are inflation-protected bonds (IPBs) that are issued by the U.S. Treasury. Their face value is pegged to the CPI and adjusted in step with changes in the rate of inflation. The National Financial Conditions Index (NFCI) is a weighted average of a large number of variables (105 measures of financial activity) each expressed relative to their sample averages and scaled by their sample standard deviations. The short interest ratio is a mathematical indicator of the average number of days it takes for short sellers to repurchase borrowed securities in the open market. The ratio is calculated by dividing the total number of shorted shares of a stock by the average daily trading volume. CBD stands for central business district, which is the commercial and business center of a city. The Personal Consumption Price Index (PCE) is a measure of the prices that people living in the United States, or those buying on their behalf, pay for goods and services. EM Debt refers to Emerging Market Debt, which is represented by the Bloomberg Emerging Markets Tradeable External Debt Index. Precious metals are represented by the Bloomberg Precious Metals Subindex. The Bloomberg Precious Metals Subindex, is a commodity group subindex of the Bloomberg Commodity Index. It is composed of futures contracts on gold and silver. It reflects the return of underlying commodity futures price movements only and is quoted in USD. Industrial metals are represented by the Bloomberg Industrial Metals Subindex, which is composed of futures contracts on aluminum, copper, nickel and zinc. It reflects the return of underlying commodity futures price movements only. It is quoted in USD. Energy is represented by the Bloomberg Energy Subindex which is a commodity group subindex of the Bloomberg CI. It is composed of futures contracts on crude oil, heating oil, unleaded gasoline and natural gas. It reflects the return of underlying commodity futures price movements only and is quoted in USD. Infrastructure is represented by the S&P global Infrastructure Index, which is designed to track 75 companies from around the world chosen to represent the listed infrastructure industry while maintaining liquidity and tradability. To create diversified exposure, the index includes three distinct infrastructure clusters: energy, transportation, and utilities. Agriculture is represented by the Bloomberg Agriculture Subindex, which is a commodity group subindex of the Bloomberg CI. It is composed of futures contracts on coffee, corn, cotton, soybeans, soybean oil, soybean meal, sugar and wheat. It reflects the return of underlying commodity futures price movements only and is quoted in USD. High-Yield Bonds that invest in lower-rated debt securities (commonly referred to as junk bonds) involve additional risks because of the lower credit quality of the securities in the portfolio. The investor should be aware of the possible higher level of volatility, and increased risk of default. Private Credit Investments (Direct Lending) involve a high degree of risk, including the loss of the entire investment. International investments carry additional risks, which include differences in financial reporting standards, currency exchange rates, political risks unique to a specific country, foreign taxes and regulations, and the potential for illiquid markets. Investing in emerging markets may accentuate these risks. The PCE price index is known for capturing inflation (or deflation) across a wide range of consumer expenses and reflecting changes in consumer behavior. The ISM manufacturing index, also known as the purchasing managers' index (PMI), is a monthly indicator of US economic activity based on a survey of executives covering all North American Industry Classification System's businesses in the manufacturing sector. Consumer Sentiment is represented by The University of Michigan Consumer Sentiment Index which rates the relative level of current and future economic conditions. The ISM Non-Manufacturing Index is a monthly indicator of US economic activity based on a survey of executives covering all North American Industry Classification System's businesses in the services (or non-manufacturing) sector. Data in this newsletter is obtained from sources which we, and our suppliers believe to be reliable, but we do not warrant or guarantee the timeliness or accuracy of this information. Consult your financial professional before making any investment decision. Past performance is no guarantee of future results. Diversification/asset allocation does not ensure a profit or guarantee against a loss. Economic and market forecasts presented herein reflect our judgment as of the date of this presentation and are subject to change without notice. These forecasts are subject to high levels of uncertainty that may affect actual performance. Accordingly, these forecasts should be viewed as merely representative of a broad range of possible outcomes. These forecasts are estimated, based on assumptions, and are subject to significant revision and may change materially as economic and market conditions change. These forecasts do not take into account the specific investment objectives, restrictions, tax and financial situation or other needs of any specific client.

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