Q4 2023 Asset Management

Index	3rd Quarter Return	YTD Return
S&P 500 Index	-3.27%	13.07%
Nasdaq Composite Index	-4.12%	26.3%
US Aggregate Bond Index	-3.23%	-1.21%
Russell 2000 Small Cap Index	-5.13%	2.54%
Bloomberg Commodity Index	3.31%	-7.06%

Equity indices ended the quarter in the red as the market began positioning for higher for longer interest rates as yields on the 10-year hit levels last seen since 2007. Smaller caps had the most pain as they have higher debt levels in need of refinancing and are more impacted by a slowing economy. Of note, August and September tend to historically be the worst performing months of the year and an oversold bounce into the end of the year is our outlook.

Fixed Income markets continue to wobble with the potential for the first time in US history of investors losing money for three straight years. The Fed has left open the possibility of one more rate hike this year and has pushed back their dot plot expectations of future rate cuts. In the background, the Fed continues QT (quantitative tightening) removing the main buyer of US treasuries from the field. After years of stepping in and buying, the Fed is looking to normalize the bond market, and that is what has been causing such a rapid rise in rates.

In the commodities markets oil showed signs of life as both US and China demand came in higher than expected. OPEC+ along with Russia also committed to supply cuts to try and keep prices elevated. Gold fell for the quarter as inflation expectations continued to fall and rising real rates made CDs and money markets far more attractive.

Market Pros

- **Bull Markets:** The major averages peaked in early August and have been trending lower ever since. The S&P 500 managed to continue to trade above its long-term trendline after successfully testing and bouncing off this key level. For now, the bull market's uptrend remains intact.

- **Bearish Sentiment:** Investor sentiment took forever to turn bullish in the months after the current bull market began. Bullish sentiment turned positive this summer just as equities began to peak. Now, it is back to investors being bearish. Sentiment is contrarian, so excess bearishness is a positive over the next twelve months.

- **Seasonality:** August and September weakness for equities held true to form this year, but now Q4 is typically the best time of year for stocks. With weak performance in Q3, Q4 is positioned for an oversold bounce into year-end.

- **Peak Inflation:** Core inflation is decelerating rapidly. Core CPI has neared 2% on an annualized basis over the last three months. Core PCE is back below 2% on a monthly annualized basis, with core services even slower in the August data.

- **Jobs Steady:** Initial jobless claims have dropped sharply, and while employment growth has slowed, it remains steady. Prime-age employment remains just shy of a record set just prior to the dot com bubble. While job openings have declined, the level remains high versus history.

- **Healthy Consumer:** Consumers still have lots of cash on their balance sheets, even relative to much stronger consumer spending patterns pre-pandemic. While savings rates are low, consumer borrowing is well-covered by income and households can keep spending at a healthy pace for some time.

- **Manufacturing Bottoming:** Regional Fed surveys have showed that manufacturing activity improved in the September readings and while they are still in contractionary territory the downside momentum has abated.

- **Infrastructure Spend:** A range of manufacturing industries are rapidly adding factory capacity in response to recent industrial policy. At the same time, the housing market is still short of inventory and will be for years to come. Finally, infrastructure spending has accelerated sharply thanks to fiscal policy and is not showing any signs of slowing. All this raises the floor for GDP growth.

- **Short-Term Oversold:** Stocks hit an extreme oversold level towards the end of September and are poised for mean reversion when it gets this overdone. It does not take much for a reversal to occur when things get this one-sided.

Market Cons

- **Market Breadth:** Outside of the mega-caps, is has been a relatively flat year for the market. The median S&P 500 stock is up just over 0.4%.

- **Leading Indicators:** The rapid pace of decline in many of the leading indicators has always meant a recession going back to the 1960s. The Leading Indicators index has fallen for 17 months in a row. The only two times it fell longer was in the mid-1970s and 2007-2009, both times during a recession.

- **Fed Staying Hawkish:** The Fed has signaled it is close to the end of rate hikes but there does not seem to be a rush to immediately start cutting rates. With inflation coming down and the Fed keeping rates higher, this restrictive policy will make it difficult for the economy to expand at full capacity.

- **Tighter Lending:** The shock to the banking system delivered earlier this year has largely been digested by the market. However, leading indicators of bank credit suggest a sharp slowdown in lending over the next year. Banks have taken the brunt of an inverted yield curve and will continue to have difficulty until the curve begins to steepen more.

- **Valuations:** The market is trading back at similar valuations as it was entering 2022. At least at that time interest rates were still low. The mega-cap tech names continue to trade at much higher valuations than the rest of the market, making the index more susceptible to a pullback in valuations.

- **There are Alternatives:** Treasury yields and real rates are at their highest levels in a decade when compared as alternatives to the S&P 500 earnings yield. On this basis stocks are much less attractive than they were in previous decade.

What does this all mean?

Markets have been able to bounce back quickly from the lows in October 2022 catching many investors off guard. Investor sentiment and positioning was too bearish entering the year allowing momentum to carry stocks higher led by large cap growth. The AI news in May added more fuel to the upswing and has only petered out over the last few months. Typically, small caps and cyclicals lead the way out of bottom and not having participation from these groups, outside of Energy, has made me a little skeptical that we are out of the woods. Another benefit was having what has been termed "rolling recessions" in different parts of the economy that has softened the blow as some sectors contract while others are still able to expand over the previous two years. The Fed seems to think they can execute a soft landing, but Google trends show that the term "soft landing" hit peaks in both 2000 and 2007 just before recessions hit. The Fed is in a tricky spot as they try to squash inflation and remain just restrictive enough not to push us into a recession. The things I am looking for is for 1) the yield curve to steepen giving banks room to lend again, 2) market breadth needs to improve with small caps and cyclicals closing the gap with the mega-cap tech names, 3) and finally we need the Fed to start cutting rates not because something is broken and they need to fix it, but because inflation has been tamed and we no longer need restrictive policy.

In the meantime, it is difficult to predict exactly what the Fed is going to do. We have remained light and tight with our allocation favoring a little extra cash that we will look to put to work when the Fed becomes less restrictive.

Quick Note on Geopolitics

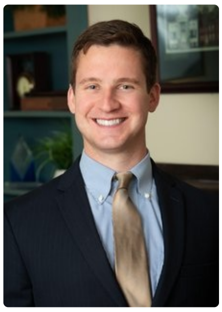
Part of our natural instinct is to always look for reasons to sell or get out of the market. When things are good, "well they have to get bad" and when things are already bad "well it's about to get worse". Over the past 100 years we have had the Great Depression, World War II, multiple coups and military conflicts as part of the Cold War, a US president assassinated, Democratic presidents, Republican presidents, the dissolution

HFS Wealth Advisors
HFS Wealth Advisors

330-659-7140
hfswealthadvisors@hfswa.com
www.hfswa.com

Patrick Hammer, MSFS, AEP®
Sr. Client Advisor and President Partner
330-659-7140
hfswealthadvisors@hfswa.com
www.hfswa.com

Todd Rohrer, C(k)P®
Client Advisor
330-659-7140
trohrer@hfswa.com
www.hfswa.com



Justin Hamlin, CFP®, AEP®
Client Advisor
330-659-7140
jhamlin@hfswa.com
www.hfswa.com

Schedule a meeting

of the Soviet Union, 9/11, ISIS and the rise of other terrorist organizations, Brexit, a global pandemic, and more recently conflicts with Russia/Ukraine, and Israel/Palestine. During these moments in history there is short-term volatility followed by rising fear that stocks are going to go down. These events tend to lead to a tendency for a negative return over the next month but almost always a positive return over the next 12 months. The initial fall in prices occurs with no drastic change in fundamentals other than we feel something bad is going to happen. I will continue to manage our models based on the macro environment/fundamentals and update our positioning when those data points change.

Positioning Update

- Still maintain a small tactical overweight of Asia Pacific vs Europe

- Within Fixed Income we prefer shorter duration (including cash) and credit vs longer duration and treasuries

- Within domestic equities we favor defensives, including a tactical overweight to trend following strategies, vs large cap growth and small caps.

Written by:

Antonio Belmonte, CFA, Chief Investment Officer