Bird's Eye View for Q4 2023

1. Q3 2023 performance review
2. Current state of economy and markets
3. Looking ahead

Power of saving early

Stock returns		Trailing 1 Yr	Q3 2023
U.S.			
Large-Cap	S&P 500	21.6%	-3.3%
Growth	Russell 3000 Growth	26.6%	-3.3%
Value	Russell 3000 Value	14.0%	-3.2%
Small-Cap	S&P 600	10.0%	-4.9%
International			
International Developed	MSCI Europe Australasia & Far East	26.4%	-4.0%
Emerging Market	MSCI Emerging Markets	12.1%	-2.9%

Interest rates		30-Sep-2023	30-Jun-23
Federal Funds	Upper Target	5.50%	5.25%
Prime		8.50%	8.25%
2-Year Treasury		5.05%	4.90%
10-Year Treasury		4.57%	3.84%
30-Year Fixed Mortgage		7.74%	7.15%

Bond returns		Trailing 1 Yr	Q3 2023
Taxable	Bloomberg Barclays Aggregate	0.6%	-3.2%
Municipal	Bloomberg Municipal Bond	2.7%	-3.9%

Looking back at the past quarter, we see:

- Large-cap stocks took a break – down 3% after a strong first part of the year
- Small-cap and international stocks were lower as well
- Interest rates continued to increase as the Federal Reserve took short-term rates to more than 5%
- The longer-term 10-year rate increased to a two-decade high at almost 4.6% … bringing the 30-year mortgage rate up along with it

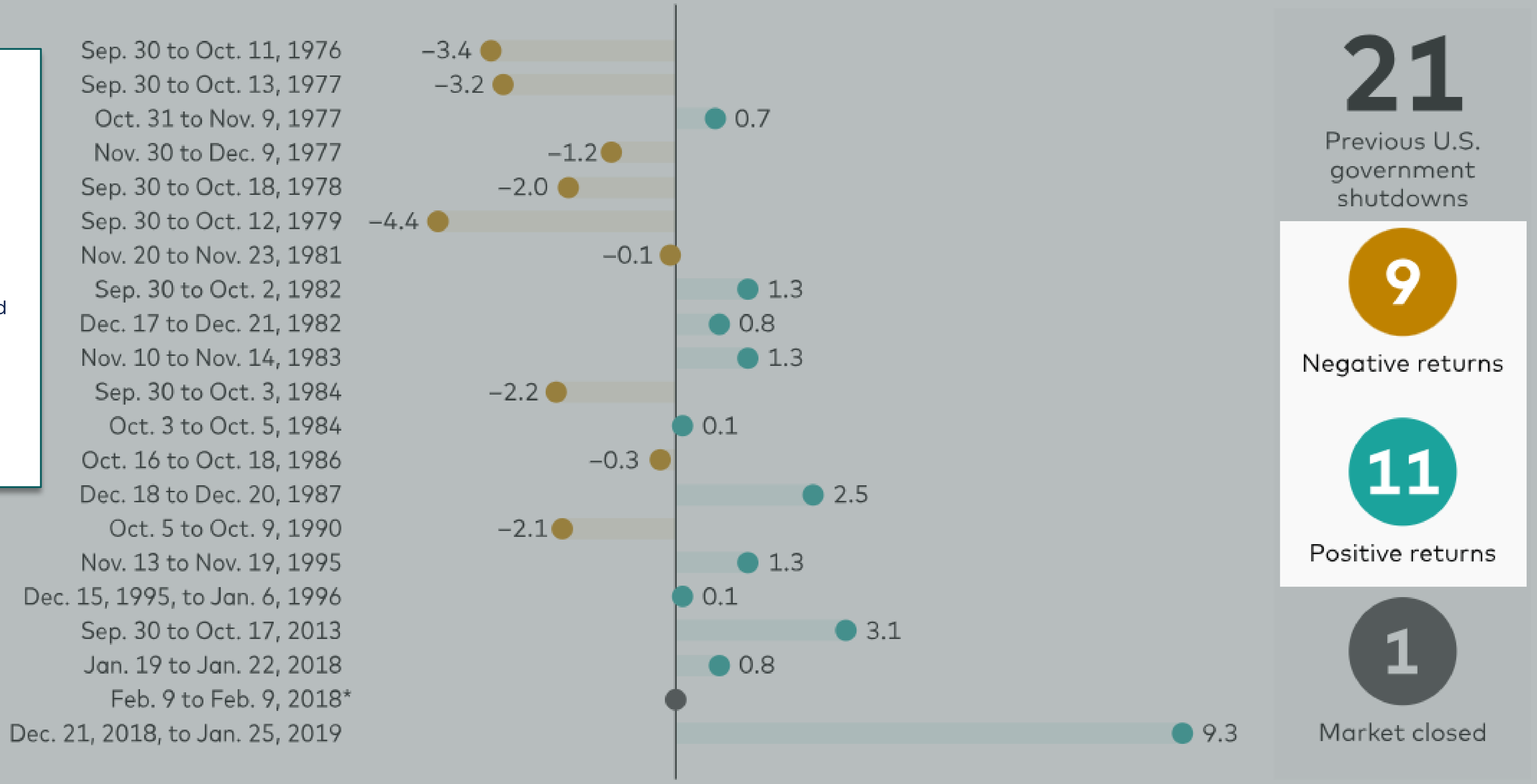
Source: Bloomberg October 1, 2023

History of mixed results during a government shutdown

One question we've been receiving is about stock-market risk and a potential government shutdown. While Congress did avert a shutdown with a six-week agreement, history shows that it's really hard to predict how the market's going to handle a government shutdown. Of the 21 we've experienced ,the stock market's been down nine times and up 11 times.

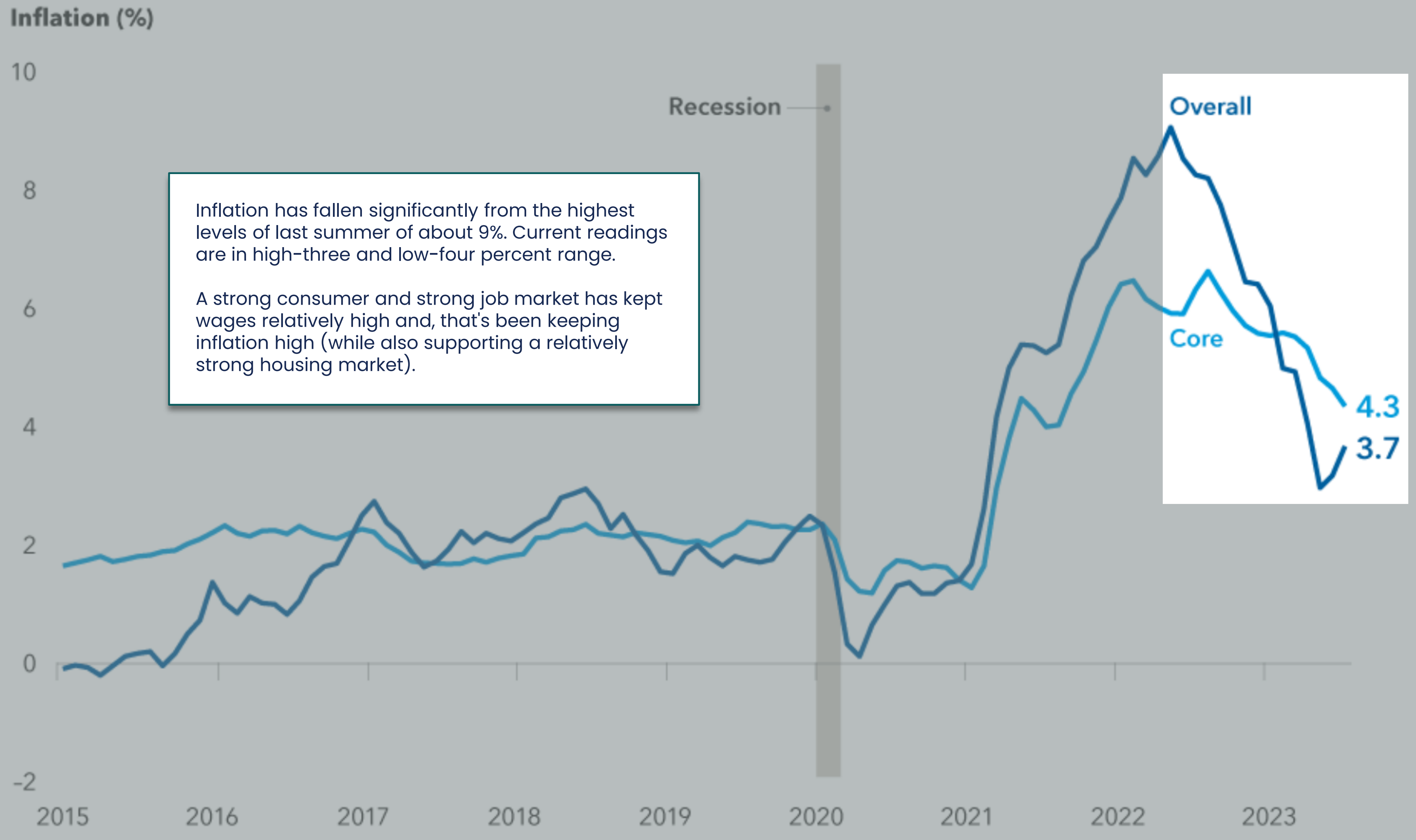
So, while we could have some short-term volatility we really think it's more important to focus on the big picture in the economy.

Standard & Poor's 500 Index price return during U.S. government shutdowns



Source: Vanguard calculations, based on data from FactSet and the Congressional Research Service

Inflation continues to fall after 2022 peak

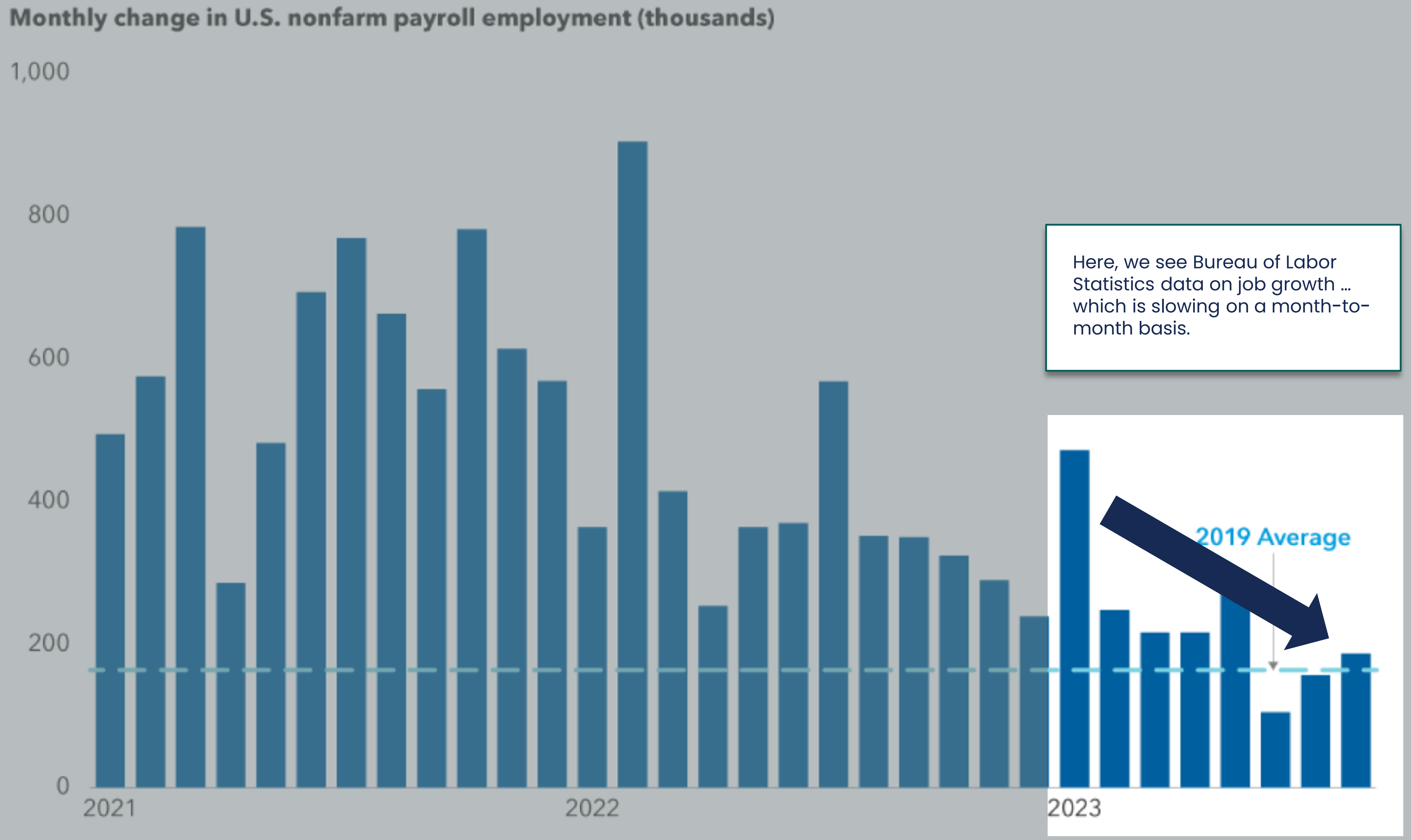


Inflation has fallen significantly from the highest levels of last summer of about 9%. Current readings are in high-three and low-four percent range.

A strong consumer and strong job market has kept wages relatively high and, that's been keeping inflation high (while also supporting a relatively strong housing market).

Source: Bureau of Labor Statistics, Refinitiv Datastream. Overall and core inflation represent the change from the previous year in the Consumer Price Index and the Consumer Price Index excluding food and energy, respectively. As of August 31, 2023.

Job market has been the linchpin … but it's cooling

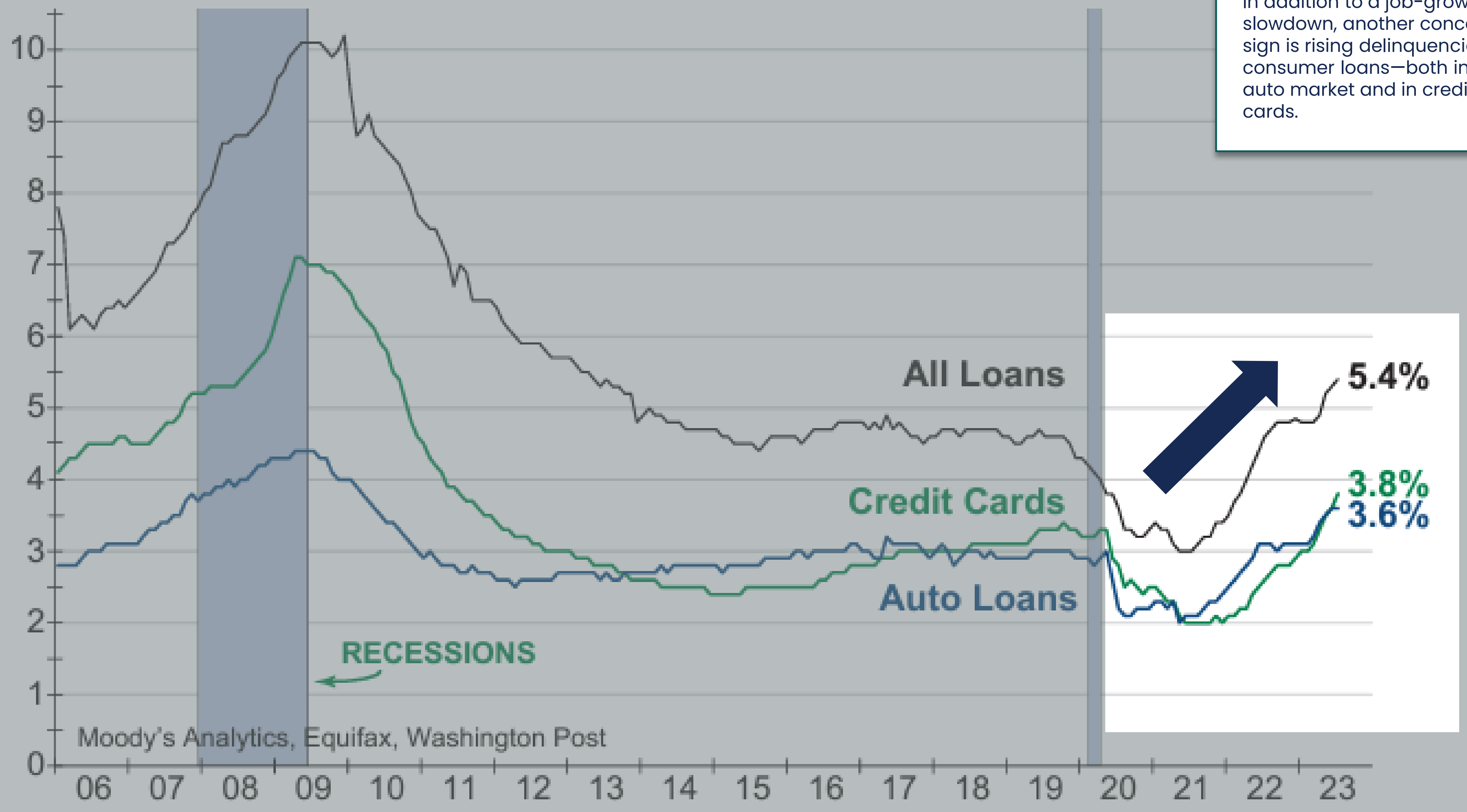


Here, we see Bureau of Labor Statistics data on job growth … which is slowing on a month-to-month basis.

Source: BLS, Strategas June 22, 2023

Consumer loan delinquencies increasing

In addition to a job-growth slowdown, another concerning sign is rising delinquencies on consumer loans—both in the auto market and in credit cards.



Source: Investec Research, Moody's Analytics, Equifax, Washington Post

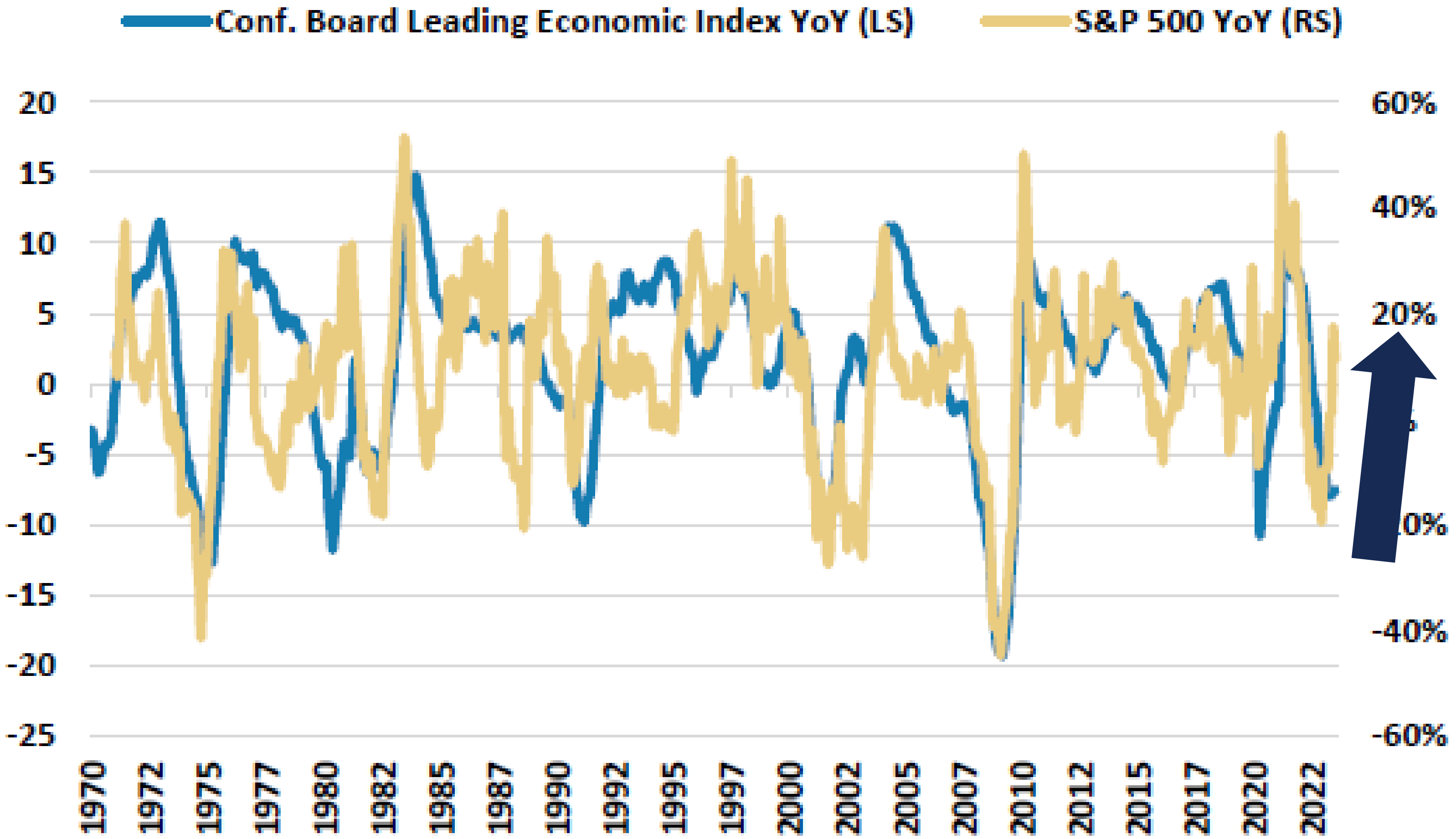
Leading economic indicators signal caution

Historically, this set of leading economic indicators has been a harbinger of slowdowns or recessions.

Even though recession has been a long time coming, the risk is clearly still there.

Source: The conference board, Sept 21, 2023

Stock market already pricing in an economic recovery



There's a pretty tight correlation between the future returns of the stock market and the leading economic indicators we showed on the last page. Here, those indicators are presented in percent-change year-over-year form (blue line)

At the right edge of the chart, note how the blue line remains lower whereas the gold line—the S&P 500 Index of stocks—has rebounded.

This suggests S&P 500 Index prices already assume a rebound in the economic indicators.

So, there's great hope that the economy will experience a so-called "soft landing" … but that recovery in leading economic indicators really needs to take place—or the assumptions behind stock-market prices will have to change.

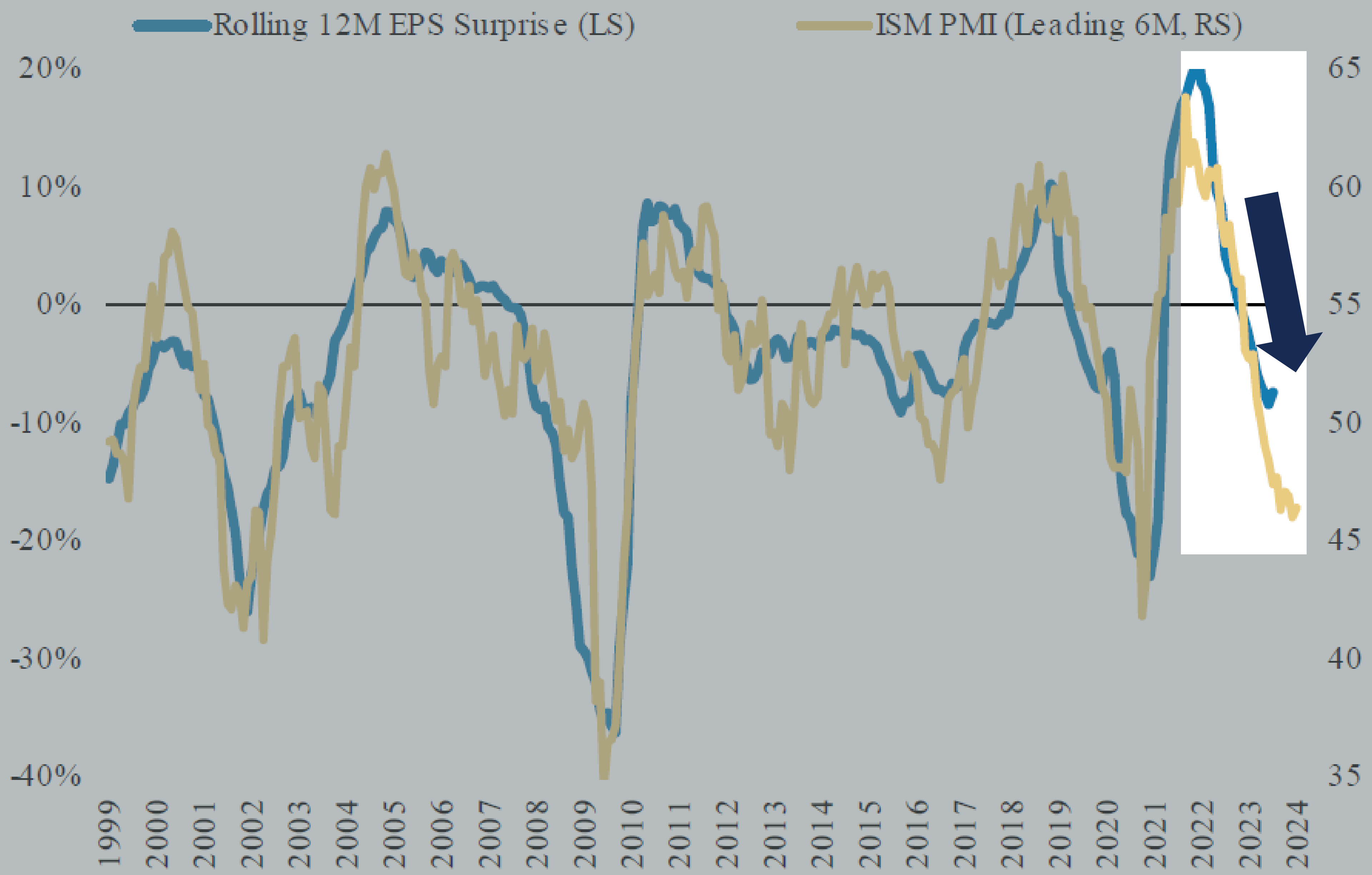
Source: Haver Analytics, Morgan Stanley Research

Earnings recession more likely to continue

While there's a question of whether we're going into a recession or not from an *economic* standpoint, we are clearly in a *corporate earnings* recession—in which earnings for companies in the S&P 500 Index fall.

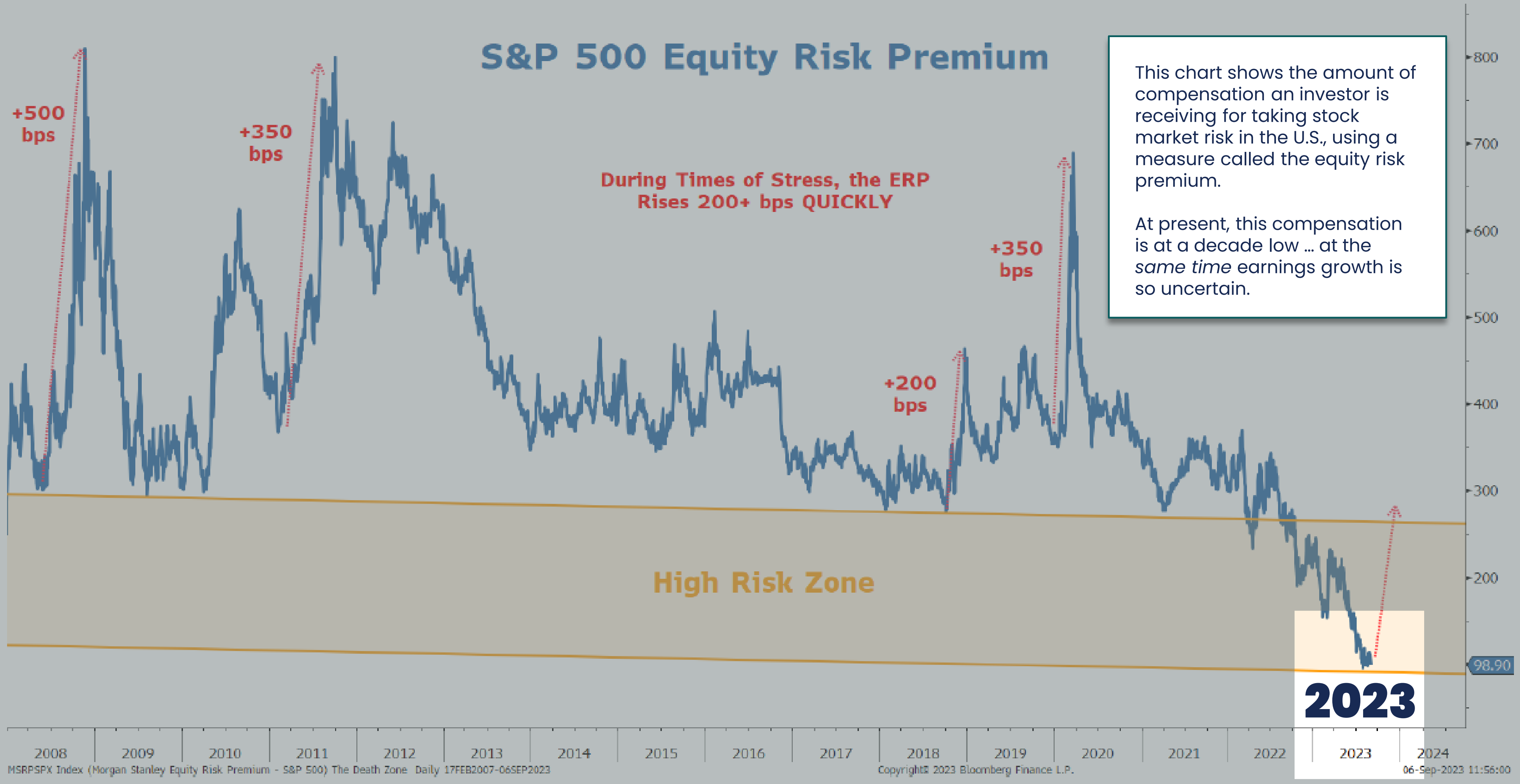
Looking back at the last year, earnings for companies are down an average of about 5% on a year-on-year basis.

As we move into the fourth quarter, we'll be watching closely the earnings progression for the companies that we own in your portfolios.



Source: Morgan Stanley, Bloomberg

Compensation for taking stock market risk is historically low

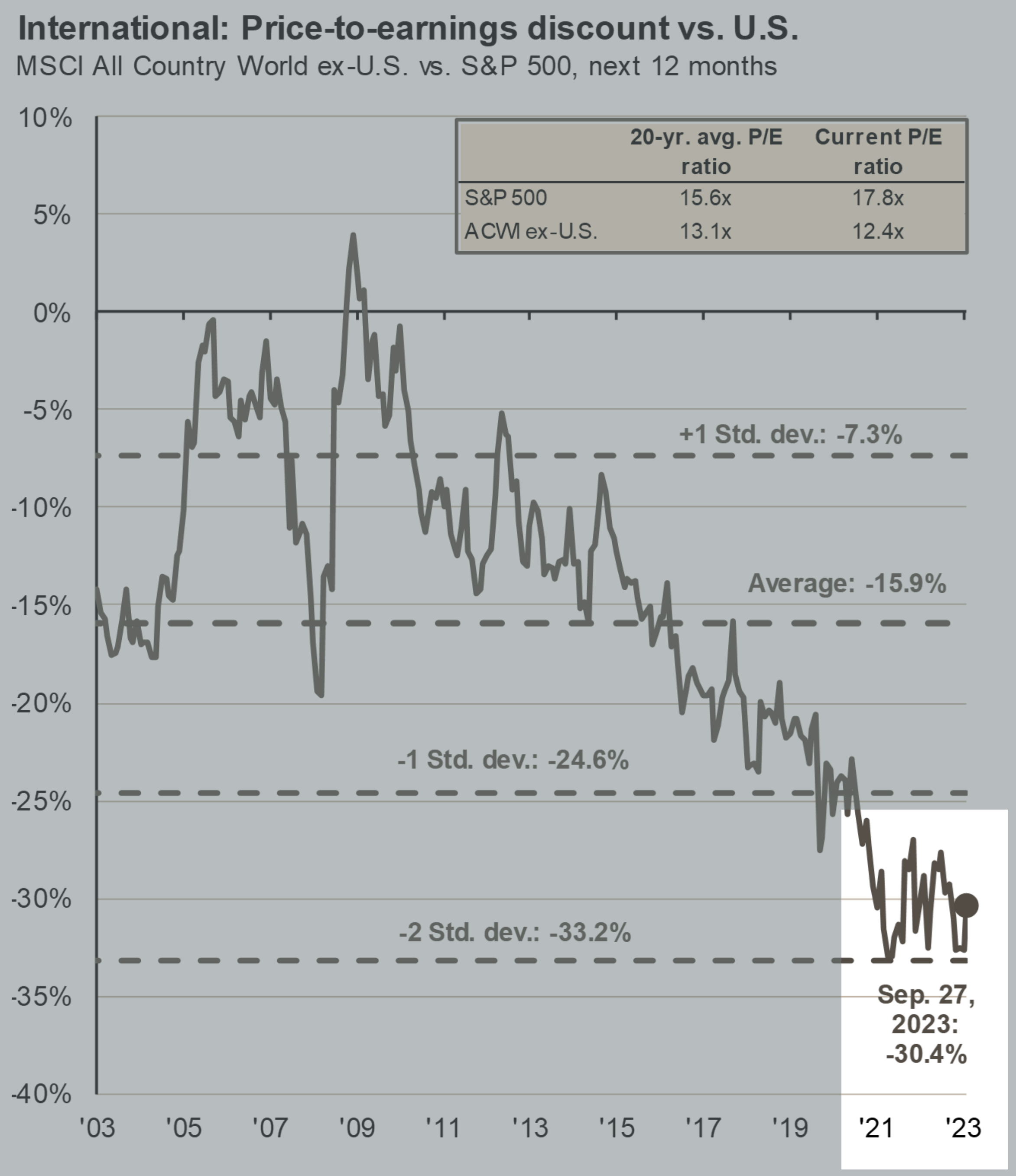


This chart shows the amount of compensation an investor is receiving for taking stock market risk in the U.S., using a measure called the equity risk premium.

At present, this compensation is at a decade low … at the *same time* earnings growth is so uncertain.

Source: Morgan Stanley, Bloomberg

Relative attractiveness of international stocks



	20-yr. avg. P/E ratio	Current P/E ratio
S&P 500	15.6x	17.8x
ACWI ex-U.S.	13.1x	12.4x

By contrast, consider international stocks.

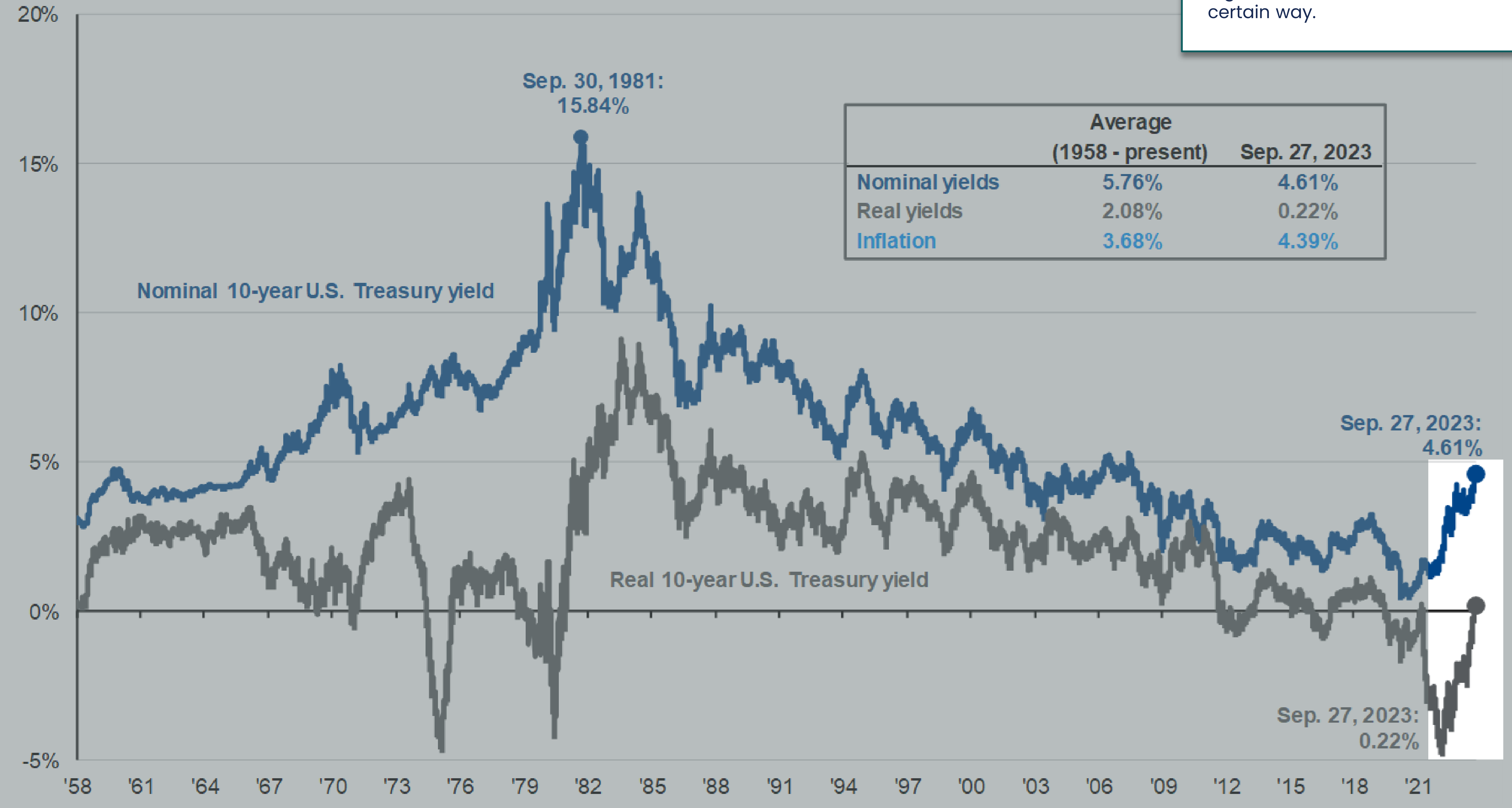
They, too, are at a decade low … but in this case it's the valuation that's low. This suggests international stocks may potentially provide a lot more compensation for risk than U.S. stocks.

Source: FactSet, MSCI, Standard & Poor's, J.P. Morgan Asset Management.
Guide to the Markets – U.S. Data are as of September 27, 2023

Interest rates … longer-term perspective

Finally, let's turn to the interest rate environment. As the Federal Reserve has increased rates to fight inflation, higher rates have provided our clients the opportunity to earn much higher returns in a much more certain way.

Nominal and real U.S. 10-year Treasury yields

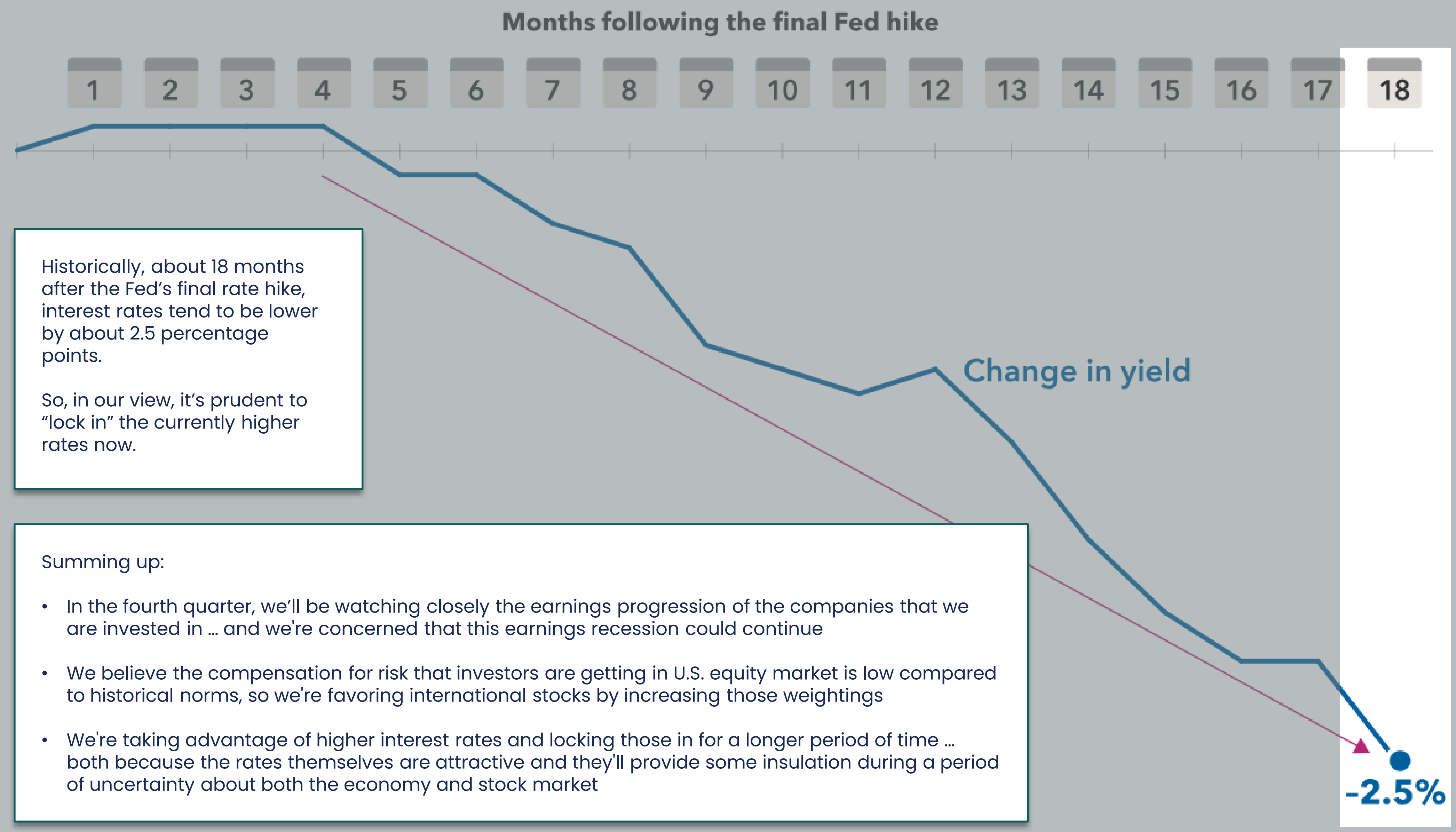


	Average (1958 - present)	Sep. 27, 2023
Nominal yields	5.76%	4.61%
Real yields	2.08%	0.22%
Inflation	3.68%	4.39%

Source Source: BLS, FactSet, Federal Reserve, J.P. Morgan Asset Management.
Real 10-year Treasury yields are calculated as the daily Treasury yield less year-over-year core CPI inflation for that month. For the current month, we use the prior month's core CPI figures until the latest data is available.
Guide to the Markets – U.S. Data are as of September 27, 2023.

Trajectory of rates following final rate hike

3-month T-bill yields declined sharply following the Fed's final hike in the last four cycles



Historically, about 18 months after the Fed's final rate hike, interest rates tend to be lower by about 2.5 percentage points.

So, in our view, it's prudent to "lock in" the currently higher rates now.

Summing up:

- In the fourth quarter, we'll be watching closely the earnings progression of the companies that we are invested in … and we're concerned that this earnings recession could continue
- We believe the compensation for risk that investors are getting in U.S. equity market is low compared to historical norms, so we're favoring international stocks by increasing those weightings
- We're taking advantage of higher interest rates and locking those in for a longer period of time … both because the rates themselves are attractive and they'll provide some insulation during a period of uncertainty about both the economy and stock market

Source Sources: Bloomberg, Federal Reserve. As of 6/30/23. Chart represents the average decline in 3-month Treasury bills starting in the month of the last Fed hike in the last four transition cycles from 1995 to 2018. Past results are not predictive of results in future periods

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