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FOURTH QUARTER 2023 OUTLOOK

October, 2023

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OCTOBER/NOVEMBER FED RATE DECISION

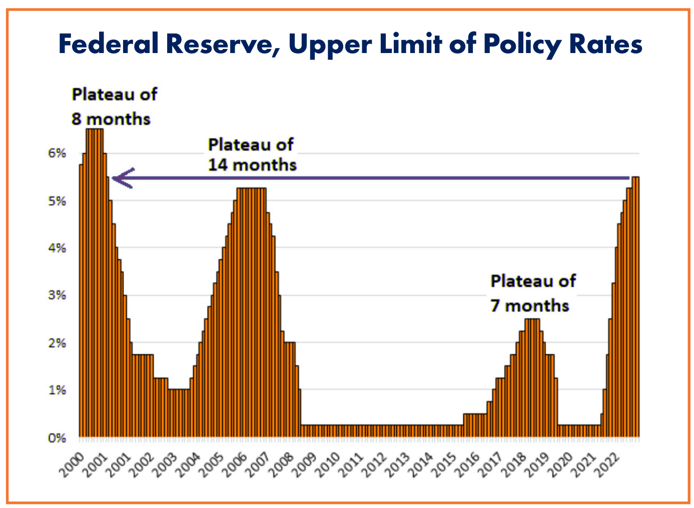
WILL LIKELY DEPEND IMPORTANTLY ON THREE CPI AND FOUR PCE PRICE INDEX REPORTS PRECEEDING THAT MEETING— EXPECT FUNDS RATE UNCHANGED IN NOVEMBER

At its September meeting, the Fed kept an unchanged but hawkish hold on its target range of 5.25-5.50%. The Fed's next meeting on October 31-November 1, will follow the release of three CPI and four PCE price index reports. During its November meeting, the Fed will likely assess the balance between concerns over inflation arising from the current strong economy and the uncertain delayed economic effects from the previous rapid increases in the funds rate. Balancing those concerns and reflecting current geopolitical developments, the Fed will likely leave its target range unchanged. Whether the Fed raises the rate or not, it will likely be less than a month before the funds rate reaches its peak for this cycle.

PEAK RATE LIKELY CONTINUES

FOR SOME TIME INTO 2024

Our past Outlooks focused on the Fed's failed stop-and-go funds rate policies in the seventies and how they would likely influence current Fed policies. Given those concerns, members of the FOMC reduced their rate-cut projections for 2024 from four to two. Looking at recent history, the Fed usually waited 7-14 months after reaching its peak rate before making its first cut (see Figure 1). If the peak rate occurred in July, then, a rate cut would likely occur late in the second quarter of 2024. If, instead, the funds rate peaks in November, a rate cut would typically occur in mid-summer. The recently released minutes of the Fed's September meeting indicated they would likely continue to reduce the size of its balance sheet even after it begins cutting rates. However, presidential politics next year might force an earlier date. Finally, sounding like Chair Powell, incoming data will likely alter this outlook.



(FIGURE 1) Sources: Federal Reserve Data, WOLFSTREET.com

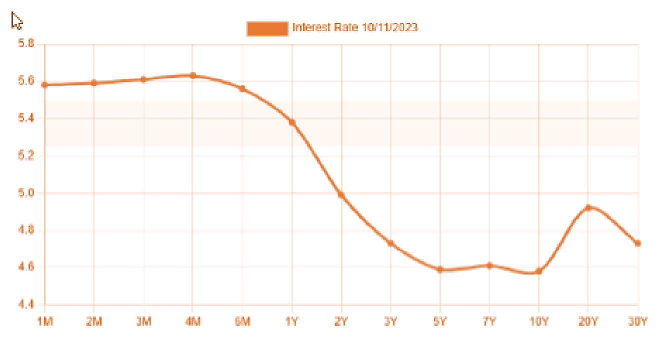
SIGNS OF RATES IMPACTING ECONOMIC ACTIVITY

In its September meeting, the Fed nearly doubled its forecast for 2023 GDP to 2.1%. However, concerns arise from the Fed's restrictive real rate policy which could hamper economic activity (see Figure 2). In the past six months, the 10 year Treasury rate increased sharply while the Treasury yield curve remained inverted (see Figures 3 and 4). Increased long-term rates could potentially slow capital investment spending while tempering financial market valuations. Conversely, high short-term rates primarily impact the financing cost of corporate working capital such as inventories and accounts receivables. If these concerns persist, it would support maintaining the current target range at the next Fed meeting.

Fed Real Policy Rate Finally Restrictive

(FIGURE 2) Sources: BEA, Fed, Macrobond, ANZ Research, The Daily Shot

US Treasuries Inverted Yield Curve

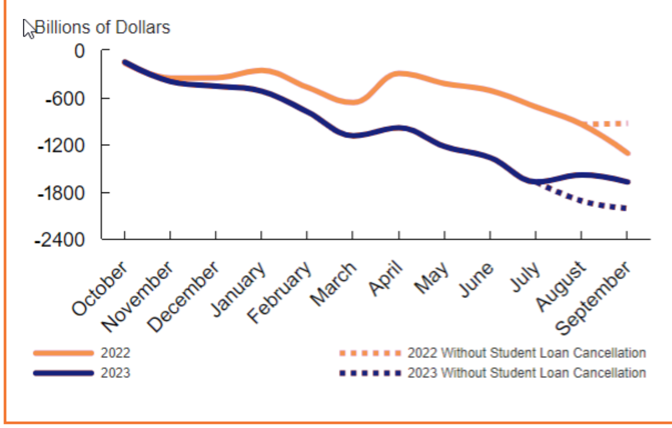


(FIGURE 3) Source: U.S. Treasury Department

INCREASING FEDERAL DEFICITS
ERODING FINANCIAL MARKET CONFIDENCE

The political disfunction in Washington increases concern that the federal budget deficit will be heading towards eight percent of GDP. The increased federal spending is happening despite both historically low unemployment rates and a resilient economy. Congress will soon face another budget funding decision in mid-November and, if not quickly resolved, could further erode confidence in the government's ability to manage its finances (see Figure 5). Unlike many home buyers, the federal government did not significantly lock in lower long-term rates. As a result, the runup in interest rates led to sharply higher interest payments on the federal debt (see Figure 6).

Cumulative Monthly Deficits
Fiscal Years 2022 and 2023

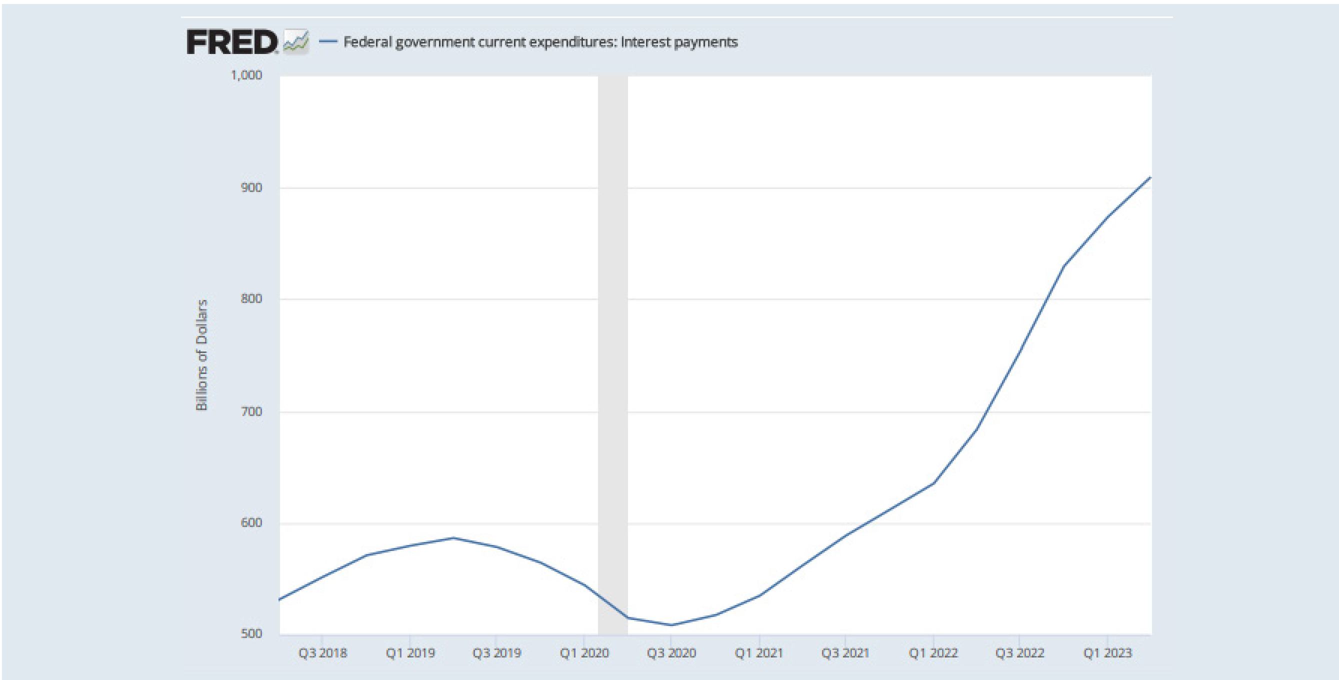


(FIGURE 5) Source: Congressional Budget Office

10 Year Treasury Yields-10/2018-10/2023

(FIGURE 4) Source: Ycharts.com

Interest Payments on Federal Debt/Quarterly
(2nd Quarter 2018 - 2nd Quarter 2023)



(FIGURE 6) Sources: Federal Reserve of St .Louis, U.S. Bureau of Economic Analysis

INVESTMENT CONCLUSIONS

Equities:

Both the Fed and economists expect a soft landing for the economy with moderating inflation. Consequently, the Fed will likely maintain its current funds rate. Investors will weigh increasing concerns about the rising federal deficit against the economy's ongoing strength. This will lead to heightened investor focus on high quality stocks that combine a positive earnings outlook with a strong balance sheet.

Fixed Income:

As the Fed either reached or reaches its peak funds rate decision, moderately extending fixed income duration seems appealing despite the rise in long-term rates. Additionally, lower rated debt may also prove attractive if the economic outlook further improves. In such a scenario, incorporating alternative investments can also be used to diversify the portion traditionally committed to fixed income. Alternatives provide lower correlations with stocks and bonds, providing diversification benefits. Exploring alternative investments can help manage risk and potentially enhance returns in a changing market environment.

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The S&P 500 Index is a market-capitalization-weighted index of the 500 largest U.S. publicly traded companies by market value, the index is widely regarded as the best single gauge of large-cap U.S. equities.

The Russell 1000 Value Index measures the performance of those companies in the Russell 1000 Index with lower price-to-book ratios and lower forecasted growth values. The Index is calculated on a total return basis with dividends reinvested and is not assessed a management fee. It is not possible to invest directly in an index.

The Russell 2000 index is an index measuring the performance of approximately 2,000 small-cap companies in the Russell 3000 Index, which is made up of 3,000 of the biggest U.S. stocks. The Russell 2000 serves as a benchmark for small-cap stocks in the United States.

The Russell 2500 Index is a broad index, featuring 2,500 stocks that cover the small- and mid-cap market capitalizations. The Russell 2500 is a market cap-weighted index that includes the smallest 2,500 companies covered in the Russell 3000 universe of United States-based listed equities.

The MSCI World Index captures large and mid-cap representation across 23 Developed Markets (D.M.) countries. With 1,633 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country.

The MSCI EAFE Index is an equity index which captures large and mid-cap representation across 21 Developed Markets countries around the world, excluding the U.S. and Canada. With 920 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country.

The MSCI Emerging Markets Index captures large and mid-cap representation across 24 Emerging Markets (E.M.) countries. With 1,125 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country. An index is a portfolio of specific securities, the performance of which is often used as a benchmark in judging the relative performance to certain asset classes. Indexes are unmanaged portfolios and investors cannot invest directly in an index. An index does not charge management fees or brokerage expenses, and no such fees or expenses were deducted from the performance shown. Past performance is not a guarantee of future results.

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