# WealthIQ: October 2023

## So long, Summer

**Executive Summary: Following a strong first half of the year, the summer season brought a 'pause' to financial markets. With the arrival of fall, financial markets appear to be struggling with competing economic narratives and, at times, contradictory economic data. Inside this edition of WealthIQ, we'll get you caught up on what happened over the summer in financial markets and break down some recent events that have the potential to move markets in the months ahead.**

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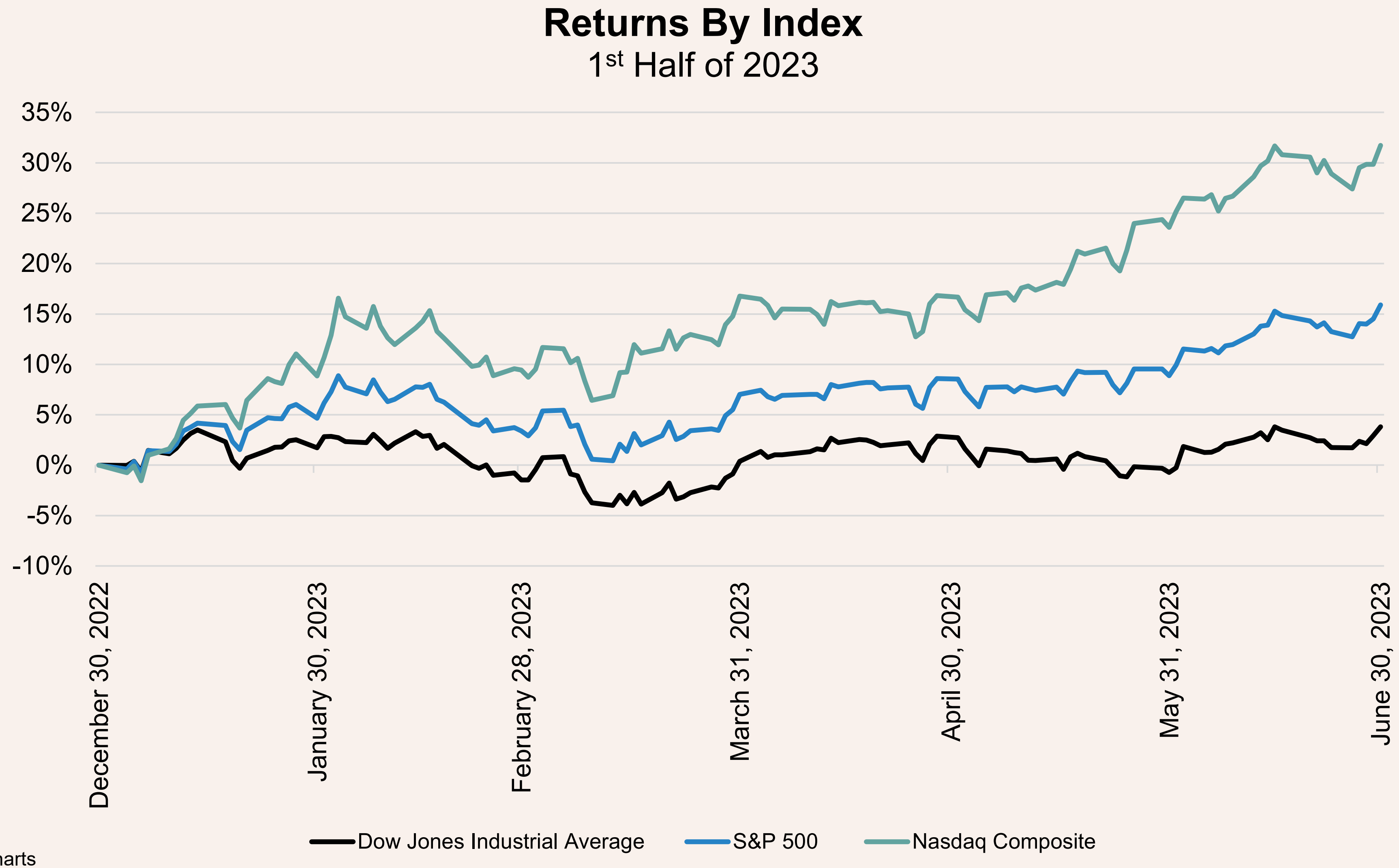
1) Simply put, hopes for equities were not high coming into 2023. Following the S&P 500's worst annual return since the Global Financial Crisis, worries about inflation, a recession, and continued Fed tightening led analysts to predict a tough, choppy year for equities. Entering 2023, newly improved yields appeared to offer an alternative for investors wary of stocks. Accordingly, at the halfway point of 2023, the S&P 500 had rallied over 15%. Even better, the tech-focused Nasdaq Composite closed the first half up more than 30%, while the less tech-focused Dow Jones Industrial Average advanced less than 5%.




Data Source: YCharts

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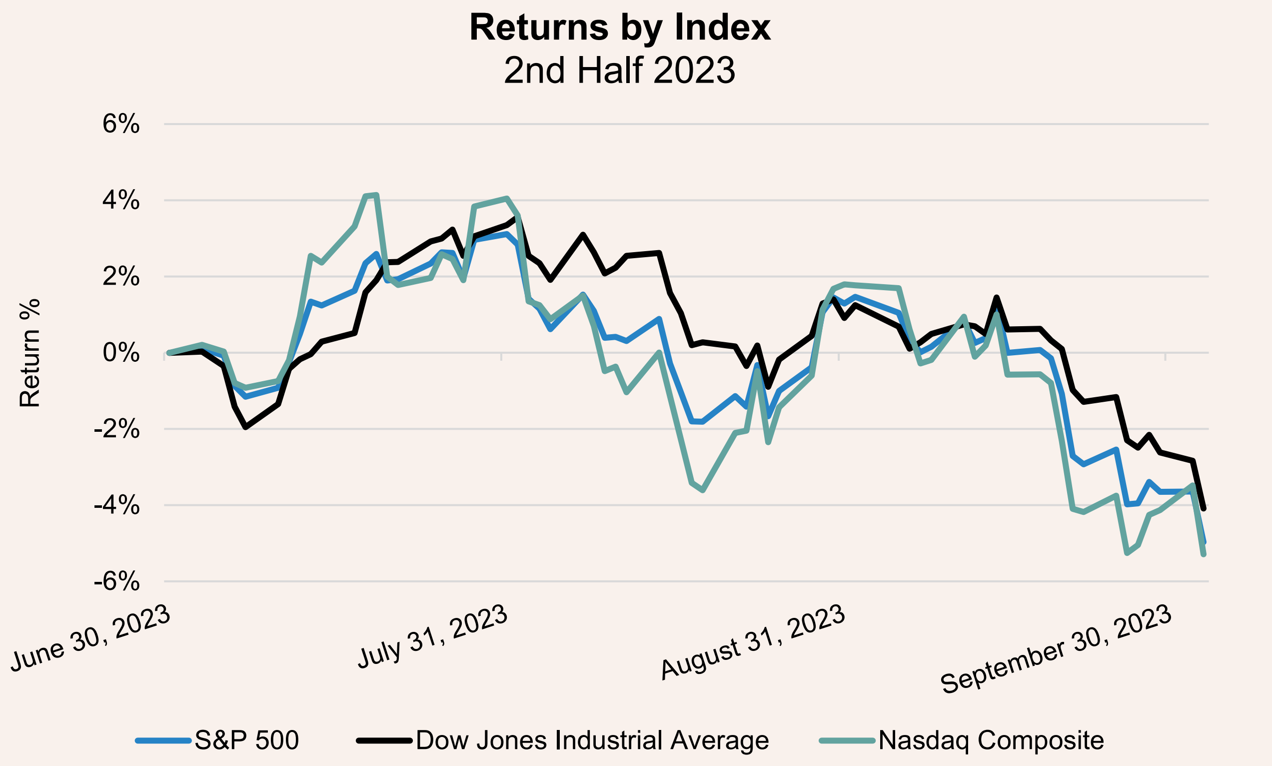
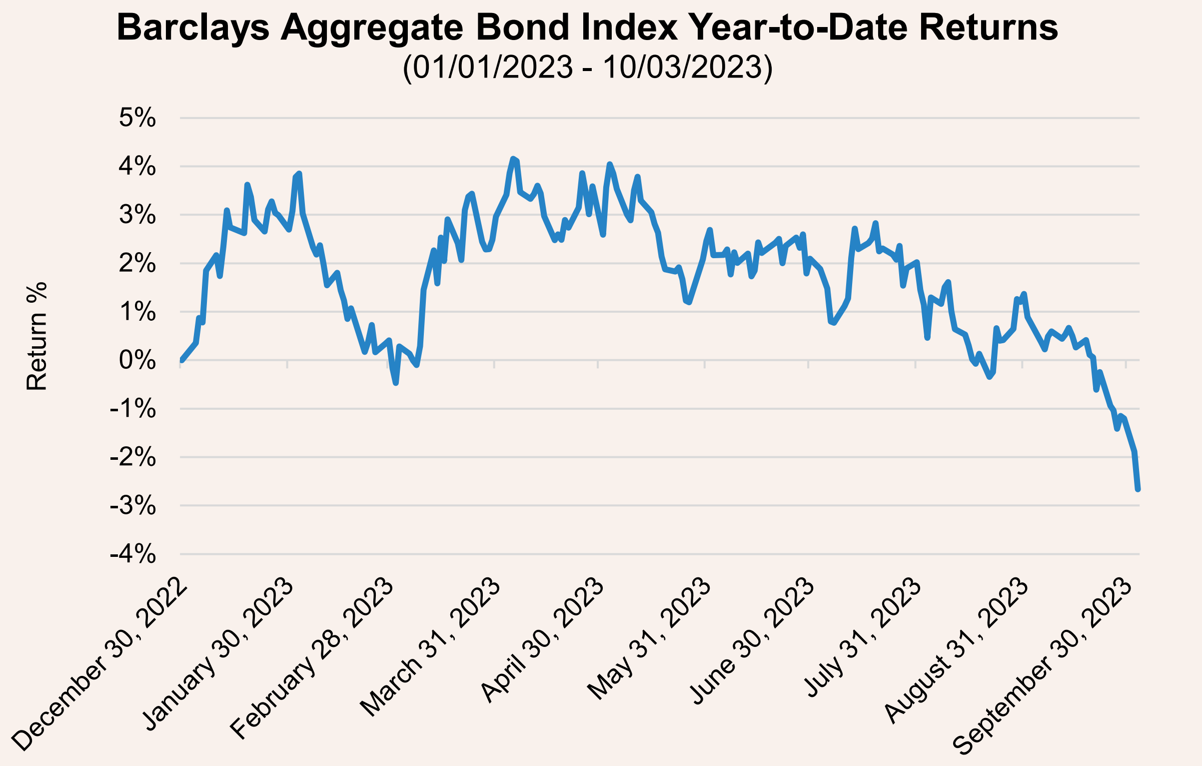
2) However, since the start of July, sustained market advances have been harder to come by with the major indices declining so far in the second half of the year. These declines can likely be attributed to several factors including an exhaustion of the AI rally that dominated the first half of the year and a strong interest rate resurgence. Today, markets continue to grapple with economic data and its impact on the future path of monetary policy. Markets have seen yields climb recently on these changing monetary policy expectations, weighing on bond prices.

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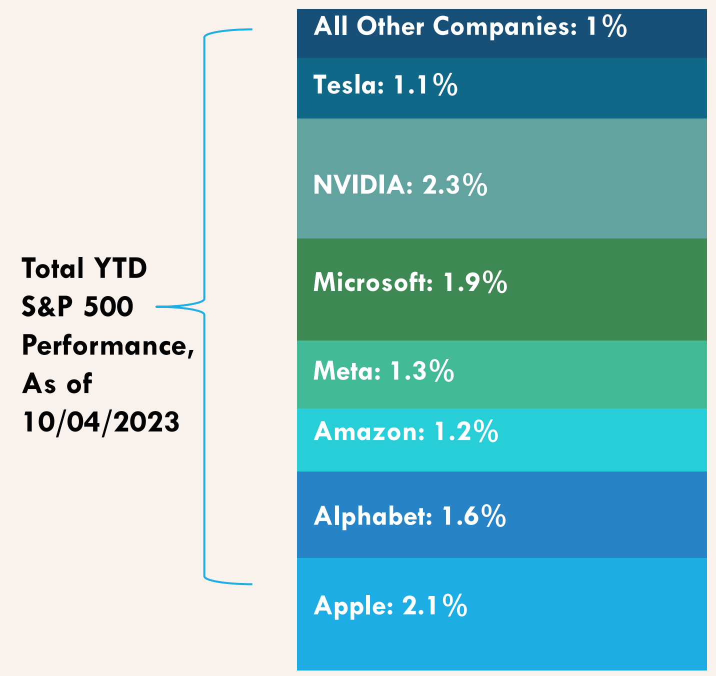
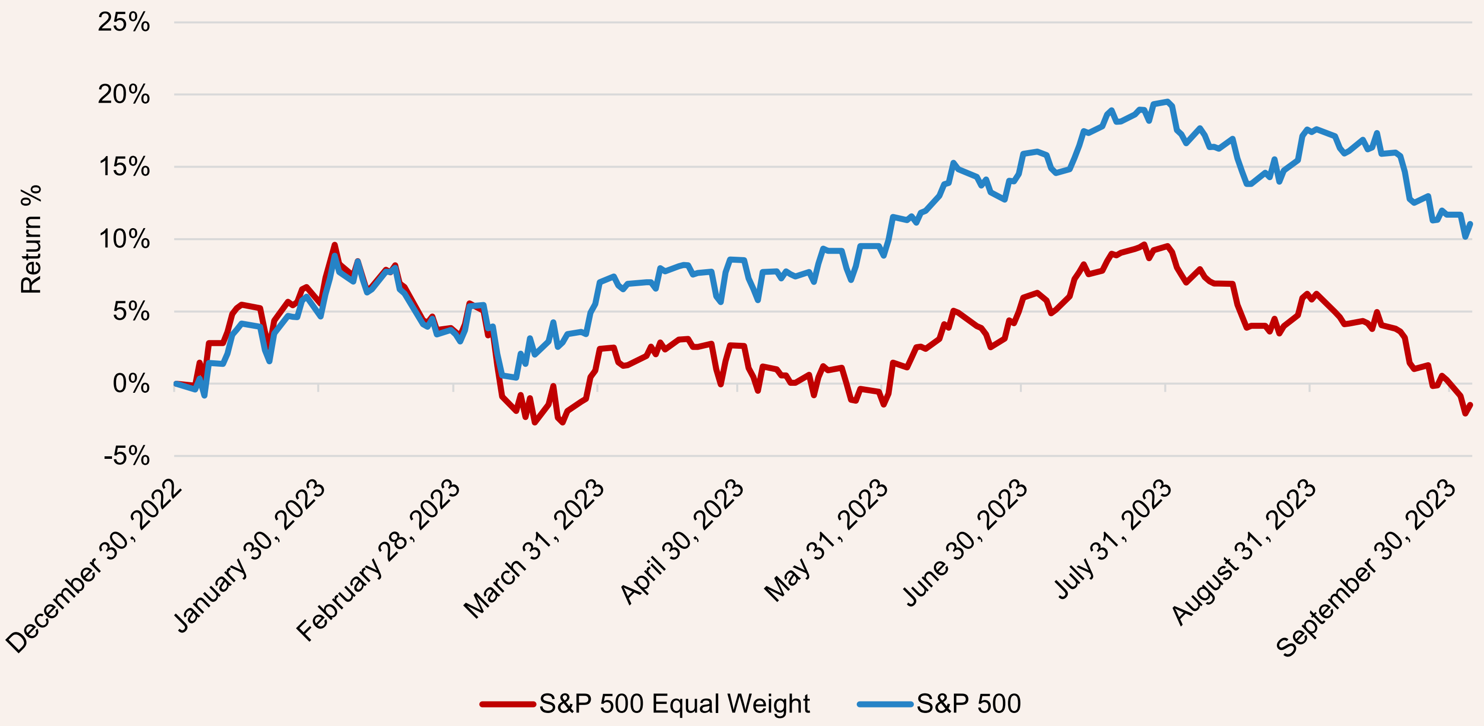
Data Source: YCharts

3) As noted, this year's market rally had been heavily driven by the technology sector. After weathering the 2022 storm of higher rates and fears of slowing growth, tech stocks rallied as excitement around Artificial Intelligence reached a fever pitch in the first half of 2023. At the end of September, a majority of S&P 500 year-to-date performance could be attributed to just seven tech-focused stocks- Alphabet, Apple, Amazon, Meta, Microsoft, NVIDIA, and Telsa. When comparing the S&P 500 against the S&P 500 Equal Weight Index (an index that weights all S&P 500 companies equally regardless of market cap) we see a very different story about the strength of this year's market advance.

**Contribution to S&P 500 Return (%)**




**Year-to-Date S&P 500 & S&P 500 Equal Weight Performance**
(Price Returns, 01/01/2023 - 10/04/2023)

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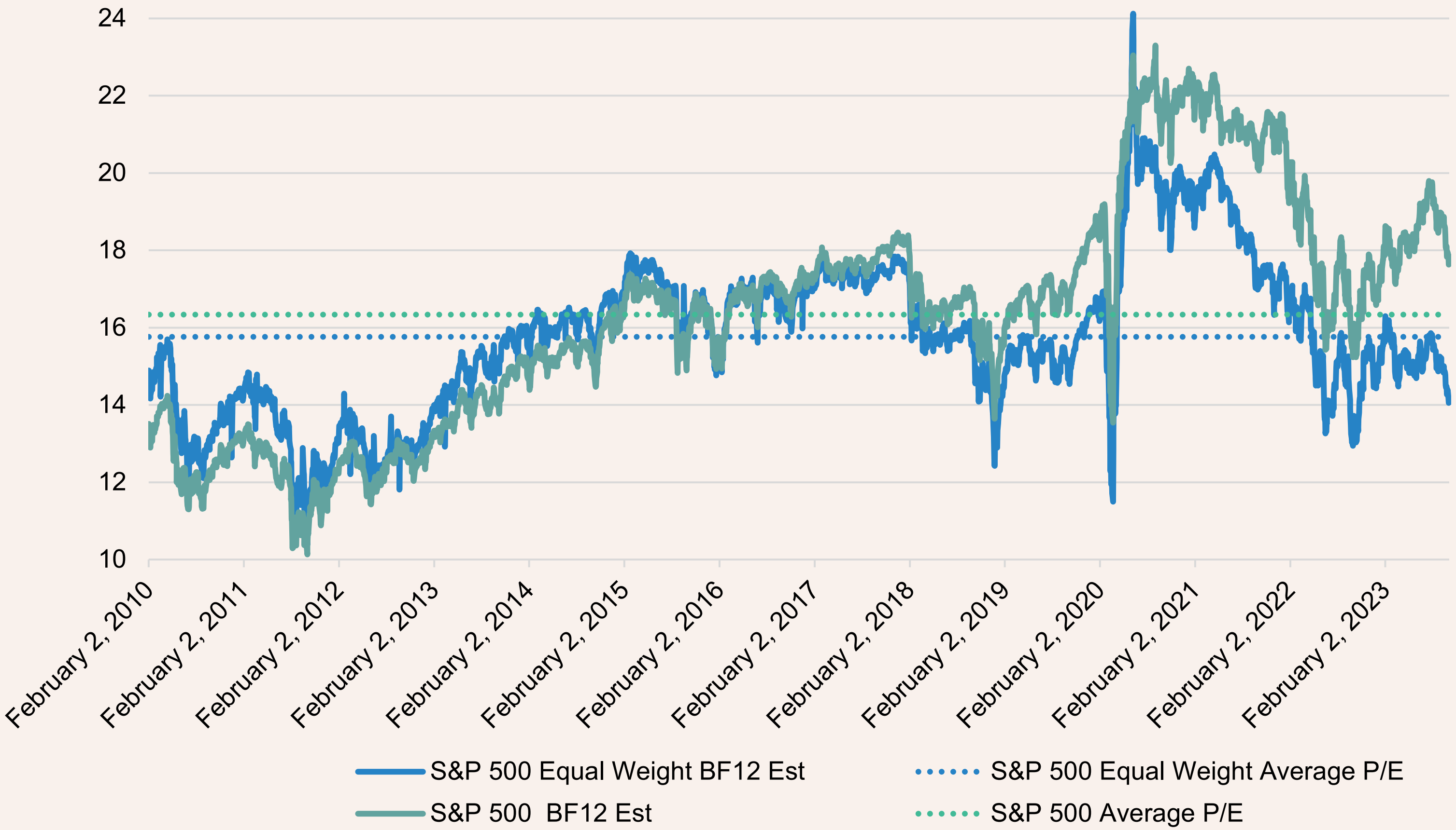
Data Source: YCharts, Bloomberg, L.P.

4) The S&P 500 Equal Weight performance on the prior page shows it hasn't been as strong of a year for equites as the market cap weighted S&P 500 would lead an investor to believe. Because the S&P 500 Equal Weight index hasn't experienced the same level of year-to-date performance as the traditional S&P 500, its valuations appear more attractive on a relative basis, especially as forward earnings estimates have migrated higher. Looking forward, this can be constructive as equity markets may not actually be as richly valued as the traditional market-cap weighted index shows.

**Forward P/E Multiples: S&P 500 & S&P 500 Equal Weight**
(02/02/2010 to 10/04/2023)

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Data Source: Bloomberg, L.P. Definitions: BF12 Est means Blended Forward 12 Month Estimate

5) Recent, sharp advances in treasury yields have also weighed on equities. One measure used to evaluate the attractiveness of stocks relative to bonds compares the earnings yield (earnings/price) of stocks to bond yields. The guiding wisdom is when earnings yield exceeds comparative bond yields (a positive spread) stocks may be attractive relative to bonds (and vice versa). In the chart below, we use the forward earnings yield for the S&P 500 and the effective bond yield for investment grade corporate bonds to assess this metric. As the chart demonstrates, it has been over a decade since bonds yields appeared this attractive relative to stocks. In other words, current bond yields present a potential alternative to stocks given current earnings and index levels.

**S&P 500 Forward Earnings Yield Minus U.S. Corporate Index Effective Yield**

(Weekly, January 2006 – September 2023)


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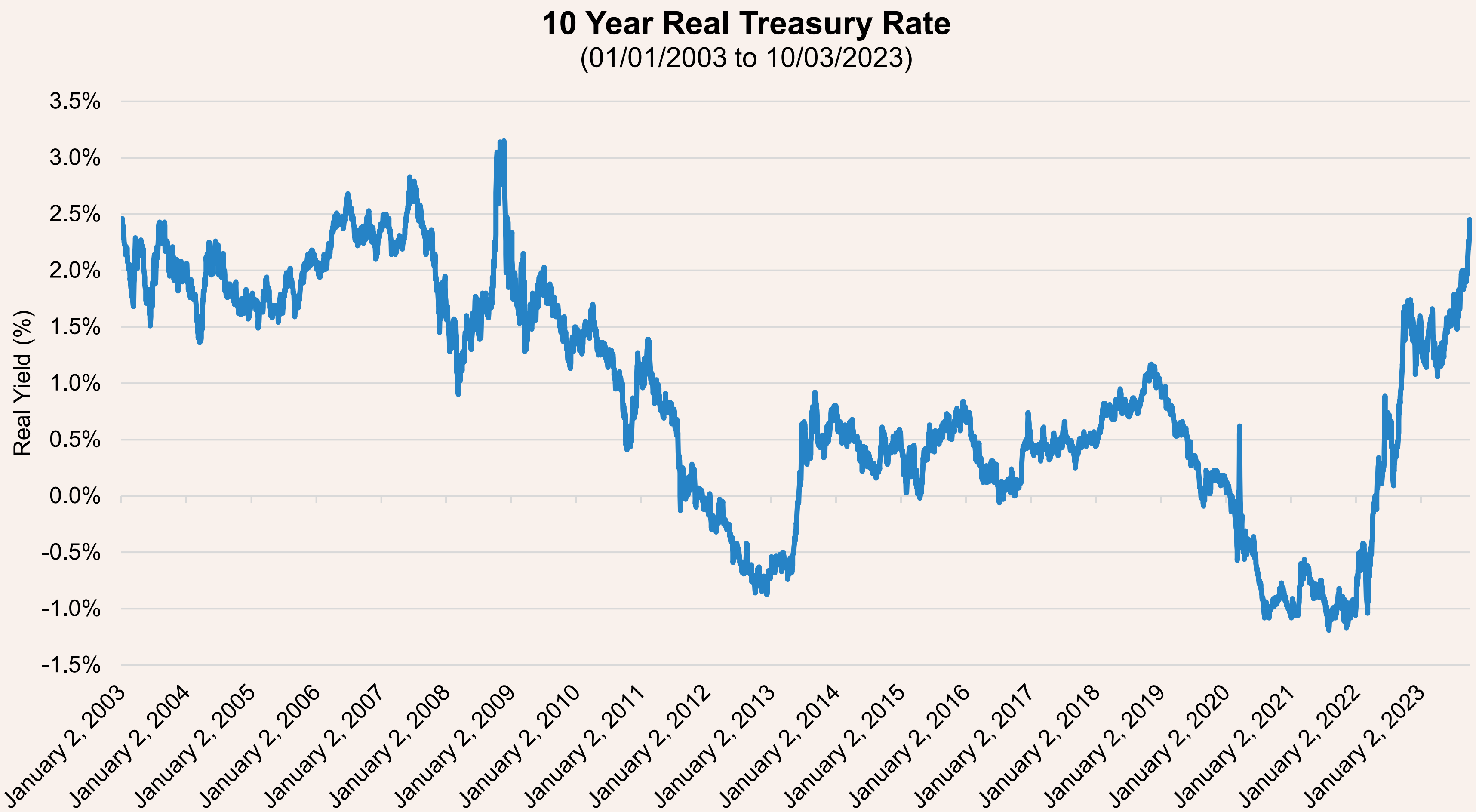
Data Source: Bloomberg, L.P.; Federal Reserve Bank of St. Louis. Earnings Yield Calculated as inverse of S&P 500 Blended Forward 12-month P/E. U.S. Corporate Index Effective Yield represent ICE BofAML US Corporate Index Effective Yield

6) Another metric demonstrating that a possible regime shift may be underway in markets is real yields. Real yields calculate the difference between nominal interest and inflation rates. As an example, if 10-year treasury rates had a stated nominal yield of 5% and inflation was 2%, the real yield would equal 3%. Savers benefit when real yields rise as they do a better job of maintaining their purchasing power (i.e., earning an amount greater than inflation). Conversely, borrowers are negatively impacted when real yields rise as borrowing costs increase. These higher borrowing costs can have economic implications and, in turn, stock market implications. Today, real yields are at their highest levels since the 2008 Global Financial Crisis. After a decade where the phrase TINA or 'there is no alternative' to stocks was often quoted in financial media, today's investors seem to have alternatives as real yields have risen.

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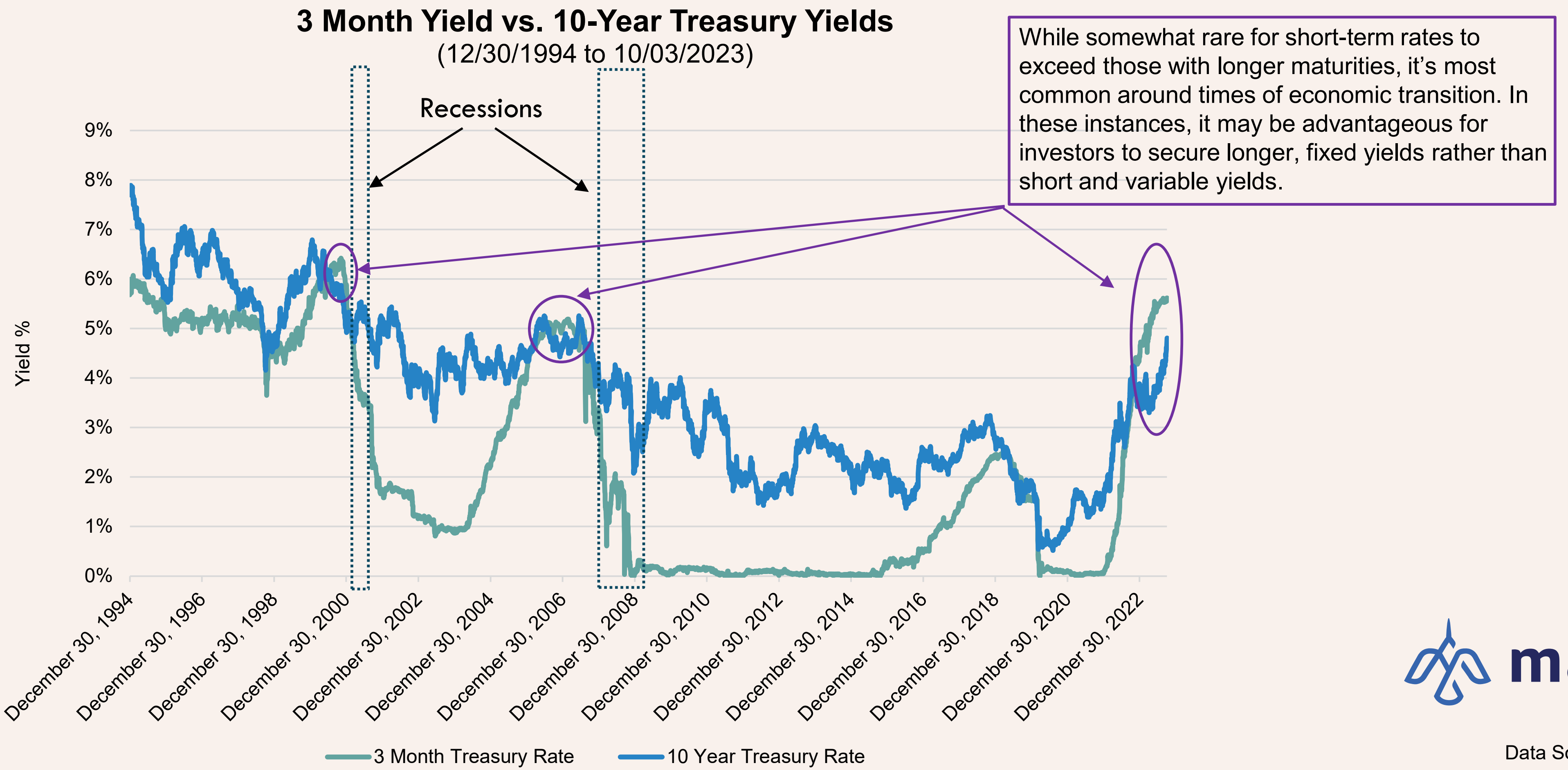
Data Source: YCharts

7) One of the alternatives that we're occasionally asked about are money market funds or CDs as substitutes for bond investing. In a recent article published by Yahoo Finance, Marshall's Chief Investment Officer, Adam Reinert, was quoted as explaining 'While short-term investment products, like money markets and CDs, can play a role in portfolios, it may be difficult to build a longer-term portfolio allocation around them as short-term interest rates can fluctuate as monetary policy changes." Although the desire to avoid bond volatility is understandable, it may not make much sense at current levels to swap intermediate-term debt for short-term instruments as part of a long-term investment plan. With yields on intermediate-term and short-term debt starting to converge, intermediate-term debt gives an investor the chance to 'lock-in' a yield for a period of several years while short-term debt is only 'locked-in' for several months. Take a look at the chart below:

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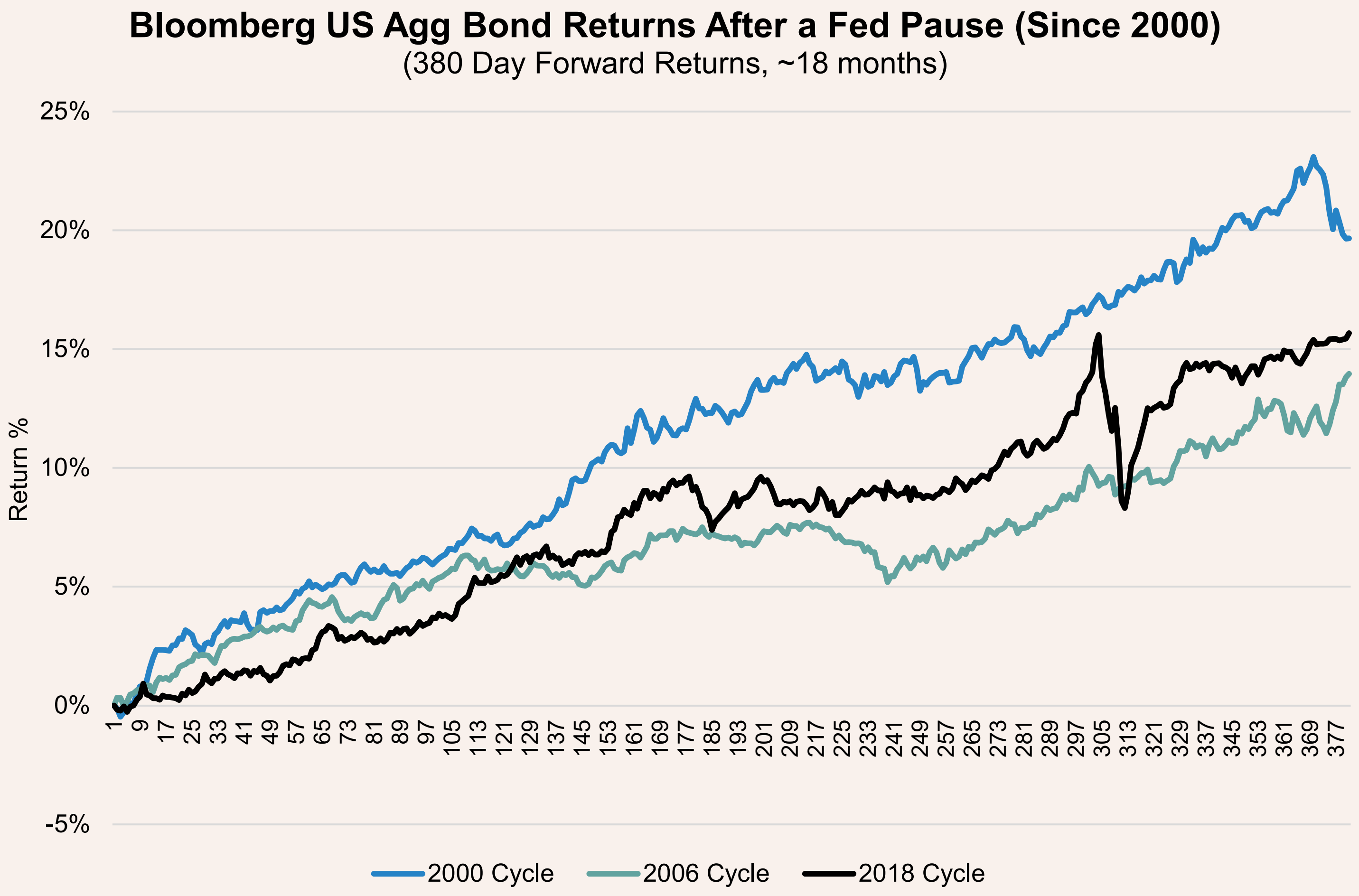
Data Source: YCharts

8) During September's Federal Reserve meeting, policy makers released their 'Summary of Economic Projections,' better known as the 'dot plot.' The dots, or Federal Reserve member expectations, indicated the Federal Reserve consensus to be one more 0.25% hike in short-term interest rates and the belief that rate cuts may be warranted next year. If history is any guide, the pivot to the end of the hiking cycle is often constructive for intermediate-term bonds as short-term rates fall.



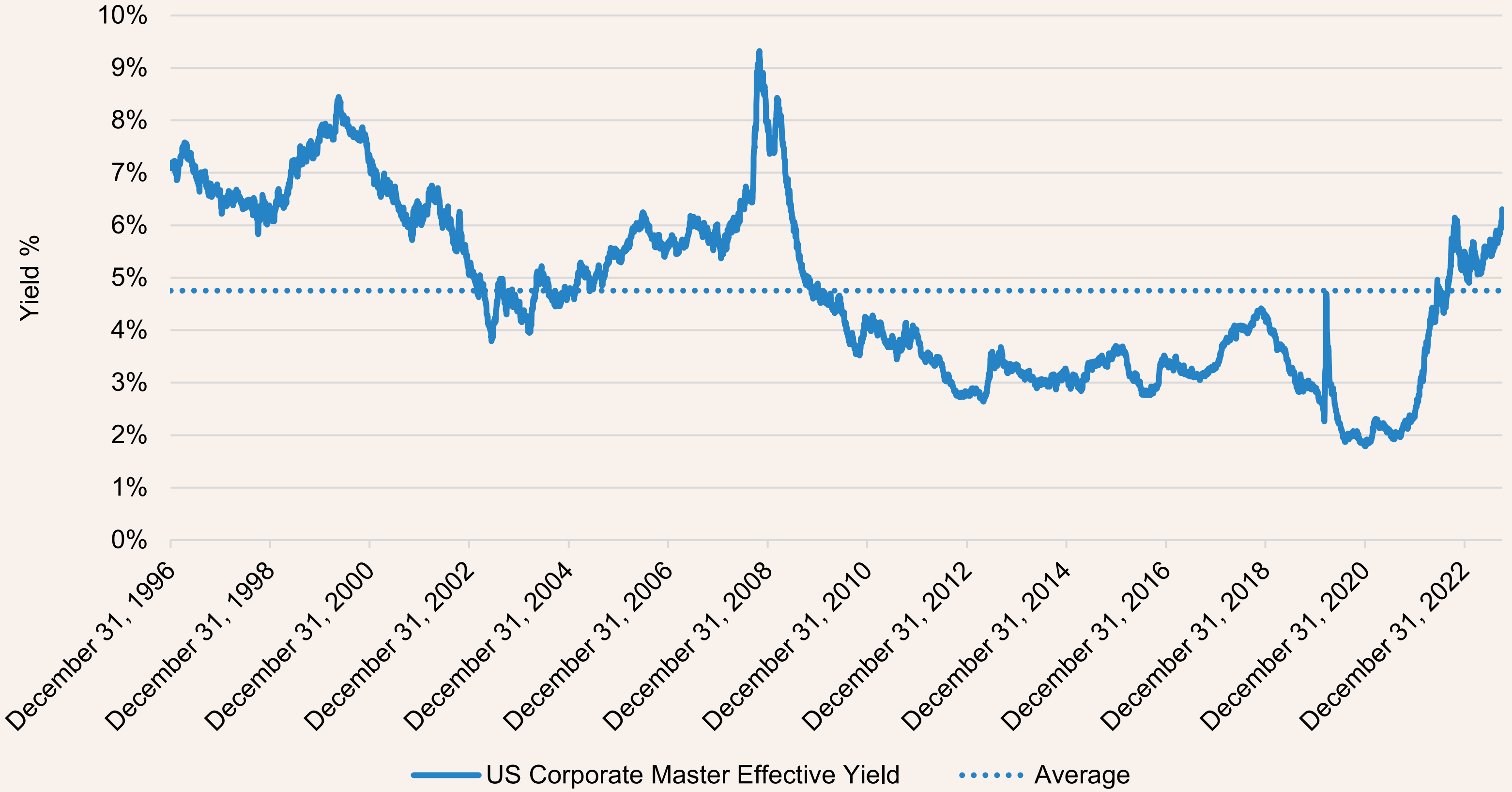

Data Source: YCharts

9) Selling intermediate-term or even longer-term bonds today, in our opinion, would be akin to selling stocks during a bear market. It's important to remember there is a fundamental difference between stocks and bonds. Stocks represent fractional ownership in a company, while bonds are loans to borrowers. While rising rates may have lowered the price of some bonds below their par value, absent the event of default, a bondholder can expect to receive back par value at maturity. The same cannot be said for equity investment, which requires the right mix of business, economic, and sentiment conditions to generate capital gains. Below, we show a 10-year U.S. Treasury Bond that was issued in August 2020 with a coupon of just 0.625%, something very unattractive in today's higher rate world. That bond is currently worth around $0.75 for every $1 initially invested. Unless the U.S. government defaults, in addition to their low interest payments, the original investor will receive back their $1 principal when the bond matures in 2030, making current principal losses temporary. Today, an investor could buy that bond from the original investor at the current discount around $0.75, collect the 0.625% of annual coupon, and receive back the $1 par value upon maturity of the bond.


Data Source: Bloomberg, L.P.

10) It seems we are often saying the ‘highest level since the 2008 Global Financial Crisis’ when looking at current yield me trics. Even outside of government securities, areas like investment-grade corporate bonds are offering attractive yields. After a decade of low interest rates, corporate issues are paying yields to investors last seen around the 2008 Global Financial Crisis. In our opinion, while today’s yield environment feels high through the lens of the prior decade, what is most unique about the current rate environment is how quickly yields returned to levels ‘closer’ to historical averages, rather than the levels themselves. Despite the resulting fixed income volatility, an investor could make the case the current yield environment is objectively more constructive for longer-term, forward-looking investors than what the prior decade provided.

**U.S. Investment Grade Corporate Yields**
(12/31/1996 to 10/04/2023)

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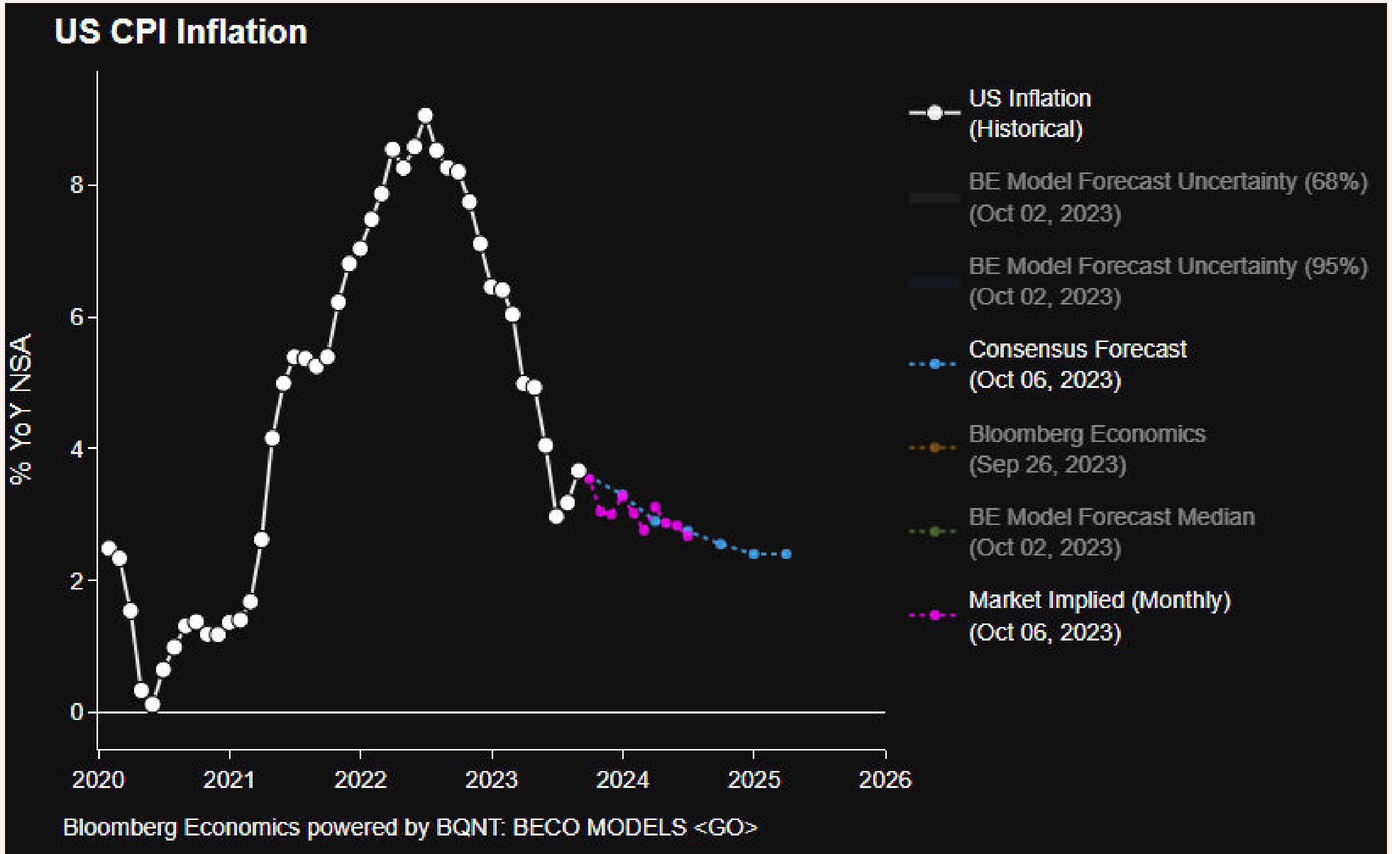
Data Source: YCharts

11) Last month, Federal Reserve Chairman Jerome Powell said, “As is often the case, we are navigating by the stars under clou dy skies.” Just this week different indicators painted varying pictures of the labor market - one was too hot, one was too cold, and the third was more balanced. When economic data is this open to interpretation, the need to proceed cautiously with monetary policy increases so as to minimize the chance of a major policy error. Despite continued ‘hawkish’ rhetoric from some members of the Federal Reserve, the reality is they have only raised interest rates at one of their past three meetings as they take a more nuanced approach with current policy. The Federal Reserve’s strong influence will likely continue to be felt by markets, though as inflation moderates, we may begin to see the central bank’s strong grip loosen.




Our current preferred metric, the market implied rate (purple dots), shows continued inflation moderation is expected in the months ahead, albeit with some variance.

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Data Source: Bloomberg, L.P.

Last month our Chief Investment Officer, Adam Reinert, CFA, CFP® and Research Analyst, Sean Dann, CFA, were invited to bring the Off Street Podcast to the Financial Planning Association's Annual Conference in Phoenix. At the conference, Adam and Sean had the opportunity to interview guests, including Caleb Silver, Editor-in-Chief of Investopedia.

The show is recorded and released weekly and can be streamed on all major listening platforms, including Apple Podcast and Spotify.

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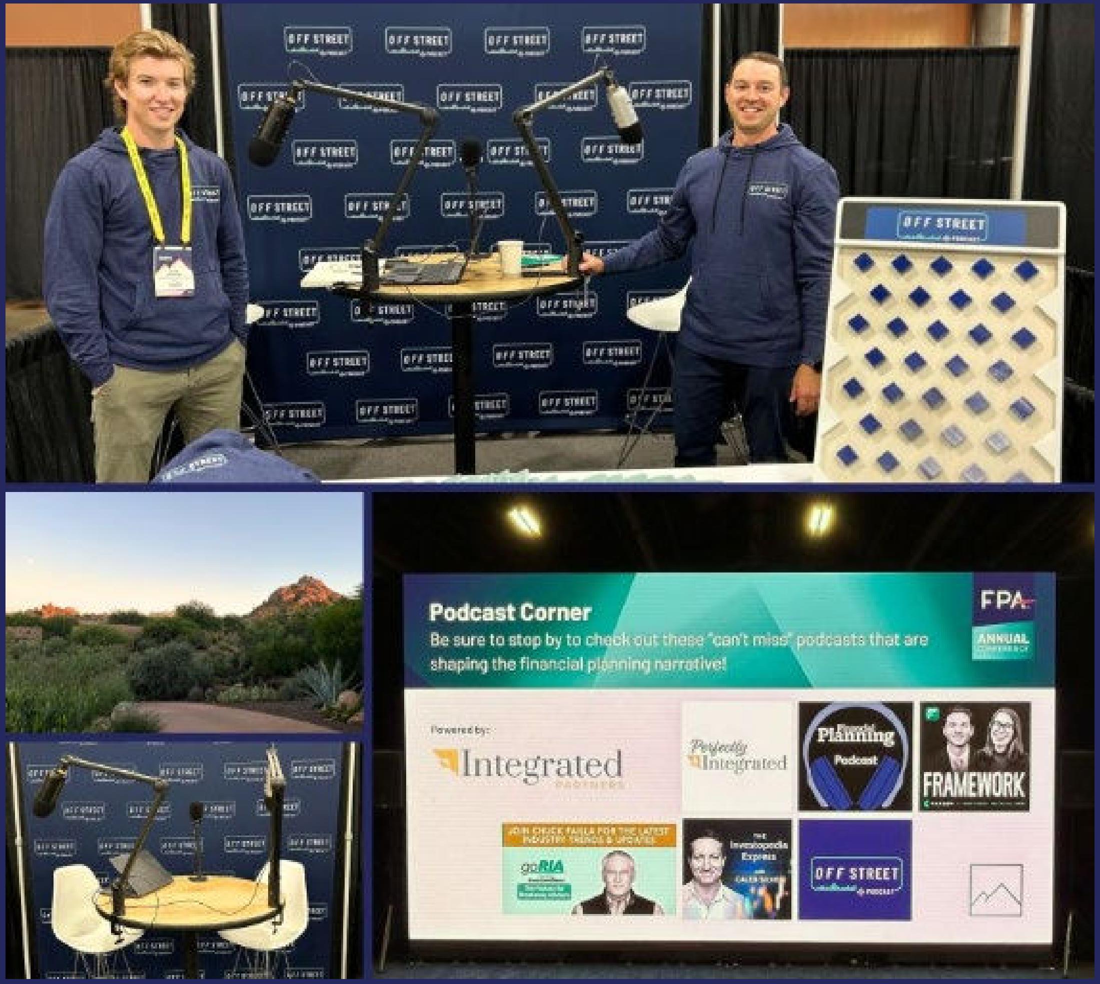

Interested in sending our investment team a note? Please send an email to wealthiq@marshallfinancial.com.

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It's impossible for anyone to know with certainty what will happen today, tomorrow, or even a minute from now. Investment involves risk and volatility; it's why long-term investors have historically been rewarded with excess returns relative to cash. Our investment department monitors market data and works with our wealth advisory teams to right-size portfolios should something change relative to long-term trends. In the meantime, we'll continue to share financial and economic data we believe is insightful and relevant to your wealth to help you feel informed.

Thank you for reading; please be well.

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