THIRD QUARTER 2023

Matt's Market Update

IN THIS REPORT

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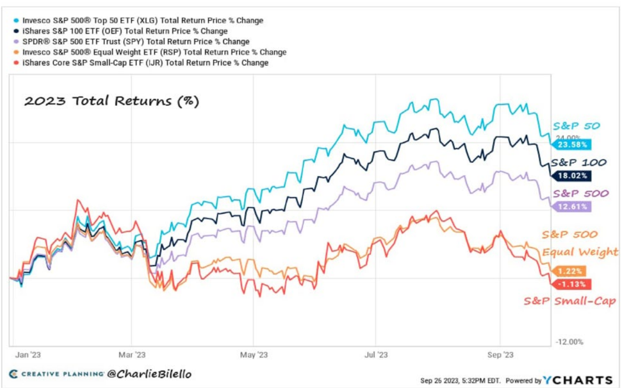
Market Review

Global equity markets were unable to sustain the positive momentum of the first seven months and posted broad-based declines in Q3. September, in particular, was the source of most weakness for the popular indices. The S&P 500 index declined -4.77% in September and -3.27% in Q3. While the YTD total return for the index remains at +13.07%, much of that performance is driven by just seven companies (Nvidia, Apple, Microsoft, Meta, Amazon, Tesla and Alphabet). Without the contributions from these companies, the return for the index over the first three quarters is approximately 1%. Examining the chart on the next page, you'll note the performance advantage for the largest companies this year. In terms of price change only (not including dividends), the 50 largest stocks in the S&P 500 (light blue line) are up nearly 24% this year. An index of the largest 100 S&P 500 stocks (dark blue) are up 18%. The key is the orange line on the chart. This shows how the index performed if every stock in the S&P 500 was held in equal proportion. Note the flat performance. Another way to show that all the performance generated in 2023 has come from the largest stocks in the index.

Small-cap stocks as represented by the Russell 2000 index declined by -5.13% in Q3. While valuations for small-caps relative to larger companies are at historically attractive levels, investors are likely to need more reassurance on the U.S. economic outlook before moving out of the large-cap stocks that have performed so well in recent years. A simple comparison of the S&P 500 vs. Russell 2000 performance over the past five years shows a 750 basis point annual advantage for the large-caps.

The media loves to debate the potential of a soft landing (zero growth or slight recession), hard landing (deep recession) or no landing (growth slows, but no recession). Which will it be? We have no prediction to offer, but we would confidently say that a U.S. economy with record breaking (and ever increasing) levels of debt is highly unlikely to emerge unscathed following an unprecedented 525 basis point increase in interest rates courtesy of the Federal Reserve over the past 18 months. The Fed raised the Federal Funds interest rate by 25 basis points at their July meeting, while taking no action during the September meeting. Views are mixed whether the Fed could move rates higher again at either the November or December meeting. The market's focus has seemingly shifted from the level of peak rates, to how long central banks will hold rates at restrictive levels, with "higher for longer" increasingly viewed as the necessary scenario to tame inflation. The key 10-year Treasury yield finished the quarter at 4.57% (a massive move up from 3.81% to start the quarter). In fact, the total return for the 10-year Treasury is on pace for a record three straight calendar year declines. We are currently living through the longest bear market in bonds in history at 38 months. The rapid increase in rates across the curve this quarter pushed the Bloomberg Barclays US Aggregate index to a decline of -3.23%.

While the current environment for fixed-income investing is very challenging, there are some positive signs for long-term investors. First, the US M2 money supply is declining rapidly. Historically speaking, this type of decline will act to reduce the impact of inflation. After a 40% increase in 2020-21 during the pandemic, we've since seen a massive decline. The US Money Supply fell 3.7% over the last year, a record 9th consecutive month with a YoY decline. Second, the growth rate of inflation (as measured by the CPI) continues to decline. The biggest single contributor to CPI, Shelter, should continue to move lower as well as US rents are down -1.2% over the past year. Getting down to the Fed's stated goal of 2% CPI will be a challenge for sure, but prices across a wide variety of goods and services have fallen dramatically in the past year. Finally, for new money entering the bond market, the starting yields on these investments are the highest since 2007. In the short run, the direction of interest rates drive bond market returns, but in the long run, it's the starting yield that is the key to returns if the bond is held to maturity.



Looking for Value Overseas

In last quarter's commentary we discussed no giving up on your exposure to the value style as the gap in performance between value and growth managers has rarely been wider. While value generally held up better during the volatile third quarter, the performance gap remains wide in comparing the U.S. mutual fund categories. The average fund in the Morningstar Large Growth category has returned +19.38% year-to-date (YTD), while the average for Large Value managers YTD is +1.94%. We've mentioned in the past that just because an asset class has lagged or is comparatively cheaper on a valuation basis, this doesn't mean it's necessarily ready to buy. That being said, performance tends to be cyclical and mean reverting. We continue to believe now is an excellent time to check your portfolios to make sure you're comfortable with the split between growth and value.

This advice applies to foreign equity holdings as well. In fact, in contrast to the U.S. markets, we've already begun to witness a turn in relative performance overseas in favor of value strategies. The average manager in the Morningstar Foreign Large Value category has outperformed their Growth category manager over the trailing YTD, 1 & 3-year periods through the third quarter. One reason this may continue is found in the chart on this page which examines current valuations versus history for the major foreign indices. The main core index (MSCI EAFE which has exposure to both value and growth stocks) currently has a lower P/E valuation than the historic average. What really stands out though is the valuation comparison of the value (MSCI Value) and growth (MSCI Growth) indices. The former currently trades at a large discount to its historic P/E average while the latter appears fully valued and trades at a premium to its historic average. To sum up, value strategies in the foreign markets have already started to outperform while exhibiting cheaper valuations than growth strategies.

INTERNATIONAL VALUE EQUITIES ARE TRADING AT AN ATTRACTIVE ENTRY POINT COMPARED TO HISTORY

January 1995 through September 2023

Source: Boston Partners

RETIREMENT BLIND SPOTS

Wealth Management Corner

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Whenever I start working with a new client, my goal is to help them answer two key questions: "Will I make it?" and "Do I have any financial blind spots?" I do my best to help them define what they want to accomplish with as much specificity as possible. For most people, their top priority is being able to live comfortably in retirement whenever they decide to call it a career. But how do they define comfort? Because of the context of our profession, most financial planning conversations center around being financially comfortable. Transitioning out of the workforce, however, requires preparation in other areas as well. As important as it is to prepare financially for retirement, neglecting these other key areas can leave retirees yearning for fulfillment in their golden years.

Experts say lifestyle planning is every bit as important as financial planning in the pursuit of retirement happiness. There are the lost connections to longtime colleagues we shared valuable experiences with over our career. There are big questions about how to fill the weekdays that used to be spent at the office. There is the need to confront one's own mortality and the physical and mental challenges of aging.

People tend to significantly overestimate their ability to transition smoothly and happily into retirement, but at the same time, many who engage in the proper planning activities pre-retirement are able to find enjoyment and meaning in their golden years. Three of these retirement blind spots are lost connections, health, and purpose.

Lost connections are something that is often overlooked. When clients leave the workforce, they prepare for losing that paycheck. However, they don't often think about the social aspect of their careers. Losing these connections is something to consider. It's important to make plans to replace those lost relationships when retiring. Socializing helps to improve quality of life in old age. Studies have also shown that regular social activities may decrease the risk of Alzheimer's disease and other forms of dementia.

Thinking about ways to stay active in retirement is also important. Even the healthiest person can expect some litany of ailments in retirement. Actively planning and thinking about ways to stay fit and active as an aging adult are deeply important to retirement happiness. The Center for Disease Control (CDC) has reported that most people do not engage in enough physical activity once they retire. According to the CDC, 50 percent of women and approximately 33 percent of men get no exercise at all after retirement. As the body changes and ages, it's important to adapt exercise routines also. Thinking about how you will exercise and stay fit are deeply important to retirement happiness, whether it's going for long walks or staying active with sports like tennis or pickle ball.

Establishing a sense of purpose later in life is also a key part of maintaining a healthy lifestyle. It is important to be more intentional about building relationships with people who will still be there after leaving the workplace. Get involved in social organizations or charities. Maybe call somebody you haven't talked to in a while. Pick up the phone and see if they want to go play a round of golf or have a lunch together. Before people retire, work and family are what a lot of people associate their purpose with. So, when you retire, it's important to find an outlet to devote yourself to.

When you have a financial plan in place, most of the work is already complete to answer those two key questions we mentioned earlier. However, thinking about health, replacing or reconnecting with lost connections, and establishing a sense of purpose in retirement will help provide a sense of fulfillment and happiness. As always, please don't hesitate to reach out to your Sentinel financial planner.

Our Portfolio Strategy & Allocation Outlook

We made one change to our managed private client accounts in Q3. Within or foreign equity segment, we moved out of manager that focused on small and micro-cap stocks in favor of another manager that operates in large-cap developed regions. One dynamic in recent years that applies globally is the current superior performance of lager-cap over small cap equities. Generally speaking, large-caps exhibit stronger balance sheets, superior credit ratings and many pay higher dividends. It's not surprising that relative performance of the major indices has tended to favor larger firms in the face of ongoing global economic headwinds.

In our discussions with various firms and portfolio managers this year, one theme continues to come up. That being the opportunities present today in the fixed-income markets. This might sound surprising in the current environment of interest rate volatility, continued concerns over Fed rate hikes and geopolitical tensions rising. In fact, judging by the drawdown in the Bloomberg U.S. Aggregate Bond Index, the recent period represents the worst bear market since the '79-80 period. Why the optimism from the portfolio managers? Simply put, the bear market has pushed prices down and pushed rates up to levels not seen since 2007. Today, an investor doesn't have to reach for yield by venturing into the most volatile sectors of the fixed-income market. Investments made today within the highest quality sectors of the market can generate income ranging from 5% (T-Bills) to 7% (Investment Grade Corporates). In addition, if the Fed is done (or nearly done) with rate increases, bonds of intermediate to long duration have the potential for price appreciation if yields start to head lower.

Bloomberg US Aggregate Bond Index: Longest Drawdowns (Monthly Data, 1976 - 2023)

Start of Drawdown	End of Drawdown	# Months	Max Drawdown During Period (Monthly)
Aug-20	?	38	-17.2%
Jul-80	Oct-81	16	-9.0%
May-13	Apr-14	12	-3.7%
Aug-16	Jul-17	12	-3.3%
Feb-94	Jan-95	12	-5.1%
Mar-87	Nov-87	9	-4.9%
Aug-79	Apr-80	9	-12.7%
Apr-08	Nov-08	8	-3.8%
Feb-96	Sep-96	8	-3.2%
Jun-03	Nov-03	6	-3.6%
Feb-84	Jun-84	5	-4.9%
May-83	Aug-83	4	-3.5%

CREATIVE PLANNING @CharlieBilello (As of 9/30/23)

Please let us know if you'd like to discuss your personal investing and financial planning needs.

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Market Scoreboard

Index Returns (%)	Q3 2023	YTD	1 Year	3 Year	5 Year	10 Year
S&P 500	-3.27	13.07	21.62	10.16	9.92	11.92
DJIA	-2.10	2.73	19.18	8.62	7.14	10.79
NASDAQ	-4.12	26.30	25.00	5.79	10.44	13.36
Russell 2000	-5.13	2.54	8.93	7.17	2.40	6.65
MSCI ACWI Ex USA	-3.77	5.34	20.39	3.74	2.58	3.35
Barclays Aggregate Bond	-3.23	-1.21	0.64	-5.21	0.10	1.13

Source: Morningstar
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Diversification and asset allocation do not ensure a profit or protect against loss.

S&P 500 TR: A market capitalization-weighted index of 500 widely held stocks often used as a proxy for the large-cap segment of stock market.

Russell 2000 TR: Consists of the smallest 2000 companies in the Russell 3000 Index, representing approximately 7% of the Russell 3000 total market capitalization often used as a proxy for the small-cap segment of the stock market.

Barcap Aggregate Bond TR: The Barclays Capital Aggregate Bond Index is a market capitalization-weighted index, meaning the securities in the index are weighted according to the market size of each bond type. Most U.S. traded investment grade bonds are represented. The index includes Treasury securities, Government agency bonds, Mortgage-backed bonds, Corporate bonds, and a small amount of foreign bonds traded in U.S.

MSCI EAFE NR USD: Widely accepted as a benchmark for international stock performance, the EAFE Index is an aggregate of 21 individual country indexes that collectively represent many of the major markets of the world.

DJ US Industrials TR USD: Computed by summing the prices of the stocks of 30 U.S. companies and then dividing that total by an adjusted value--one which has been adjusted over the years to account for the effects of stock splits on the prices of the 30 companies.

NASDAQ: Measures the performance of all issues listed in the Nasdaq Stock Market and is often used as a proxy for the large-cap technology segment of the U.S. stock market.

DJ/UBS Commodity: The DJ-UBSCI is composed of futures contracts on physical commodities and is often used as a proxy for broad-based exposure to the commodity markets.

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