WestStar Wealth Management

Wealth Watch

As we look out at the economic landscape we find both strengths and weaknesses, positives and negatives, risks and opportunities. What factors are currently affecting markets and what might be in store as we close out 2023 within this bifurcated environment?

2023 Q3 Review & Q4 Outlook

The third quarter was markedly different than the first half of the year. Both stocks and bonds actually declined in the July through September period, with stocks experiencing the first negative quarter since Q3 2022 and bonds posting their worst return of the year.

Indeed, any semblance of stock market sanctuary was lacking in the third quarter. All market capitalization and styles were negative as were nine of eleven S&P sectors and five of seven MSCI major country/region indices. Bonds were no safe haven either amid a continued rise in interest rates, with longer-dated maturities most adversely impacted. In fact, long-term US Treasurys posted the fourth-worst quarter since 1926.

The third quarter market reversal was further evidenced by the outperformance of Commodities, the sole winner over the period after having previously been at the bottom of the pack.

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What You Need To Know:

- The stock market has rebounded in 2023 due primarily to a handful of companies
- Bond yields have risen to levels not seen in nearly two decades, benefitting income seekers
- War events do not necessarily portend a market downturn and, in fact, positive performance typically ensues
- Recession remains unlikely at this time
- The Fed may hike once more in late 2023 but we may see cuts in 2024 and beyond
- Maintain your long-term investment strategy for best chance of meeting goals and objectives

Asset Class Index Performance* Year to Date As of 09/30/2023

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US Large Cap Stocks
13.07%

International Developed Market Stocks
7.08%

High Yield Bonds
5.86%

Money Market (Cash)
3.62%

US Small Cap Stocks
2.54%

Alternative Investments
2.39%

International Emerging Market Stocks
1.82%

US Investment-Grade Bonds
-1.21%

International Bonds
-3.20%

Commodities
-3.44%

Real Estate
-4.10%

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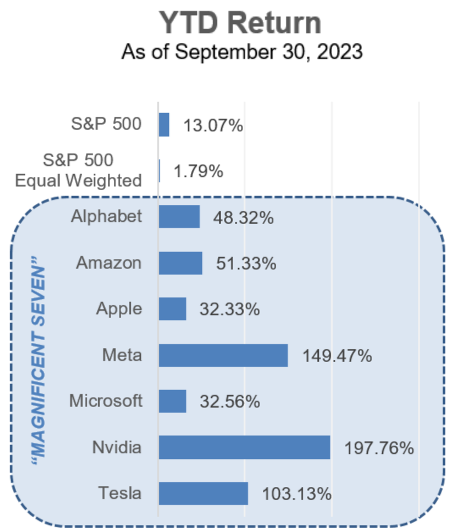
As bad as the third quarter was overall it did little to change the year-to-date performance figures, wherein Large Cap stocks continue to lead the way while Commodities remain near the bottom. Perhaps more worthy of note is the concentration of performance among a handful of stocks within the S&P 500 index. As shown on the chart at right, year-to-date stock market performance has been driven almost solely by a mere seven stocks. Were one to adjust for this concentration by equal-weighting the 500 companies in the index, the stock market would only be up +1.79% through September rather than +13.07%! This lack of breadth is a factor we are closely monitoring, as broad based strength would most certainly be preferable. For the time being, however, we remain cautiously optimistic as it relates to the fourth quarter.



Tactical Strategy for Actively-Managed Portfolios

In January of this year our research led to an anticipation of a stock market rebound and a continued downward trajectory of inflation in 2023. Accordingly, we increased our exposure to equities and reduced exposure to commodities and real estate in actively-managed client accounts. Despite the previously-discussed difficulties experienced by the stock market and the rebound of commodities in the third quarter, our tactical positioning has remained accurate and beneficial year-to-date through September as reflected in the column at left.

Our research has included a study of historical stock market performance amid market and economic environments similar to those presently in play. Interestingly, when we go all the way back to 1926 and examine past instances of the market being up 10%+ in the first half of the year followed by a negative third quarter, we find that 80% of the time the market rallies in the fourth quarter, averaging +6.8%. For this and other reasons we will discuss in the remainder of this edition of the Wealth Watch, we are making no tactical changes at this time.

War & the Stock Market

An additional element of concern was introduced to the global economic equation in the third quarter—the horrific attack on Israel by Hamas. For stock market perspective we again review historical market reactions around war events since 1907 in the table at right. We find that though the market initially declines, it rebounds within a month and is up by 7% within six months on average. Examining economic patterns we find that growth following all crisis events was below-average up to a year hence, though the negative impact was much smaller in non-recessionary instances.

In summary, markets tend to be resilient following war events, though the economy may slow. How likely, then, might recession be in the near future?

Dow Jones Industrial Avg %Change: Months After War

EVENT	EVENT DATE	1	3	6
WWI - Assassination in Sarajevo	6/28/1914	-0.5	-1.1	10.2
WWI - Austria declares war on Serbia	7/28/1914	-4.2	-6.4	7.1
WWI - Exchange closed	12/12/1914	8.1	5.5	20.4
WWI - U.S. declares war on Germany	4/6/1917	-2.3	1.2	-11.8
WWI - U.S. troops arrive in France	6/26/1917	-5.1	-14.4	-24.4
WWI - Austria Hungary Surrender	11/4/1918	-3.3	-6.1	6.8
WWI - Germany Surrenders	11/11/1918	-5.3	-7.3	3.9
WWII - Germany invades Poland	9/1/1939	13.9	12.3	8.1
WWII - Germany invades France	5/10/1940	-23.6	-17.9	-9.9
WWII - France Surrenders	6/22/1940	0.3	9.4	7.4
WWII - Pearl Harbor	12/7/1941	-2.4	-9.6	-16
WWII - D Day	6/6/1944	4.8	5.2	4.4
WWII - Germany Surrenders	5/7/1945	0.8	-3	12
WWII - Hiroshima	8/6/1945	8.3	13	24.8
WWII - Nagasaki	8/9/1945	9.8	16.7	21.5
WWII - Japan Surrenders	8/14/1945	8.3	15.5	21.9
Korea - North Korea invades South	6/25/1950	-8.9	1	2.2
Korea - U.S. troops arrive in Korea	6/30/1950	2.5	9.3	10.5
Korea - Cease Fire Signed	7/27/1953	-0.9	2.1	8.3
Vietnam - Gulf of Tonkin	8/2/1964	0.3	3.7	7.4
Vietnam - U.S. Marines sent	3/8/1965	-0.4	0.6	0.5
Vietnam - North Vietnam takes Saigon	4/30/1975	3.6	2.7	4.4
Gulf - Iraq invades Kuwait	8/2/1990	-9.8	-15.6	-6.4
Gulf - U.S. troops in Saudi Arabia	8/9/1990	-4.4	-9.1	3.5
Gulf - U.N. authorizes force	11/29/1990	3.9	13.7	18.4
Gulf - Desert Storm begins	1/17/1991	17	19.8	18.7
Gulf - Ground assault begins	2/24/1991	0.9	0.4	4.1
Gulf - Kuwait Liberated	2/27/1991	1.7	3.3	6.1
Afghanistan - Initial Bombing	10/7/2001	5.2	11.8	11.9
Afghanistan - Fall of Kabul	11/12/2001	3	2.7	7.2
Iraq - Use of Force Authorized	10/10/2002	17.2	20.4	12.8
Iraq - US Invasion	3/20/2003	0.8	12.4	15.5
Iraq - Fall of Baghdad	4/12/2003	5.4	11.9	17.9
	MEAN	**1.4**	**3.1**	**7.0**
	MEDIAN	**0.8**	**2.7**	**7.4**

Source: Ned Davis Research

*Large Cap: S&P 500 Index; Small Cap: Russell 2000 Index; Int'l Developed: MSCI EAFE Index; Int'l Emerging: MSCI Emerging Markets Index; US Inv-Grade Bonds: Bloomberg Aggregate Index; Int'l Bonds: Bloomberg Global Aggregate ex-USD Index; High Yield: Bloomberg US Corporate High Yield Index; Cash: BofA Merrill Lynch 3-Month US Treasury Index; Real Estate: FTSE EPRA/NAREIT Developed Index; Commodities: Bloomberg Commodity Index; Alternatives: Wilshire Liquid Alternatives Index

Recession Potential

In early 2023 it was widely thought that a recession was likely in the near term, with the only question being how severe it might be. The economy has proven much more resilient than any observer expected, however. The table to the right is a "Recession Watch Report." When a key level is reached on six of these ten measures (i.e. the current level falls within the "red zone"), it would indicate a recession is imminent. Earlier this year, five of the ten measures had reach key recession levels; as of this writing only one remains (dashed red circle). In other words, the prospects of potential recession have improved markedly. The weight of the evidence continues to point to a soft landing scenario and recession remains unlikely at this time.

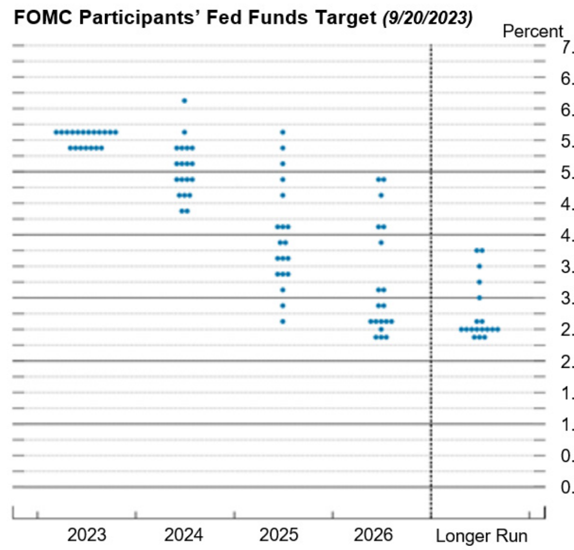
US Recession Watch Report

Indicator	Reading			
NDR Recession Probability Model	0.0	*5.3*	50.0	99.9
Housing Starts (Smoothed 3-Month)	-23.7	-7.9	*-0.5*	23.0
NDR Economic Timing Model	-24.0	0.0	*1.0*	27.0
NDR Composite Leading Index	-14.4	-3.8	-2.6	17.3
National Financial Conditions Index	-1.1	*-0.3*	0.9	5.0
Initial Unemployment Claims (4-wk avg)	179.0	*253.5*	500.0	5288.3
Consumer Confidence Index	25.3	63.2	*103.0*	144.7
CEO Confidence Index	24.0	43.0	*46.0*	82.0
ISM Manufacturing PMI	29.4	48.0	*49.0*	77.5
ISM Services PMI	37.8	51.4	*53.6*	67.6

Source: Ned Davis Research — Key Level — *Current Level*

Interest Rate Outlook

Recession discussions have in large part been related to the Fed's aggressive rate hikes over the past year. The Fed's efforts have been rather successful in bringing down inflation from a CPI reading of over 9% last summer to 3.7% in September 2023. The downward trajectory of inflation is also evident in so-called "Core Inflation" which excludes the volatile food and energy segments and was down to 4.1% in September. That said, inflation remains higher than Fed's long-term 2% target. To get a sense of what the Fed may do in the future we can refer to their "dot plot" as shown on the chart to the right. The blue dots on the chart reflect the level each Fed participant believes their key interest rate will be by the end of the next few years. We can see by the tight cluster in the 2023 column that there is general consensus of opinion at a level which might suggest another 0.25% hike by year-end. Beginning next year, however, we see an increase in dispersion and clustering forming at rates below current levels, indicating rate cuts may be in store in 2024 and beyond. Ultimately, 70% of Fed participants see rates settling at the 2.25% - 2.75% range after 2026. Between now and then there are a number of factors that will play a role in the Fed's rate path decisions including the wars in Ukraine and Israel, higher oil prices, labor strikes, resuming student loan payments, etc. While rates may remain higher for longer, it is less likely they will be at levels much higher than at present.



WestStar's Strategy

In reviewing the current state of markets and the economy we see a dichotomous environment exhibiting both strengths and weaknesses, both opportunities and risks. The US stock market has rebounded in 2023, though it was due almost solely to a mere handful of companies. Bond investors are enjoying income yields not seen in nearly two decades, yet they have seen the market value of their holdings decline amid climbing interest rates. The Fed's aggressive actions have helped to curtail inflation while avoiding recession to date, however both the geopolitical and domestic landscape may challenge continued economic resiliency. Add to these issues the fact that 2024 is a presidential election year and we understand the coming months may be arduous. WestStar Wealth Management remains committed to monitoring developments as they arise and striving to fulfil the long-term investment strategies of each of our clients.

WestStar
Wealth Management

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As true fiduciaries, our focus isn't on selling products to our clients. Instead, we focus on providing personalized service and real financial solutions.

Our team of wealth management professionals has the valuable depth of expertise you need to navigate life's events.

From retirement planning and investment management to trust services and estate settlement, we can help you devise the most effective plan to meet your financial goals.

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