BRIAN D. LOWDER, INC.

QUARTERLY NEWSLETTER

Volume 26, Issue 3 October 2023

INSIDE THIS ISSUE

- **Financial Market Overview**
- **Financial Market Outlook**
- **Investment Outlook and Recommendations**

FINANCIAL MARKET OVERVIEW

The third quarter performance for stocks was negative in all stock index categories ranging from negative 2.6% to negative 7.4%. The only positive performance came from safe money market funds, short-term U.S. Treasuries and energy stocks.

The overall broad stock market index and the S&P 500 Index were both down about 3% during the third quarter, but still up 12-13% year-to-date. The NASDAQ stock index, which is dominated by technology stocks, was down just over 2% during the third quarter, but still up about 26% year-to-date.

The Dow Jones Industrial Average fell about 2.6% during the third quarter and was up only 1% year-to-date. The small-company stock index, the Russell 2000, was down less than 1% year-to-date through September 30, 2023.

Large-company ***growth*** stocks (dominated by tech stocks) were down over 3% during the third quarter, but up nearly 25% since January 1st. Similarly, large-company ***value*** stocks (older and established companies) also fell about 3% during the third quarter and but only advanced 1.7% since January 1st. Mid-size ***growth*** stocks were down over 5% during the third quarter, but up just under 10% year-to-date. Mid-size ***value*** stocks were also down nearly 5% during the third quarter and up less than 1% year-to-date for 2023.

International stocks fell nearly 5% during the third quarter and emerging markets (smaller-country international stock indexes) declined about 4% during the third quarter.

Investment real estate prices (real estate investment trusts) had the largest decline during the third quarter – down over 8.5%. Rising mortgage rates are clearly beginning to impact real estate values. Water utility stocks were down about 10% during the third quarter, however, energy stocks were up 11% as gas prices are once again on the rise. Gold prices were down nearly 4% during the third quarter and up only 1% year-to-date.

Fixed income or bond prices for intermediate and long-term bonds were down nearly 5% during the third quarter – again, rising interest rates translates into declining bond prices that exceed the interest income. Only short-term bonds (one year or less) were up during the third quarter and year-to-date. While investors still receive the interest income, the loss in value exceeds the interest income.

The following chart displays sample returns of various asset categories year-to-date and during the third quarter of 2023:

Year-To-Date 2023	3rd Qtr. 2023	Index Return (*includes dividends reinvested*)
+ 1.09%	- 2.62%	**Dow Jones Industrial Average (^DJI)**
+ 13.02%	- 3.22%	**S&P's 500 Index (^GSPC)**
+ 12.38%	- 3.22%	**DJ U.S. Total Stock Market (VTI)**
+ 24.85%	- 3.15%	**Large-company Stock Growth (IWF)**
+ 1.70%	- 3.19%	**Large-company Stock Value (IWD)**
+ 9.77%	- 5.28%	**Mid-Size Stock Growth (IWP)**
+ 0.45%	- 4.48%	**Mid-Size Stock Value (IWS)**
+ 5.08%	- 7.44%	**Small-company Stock Growth (IWO)**
- 0.61%	- 3.06%	**Small-company Stock Value (IWN)**
+ 6.92%	- 4.94%	**International (EFA)**
+ 0.90%	- 4.07%	**Emerging Markets (EEM)**
- 5.39%	- 8.57%	**Real Estate Investment Trusts (VNQ)**
		Fixed Income (includes appreciation)
+ 1.62%	+ 0.63%	**Short-term U.S. Treasury (SHY)**
- 2.59%	- 4.47%	**Intermediate U.S. Treasury (IEF)**
		Alternative Investment Category
+ 1.07%	- 3.83%	**Gold (GLD)**

**All returns calculated using adjusted historical quotes from finance.yahoo.com*

Continued on page 2

Continued from page 1

Financial Market Outlook

Brief update: We discussed in our previous newsletter that the new "rage" on Wall Street moved away from bitcoin prior to 2023 and into AI or Artificial Intelligence technology stocks in 2023. The rush to invest in AI stocks was the new rage during the first 6 months of 2023 with the NASDAQ Index (loaded with tech stocks) up a **whopping 32%.** The Nasdaq Index is down 8% since August 1st. Just in the month of September alone, Nvidia is down 12%, Apple is down 9% and Microsoft is down 8%.

It's true that these stocks have advanced tremendously over the first half of 2023. The past 30- day downward movement in price is still tiny compared to the first 8-month advance in 2023 – I am just reminding investors that abnormally excessive stock price movements can (more often than not) easily move significantly in both directions.

One of the best measures or indicators of the **strength of a stock market rally** and whether or not the **advance is sustainable** is the breadth or how broad-based the rally is. Are most stocks participating in the advance or are just a few stocks in a particular sector leading the way?

The Dow Jones Industrial Average (30 of the biggest stocks) is up 1% during the first nine months of 2023, and the total stock market index (over 5,500 stocks) is up 13%. Not bad. However, the largest companies have more weight and the smaller companies have lesser weight in the index. If we were to include all 500 companies in the S&P 500 and give them **equal weighting**, stocks are up 0.3% year-to-date – essentially flat performance. The overall breadth or participation in the year-to-date stock market advance is very thin – mostly 25 tech stocks and a half dozen home builder stocks.

The best approach in trying to determine whether the stock market is fairly valued is to start with a **macro perspective – meaning let's look at all the variables together** and not just one or two indicators that most authors of news articles focus on in an effort to support a particular forecast.

First, the stock market advance thus far in 2023 is primarily limited to about 25 to 30 (mostly tech) large companies and homebuilders (homebuilder stocks are down significantly since Sept 1st) – *the 2023 stock market advance has not been broad-based* and therefore is not a positive indicator.

The employment or labor market has been a positive indicator since the economic recovery began after dealing with supply chain problems and job losses due to COVID.

The *U.S. unemployment rate* is currently about 3.8% - a historically low level (people are working). Even when workers have begun to strike and demand more pay (higher pay to cover higher inflation costs), many jobs remain intact. The labor market's persistent strength has surprised many economists. "Normally" fighting inflation by cooling the economy (raising interest rates) translates into rising job losses. Why job losses haven't materialized seems to be an unusual blessing and some are hopeful this may mean that a recession can be avoided and the stock market may continue to advance.

Interest rates continue to rise and any further increases that may occur in the future will have negative consequences. Since January 1st 2023, the big theme shouted by Wall Street was interest rates will stop rising and the Fed will start reducing rates. This hopeful theme (no more interest rate increases and eventually decreases are imminent) pushed stock prices up in early 2023 and now reality is pushing stock prices down.

The Federal Reserve does not raise interest rates 10 times and then suddenly start reducing the rate – rather the Fed takes a wait-and-see approach (waiting 1-2 years) after raising interest rates to see if the rate increases have the intended effect before lowering interest again. Expect borrowing rates to stay at current levels for a while.

Home mortgage rates have climbed quickly over the past 2 years from less than 3% to the current 7.5% home mortgage rate. Home mortgage rates are now at a 23-year high. Will 7.5% mortgage rates "kill" the real estate market? Not likely because a 7%-8% mortgage rate is the mid-range over the past 40 years BUT, there will be fewer and fewer buyers in the months ahead. Two years ago, a Buyer would pay $3,300 per month for an $800,000 mortgage at 3%. Today, an $800,000 mortgage would cost $5,600 per month at 7.5% mortgage rate. First-time buyers will still be out there, but they will be looking at the lower end of the price range.

In addition, 80% of all homeowners with mortgages have an average mortgage rate below 5%. These homeowners have little incentive to sell. Why would a homeowner sell their home now and trade in their lower monthly housing costs for the much higher housing costs they would face as a buyer in today's 7.5% mortgage rate environment? When the number of home sales decline and the number of potential buyers decline, prices will adjust downward. The bottom line is when interest rates rise, consumers and businesses will borrow less than before. How much longer will the economy keep expanding as borrowing costs increase?

Continued on page 3

Continued from page 2

The U.S Dollar is surging (up) in value. The US dollar index rallied to the highest level since November 2022 and the interest paid on a 10-year U.S. Treasury hit its highest level since 2007. When interest rates rise, the interest paid on U.S Treasury bonds rise as well. In summer 2020 during COVID, the interest paid on a 10-year U.S. Treasury was about 0.75%. Today, the 10-year Treasury rate is 4.55%.

Higher interest rates paid on U.S. Treasuries strengthens the U.S. Dollar and this higher and safer interest rate along with a strong U.S. Dollar attracts money from abroad (foreign accounts). Just two years ago, the safe interest rate paid on Treasuries was so small (less than 1%) that money flowed away from Treasuries and bank savings accounts into stocks in search of a decent investment return. The stock market rallied significantly. Now, with a strong and safe U.S. Dollar, plus Treasuries paying 4-5% to investors, money has and may continue flowing away from and out of the stock market and into the Treasury bond market – not a favorable indicator for stocks.

The U.S. National Debt and repetitive annual Deficit Spending is truly the big elephant in the room. Our National Debt is over 33 TRILLION dollars – up from 10 trillion in 2009. This means our government has spent 33 trillion dollars **more** than (over and above) the taxes collected from its citizens. Most Americans simply do not have an understanding or perspective as to why this new record 33 trillion figure is so problematic for the future of our children/grandchildren and for the U.S. stock market.

For perspective, American taxpayers are paying $**707 billion dollars** per year **just in interest costs on our national debt and this cost does not reduce** this debt at all. And, as interest rates rise, the dollar cost of interest payments will also rise. Our entire Military Defense Budget is $850 billion. Our politicians and Government are overspending and increasing our debt burden. The annual *interest costs* on this debt almost equals the entire amount we spend to protect our country through our entire Defense Budget. On the other side of the ledger, federal revenue (tax collection) dropped by 8% or 409 billion and this occurred during an economy with near full employment.

The inflation rate is still elevated and starting to rise again. The inflation rate peaked at 9% in June 2022 due to supply chain problems, both product and worker shortages following COVID shutdown, spiking oil prices and oil production cuts by OPEC. Recently, the inflation rate has dropped to 3.7% in August 2023 but that is clearly looking in the rearview mirror. Grocery prices are on the rise again and gas prices have recently spiked - $6.50 to $7 per gallon in San Diego and the price per barrel for oil is above $90 and getting closer to the $100 per barrel which is the same cost we experienced in the summer of 2022.

Healthcare costs are projected to rise 6.5% in 2024, the labor market is tight with workers joining picket lines and wages are on the rise again. Governor Newsom just raised the minimum wages for fast-food workers from about $16 per hour to $20 per hour (with 3.5% annual increases possible). All of these increased costs will put upward pressure on the inflation rate.

This upward pressure on prices will definitely be reflected in the inflation rate figures in the very near future and therefore the inflation rate is likely to rise modestly again – certainly much higher than the Federal Reserve's 2% long-term average target rate.

Corporate Earnings are expected (according to a majority of forecasters) to rise noticeably beginning in the 4th quarter. We are not exactly sure why the 4th quarter of this year is supposed to be significantly better. If true, this would be very positive for stocks. However, stocks are already 20% overpriced based on the historical average of the Price-to-Earnings Ratio and the immediate outlook doesn't seem to justify an optimistic P/E ratio environment that would be sustainable. The P/E ratio today is 19.7 compared to a historical average of 15-16, and tech stocks are already sporting a 37 average P/E ratio with some companies (Nvidia) 100+.

INVESTMENT OUTLOOK AND RECOMMENDATIONS

The expected growth in corporate earnings later this year and the current low unemployment rate are positive signals for continued stock market growth. But collectively, all of the other indicators discussed above clearly outweigh the odds of experiencing a sustainable near-term stock market rally. In addition, the current 3.75% inflation rate measured from August 2022 to August 2023 is unlikely to repeat and a potential interest rate decrease - often written about in the press is still further away. Taking a backseat over the near-term is attractive – especially when investors can earn a safe and guaranteed 5% on U.S. Treasuries with maturities of one year or less.

We are still taking a middle-of-the-road stance and are cautious over the short-term. A broad-based stock market rally is still elusive and is necessary before we can experience a *sustainable* rally. Lastly, we have purposely ignored discussing the fact that the Presidential election kicks off in the fall of 2023 - adding another smothering layer of uncertainty. Even if either party came up with a roadmap to move toward a more responsible spending

Continued on Page 4

Continued from page 3

budget, the other side (party) would instinctively fight it. That's the reality of politics today. The longer this scenario continues, the more likely that hardship will rear its ugly head.

Early in 2022, we began reducing stocks in our managed accounts and reinvested those funds into short-term (1-year or less maturities) Treasuries and CDs. We are continuing with the same strategy. About one year ago, the yield or interest was approximately 4%. Today, the yield or interest on new one-year Treasuries or CDs is over 5%. Most of the Treasuries purchased in early 2022 have recently matured in May through September of 2023 and have been reinvested in 5% or higher treasuries or CDs with one year or less maturities. Most client portfolios now have several short-term Treasuries and CDs maturing continuously every 60-90 days. These funds will eventually be re-allocated back into stocks in the future.

If and when a sustainable stock market arrives, the easiest way to participate is to re-allocate funds back into the broad market stock indexes. Small-company U.S. stocks are even more attractive. This category has lagged in performance due to last year's stock market decline, but this category excels above the market averages when sustainable stock market advances are underway. Emerging markets (small-company stocks of smaller international companies) will also be on the list for new purchases as well as mid-cap stocks.

We have identified several stock investments that we intend to add to client portfolios but the timing is clearly uncertain. Ideally, we will begin adding additional stocks to client portfolios carefully and slowly within the next 12 months.

In the meantime, caution is your best friend.

Contact Us

Brian D. Lowder, Inc.

Brian D. Lowder, CFP®, CFA
Michael Kinnear, CFP®, CFA
Rebecca Dodge, CFP®, CFA
Jennifer Finley
Pamela Priest

Address
12780 High Bluff Drive Suite 100
San Diego, CA 92130

Telephone
(858) 794-6800

Fax
(858) 794-6906

Website
www.bdlowder.com

Email
brian@bdlowder.com
mike@bdlowder.com
rebecca@bdlowder.com
jenn@bdlowder.com
pam@bdlowder.com

Brian D. Lowder, Inc., a California Corporation, is a fee-only wealth advisory firm specializing in comprehensive financial planning and investment management. Brian D. Lowder, Inc. is registered with the Securities and Exchange Commission and licensed by the State of California Department of Corporations as an Investment Advisor.

Best Regards,

Brian Lowder | Michael Kinnear | Rebecca Dodge | Jennifer Finley | Pam Priest