SHAW Investment Management of RAYMOND JAMES®

Quarterly Update – September 30, 2023

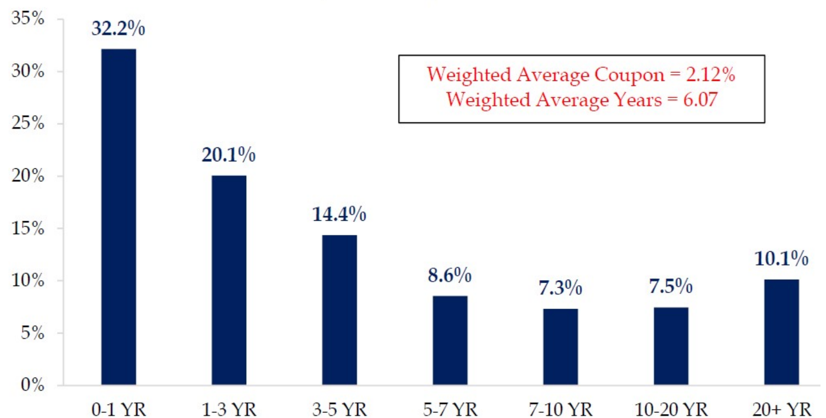
The first half of 2023 was a solid start to the year, however the good times took a bit of a break in the 3rd quarter. We saw a pullback in both the stock and the bond markets in the 3rd quarter as global growth slowed and long term interest rates continue to creep higher. Large cap US stocks outperformed small and midcap stocks as the S&P500 fell -3.27% vs. a drop of -4.68% and -5.13% respectively for midcaps and small caps. Growth stocks and international stocks both slipped about –4%. Bonds (the Barclay's Aggregate Bond Index) also fell over –3% as interest rates continue to rise. Despite the pullback, most stock indices remain positive for the year.

Here are the returns of the major asset classes at the end of the 3rd quarter 2023:

Asset Class	Index	3rd Q	YTD	1yr	3yr*	5yr*
US Large Cap Stocks	S&P500	-3.27%	13.07%	21.62%	10.15%	9.91%
US Mid Cap Stocks	Russell Midcap	-4.68%	3.91%	13.45%	8.09%	6.38%
US Small Cap Stocks	Russell 2000	-5.13%	2.54%	8.93%	7.16%	2.39%
Dow Jones Industrial Avg	DJIA	-2.10%	2.73%	19.18%	8.62%	7.13%
US Dividend Paying Stocks	DJ Select Dividend	-3.69%	-7.84%	4.84%	14.08%	5.76%
NASDAQ	NASDAQ	-4.12%	26.30%	25.00%	5.78%	10.43%
Int'l Developed Mkt Stocks	MSCI EAFE	-4.11%	7.08%	25.65%	5.75%	3.24%
Int'l Emerging Mkt Stocks	MSCI EM	-2.93%	1.82%	11.70%	-1.73%	0.55%
US Bonds	Bar Aggregate Bond	-3.23%	-1.21%	0.64%	-5.21%	0.10%

YTD = Year to Date *return is annualized [1]

The new buzzword on Wall Street is "higher for longer," referring to the growing expectation for interest rates to persist at the current high level and stay higher for longer than many believed just a few months ago. As investors adjust to the expectations for higher rates, the required return for US Treasuries continues to push higher as well. For example, the US 10year treasury rate has moved from 3.3% in April to 4.6% at the end of September. While the higher rates are positive for savers and investors, the US taxpayer is likely to pay the price over the next decade. In fact, 50% of America's debt matures in the next three years. Most of that debt was added while rates were extremely low so the US government will have to quickly reduce outstanding debt or refinance it at rates significantly higher.

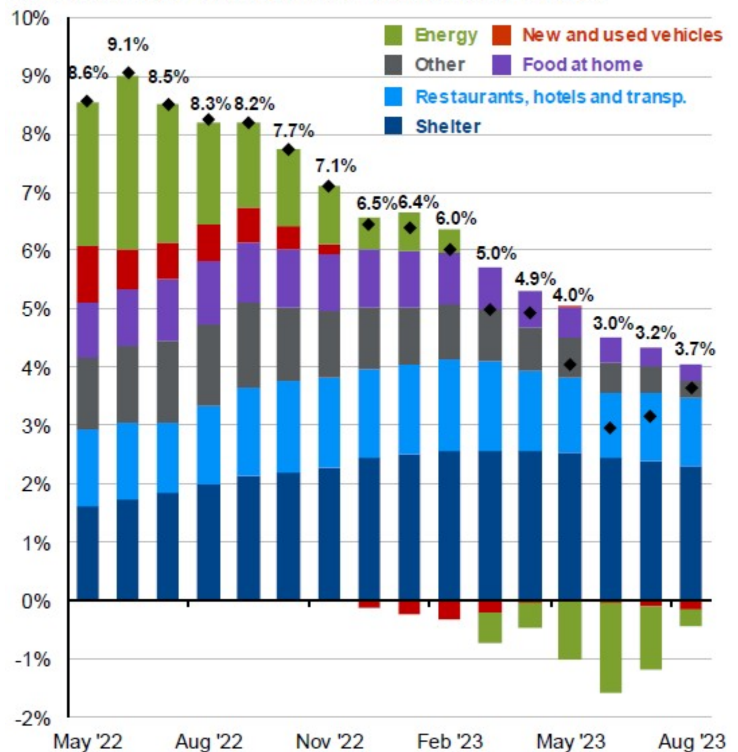


[2]

[1] Source: Raymond James Client Center Reporting
[2] Source: Strategas, "Quarter End In Charts—3q 2023" p.7

Many expect the FED is near the end of the rate hiking cycle. We think that if the FED raises rates again in November (which is not a guarantee) they will then pause for several months to determine how the economy/inflation reacts. They are trying to thread the needle so to speak. They are attempting to get economic activity slow enough to get inflation under control while simultaneously trying not to cause a severe recession.

Generally speaking, rate increases have worked as inflation has been falling since July of 2022. However, it remains higher than we have all become accustomed to and many suggest we will not return to the days of 1-2% inflation. In the chart you can see the impact rate increases have had on the inflation constituents in the last 18 months. Costs for food, energy, and vehicles have fallen recently as shelter and other services have been stickier.



[3]

As we mentioned earlier, another element that impacts inflation is government spending. According to Brian Wesbury, Chief Economist at First Trust Advisors, "the rise in the deficit of almost four percentage points of GDP with the unemployment rate so low is unprecedented. Other prior leaps in the deficit of this magnitude have been during major wars or recessions, not when the US is at peace and the unemployment rate is unusually low." In order to get inflation fully under control we believe we must stop running annual federal deficits and slowly reduce the total debt as well. This seems to be a low probability considering the spending habits of elected officials from both sides of the aisle.

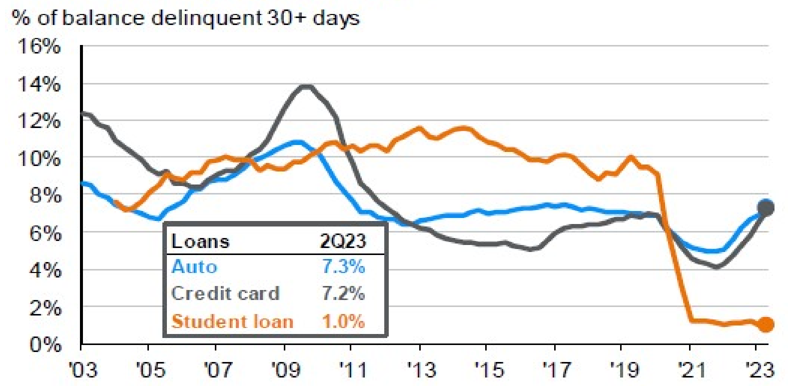
In the most recent JOLTS (Job Openings & Labor Turnover Survey) data we see that new job openings have come down significantly and are now the lowest since March 2021. Layoffs were relatively flat and the unemployment rate has settled just under 4%. This is generally a welcomed sign for the FED that excess demand in the labor market may finally be starting to cool. This also signals that wage growth concerns that put upward pressure on inflation may subside.

Keep in mind that the labor market still remains tight by historical measures and any new wage pressure could reappear quickly. So, while the recent softening jobs data supports the "soft landing" narrative, we still have a ways to go to ensure that wage pressure doesn't derail the FED's 2% inflation target.

[3] Source: JP Morgan, "Guide to the Markets-4thQ 2023" p.30

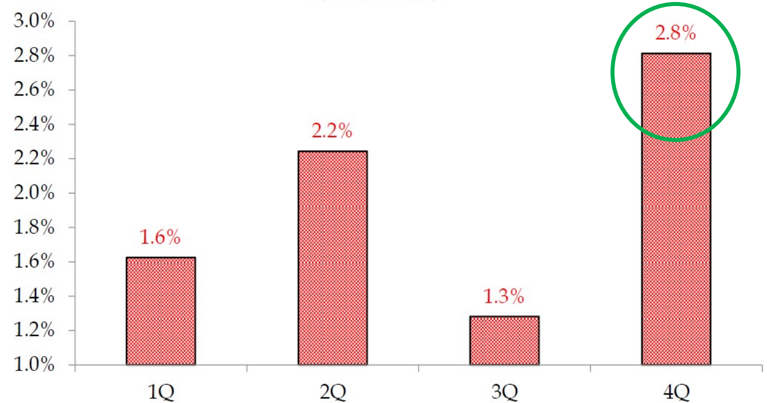
SHAW Investment Management of RAYMOND JAMES®

There are other issues we worry about as well. We notice a dislocation in earnings and net income growth in the S&P500 companies. Earnings are holding up quite well, but net income has declined over the last 2 quarters. We are also concerned that the average mortgage rate hit a 20 year high of 7.3%. This combined with student loan payments and increased credit card balances could negatively impact consumers going forward. Layer in new and increasing global geopolitical issues (Ukraine & Middle East) and there are plenty of issues to closely follow.



[4]

On the positive side, the market has been resilient this year driven by solid earnings and a strong labor market. Going forward, seasonality, healthy corporate balance sheets, and significant cash on the sidelines are additional reasons the market can continue to grind higher. Historically, the 4th quarter is seasonally the best quarter of the year for stock market returns. The chart to the right shows we are entering a period that is typically favorable for stock market investors.



[5]

The biggest growth catalyst in 2023 has been the commercialization of artificial intelligence (AI). These new opportunities created by AI have stoked the flames of growth for technology stocks globally. When we examine the number of Google searches for the term "AI" this year, we see that interest has exploded and the number of searches are exponentially higher than a year ago. AI is expected to impact many areas of the economy such as legal services, healthcare, banking, customer service, sales support, and even creative industries.

Moving to current portfolio positioning, we believe short term US corporate and treasury bonds are the best place to position in the fixed income market. We also like the security that money market funds offer while they yield over 5%. Most money market funds have a duration of less than 30 days, so we think investors should consider extending duration just slightly in order to lock in these rates for longer. The best way to do that is to buy short term corporate bonds (both investment grade and high yield).

---

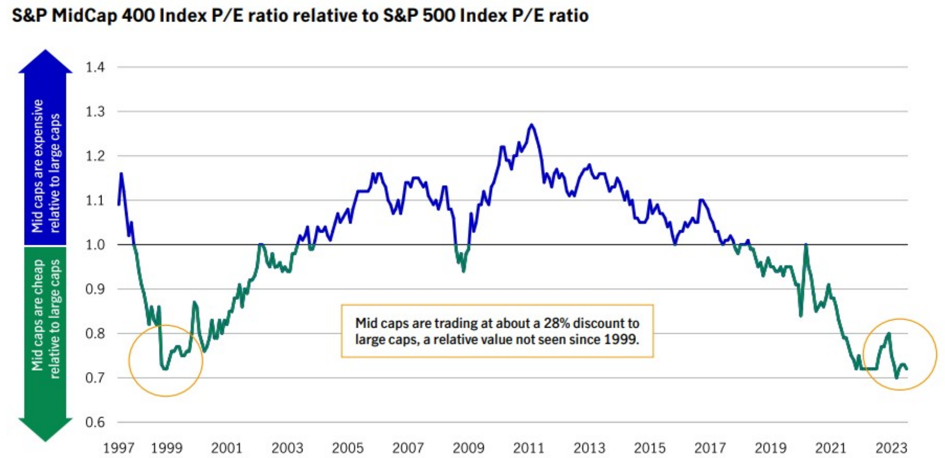
[4] Source: JP Morgan, "Guide to the Markets-4thQ 2023" p.21

[5] Source: Strategas, "Quarter End In Charts—3q 2023" p. 7

SHAW Investment Management of RAYMOND JAMES®

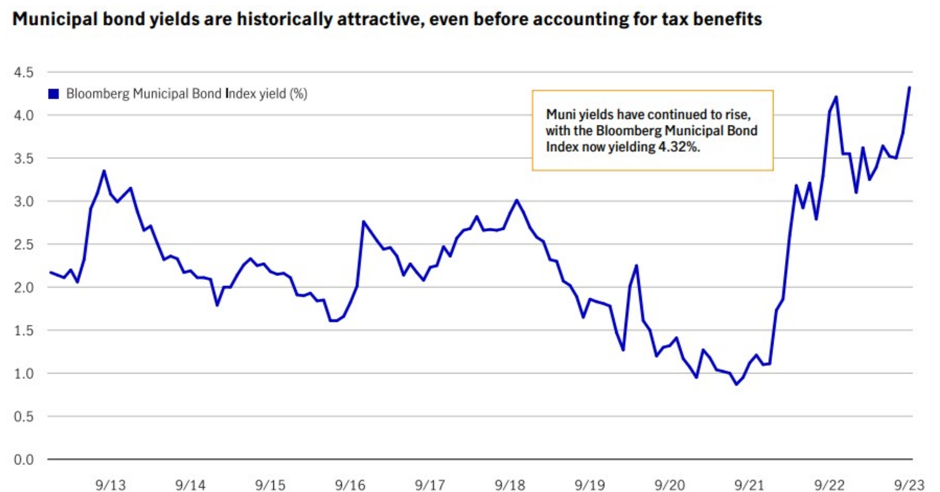
We think US large caps and midcaps are the best current opportunity in the stock market. Many large caps offer a favorable balance between growth and free cash flow strength. This may allow them to make it through the economic ups and downs over the next few years. Midcaps currently offer higher growth at a much better valuation.

The chart to the right shows the midcap valuation relative to large caps (S&P500) since the mid 90's. US midcap stocks are trading at valuations we have not seen since 1999. We think this is a preferred entry point for any new cash being added to the market.



[6]

On the other side of the risk spectrum, we think it is a great opportunity to start or add to a municipal bond ladder. Municipal yields are higher than they have been in years and record sales tax and property tax receipts have improved the credit quality of municipal bonds across the board.



[7]

We know the bond market has been disappointing over the last two years, but we expect the bond market to improve as we get to year end and head into 2024. We also think the stock market can grind along despite many of the difficulties we have outlined. The biggest driver of returns may come from investors deciding to get some of the historic level of cash back to work. Currently there is approximately $5 trillion in cash and short term investments. Timing this move is next to impossible, but when money starts to move, it's enough to make a significant impact on the market.

We thank you for the trust you place in our team. Please reach out to us with any questions.

-Shaw Investment Management

[6] Source: John Hancock Investment Management, "Market Intelligence - 4q2023 Outlook" p.12
[7] Source: John Hancock Investment Management, "Market Intelligence - 4q2023 Outlook" p.26

The foregoing represents the opinions of the authors and not necessarily those of Raymond James & Associates, Inc. Information contained herein has been derived from sources believed to be reliable but is not guaranteed as to accuracy and does not purport to be a complete analysis of the security, company or industry involved. This report is designed to provide commentary on market strategy and the opinions expressed reflect the judgment of the author as of the date of publication and are subject to change without notice. Neither the information, nor any opinions expressed, constitute a solicitation for the purchase or sale of any security. The S&P 500 is an unmanaged index of 500 widely held stocks. The Dow Jones Industrial Average is an unmanaged index of 30 widely held securities. The NASDAQ Composite Index is an unmanaged index of all stocks traded on the NASDAQ over-the-counter market. The Russell 2000 index is an unmanaged index of small cap securities which generally involve greater risks. The Barclays Capital U.S. Aggregate Bond Index is often used to represent investment grade bonds being traded in United States. The MSCI EAFE Index is a stock market index that is designed to measure the equity market performance of developed markets (Europe, Australasia, Far East), excluding the US & Canada. MSCI Emerging Markets Index is designed to measure equity market performance in 23 emerging market countries. The index's three largest industries are materials, energy, and banks. The Russell Mid-cap Index consists of the bottom 800 securities in the Russell 1000 index as ranked by total capitalization. The Dow Jones US Select Dividend Index aims to represent the US's leading stocks by dividend yield. Dividends are not guaranteed and must be authorized by the company's board of directors. Investing in commodities is generally considered speculative because of the significant potential for investment loss. Their markets are likely to be volatile and there may be sharp price fluctuations even during periods when prices overall are rising. Investing in oil involves special risks, including the potential adverse effects of state and federal regulation and may not be suitable for all investors.

Raymond James is not affiliated with and does not endorse the opinions or services of Strategas Research Partners, LLC. It is not possible to invest directly in an index. Index performance does not transaction costs or other fees, which will affect the actual investment performance. Individual investor results will vary. Investments are subject to market risk, including possible loss of principal. International investing involves additional risks such as currency fluctuations, differing financial accounting standards, and possible political and economic instability. These risks are greater in emerging markets. Investing always involves risk and you may incur a profit or loss. No investment strategy can guarantee success. Past performance is not a guarantee of future results. Raymond James Financial Advisors do not provide advice on mortgages. Investing in commodities is generally considered speculative because of the significant potential for investment loss. Their markets are likely to be volatile and there may be sharp price fluctuations even during periods when prices overall are rising.

Raymond James & Associates, Inc. member New York Stock Exchange/SIPC
1100 Ridgeway Loop Rd, Suite 600
901.766.7700