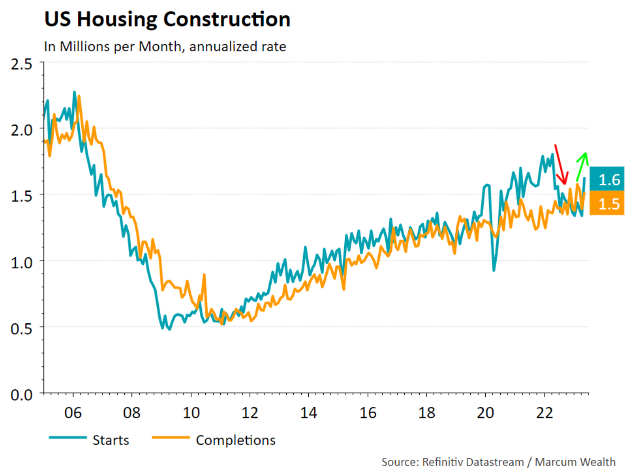
Strategy Newsletter – 3rd Quarter 2023

- Positive economic surprises keep pushing recession calls further into the future.
- A concentrated market leads to technology outperforming while earnings flatten out.
- Savers now earn a positive real return.
- Loan delinquencies start to turn higher in real estate, which may bring opportunities.

Economy

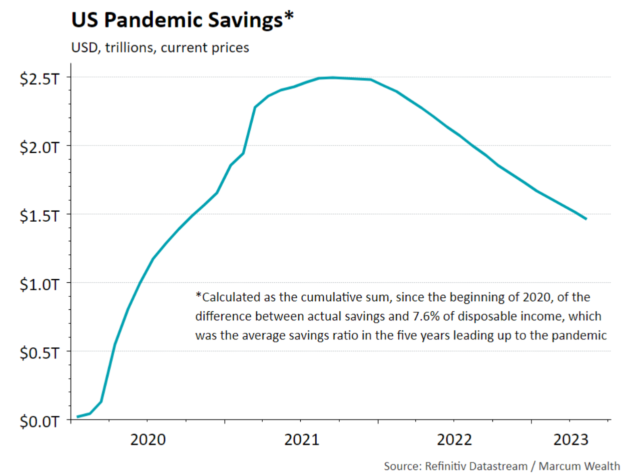
What will send the economy into recession? Bank failures in the first quarter? No. The debt ceiling debate in the second quarter? Nope. The punches keep coming but the data surprises on the upside.

Perhaps one of the biggest positives is housing. Despite the highest mortgage rates in the last 20 years, new housing starts increased this year. The lack of available home inventory and the demographic trends play a role.



Many households locked in mortgage rates around 3%, so the latest rise is not affecting most homeowners. Debt service for household spending remains manageable. Labor markets show strength despite expectations it would crack. The unemployment rate remains near 50-year lows at 3.6%.

The government's fiscal spending in 2020 and 2021 added fuel directly to private balance sheets. It made consumers much more resilient in the face of higher prices and less confident in the outlook. The excess savings is still over $1 trillion, as demonstrated below.



Not everything is perfect. Concerns are on the horizon, with higher interest rates putting a dent in large purchases like cars and durable goods. Student loan payments restarting are a negative hit to cash flows for many households.

The U.S. has the best demographic trends among developed countries. The innovation economy remains alive and well, with a productivity game-changer due to artificial intelligence. Despite so much going wrong, according to the headlines from the media, a lot is actually going right. The recession calls by economists continue to be pushed out into 2024 and beyond.

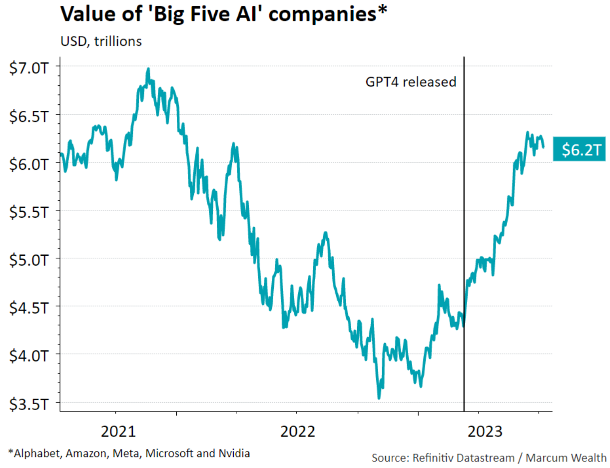
Equity

This marks three straight quarters of returns greater than 7% for the S&P 500. Growth beat value and the U.S. outperformed foreign stock market indices.

U.S. Equity	2Q 2023
Large Cap Stock	
S&P 500	8.7%
Small & Mid Cap Stock	
S&P 400 Mid Cap	4.7%
S&P 600 Small Cap	3.2%
All Cap Style Indices	
S&P 1500 Value	6.4%
S&P 1500 Growth	10.2%
International Equity	**2Q 2023**
MSCI EAFE	3.2%
MSCI EAFE Value	3.5%
MSCI EAFE Growth	2.9%
MSCI Emerging Markets (EM)	1.0%
MSCI EM Value	2.7%
MSCI EM Growth	-0.6%

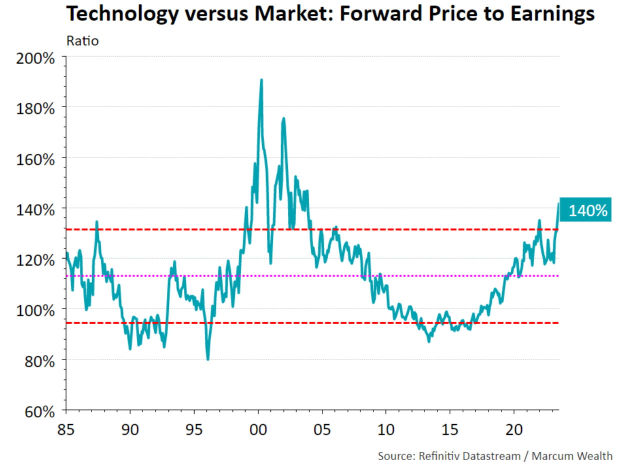
Through May, there was little participation in the gains beyond the largest ten companies in the S&P 500. Many took this as a warning sign. Instead, broader market participation began in June. Below we can see the trillions of market value added by the companies most exposed to the artificial intelligence trend.

Value of 'Big Five AI' companies*



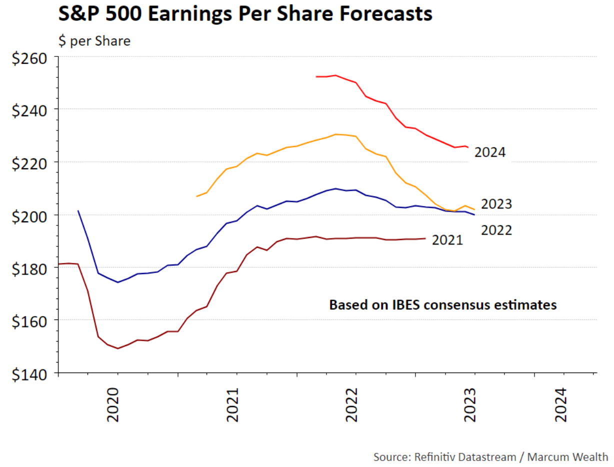
Technology trades a premium to the market. It is now 40% higher than the forward price-to-earnings ratio for the S&P 500 Index. It was only higher in the 1999 to 2002 period, which was the peak of the technology stock market bubble.

Technology versus Market: Forward Price to Earnings



Earnings forecast bottomed during the second quarter. It seems like corporations are becoming more confident in guiding profit expectations higher. The analyst community responded, and the rate of change for 2024 earnings is beginning to flatten out and rise in some sectors.

S&P 500 Earnings Per Share Forecasts



The Marcum Wealth Asset Allocation Frameworks are above target for equities. We see opportunities within international equities that have lagged over the last decade. In addition, small and mid-cap indices trade at lower multiples, which we find attractive for long-term investors.

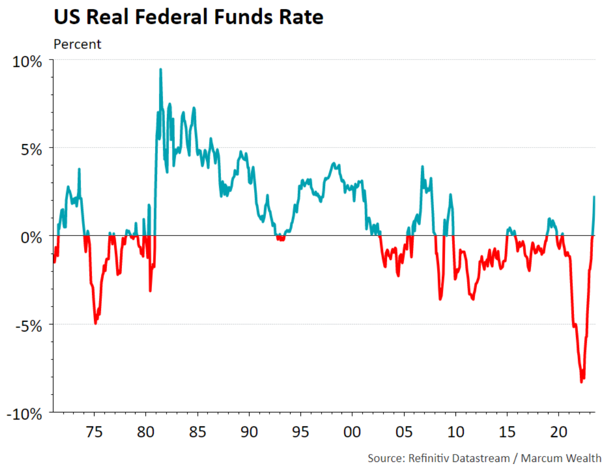
Fixed Income

Bonds indices fell during the second quarter as fears of the banking crisis and debt ceiling went away. The 10-Year Treasury started at 3.48% and ended the quarter at 3.84%.

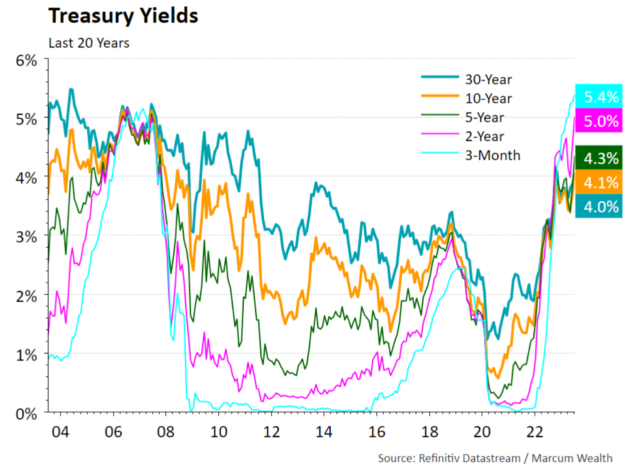
Fixed Income	2Q 2023
Bloomberg U.S. Aggregate Bond	-0.9%
Bloomberg Corporate Inv. Grade	-0.3%
Bloomberg High Yield Bond	2.0%
Bloomberg Global ex. U.S. Treas.	-2.8%
Bloomberg Municipal Bond	-0.1%
Bloomberg TIPS	-2.0%

It seems the Federal Reserve is near the end of the interest rate hiking cycle. That does not mean the fight with inflation is over, but it is winning. The latest consumer price index, a key inflation gauge, came in at 3.0%, down substantially from June 2022, when it hit 9.1%.

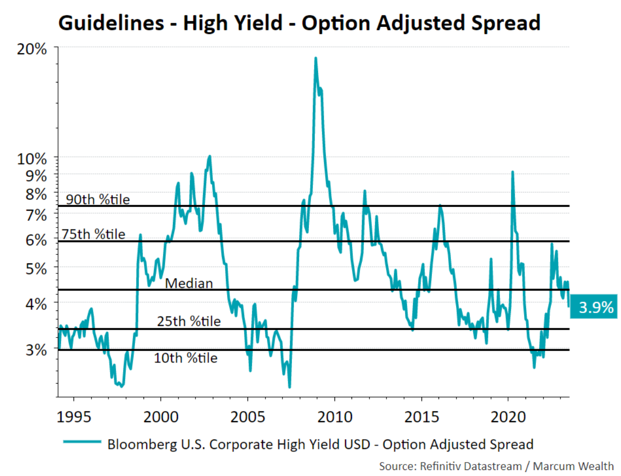
The Fed's main policy tool is controlling the Fed funds rate. It serves as a proxy for short-term interest rates that savers earn. It is finally positive or above inflation for one of the few times since 2003.



Yields across the Treasury curve are now above inflation. Uniquely, the 3-month yield is above the rest of the yield curve. This is one reason savers at banks have been moving money over to buy Treasuries directly. It usually does not last forever, as the restrictive rates could come down over time. This may normalize the curve, bringing short-term rates back below the long-term maturities.



Credit market valuations remain near fair value. The spread over Treasuries going back over 30 years sits just below the median at 3.9%. This puts total yields close to double digits. In a risk-off environment, the spreads could go higher and put pressure on bond prices. If we continue to see positive economic data, then investors will be rewarded for taking on additional credit exposure.



The Marcum Wealth Asset Allocation Frameworks hold a small underweight to fixed income.

Real Estate

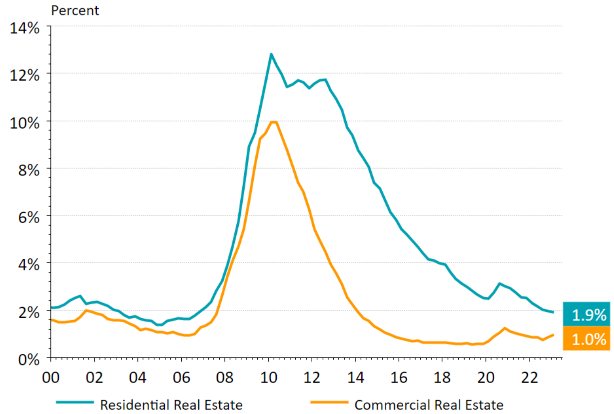
In the U.S., REITs returned 3.3% for the second straight quarter.

Real Estate	2Q 2023
Wilshire U.S. REIT	3.3%
Wilshire Int'l REIT	-2.3%

On the positive side, loan delinquencies continued falling in the residential sector. Homeowners have plenty of equity after the run-up in home prices.

Defaults for commercial mortgage loans began to pick up over the past two quarters. Specifically, the office sector saw weakness as the 'work-from-home' trend is yet to reverse.

Loan Delinquency Rates, US top 100 banks



Source: Refinitiv Datastream / Marcum Wealth

We see opportunities for managers with the ability to turn around underperforming office assets. In addition, any forced selling from commercial borrowers that took out floating rate notes should be met with buyers in other sectors. Fundamentals remain strong, particularly in apartments and industrials.

The Marcum Wealth Asset Allocation Framework continues to maintain equal weight exposure to REITs.

Summary

The seasonal tailwinds for equities are behind us, yet the momentum of markets remains positive. The most watched data now is inflation. A year ago, the consumer price index rose to 9.1% in the U.S. In the last year, it is down to 3.0%. Around the world, the trend is lower, outside of the U.K. The stickiness of inflation and the possibility of a regime change to a higher level of inflation remains in question. Yet the trend is positive for markets here. As central banks consider calibrating short-term interest rates, watching inflation data will be key.

G7 CPI

Country	Canada	France	Germany	Italy	Japan	UK	US
Dec 21	4.8	2.8	4.9	3.9	0.8	5.4	7.0
Jan 22	5.1	2.9	4.2	4.8	0.5	5.5	7.5
Feb 22	5.7	3.6	4.3	5.7	0.9	6.2	7.9
Mar 22	6.7	4.5	5.9	6.5	1.2	7.0	8.5
Apr 22	6.8	4.8	6.3	6.0	2.4	9.0	8.3
May 22	7.7	5.2	7.0	6.8	2.4	9.1	8.6
Jun 22	8.1	5.8	6.7	8.0	2.3	9.4	9.1
Jul 22	7.6	6.1	6.7	7.9	2.6	10.1	8.5
Aug 22	7.0	5.9	7.0	8.4	3.0	9.9	8.3
Sep 22	6.9	5.6	8.6	8.9	3.0	10.1	8.2
Oct 22	6.9	6.2	8.8	11.8	3.8	11.1	7.8
Nov 22	6.8	6.2	8.8	11.8	3.8	10.7	7.1
Dec 22	6.3	5.9	8.1	11.6	4.0	10.5	6.5
Jan 23	5.9	6.0	8.7	10.0	4.4	10.1	6.4
Feb 23	5.3	6.3	8.7	9.2	3.3	10.4	6.0
Mar 23	4.3	5.7	7.4	7.6	3.3	10.1	5.0
Apr 23	4.4	5.9	7.2	8.2	3.6	8.7	4.9
May 23	3.4	5.1	6.1	7.6	3.2	8.7	4.1
Jun 23	N/A	4.5	6.4	6.4	N/A	N/A	3.0

High inflation | Low inflation/deflation

Source: Refinitiv Datastream / Marcum Wealth

Marcum Wealth Asset Allocation Frameworks

	Income	Conservative	Balanced	Moderate	Growth
Asset Class	Strategic	Strategic	Strategic	Strategic	Strategic
Equity	**20%**	**35%**	**50%**	**65%**	**80%**
U.S. Equity	12%	21%	30%	39%	48%
International Equity	6%	11%	15%	20%	24%
Emerging Markets Equity	2%	4%	5%	7%	8%
Fixed Income	**77%**	**62%**	**47%**	**32%**	**17%**
US Fixed Income	69%	56%	42%	29%	15%
Global Bonds	8%	6%	5%	3%	2%
Real Estate / REITs	**3%**	**3%**	**3%**	**3%**	**3%**

The risk designations are relative only to the five Strategic Allocation targets and do not represent comparisons with any other investment or risk of the overall strategies.

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