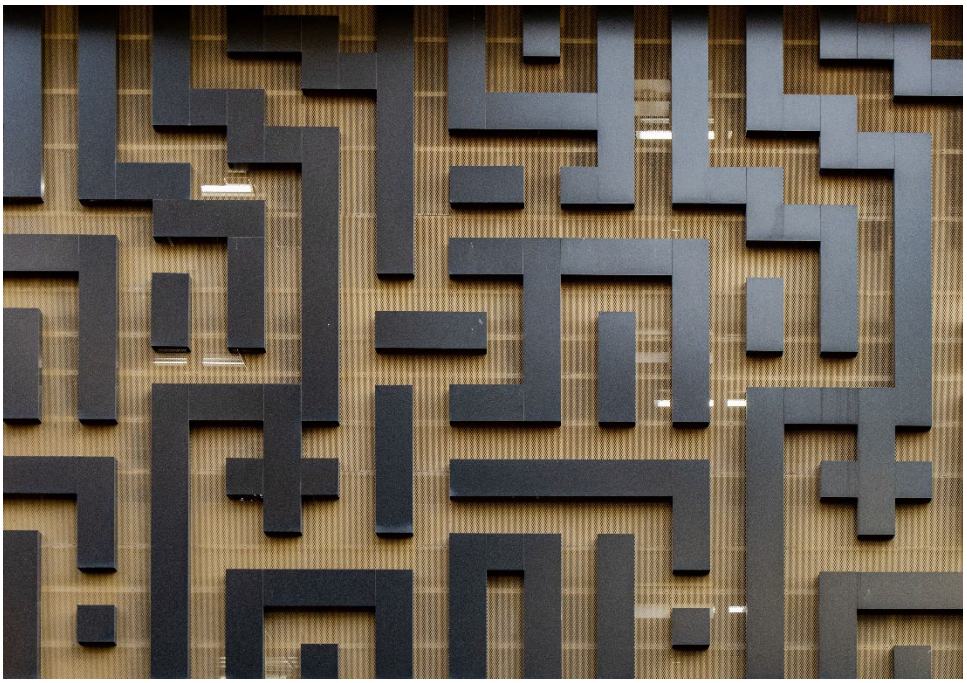
# Capital Markets Outlook
# 4Q 2023



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## Summary

*Outlook*

- Easing inflation and stronger economic growth have improved the economic outlook. Many forecasts have shifted to a soft-landing or no near-term recession.
- Although equity markets faltered in the third quarter, improving economic outlook and favorable valuations are positives going forward.
- Fixed income yields have ticked higher, offering favorable future return opportunities.
- Slowing economic activity and the end of the Fed tightening cycle favor high-quality stocks and bonds.

*Key Risks*

- A continued rise in energy costs would be an unwelcome shock in an environment already characterized by high inflation and slowing growth.
- Rising interest rates could impact the economy in an unforeseen way.

### Review

Both stock and bond prices fell in the third quarter. A strong first half of the year combined with some lingering recession fears led to some profit taking. Stocks fell in both August and September, resulting in the first back-to-back monthly declines in a year.

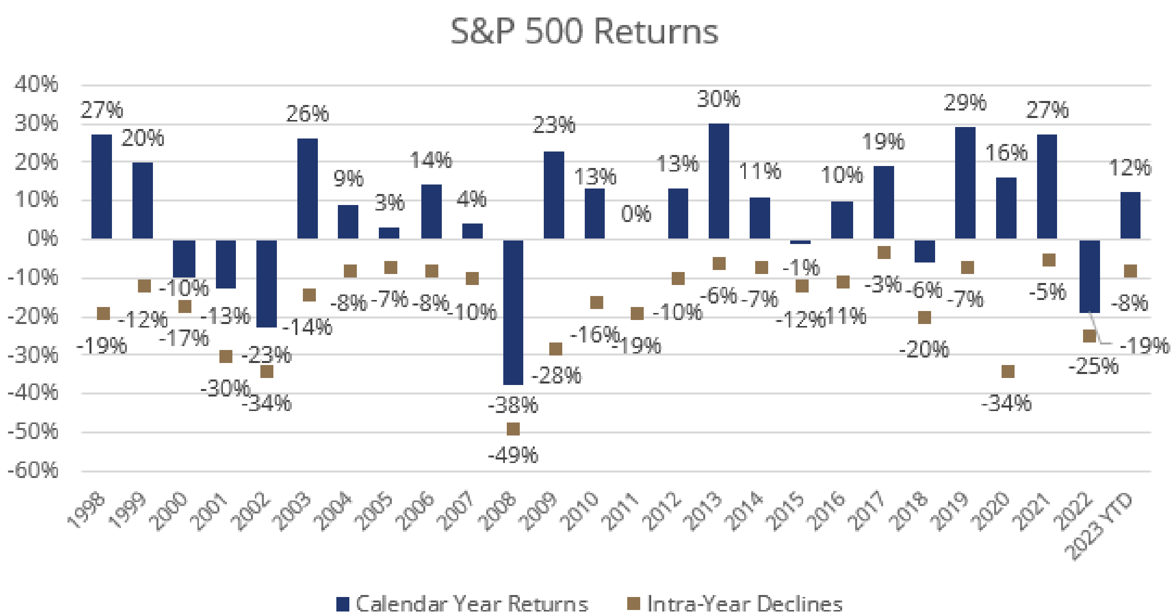
| | 3 Months | YTD | 1 Year |
|---|---|---|---|
| **Large Cap** | -3.22% | 13.03% | 21.59% |
| **Mid Cap** | -4.20% | 4.28% | 15.54% |
| **Small Cap** | -4.87% | 0.88% | 9.96% |
| **International** | -4.94% | 6.94% | 25.82% |
| **Emerging Markets** | -4.07% | 0.92% | 11.32% |
| **High Yield Bond** | -0.13% | 4.90% | 9.91% |
| **1-3 Year Treasuries** | 0.64% | 1.62% | 2.31% |
| **7-10 Year Treasuries** | -4.47% | -2.59% | -2.03% |
| **20+ Year Treasuries** | -13.10% | -9.00% | -10.72% |
| **Aggregate Bond** | -3.22% | -1.03% | 0.54% |
| **TIPS** | -2.67% | -0.68% | 1.23% |

*Source: YCharts. S&P 500 Index, S&P MidCap 400 Index, S&P SmallCap 600 Index, MSCI EAFE Index, MSCI Emerging Markets Index, ICE Us Treasury 1-3 Year Bond Index, ICE US Treasury 7-10 Year Bond Index, ICE US Treasury 20+ Year Bond Index, Bloomberg US Aggregate Bond Index, Bloomberg US Treasury Inflation-Linked Bond Index*[1]

Despite the recent decline in markets, the economy has remained resilient. GDP growth forecasts have risen as inflation has continued to moderate. At its September meeting, the Fed kept interest rates unchanged, and it appears that the tightening cycle will come to an end soon.

**Outlook**

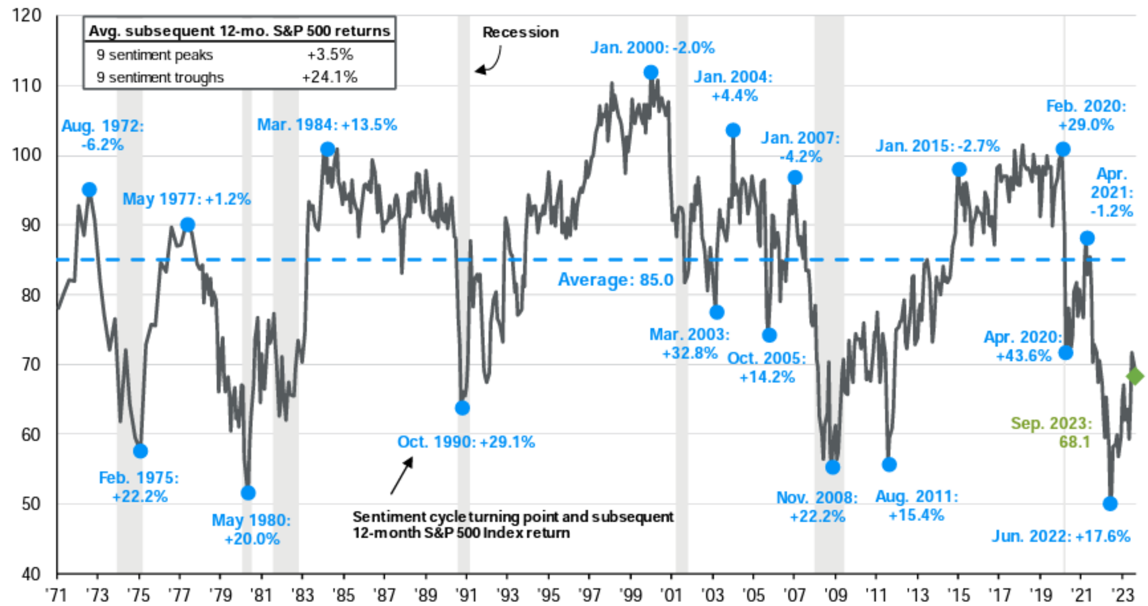
Although stocks declined in the third quarter, intra-year declines are very common, even in years with strong positive returns. Short-term drawdowns are not necessarily indicative of sustained market declines, and we do not view the recent downturn as symptomatic of any larger market or economic issues.




*Source: YCharts, Standard & Poors. Data as of 9/30/23. Returns are based on price index only and do not include dividends. Intra-year declines refer to the largest market drops from a peak to a trough during the year.*

At least some of the decline can be attributed to fears of recession as investors became concerned with the uncertain economic outlook. However, investor sentiment souring has often been a contrarian indicator of stock market performance. The S&P 500 has averaged 24% in the 12 months after a sentiment trough, while only returning 3.5% after a sentiment peak.

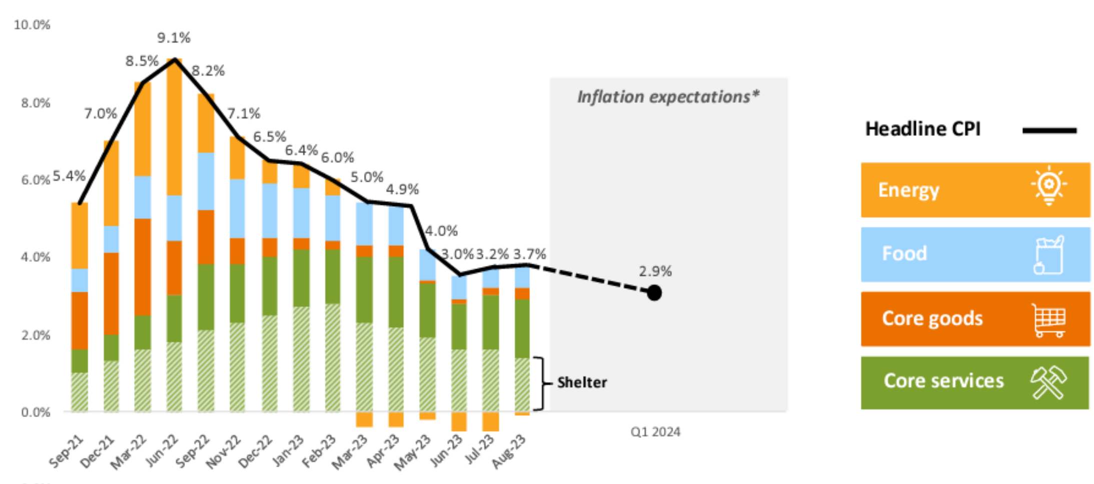
**Consumer Sentiment Index and subsequent 12-month S&P 500 returns**




*Source: Source: FactSet, Standard & Poor's, University of Michigan, J.P. Morgan Asset Management Guide to the Markets as of 9/30/23.*

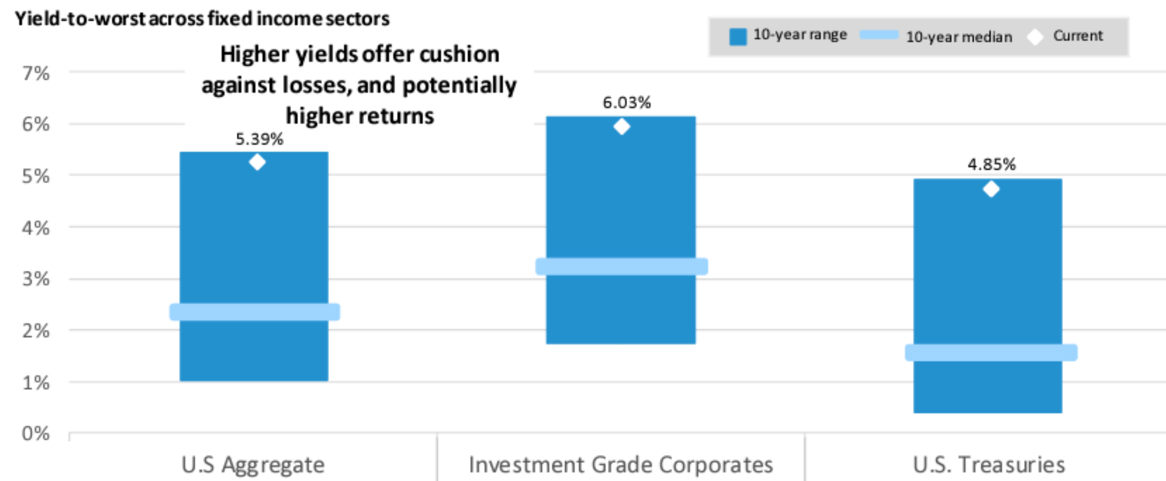
Another reason for optimism is the continued decline in inflation from the peak in June 2022. Since hitting a more than two-year low of 3% in June, rising energy prices caused inflation to tick higher in both July and August. However, there were some positive signs. Core inflation, which excludes food and energy from the index, has continued its downward trajectory. Additionally, shelter prices have begun to move lower after peaking in the first half of 2023.

**Headline CPI and contributions to CPI inflation (Year-Over-Year)**



*Source: Lincoln Financial Market Intel Exchange, U.S. Bureau of Labor Statistics. Inflation projections for 2023 represent median analyst expectations compiled by Bloomberg as of 9/30/23.*

While inflation is easing, interest rates are expected to remain higher for longer. Both the Fed and market forecasts point to a sustained period without any interest rate cuts. With fixed income yields at some of the highest levels seen in decades, bonds could be an attractive investment. Higher yields provide investors with more meaningful income and the potential for higher returns. Additionally, they help provide a cushion against price losses if rates were to rise since bond prices move inversely to changes in interest rates.




| | U.S Aggregate | Investment Grade Corporates | U.S. Treasuries |
|---|---|---|---|
| Total return if rates **decrease** 1% | **10.54%** | **11.87%** | **9.71%** |
| Total return if rates **increase** 1% | **0.24%** | **0.19%** | **–0.01%** |
| Total return if rates **unchanged** | **5.39%** | **6.03%** | **4.85%** |

*Source: FactSet as of 9/30/2023. Hypothetical total return scenarios are estimates and assume the following: interest rate changes occur at the beginning of the period before any reinvestment occurs, spreads remain constant, and convexity is not considered. U.S. Aggregate as represented by the Bloomberg U.S. Aggregate Bond Index with a yield of 5.39% and duration of 6.15 years. Investment grade corporates as represented by Bloomberg U.S. Corporate 1% Cap Index with a yield of 6.03% and duration of 6.84 years. U.S. Treasuries as represented by the Bloomberg Global U.S. Treasury Index with a yield of 4.85% and duration of 5.86 years.*

If a slowing economy does fall into recession, it is important to remember that equity returns do not always have extreme downturns. The Great Financial Crisis caused significant losses and often comes to mind because it was so recent. However, history shows that returns during a recession can follow many different paths and that returns following a recession are almost always strong. There have been multiple recessions that featured positive returns and only one case where returns were negative the year following a recession.

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**Conclusion**

Improving economic data has reduced the probability of a recession. Most analysts believe there will either be a mild recession or no recession at all in the near term.

| *Probabilities from our Network:* | 12% | 88% | 0% |
|---|---|---|---|
| | ***Hard landing*** *(deep recession)* | ***Soft landing*** *(mild or no recession)* | ***No landing*** *(no recession near term)* |
| **Inflation** | • Disinflationary process slows | • Eases and returns to pre-2022 levels | • Inflation remains high despite aggressive fed policy action |
| **Fed** | • Overtightens policy or acts too aggressively; subsequent cuts could be needed | • Pauses rate hikes, then slowly lowers back down to neutral | • Further hikes necessary and higher for longer rates |
| **Labor** | • Spike in unemployment | • Moderate increase in unemployment, but no spike<br>• Job openings decline | • Tight and resilient labor market; absorbs rate increases |
| **Consumer** | • Broad pullback in spending, credit and increased delinquencies | • Mild spending declines | • Spending remains resilient, driving sticky inflation |
| **Economy** | • Steeply negative GDP growth | • Moderate, but positive growth | • Positive GDP growth, but uncertainty around a recession persists |
| **Market** | • Increased volatility and price pressure | • Restored price stability | • Increased volatility; potential for sideways/choppy price action |

*Source: Lincoln Financial Market Intel Exchange. The probabilities expressed above are those of select asset managers surveyed as of 6/30/23 and not necessarily that of any Lincoln Financial Group affiliate. Results are not based on any particularized financial situation, or need, and are not intended to be, and should not be construed as, a forecast, research, investment advice or a recommendation for any specific strategy, product or service from any of the participating investment managers.*

While there are positives for both stocks and bonds, there is still a good deal of economic and market uncertainty. The next few months should provide more clarity on rate policy, economic conditions, and earnings trends, which could help establish an investment roadmap heading into 2024.

We will continue to monitor trends that we believe could impact your portfolios, such as the pace of the recovery, earnings growth, valuation, and inflation. Our goal is always to be efficient and selective in portfolio construction to best position clients for success.

If you have any questions, please don’t hesitate to reach out to your Academy Financial advisor.

*[1]The S&P 500 index covers the 500 largest companies that are in the United States. These companies can vary across various sectors. The S&P MidCap 400 Index, more commonly known as the S&P 400, is a stock market index from S&P Dow Jones Indices. The index serves as a barometer for the U.S. mid-cap equities sector and is the most widely followed mid-cap index in existence. The S&P SmallCap 600 Index is a stock market index established by Standard & Poor's. It covers roughly the small-cap range of US stocks, using a capitalization-weighted index. The MSCI EAFE Index tracks large cap and mid cap companies in developed countries around the world. The index primarily covers the Europe, Australasia, and the Far East regions. The MSCI Emerging Markets Index represents securities that are headquarted in emerging markets. An emerging market is considered a country that has not yet become developed because of economic characteristics. The ICE U.S. Treasury 1-3 Year Bond Index is part of a series of indices intended to assess the U.S. Treasury market. The Index is market value weighted and is designed to measure the performance of U.S. dollar-denominated, fixed rate securities with minimum term to maturity greater than one year and less than or equal to three years. The ICE U.S. Treasury 7-10 Year Bond Index is part of a series of indices intended to assess the U.S. Treasury market. The Index is market value weighted and is designed to measure the performance of U.S. dollar-denominated, fixed rate securities with minimum term to maturity greater than seven years and less than or equal to ten years. The ICE U.S. Treasury 20+ Year Bond Index is part of a series of indices intended to the assess U.S. Treasury market. The Index is market value weighted and is designed to measure the performance of U.S. dollar-denominated, fixed rate securities with minimum term to maturity greater than twenty years. The Bloomberg USAgg Index is a broad-based flagship benchmark that measures the investment grade, US dollar-denominated, fixed-rate taxable bond market. The index includes Treasuries, government-related and corporate securities, MBS (agency fixed-rate pass-throughs), ABS and CMBS (agency and non-agency). The Bloomberg US Treasury Inflation-Linked Bond Index measures the performance of the US Treasury Inflation Protected Securities (TIPS) market. CRN-6026209-101623*