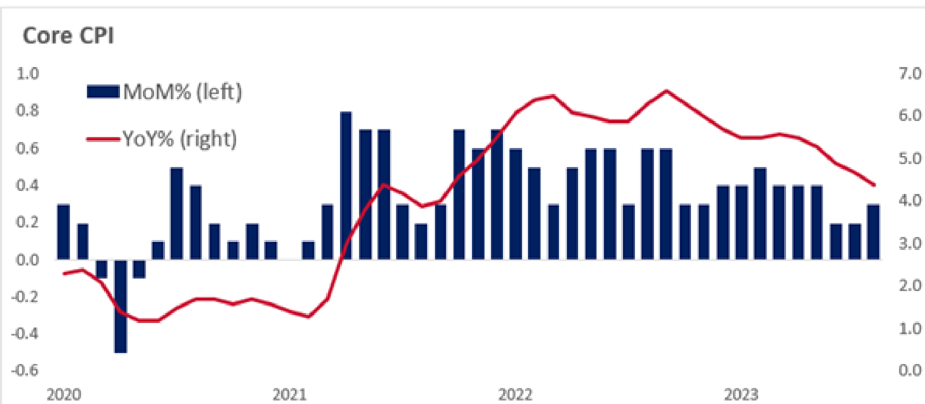
Economic & Market Commentary

Fall 2023

Heading for a Soft(ish) Landing

Last quarter's **Commentary** presented our case for a soft landing for the U.S. economy – one we will walk away from. We remain committed to this view. The long term outlook continues to deteriorate, largely due to the Federal government's inability to reign in deficit spending. The fiscal drag from higher interest payments on ballooning debt will draw resources better used for more productive purposes.

The near term picture is brighter. The Federal Reserve's record pace of rate hikes over the last year-and-a-half are now showing results. Core inflation is declining, notwithstanding the August blip (primarily) from rising energy prices. As shown below, the trend is moving in the right direction. Energy costs will remain a wild card for the inflation outlook; however, history shows price spikes in the absence of significant supply shocks are often quickly reversed.



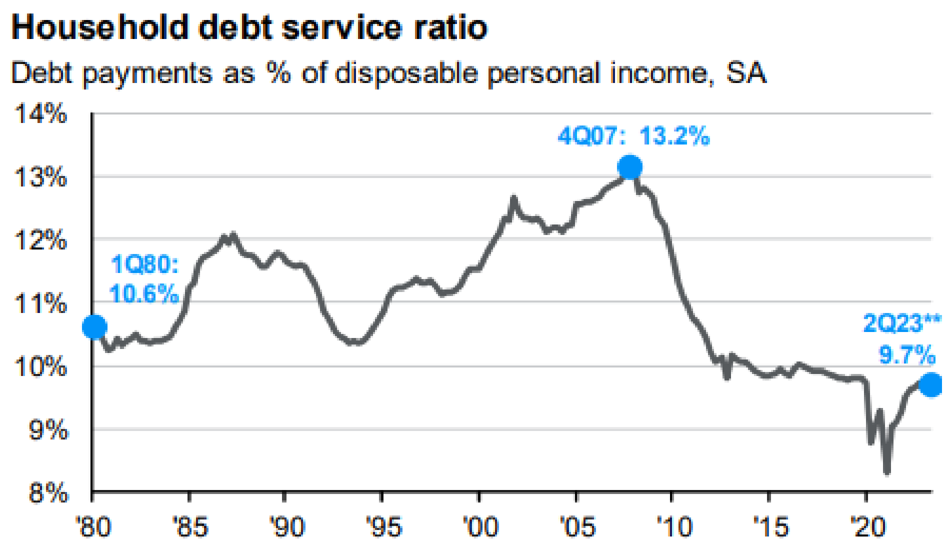
Source: U.S. Bureau of Labor Statistics; FHN

While the Fed's actions are producing the desired effect on inflation, most of the rest of the economy is holding its own. Employment data, while showing softness from peak levels, remain strong by historic standards.

Much has been said about consumer debt levels, particularly with the end of most student loan deferments/forgiveness. While debt service is always a drag on consumer spending, it remains well below levels witnessed before the financial crisis a decade-and-a-half ago. If the Fed is reaching the end of its tightening cycle – and we believe it is, even if rates do not fall appreciably – the consumer sector should pull through. The savings rate is low, but it will recover.

Any Landing You Can Walk Away From Is a Good One

This phrase was initially coined by photographer Gerald Massie in 1944 following the crash landing of the B-17 bomber in which he was flying. Chuck Yeager, the first person to break the sound barrier, later added 'If you can use the airplane the next day, it's an outstanding landing.'

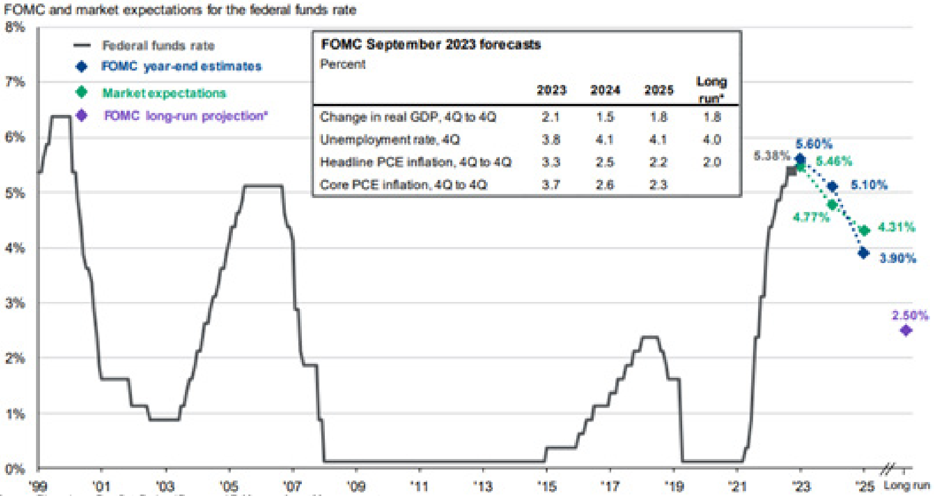


Source: FactSet, FRB, J.P. Morgan Asset Management;

The Fed kept its key rate unchanged at its September meeting but reiterated its intent to remain vigilant and data dependent. This is interpreted as a 'higher for longer' approach. Only small cuts projected into 2024 and 2025. 'Real' interest rates – the nominal rate minus inflation – are noticeably positive. Historically, this status creates enough pressure on economic activity to dampen inflation. We are seeing this now. The Fed's 2.0% inflation target remains well in the future, but we are moving in the right direction.

Federal funds rate expectations

FOMC and market expectations for the federal funds rate



FOMC September 2023 forecasts

Percent

	2023	2024	2025	Long run*
Change in real GDP, 4Q to 4Q	2.1	1.5	1.8	1.8
Unemployment rate, 4Q	3.8	4.1	4.1	4.0
Headline PCE inflation, 4Q to 4Q	3.3	2.5	2.2	2.0
Core PCE inflation, 4Q to 4Q	3.7	2.6	2.3	

Source: Bloomberg, FactSet, Federal Reserve, J.P. Morgan Asset Management.
Market expectations are based off of the respective Federal Funds Futures contracts for December expiry. *Long-run projections are the rates of growth, unemployment and inflation to which a policymaker expects the economy to converge over the next five to six years in absence of further shocks and under appropriate monetary policy. Forecasts are not a reliable indicator of future performance. Forecasts, projections and other forward-looking statements are based upon current beliefs and expectations. They are for illustrative purposes only and serve as an indication of what may occur. Given the inherent uncertainties and risks associated with forecasts, projections or other forward-looking statements, actual events, results or performance may differ materially from those reflected or contemplated.
Guide to the Markets – U.S. Data are as of September 20, 2023.

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Protecting the Downside

We expect economic activity to progress at a slow but steady pace as monetary policy completes its work. As always, we ask, 'What if we're wrong?' Protection of client wealth is paramount; our philosophy is built on broad diversification and attention to valuation.

Major U.S. market averages are near peak valuations. As noted in previous writings, this position is driven by a handful of mega-capitalization growth themes. Sectors identified as value themes (energy, industrials, finance, and stable growth, among others) are priced at their long term average multiple and yield levels. Opportunities exist inside these areas, and valuations provide support if markets do not behave as expected.

Valuation opportunities are even more pronounced overseas. Earnings multiples and dividend yields are near two-decade levels of attractiveness compared to U.S. markets. While the rest of the world has its challenges as well, these appear adequately discounted at current prices.

Together, a broadly diversified equity portfolio with a high quality value tilt and healthy international exposure will provide a strong combination of reasonable growth and controlled risk. Add to this mix high quality, short- to intermediate-term fixed income; yields on such issues are above current inflation rates and will lock in those returns well beyond the end of the Fed's tightening cycle.

In Sum

History shows that markets anticipate changes in the economy and Fed policies. We believe a recession will be avoided and the Fed is reaching the end of its restrictive stance (although rates will not fall as quickly as many hope). A diversified, conservatively structured portfolio will provide appreciation potential and risk control. While the timing is uncertain, we are confident we will walk away from this landing.

Value vs. Growth relative valuations

Rel. fwd. P/E ratio of Value vs. Growth, 1997 - present

	Forward P/E		Div. yield**	
Style	Current	Long-term avg.*	Current	Long-term avg.*
Value	14.15x	14.09x	2.45%	2.58%
Growth	25.03x	20.83x	0.84%	1.33%

Source FactSet, FTSE Russell, NBER, J.P.Morgan Asset Management
(left) Growth is represented by the Russell 1000 Growth Index and Value is represented by the Russell 1000 Value Index. *Long-term averages are calculated monthly since December 1997. **Divident yield is calculated as the next 12-month consensus divident divided by most recent price.

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International: Price-to-earnings discount vs. U.S.

MSCI All Country World ex-U.S. vs. S&P 500, next 12 months

	20-yr. avg. P/E ratio	Current P/E ratio
S&P 500	15.6x	18.4x
ACWI ex-U.S.	13.1x	12.7x

Source: FactSet, MSCI, Standard & Poor's, J.P. Morgan Asset Management.
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International: Difference in dividend yields vs. U.S.

MSCI All Country World ex-U.S. minus S&P 500, next 12 months

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Economic & Market Commentary is written by the Investment Services Department at Security National Wealth Management.