MARKET AND ECONOMIC
REVIEW & OUTLOOK

AN UPDATE FROM THE ADVISORS AT GASKIN ASSET MANAGEMENT ***CHARLOTTE, NORTH CAROLINA***

The following letter was written for you by the undersigned. The opinions expressed are those of your advisors at Gaskin Asset Management and do not necessarily reflect the opinions of Raymond James or its affiliates. We know this is a long letter, but we hope you will invest five minutes in reading it. Thank you.

As I write to you today, war rages in Eastern Europe and the Middle East. We mourn for those who have suffered the loss of loved ones, homes, livelihoods, communities, and the absence of a simple life lived in quiet peace with family. Meanwhile, here at home, protests, civil unrest, political turmoil, and a general sense of uncertainty seem to be the everyday "norm." Aside from all these external struggles that are beyond our ability to control, we are grateful for the safety and well-being of our families and yours.

Just as geopolitical events are unusually volatile these days, the investment markets fluctuate daily in the search for direction. This would seem to leave each of us, as investors, in a tough spot. With this brief communication, we would like to provide a few thoughts on how we understand the current state of the investment markets and our outlook going forward.

Index	12/30/22 Close	% Gain/Loss Year End 2022	Price Change Year to Date 2023	% Gain/Loss Year to Date 2023
Dow Jones Industrial Average	33,147.25	-6.86%	-94.38	-0.28%
NASDAQ	10,466.48	-32.54%	+2,384.76	+22.78%
S&P 500	3,839.50	-18.11%	+354.30	+9.23%
MSCI EAFE	1,943.93	-14.27%	+8.03	+0.41%
Russell 2000 Small Cap	1,761.25	-20.39%	-98.97	-5.62%
Bloomberg Aggregate Bond	2,048.73	-13.0%	-54.71	-2.67%

*Performance reflects index values as of market close on Oct. 31, 2023. Bloomberg Aggregate Bond and MSCI EAFE reflect Oct. 30, 2023, figures.

Let's start with a quick look at the markets as of October 31st as noted above. The Dow Jones Industrial Average is negative year-to-date after suffering losses of -6.86% last year. Yet while the tech heavy NASDAQ is up an impressive +22.78% this year, it had a loss of -32.54% from last year to overcome, which it has yet to achieve. Bonds were down last year, and they remain in negative territory this year. It's been a grind.

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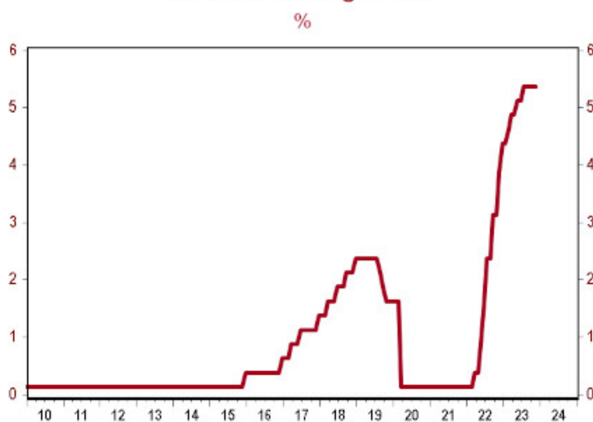
As we position for the end of the year and an upcoming election year, the future direction of the bond and stock markets range from the risk of an impending recession, expanding war in the Middle East, overpriced securities, Washington's political disagreements and high interest rates. While all these risks and more could ultimately serve as the driving force for the markets leading into the next year, we believe the most likely driver will be the direction of inflation and interest rates.

In previous communications over the last few years, we warned of the long-term risk of ultra-low interest rates and the unusually high increases in the U.S. money supply. For instance, in our August 2021 newsletter, we noted that the Fed had increased the money supply by 32% in the previous 18 months far exceeding the highest annualized increases since WWII.[i] While pouring more money into the economy, the Fed maintained the Fed Funds Target Rate at the lowest levels in generations. These decisions and the supply disruptions led to inflation and its persistent and lingering effects. Mickey Levy of *The Wall Street Journal* recently noted that while the published rate of inflation has been in steady decline, the consumer-price-index (CPI) is still 18.9% higher than before the pandemic[ii]. But you already know this because we all feel it. While the rate of inflation may be coming down, prices of virtually everything from bacon to boats remain much higher than just two years ago.

The Fed's response to inflation has been to steadily increase the Fed Funds Rate to its current target of 5.25 to 5.5% as noted in the nearby chart while also reducing the money supply as measured by M2 which has declined in eleven of the last fourteen months. These Fed actions are directional reversals of the moves made prior to and during the early stages of the pandemic. And if you have paid attention to the political turmoil in Washington, you may have noticed that much of the current debate revolves around fiscal policy which we believe simply must move toward less spending, but few have the resolve to vote for it, thus the borrowing continues.

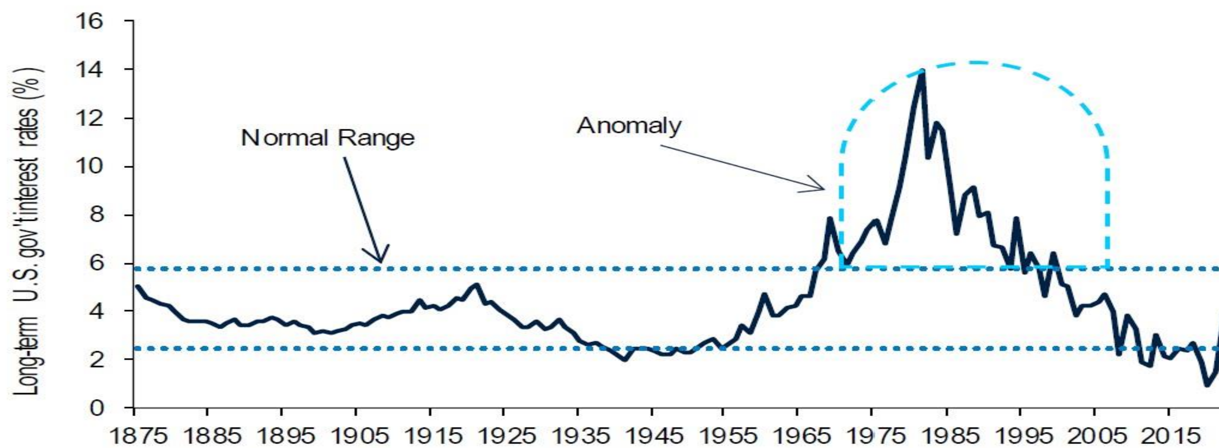


Speaking of borrowing money, the yield on the 10-year U.S. Treasury note touched 5% in mid-October for the first time in 16 years[iii]. As mortgage rates are closely linked to the 10-year note, we have seen them increase leaving homebuyers in a bit of a bind. The surprisingly resilient housing market belies a challenge facing those who would like to move to new homes as well as first-time home buyers.

For example, according to Realtor.com, the median sales price of a home in our Charlotte market is currently about $405,000 while it was just $286,000 three years ago in September of 2020[iv]. That's an increase of about 42%. Back in September of 2020, a qualified buyer may have been able to secure a 30-year mortgage as low as 2.8% which would have resulted in a monthly payment of approximately $940.13 (principal and interest only) after a 20% downpayment of about $57,200. Now let's fast forward to today in the same market. The $405,000 median home buyer might be lucky enough to finance the purchase at a rate in today's market around 8% based on FreddieMac.com[v]. After shelling out a 20% downpayment of about $81,000, the buyer would be left with a monthly payment of roughly $2,377 on the principal of $324,000. Let that soak in for a second. In just three years' time, the monthly "out of pocket" cost to own a home in Charlotte has risen about $1,437 or 153% after downpayment! This is not isolated to Charlotte, of course. And according to *Barron's* newspaper, the national average for home mortgage payments is now 52% higher than apartment rents which is the widest spread since 1996[vi].

So, the big question facing investors is, "Where are interest rates going from here?" We agree with many market strategists including Raymond James Chief Investment Officer Larry Adam who believes the Fed is likely near the

end of its rate increase cycle[vii]. Once the economy begins to show consistent signs of significant cooling, we believe the Fed is likely to begin lowering short-term rates which will likely lead to a decline in longer term rates thus improving borrowing costs for homeowners in transition. We have experienced unusually low rates for so long that memories of "normal" rate cycles may have faded into the past for older investors and may have simply never been experienced by the younger crowd. The chart below begins in 1875, but Treasuries have averaged around 5% since Alexander Hamilton was Secretary of the Treasury in the late 1700's. Maybe, just maybe, we'll settle in for a little "normal" when it comes to U.S. treasury bonds.



Source: Bloomberg, PGIM Fixed Income. Reflects period from 1875 to 2022.

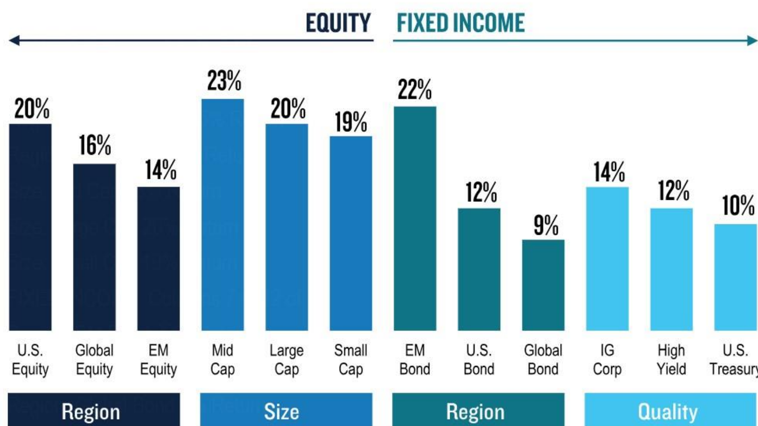
So, where do we go from here? A recent survey of professional investors conducted by *Barron's* revealed in some informative opinions we would like to share with you[viii]. The most interesting finding is that there is little consensus among money managers regarding the general direction of the stock market with 38% professing bullishness while 38% are neutral and 24% are bears. Sounds like our political environment, doesn't it? There does seem to be some areas of consensus with 53% expecting bonds to outperform stocks over the next 12 months and 64% expecting value stocks to outperform growth stocks.

Frankly, we are not the least bit surprised by these findings. After all, go back to the market chart from earlier. After significant gains in 2020 and 2021, the markets suffered a significant pullback in 2022 and have failed to fully recoup those losses in 2023. But if you're paying attention, you may remember that I said we believe the driver going forward is going to be interest rates and their effect on the economy and financial markets. While low rates ran many valuations up, higher rates are bringing many back down to earth. But all the while, interest bearing investments are paying income irrespective of the fluctuating values of the underlying securities. The factors that have driven down bond prices for nearly two years are likely to reverse in the coming months, which we believe will lead to gains in bond valuations while providing investors an opportunity to lock in yields not seen in years. That's one of the silver linings in this market cycle in our judgment. Another opportunity is value stocks which are undervalued today when compared to growth stocks in our judgment. Additionally, value stocks pay dividends that

provide income to portfolios regardless of market prices. It's worth noting that dividends have provided approximately 32% of the total return for the S&P 500 since 1926[ix].

Finally, these are challenging times for the U.S. and international economies. Interest rates reflect the cost of funds for borrowers whether they be governments, businesses, or individual homeowners. They were too low for too long, but the problem is being addressed now. We believe the correction in interest rates will ultimately lead to more traditional markets after years of distortion. What we cannot know is how long it will take the markets to absorb and adjust to the changes in rates.

AVERAGE RETURNS 12 MONTHS AFTER PAST FOUR RATE HIKE CYCLES ENDED



Source: Morningstar and S&P. Average returns 12 months following the end of each of the past four Fed rate hike cycles (end dates used: 2/1/1995, 5/16/2000, 6/29/2006, 12/20/2018). S&P 500 Index (U.S. Equity), MSCI All Country World Index (Global Equity), MSCI Emerging Markets Index (EM Equity), Russell Mid Cap Index (Mid Cap), Russell 1000 Index (Large Cap), Russell 2000 Index (Small Cap), JP Morgan EMBI Global Diversified Index (EM Bond), Bloomberg U.S. Aggregate Bond Index (U.S. Bond), Bloomberg Global Aggregate Bond Index (Global Bond), Bloomberg U.S. Credit Index (IG Corp), Bloomberg High Yield Corporate Index (High Yield), Bloomberg U.S. Treasury Index (U.S. Treasury).
Past performance does not guarantee future results.

So, we'll close our comments with a very informative and interesting chart. The chart nearby displays the average returns 12 months after the last four rate cycle increases in 1995, 2000, 2006, and 2018. Remember, these returns are averages so we cannot be certain of how the markets will respond to this cycle over the 12 months following the end of this cycle. But there is a lesson in this chart: markets respond well to a low cost of funds. We all need some degree of certainty about interest rates if we hope to make long-term investment or purchase decisions. After all, the use of borrowed funds underlies many of our personal and corporate decisions. So, you might even say that low or stable interest rates are the grease that keeps the wheels of the economy turning.

No matter what comes in the next few months, we will continue keep our eyes forward with your goals in sight. On behalf of Paul, Ivey, Dennis, Summer, Gayle and Lorie, thank you for your continued faith and confidence in our team! If we don't get a chance to speak before the holidays, we wish you and your family a safe and wonderful holiday season!

Best wishes,

Robert J. Gaskin, CIMA®
Managing Principal
Senior Financial Advisor, RJFS

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[i] "Market Review & Outlook," Gaskin Asset Management, August 2021.
[ii] Levy, Michael, "We're Still Paying for the Federal Reserve's Blunders," The Wall Street Journal. Oct. 25, 2023
[iii] https://www.wsj.com/finance/investing/decoding-the-almost-5-10-year-treasury-yield-9cb86b27?mod=investing_news_article_pos3
[iv] https://www.realtor.com/realestateandhomes-search/Charlotte_NC/overview
[v] https://www.freddiemac.com/
[vi] "The Numbers," Barron's. October 30, 2023. Page 12.
[vii] Adam, Larry. "Sailing on Strange Seas," Raymond James Investment Strategy Quarterly, October 2023, p. 2.
[viii] Jasinski, Nicholas. "The Big Money Poll," Barron's, October 30, 2023, pp.22-27.
[ix] https://www.spglobal.com/spdji/en/research/article/a-fundamental-look-at-sp-500-dividend-aristocrats/