Quarterly Market Update – 3Q, 2023

VIRTUS CAPITAL

Market Summary & Outlook

Recap

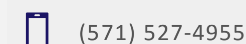
- **Narrow Leadership in Equity Market Rebound Continues –** The top 10 market-weighted U.S. stocks have risen nearly 40% year-to-date, while the remaining 490 stocks in the S&P 500 have returned mostly flat results on the year. Domestic equity returns to date are most attributed to expanding multiples of stocks' prices relative to their earnings.
- **Risk Sensitive Assets Remain Challenged –** An increasing interest rate environment in 2023 has created strong headwinds for fixed income, as yields continue to rise and prices drop. U.S. long-dated treasury bond prices dropped nearly 12% in Q3, down just over 8.5% on the year.
- **Historic Rate Hike Cycle May Be Nearing its Peak –** The world's central banks have continued their tightening of monetary policy throughout 2023, in an effort to combat persistent global inflationary pressures. However, some relief may be in sight as the Fed has paused their rate hikes since July, holding the federal funds rate steady at 5.25-5.5%.
- **Global Business Cycle Remains Resilient –** The global cycle has been unexpectedly resilient given a variety of dampening factors, such as high consumer inflation, geopolitical conflicts, and secular shifts to deglobalization. Global leading and manufacturing indicators have risen steadily in 2023, with the Purchasing Managers Index (PMI) expanding for over 50% of countries.
- **Re-acceleration of Commodity Prices Elevates Inflation Risk –** Despite global economic policy tightening, emerging markets remain disproportionately exposed to persistent inflation due to a re-acceleration of commodity prices. Households in developing countries are spending a larger proportion of their disposable income on energy and food. With both India and Chinese households devoting approximately 27-35% of their income to food and energy needs, compared to 9% for U.S. households.
- **Deeply Inverted Yield Curve Typical of Late Cycle –** Again, typical of late-cycle dynamics, the inversion of the 10-Year and 3-Month yield curve has been a historically reliable indicator of recession, but with variable timing. The 10-Year and 3-Month have been inverted for a year now and have prompted banks to tighten their lending standards across multiple categories for 5 consecutive quarters.
- **Market Forecasts Earnings Rebound in 2024 –** S&P 500 companies have experienced a YoY sales growth of 2% with declining earnings of -3%. Analysts' expectations on the street are for expanding growth in sales and earnings in 2024 of 5% and 12%, respectively.

ABOUT THE FIRM

Virtus Capital is an independent investment advisory firm serving high net-worth individuals, families, and business owners.

CONTACT US

Virtus Capital, LLC
Office
4250 North Fairfax Dr.
Suite 600
Arlington, VA 22203



Performance

Equity Benchmarks	Returns as of 9/30/23	
	3 Month	YTD
S&P 500 PR	-3.65%	11.68%
DJ Industrial Average PR	-2.62%	1.09%
Nasdaq Composite PR	-4.12%	26.30%
Vanguard Balanced Composite	-3.20%	7.00%
MSCI AC World Index ex USA Net	-3.77%	5.34%
Spliced Emerging Market Index	-1.48%	2.60%

Bond/Commodity Benchmarks	Returns as of 9/30/23	
	3 Month	YTD
Bloomberg US 1-5 Year Treasury	0.17%	1.12%
Bloomberg US 5-10 Yr Treasury	-3.14%	-1.76%
Bloomberg US Long Treasury	-11.83%	-8.55%
Bloomberg US 5-10 Yr Corp	-2.69%	0.37%
Bloomberg Municipal Bond	-3.95%	-1.38%
Bloomberg Commodity Index TR	4.71%	-3.44%

*Data Source: Morningstar and Vanguard Funds

Securities and investment advisory services offered through **Osaic Wealth, Inc.**, member FINRA/SIPC. **Osaic Wealth** is separately owned and other entities and/or marketing names, products or services referenced here are independent of **Osaic Wealth**. The S&P500 Index is unmanaged and cannot be invested in directly. Graphs and charts created by Virtus Capital, LLC are for illustrative purposes only. The information contained in this report is not a recommendation to buy or sell any security. Virtus Capital provides no gaurantees or assurances to the accuracy of third-party data. **Past Performance is not a guarantee of future results.**

VIRTUS CAPITAL

Market Summary & Outlook

Discussion

Equity Markets

A return mentality of "don't fight the fed" weighed on the mind of equity investors in Q3, as markets pulled back and yields rose again in anticipation of interest rates staying higher for longer. The S&P 500 PR, a measure of the broad economy, fell over 3.5% on the quarter while commodities experienced a cyclical rebound and gained nearly 5%, but still underperforming on the year. The net takeaway for capital markets in Q3 was a not so atypical melody of rising interest rates interrupting a narrow-based stock market rally, with investors feeling queasy over increasing equity market volatility in the midst of improving yields on fixed-income investments. Equity investors benefitted from a healthy up-market in the first half of 23', propelled by appreciation in valuation multiples and an anticipation of positive earnings growth in 24'. The Fed's interest rate hiking cycle (which has paused since July), appears to be reaching an end (for now) but sentiment has changed on the flip side for anticipated rate cuts in 24'. Fed watchers, including Goldman Sach's economists, have recently updated their forecasts, predicting any rate cuts to now come in Q4, 24' – a full two quarters later than anticipated just a few months prior (1). Additionally, at the Fed's recent September meeting, they showed projections that now expect only 50bps worth of rate cuts in 24', down a full percentage point from their earlier estimates (1). Prior to the brakes being put on the stock market rally, all three major U.S. indices (S&P 500, Dow Jones, and Nasdaq) were in positive territory on the year, with the tech-heavy Nasdaq the clear winner – climbing nearly 32% by the end of June. But the more granular story here has been the precariously narrow stock-rally, with the top 10 market-weighted U.S. stocks, such as Apple (AAPL) Amazon (AMZN) and Nvidia (NVDA), accounting for the vast majority of indices' gains, YTD. This scenario represents a large concertation-risk for investors of U.S. equities that allocate a significant portion of their holdings to index funds that replicate the market-weighted capitalization of the S&P 500, or for those who have direct exposure to the individual top 10 holdings. The shallowing of liquidity in capital markets which began in the front-end of the year with the Federal Reserve's quantitative tightening policy, has started to make its presence known, as the VIX index - a broad indicator of volatility in the equity markets – has risen steadily since early September to late October, increasing nearly 70% from a tranquil 13.09 to a billowy 21.79. The average S&P 500 VIX reading since 1990 has been a little below 20. Equity markets tend to rise when the VIX remains low, as investors feel more confident in the stability of market prices and the predictability of trade executions. Asset allocation strategies continue to prove challenged in 23'. Since 21' stock-bond correlations have remained positive, owed to historically high inflation and a prior decades long low-rate regime. This systematic challenge for multi-asset managers and investors becomes even more tedious, as a higher interest rate backdrop also erodes the future cashflows that companies can reinvest or return to shareholders, thus necessitating a thorough analysis of companies and sectors that may have an uneven exposure to interest rate risk. For example, cyclicals such as autos and air travel, typically suffer during rising rates as do technology stocks. However, the latter has bucked this trend in 23', while the former has largely stayed on script. One rationale for why large tech companies have managed rising stock prices in the face of higher rates could in part be owed to better debt and financial management than in previous higher rate cycles. This would make sense, given a number of large tech companies (such as AAPL) loaded up on long-dated debt at low rates during the 2010-2019 timeframe, leading to a lower cost-of-capital and a more manageable debt-service. How long though before this debt matures and has to be re-papered at higher rates? If the economic back drop remains favorable and the fed reduces rates in 24', the "soft landing" that Jerome Powell (Federal Reserve chairman) has been eyeing since late 21', could become a reality. Recapping the top equity sector performers in Q3 were Energy growing 11.33%, Communication Services rising 2.84%, and Financial Services losing -1.6%. The bottom three performers were utilities (-10.09%), real estate (-9.66%), and consumer staples (-6.61%) (9).

Securities and investment advisory services offered through **Osaic Wealth, Inc.**, member FINRA/SIPC. **Osaic Wealth** is separately owned and other entities and/or marketing names, products or services referenced here are independent of **Osaic Wealth**. The S&P500 Index is unmanaged and cannot be invested in directly. Graphs and charts created by Virtus Capital, LLC are for illustrative purposes only**.** The information contained in this report is not a recommendation to buy or sell any security. Virtus Capital provides no gaurantees or assurances to the accuracy of third-party data. **Past Performance is not a guarantee of future results.**

VIRTUS CAPITAL

Market Summary & Outlook

Fixed-Income Markets

Global central banks, which have been tightening since 22’ and throughout the H1, 23’, have generally paused or even loosened their belts in some emerging markets. Since the fed’s July meeting, the base rate of borrowing – the Federal Funds Rate – still stands at 5.25-5.5%. Consumers’ pocketbooks have felt the rate increases in the form of higher borrowing rates for homes and autos, with the national averages in Q2 coming in at 7.50% for a 30-year fixed mortgage and an even 9.00% for the typical car loan [(2)]. The current mortgage rates represent a +20% increase since the beginning of 23’, which has done little to cool red-hot housing prices that hit an all-time high in Q4, 22’ with the average home sale price in the U.S. reaching $552,600 – 2.5 years prior it was $374,500, a whopping 48% increase during the period. The deeply inverted yield curve – the 10-year less 3-month treasury yield – has been inverted for a year and prompted banks to tighten their lending standards. This has had a particularly strong effect on the commercial real estate market and fixed-income investors that rely on real estate investors’ cashflows for dividend payouts. Rising rates reduces the present value of future cashflows, so once positive net-present-value (NPV) projects are turning negative without injection of additional capital (typically coming in the form of equity), and thus with higher equity allocation comes an increase in risk-compensation (and again), thus, a higher risk-premium demanded by investors. The merry-go-round doesn’t stop there, but it illustrates the point that careful selection of real estate investment managers with adequate capitalization and lower exposure to higher-rate, variable debt, may prove more resilient in navigating the current rate environment. For example, according to Haver Analytics and AART Research, the share of U.S. banks that have tightened lending standards by size (large vs small banks) and the loan type they are exposed to (commercial, commercial-industrial, multi-family residential) shows that the commercial real estate segment is the most unevenly allocated with 44% of their loan-type sourced through small banks, while only 13% of their loans are via large institutions. Conversely, multi-family, is the most diversified with 21% and 24% sourced through small and large banks, respectively, as of end of Q3. This data perhaps suggests that multi-family may have (in this current cycle) more effectively allocated their portfolio across the breadth of the banking sector and thus have less exposure to the recent regional banking instability experienced in H1, 23’. However, until this current rate cycle reconfigures, real estate assets will remain sensitive to rate movements, with longer duration assets most likely experiencing the greatest volatility in value. Labor costs and services inflation may continue to push inflation higher for longer which keeps added pressure on the fed to maintain its current fiscal policy response. Additionally, this current rate regime should keep yield-seeking investors in the driver seat for the foreseeable future, with real yields (nominal rates less inflation expectations) the highest they’ve been since 2007, at approximately 2.3% on the 10-year U.S. treasury, YTD.

Outlook

Virtus Capital’s base-case for the U.S. economic cycle has remained largely unchanged, YTD. As discussed in our three previous 2023 outlooks, the U.S. economic recession has yet to materialize as many economists predicted it would in Q4 of 22’. Instead, Virtus Capital’s analysis has been more closely aligned with a smaller (but growing) out-of-consensus view that recission risk was less likely in 23’. However, an elevated risk still remains for later in 24’ and early into 25’ if inflation does not moderate towards the fed’s low hanging target of 2-2.5%. Additionally, both sales and earnings growth for S&P 500 companies are forecasted to grow at 5% and 12% YoY, respectively, representing a 1% increase from Q2’s forecast. However, U.S. equity market investors are already sitting at higher valuations relative to their historical averages. Will earnings growth continue to lead to stock multiple expansion or will prices stay flatter as earnings grow, leading to contracting multiples? Earnings growth surprises to the upside have historically pushed returns higher for Information Technology, Consumer Discretionary, and Materials. Being that the U.S. currently stands in a late-cycle economic expansion phase, the odds for earnings growth surprises to the upside may prove less likely than would be the case in early-cycle phases. Emerging markets continue to see valuation compression and have found a new headwind in re-accelerating commodity prices, which have a disproportionately negative effect on emerging market households, as they utilize a higher percentage of disposable income to meet their energy and food consumption needs. This factor, among others, may continue to keep emerging market performance muted relative to developed foreign markets.

Securities and investment advisory services offered through **Osaic Wealth, Inc.**, member FINRA/SIPC. **Osaic Wealth** is separately owned and other entities and/or marketing names, products or services referenced here are independent of **Osaic Wealth**. The S&P500 Index is unmanaged and cannot be invested in directly. Graphs and charts created by Virtus Capital, LLC are for illustrative purposes only**.** The information contained in this report is not a recommendation to buy or sell any security. Virtus Capital provides no gaurantees or assurances to the accuracy of third-party data. **Past Performance is not a guarantee of future results.**

Quarterly Market Update – 3Q, 2023

Market Summary & Outlook

VIRTUS CAPITAL

The consensus U.S. equity market outlook for the remainder of 23' and into 24' calls for an increase in earnings and sales, with margins remaining flat, YoY. Virtus Capital's investment management strategies continue to highlight portfolio diversification and strategic asset allocations to quality companies that possess long-term competitive advantages. Our investment philosophy focuses on a long-term approach to portfolio diversification and security selection. So far in 2023, many of our investors have taken the opportunity to build cash reserves in higher yielding money market instruments. We help investors take advantage of near-term opportunities in our actively managed portfolios. Virtus Capital's Q4, 23' market outlook calls for a disciplined and thoughtful approach to portfolio construction, that aims to deliver greater long-term value through our risk-adjusted and fully customizable investment management strategies.

Q3, 2023 Quote:

"The investor's chief problem – and even his worst enemy – is likely to be himself."

-**Phillip Fisher**

American investor and author

Sources

(1) Reuters Report: https://www.reuters.com/markets/rates-bonds/goldman-sachs-pushes-its-forecast-fed-rate-cut-q4-2024-2023-09-21/

(2) Home and auto loan: https://www.marketwatch.com/guides/car-loans/auto-loan-interest-rates-by-credit-score/

(3) Benchmark return data - https://personal.vanguard.com/us/funds/tools/benchmarkreturns

(4) Benchmark return data – www.morningstar.com

(5) Fed Rates - https://www.cnbc.com/2023/05/01/what-another-federal-reserve-rate-hike-means-for-you.html

(6) Home Sale Prices - https://fred.stlouisfed.org/series/ASPUS

(7) Fidelity Data - **https://institutional.fidelity.com/app/literature/item/9871152.html**

(8) GDP Data - https://www.cnbc.com/2023/04/27/gdp-q1-2023-.html

(9) Sector Data - https://www.investopedia.com/utilities-and-real-estates-sectors-drag-down-sp-500-in-q3-despite-surging-energy-stocks-8286094

(10) Fisher Quote - https://equito.co/the-best-investing-quotes/

(11) VIX data - https://www.cboe.com/tradable_products/vix/vix_historical_data/

(12) FACTSET Report - https://advantage.factset.com/

Securities and investment advisory services offered through **Osaic Wealth, Inc.**, member FINRA/SIPC. **Osaic Wealth** is separately owned and other entities and/or marketing names, products or services referenced here are independent of **Osaic Wealth**. The S&P500 Index is unmanaged and cannot be invested in directly. Graphs and charts created by Virtus Capital, LLC are for illustrative purposes only**.** The information contained in this report is not a recommendation to buy or sell any security. Virtus Capital provides no gaurantees or assurances to the accuracy of third-party data. **Past Performance is not a guarantee of future results.**