MARKET PERSPECTIVES

PREPARED BY SMITH GROUP ASSET MANAGEMENT

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CANTOR Fitzgerald

Market Summary

U.S. Equity Markets (%)	3Q'23	1 Year	3 Years	5 Years	10 Years
S&P 500	-3.3	21.6	10.2	9.9	11.9
Russell 1000 Growth	-3.1	27.7	8.0	12.4	14.5
Russell 1000 Value	-3.2	14.4	11.1	6.2	8.5
Russell 2000	-5.1	8.9	7.2	2.4	6.7
Russell 2000 Growth	-7.3	9.6	1.1	1.6	6.7
Russell 2000 Value	-3.0	7.8	13.3	2.6	6.2

Top/Bottom Sectors (%)	3Q'23	1 Year
Energy	12.2	30.1
Comm. Services	3.1	38.4
Financials	-1.2	12.0
Cons. Staples	-6.0	7.4
Real Estate	-8.9	-2.2
Utilities	-9.2	-7.0

Price Comparison (in USD)	Sep. 30, 2022	Sep. 30, 2023
Oil (WTI spot)	$79.74	$90.77
Natural Gas	$6.83	$2.93
Gold	$1,668	$1,865
Fed Funds Rate (Upper Target)	3.25%	5.50%
10-Yr Treasury	3.83%	4.58%
VIX	31.62	17.52

Non-US Equity Markets (in USD) (%)	3Q'23	1 Year	3 Years	5 Years	10 Years
MSCI AC World Ex-U.S.	-3.8	20.4	3.7	2.6	3.3
MSCI EAFE (Developed)	-4.1	25.7	5.8	3.2	3.9
MSCI Emerging Markets	-2.9	11.7	-1.7	0.6	1.9

Non-US Regions (in USD) (%)	3Q'23	1 Year
Developed Americas	-3.8	12.3
Developed Asia	-2.6	20.7
Developed Europe	-4.9	29.3

Non-US Regions (in USD) (%)	3Q'23	1 Year
Emerging Americas	-4.7	20.5
Emerging Asia	-2.7	11.7
Emerging EMEA	-1.9	6.3

Source: MSCI, S&P Global, LSEG; Refinitiv, St. Louis Federal Reserve Bank; Periods greater than one-year have been annualized

Highlights

- Equity markets showed some modest signs of broadening out in the quarter but cap-weighted indices once again outpaced equal-weighted indices.
- Consumer spending shows little sign of slowing despite inflation and interest rate headwinds.
- Valuations on a cap and equal-weighted basis are looking more reasonable just as earnings are poised to turn upward.

Economic & Market Review

In July, US equity markets extended the rally that began in October 2022 with the S&P500 index rising 3.2%, lifting the index 30% off the October 2022 lows and a mere 1.8% below the highs of early 2022. But July 31 was the high-water mark for the index as it traded down 6.3% over the next two months and finished down 3.3% for the quarter. Traditionally defensive sectors provided little protection from the market pullback as Consumer Staples and Utilities stocks fell 7.9% and 11.4%, respectively, over August and September. Small Caps fared much worse in the sell-off with the Russell 2000 Index falling 10.6% for the last two months. The average stock in the S&P 500 continues to trail the index by a wide margin, returning 1.9% year-to-date versus 13.1% for the capitalization-weighted index. The Federal Reserve raised the Fed Funds Target another 0.25% in the quarter and the yield on the 10 Yr. Treasury rose 0.72% from 3.86% to 4.58%. Mortgage rates reached a 23-year high at quarter's end as rates on 30-year fixed mortgages rose to 7.3%. WTI Crude rose 28% to $90.77/bbl. while lithium prices continued their sell-off falling 40% for the quarter and are now down 67% from their December 2022 peak.

Over the past year, we have been of the view that at least a mild recession would be required in order for the Federal Reserve to reach its goal of bringing inflation down to its 2% target. The economy has proved far more resilient than we expected and despite the economic strength inflation has come down markedly from the June 2022 peak. We do not believe the economy is yet out of the woods as myriad concerns remain including a yield curve that remains significantly inverted, labor strife at GM, Ford and Stellantis, continued budget wrangling in D.C., the war in Ukraine and significant weakness in Europe and China. At the same time, the odds that the Fed will achieve a soft landing are also rising. Primary contributing factors to an optimistic outlook are healing of supply chain pressures, consumer and corporate balance sheets in strong positions, consumer spending remains robust, financial conditions (as measured by the Chicago FRB National Financial Conditions Index) at their most accommodative level since the Fed began rate increases in March 2022 and an acknowledgment that history may not be much of a guide given the unique nature of the pandemic that initiated this current cycle. The market sell-off that began in January 2022 was largely based on a belief that inflationary pressures would eventually lead to a recession, just as the market rebound that began in October 2022 reflected acknowledgement that the economy was defying pessimism and holding up quite well in the face of interest rate increases. The big-

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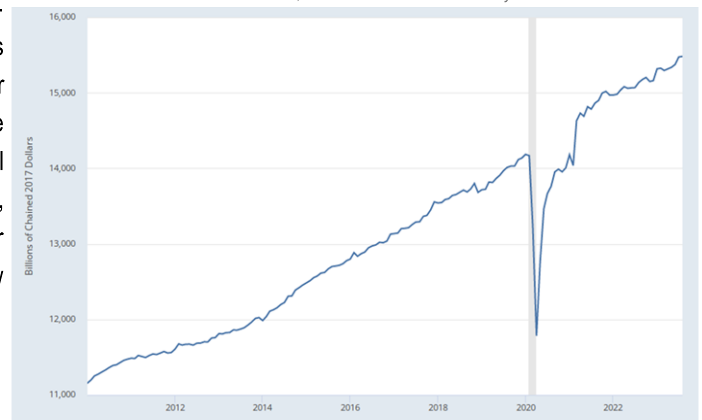
gest driver of the U.S. economy is consumer spending and there's little sign of significant pressure on consumer spending at this time. While consumer preferences may have shifted from services to goods and back again, real spending has rolled along, despite all the pressures of higher inflation. Exhibit 1 shows consumer spending has quickly returned to its trend of the post-GFC period following the brief, but dramatic downturn during the first half of 2020. Given the growth in real household income over the past year and continued strong employment readings, driven by the hesitancy of corporation's to cut payrolls following a period of labor shortage, the likelihood of the Fed threading the needle for a soft landing now appears to be the consensus outlook.

Exhibit 1: Real Personal Consumption Expenditures, 2010-2023
Source: Federal Reserve Bank of St. Louis, U.S. Bureau of Economic Analysis



Corporate Earnings and Market Valuations

In mid-2022 we stated our expectation that corporate earnings would fall by 5-10% from the mid-2022 peak due to cost pressures and a slowdown in top-line growth. This drop would have brought 2023 S&P 500 earnings to $205-$210, roughly in line with 2021 levels. Earnings have proven far more robust than we expected and after three quarters of side-ways to slightly down year-over-year reports that saw earnings fall by only 3.4%, earnings appear on an upward trajectory once again with an expected next 12-months rise of 10.2% for the average stock in the S&P 500 Index and an increase of 7.7% for the capitalization-weighted index. If consensus earnings expectations are accurate then the S&P 500 Index is trading at 19.3x forward earnings and the average stock in the index is trading at 18.0x forward earnings (see Exhibit 2). Much has been made of the performance of the Magnificent Seven stocks. Year-to-date the group is up 87.9% on average, 63.3% on a cap-weighted basis and accounts for 84% of the total return of the index. The group currently trades at 12x sales, although that metric is skewed by NVIDIA which trades at 34x trailing sales but a far less eye-popping 15x forward 12-month consensus revenues. The group is expected to see earnings growth of 37% on a cap-weighted basis although the range of growth varies from a 4% earnings drop for Tesla to a greater than 180% rise for NVIDIA. Whether the year-to-date almost triple digit price increases for the group is justified is entirely dependent on your view of the likelihood of the companies maintaining their past growth trends. The group does constitute a significantly greater capitalization-weight in the index than their earnings weight, even when forward earnings growth estimates are used. The group currently accounts for 27.3% of the S&P 500 Index weight but only 18.4% of the earnings weight of the index. This would imply that compared to the rest of the S&P 500 Index the group is relatively expensive and surpassed only by Financials, which are in the midst of an earnings downturn, and Communication Services as the most expensive groups in the index.

Exhibit 2: S&P 500 Forward 12-month Price/Earnings Multiples (excl'g Real Estate) ; *Source Standard & Poor's, Refinitiv, Bloomberg*

	Average F12M P/E	Cap-Wtd F12M P/E	Cap-Weighting Impact	Average F12M EPS Growth	Cap-Wtd F12M EPS Growth	Cap-Weighting Impact	Earnings Weight Sector	Cap-Weight of Sector	Earnings Weight / Cap Weight
Information Technology	23.9	25.9	2.0	9.2	19.6	10.4	21.4	27.2	79%
Health Care	22.9	21.8	(1.1)	8.8	12.8	4.0	16.4	13.4	122%
Industrials	21.7	23.1	1.4	10.3	11.0	0.7	10.0	8.3	121%
Communication Services	18.9	19.1	0.2	21.3	38.1	16.8	2.6	8.9	29%
Consumer Staples	18.5	21.5	3.1	4.8	6.5	1.7	7.9	6.5	122%
Consumer Discretionary	18.4	36.7	18.2	21.9	34.1	12.1	10.3	10.6	97%
Materials	16.7	19.9	3.2	(0.6)	4.9	5.5	5.8	2.5	233%
Utilities	15.3	15.7	0.3	14.9	14.4	(0.5)	4.1	2.4	169%
Financials	14.1	16.5	2.4	10.3	13.3	3.0	9.4	12.9	73%
Energy	12.9	12.9	0.0	(4.0)	(12.1)	(8.1)	12.2	4.8	254%
Total	**18.0**	**19.3**	**1.3**	**10.2**	**7.7**	**(2.5)**			
Magnificent Seven*	**34.1**	**31.4**	**(2.8)**	**47.2**	**37.1**	**5.8**	**18.4**	**27.3**	**67%**

* Apple, Microsoft, Amazon, NVIDIA, Alphabet, Tesla, Meta

Conclusion

Inflation has been receding and the U.S. economy continues a path toward normalization while generally outpacing expectations. The economic outlook for Europe and China is not nearly as sanguine as both regions are either in recession or assuredly headed toward one in short order. The Fed remains in tightening mode, but the transmission mechanism of the long and variable lags of monetary policy appear much more difficult to judge relative to prior rate cycles. Just as the causes of this inflationary spike were unique, the effectiveness of the medicine also seems unique. There is a fairly reasonable chance that the economy is just now starting to feel the effects of monetary policy and if that is the case, then a recession would seem the likely outcome. However, consumers are the most important driver of the U.S. and they appear healthy with real wages rising and consumption showing few signs of slowing. Corporate balance sheets are in good standing with little need for debt issuance to fund growth. Given these tail winds an environment of high-single digit corporate earnings growth and a slowdown but not a crash in the economy seems a reasonably likely outcome.

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