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3rd Quarter 2023 Moreno Dye Cervantes
Wealth Management Group of Wells Fargo Advisors Quarterly Newsletter

We have mentioned time and time again this year that we are cautious about the financial markets because, in our opinion, there has been an overly optimistic expectation of the economy and the Federal Reserve to engineer a "soft landing". Admittedly, we were surprised how well the first half of the year bounced back from the lows of 2022, but we have essentially remained in a protracted trading range for the last twenty months. Below you can see that the resurgence in economic uncertainty led to negative performance for all major asset classes during the 3rd quarter:

	2023 3rd Quarter	2023 Year-to-Date
Dow Jones Industrial Average	-2.10%	2.70%
Russell 1000 Growth Index	-3.10%	25.00%
Russell 1000 Value Index	-3.20%	1.80%
NASDAQ Composite Index	-3.90%	27.10%
Russell Mid Cap Index	-4.70%	3.90%
Russell 2000 Index (Small Cap)	-5.10%	2.50%
MSCI EAFE – International Index	-4.00%	7.60%
Bloomberg Barclays US AGG Bond	-3.20%	-1.20%

*Wells Fargo Advisors Monthly Major Index Returns

We would like to point out a few things regarding this year's performance numbers. The only significant gains this year have come from NASDAQ related growth/technology stocks. There are only a small handful of companies that have driven those index returns, which means that the remaining sectors of the stock market are just slightly up for the year with the exception of international stocks. If performance holds, this could be the first time in fifteen years that international stocks have outperformed domestic stocks. Lastly, the general bond market is down again this year and if the 10yr Treasury note ends negative in 2023, it would mark the first time ever in U.S history that the 10yr Treasury note has negative performance for three consecutive years.

Over the past quarter, it appears that the financial markets are finally starting to become more concerned about near-term economic growth after the Federal Reserve has raised interest rates from 0 to 5.5% and the potential for inflation to remain elevated due to high oil and gas prices. Our primary concern has been that the markets have not taken seriously the FED's threat of keeping interest rates "higher for longer" and now it seems that the entire financial spectrum is reassessing that possibility. It will not surprise us if the FED raises interest rates another 0.25% in the 4th quarter before taking a longer pause to monitor inflation levels.

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It is important to remember that inflation by definition is too much money chasing too few goods. Unfortunately, the Federal Reserve cannot produce more goods, so the only tools they have to battle inflation is to reduce the money supply by either increasing interest rates (aka the cost of borrowing), reducing their balance sheet

(quantitative tightening) or both. Currently, the FED is still utilizing the most aggressive approach of both. History has taught us that the most common killer of economic expansions has been when the FED either raises interest rates too quickly, raises rates too high and or leaves rates too high for too long. This is the crux of our near-term hesitation about economic growth, because there currently is a higher probability of one or more of those scenarios occurring.

Ultimately, we believe the Federal Reserve will be successful in bringing inflation down to their 2% target goal, but it is still going to take time. Inflation has come down to just under 4% annually, but we need to see areas like housing costs moderate more substantially than it has so far in 2023. We also should expect to see an increase in the unemployment rate, but the tight labor market has shown little signs of easing and ironically is giving the FED cover to raise interest rates further if they choose. There is also a concern that wage increases and energy prices could keep inflation above the FED's target goal leading to a higher for longer interest rate environment scenario.

As we finish out 2023, we expect that the financial markets will be laser-focused on how incoming economic data reflects on inflation. Wages, in particular, is an area that we are watching very closely because the FED has explicitly said that they are concerned about the possibility of a wage/price spiral. This occurs when wages go up giving people more money to purchase goods, which results again in the price of goods going up and then employees demand higher wages because the cost of living continues to rise. It is a nasty spiral that is typically broken by either an increase in unemployment or a reduction in job openings. As we stated previously, the labor market is still very tight, but we have seen signs of labor market softening, so the fears of a wage/price spiral seem small.

We know that we have sounded like a broken record for the last year or so, but we are starting to see signs that the FED is more likely than not to pause interest rates at current levels. The primary uncertainty is how long will the FED keep interest rates over 5% before they feel comfortable enough to begin cutting rates down to their long-term target rate of 2.5%. Therefore, because we are still in an environment where the FED is considering the possibility of raising rates and maintaining rates at higher levels, while continuing to reduce their balance sheet that we remain cautious over the next few quarters.

Once the financial markets get a little more clarity and confirmation that inflation is continuing its downward trend, would we anticipate an investment environment that can look forward to an eventual reduction in interest rates and economic expansion. Historically, bond yields tend to peak around the time the FED approaches its last rate hike, which we believe has either already occurred or will occur in the 4th quarter.

For now, we anticipate that the stock market will continue to yo-yo around for a little while longer, but we are getting closer and closer each day to a positive FED catalyst. International stocks continue to be attractive from a valuation perspective relative to domestic stocks, but the strength of the US dollar has been a headwind. We would expect that as the FED signals they are finished raising rates that the dollar will stabilize and international stocks will maintain their attractive valuations. Bond yields on the other hand are the best we have seen in about 20 years and currently provides the best risk adjusted return possibilities in the short-term. We will continue having conversations with you about further extending bond duration in order to take advantage of the higher yield environment. Who knows when we will get this opportunity again once the FED pauses and starts considering cutting rates.

This year might be a year of consolidation without a tremendous amount of growth, but the foundation is being laid for progress in the not-too-distant future. It is tempting to want to park money in cash earning 5% until we feel better about the economy, but history has taught us time and time again that the most successful investors are the ones that have a plan for the future and stick to their plan. Our focus for you remains on your long-term goals and we will continue working each and every day to help you achieve them.

Thank you so much for all the support that you have shown our team over the years. We look forward to speaking with you in the weeks and months to come, but please don't hesitate to reach out to us at any time if you have any questions or concerns about your portfolio. We also want to wish you and your families a very happy upcoming holiday season filled with good health and happiness.

Best Wishes,

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Managing Director – Investments

Michael B. Dye, CRPC®
Managing Director – Investments

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Managing Director – Investments

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The Dow Jones Industrial Average is a price-weighted index of 30 "blue-chip" industrial U.S. stocks.
The S&P 500/Barra Growth Index is an unmanaged capitalization-weighted index stocks in the Standard & Poor's 500 index having the highest price to book ratios. The Index consists of approximately half of the S&P 500 on a market capitalization basis.
The S&P 500/Barra Value Index is an unmanaged, market-capitalization-weighted index of the stocks in the Standard & Poor's 500 Index having the lowest price to book ratios. The index consists of approximately half of the S&P 500 on a market capitalization basis.
The NASDAQ Composite Index measures the market value of all domestic and foreign common stocks, representing a wide array of more than 5,000 companies, listed on the NASDAQ Stock Market.
The S&P Midcap 400 Index is a capitalization-weighted index measuring the performance of the mid-range sector of the U.S. stock market, and represents approximately 7% of the total market value of U.S. equities. Companies in the Index fall between the S&P 500 Index and the S&P Small Cap 600 Index in size: between $1-4 billion.
The S&P Small Cap 600 Index consists of 600 domestic stocks chosen for market size, liquidity (bid-asked spread, ownership, share turnover and number of no trade days) and industry group representation. It is a market value-weighted index (stock price times the number of shares outstanding), with each stock's weight in the index proportionate to its market value.
The MSCI EAFE Index is designed to represent the performance of large and mid-cap securities across 21 developed markets, including countries in Europe, Australasia and the Far East, excluding the U.S. and Canada.
Bloomberg Barclays U.S. Aggregate Bond Index is a broad-based measure of the investment grade, US dollar-denominated, fixed-rate taxable bond market.