Vestor Capital
INVESTMENT & WEALTH MANAGEMENT

Economic and Investment Outlook

October 11, 2023

Equity Market Update

Equity indexes have had a wide dispersion of returns this year. U.S. large technology stocks have posted strong gains as evidenced by the NASDAQ Composite return of 27%, whereas their small-cap counterparts are only up 1%. Developed international indexes are up modestly due in large part to a modest weighting of technology stocks and a heavier weighting in financial, health care and consumer stocks which have generally posted modest gains. Emerging market stocks, due in large part to weakness in Chinese equities, have only posted gains of 2%.

The fundamentals of mega-cap technology stocks are very strong with revenue and earnings growth well above most companies, explaining their strong performance this year. Much has been written about the "Magnificent 7" (Apple, Microsoft, Amazon, NVIDIA, Tesla, Alphabet and Meta) stocks in the S&P 500. While valuations of these companies have increased, their price-to-earnings ratio/earnings growth (PEG ratio) is 1.3 times vs. 1.9 times for the remaining 493 companies in the S&P 500. This indicates that "Magnificent 7" PE ratios, while higher than the average stock, are justified by their much faster earnings growth. We believe equity markets are efficiently pricing in company fundamentals and would expect more stocks to rally once it becomes clear that interest rates have peaked.

Total Return Performance for the Major U.S. and International Stock Market Indexes

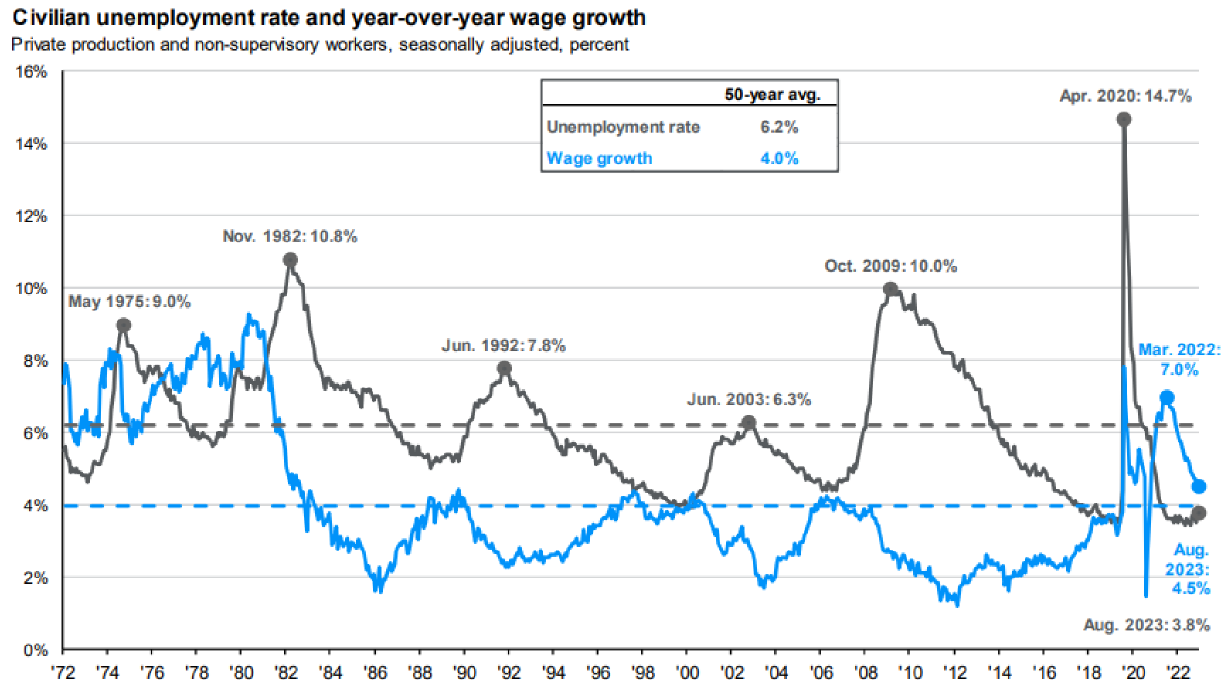
Equity Index	*YTD September 30, 2023*
United States	
Dow Jones Industrial Avg.: 30 Stock Composite	**2.73 %**
S&P 500 Composite: U.S. Large Cap	**13.06 %**
NASDAQ Composite: Technology Heavy	**27.11 %**
S&P 600 Small Cap: U.S. Small Cap	**0.76 %**
International	
MSCI EAFE Large Cap: Europe, Asia & Far East Large Cap	**7.63 %**
MSCI EAFE Small Cap: Europe, Asia & Far East Small Cap	**2.30 %**
MSCI EM Emerging Market: Emerging Market Countries	**2.07 %**

Source: Bloomberg, L.P.

Economy

There is much disagreement among economists over whether the U.S. is entering into a recession. Most economic indicators are reasonably good. Employment remains very strong with the September jobs report showing a robust addition of 336,000 workers which was well above forecasts. The graph below highlights that unemployment claims are near multiyear lows and wage growth is strong. Finally, consumer spending remains robust and while manufacturing is soft, this comprises a small portion of our economy.

We believe that the economy has performed admirably given the large increase in interest rates this year. The question is whether the economy can handle further rate hikes. We believe that further rate hikes will pose a problem for the economy. Encouragingly, a number of Federal Reserve officials have recently pointed to the fact that increases in long-term interest rates may result in not needing to raise short-term interest rates further. This would be welcome news as we believe the economy has bent in the face of rapid interest rate hikes but may break if interest rate hikes continue.



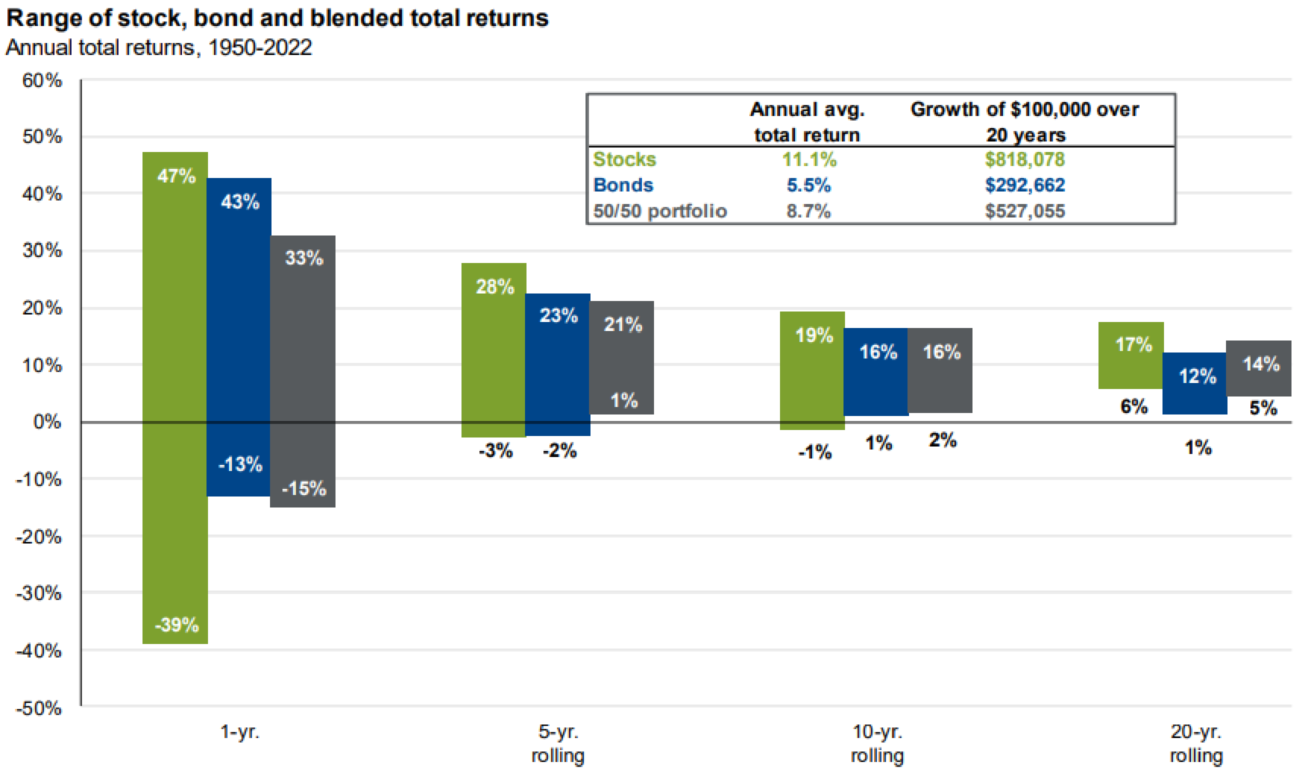
Source: JPMorgan Guide to the Markets 9/30/2023

Inflation

Interest rate hikes have had the desired effect of lowering inflation to the 3% level. The question that remains is whether it will decline further to the 2% target that the Federal Open Market Committee (FOMC) desires without additional interest rate hikes. Candidly, this is difficult to ascertain given the number of variables involved. Typically, unemployment needs to increase to stamp out inflation and we have not seen employment weaken. Also, consumer spending remains strong which is another impediment to lowering inflation. If we have learned anything post-COVID is that past economic relationships do not necessarily give you confidence in predicting the future as economists continue to be surprised. Encouragingly, we do not believe that inflation will be a persistent problem going forward and would expect equities to perform well in the current inflationary environment.

U.S. Market Outlook

Forecasting equity and bond returns over a short period of time is very difficult. However, stocks and bonds have posted strong returns over time. Market pullbacks can test the patience of investors. Interestingly, the graph below highlights the fact that over 5-year rolling periods going back to 1950, the worst performance was -3% and -2% for equities and bonds, respectively. Note that a 50/50 portfolio of equities and bonds has never posted a 5-year rolling loss. This highlights the fact that it pays to be patient during turbulent times in the market. While short-term market volatility can at times be unnerving, it is wise to take a step back and look at the big picture which has demonstrated that patient long-term investing has produced attractive returns. Moreover, the graphs below do not assume that money is added on market weakness which of course would result in even higher returns.



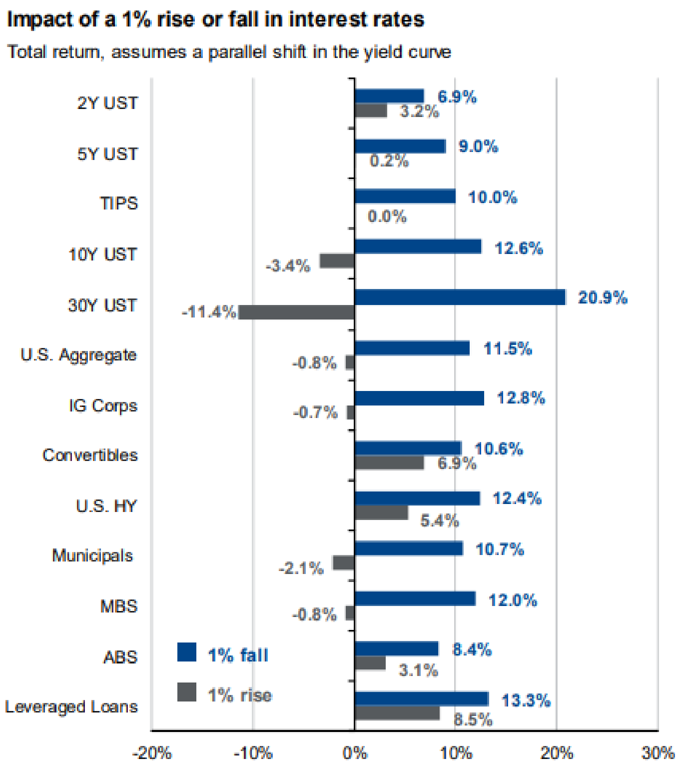
Source: JPMorgan Guide to the Markets 9/30/2023

Conflict in Israel

Sadly, violence has broken out with the Hamas attack on Israel. While markets initially sold off in response, as is typical in times of war, markets stabilized quickly. Oil prices originally jumped, but have since stabilized, indicating investors do not see the conflict affecting energy supplies from the Middle East. It is impossible to ascertain whether this conflict will escalate in the Middle East or when it will end, as is the nature of the unpredictability of war. We have seen from the war in Ukraine that if wars are contained to a region, they typically do not have wide ranging market impacts. However, we would expect market volatility to remain as the situation unfolds.

Fixed Income

The graph below is busy but the key takeaway is that even if interest rates were to rise from currently elevated levels, investors would only experience serious losses in long-term instruments. It is for this reason that we favor short-term bonds which have an attractive yield to protect against possible interest rate increases. We continue to believe that now is an excellent time to establish a position or add to fixed income.



Source: JPMorgan Guide to the Markets 9/30/2023

Summary

As we approach the end of 2023 it is a good time to reflect on how well the economy and equity markets have performed in the face of rising interest rates. While many asset classes have posted modest gains, this is better than most investors would have expected at the start of the year. A large portion of the S&P 500 performance has been due to large strong companies performing well due to secular growth drivers. We expect market breadth to improve and spread to small and mid-capitalization stocks as we approach the end of the interest rate hike cycle as these companies are more impacted by interest rates. After years of financial repression, fixed income investors are earning interest well above the paltry yields of the past decade. Looking forward, the final obstacle to markets is the inflation dragon which hopefully will be fully slain soon.

10 S. Riverside Plaza, Suite 1400 · Chicago, IL 60606 · T: 312.641.2400 · F: 312.641.3646