EQUITY MARKET UPDATE

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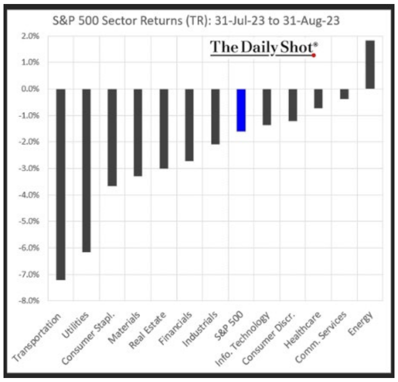

Stocks took a step backwards in August as long-term interest rates rose to their highest levels in 22 years. A flood of new Treasury bonds were issued to finance the government's deficit spending, and data continued to show the resiliency of the US economy. This further confirmed the Fed's "higher interest rates for longer" view.

The S&P 500 fell 1.59%. Selling was broad based as all economic sectors declined in value, except for energy which gained 1.81%. Interest rate sensitive sectors like real estate (-3.00%), consumer staples (-3.57%), and utilities (-6.16%) fared the worst. The Dow Jones Industrial Average fell 2.01%, while the NASDAQ lost 2.05%. Mid-cap and small-cap stocks underperformed their large cap peers with declines of 2.89% and 4.15%, respectively.

Year-to-date returns remain strong, but investors must dig deep into the data because headline numbers are a bit deceiving. The S&P 500 is up 18.72%; however, only three (communications +45.16%; technology +44.66%; and consumer discretionary +34.63%) of the eleven economic sectors are outperforming the market. Next, seven companies (Apple +45.21%; Microsoft +37.60%; Amazon +64.30%; NVIDIA +237.82%; Alphabet +54.34%; Meta Platforms +145.88%; and Tesla +109.51%) account for almost 75% of all the money made in 2023! The Dow Jones Industrial Average (+6.37%) has significantly trailed the S&P 500 due to its lower allocation to technology and its overweight of healthcare and financials. The tech heavy NASDAQ (+34.89%) has performed the best on investor enthusiasm about the future potential of artificial intelligence. Meanwhile, mid-cap (+10.02%) and small-cap (+7.19%) stocks have trailed the broader market with their overweight exposure to regional banks.

The US economy is on firm footing, but growth is not consistent across all segments. In many pockets, activity is cooling from higher interest rates (e.g., housing with 30-year mortgage rates above 7%). Labor remains the bright spot with another 187,000 jobs being created last month. Unemployment jumped to 3.8%, but the increase was attributable to more Americans joining the workforce. Wages were up 4.3% from one year ago, an amount that far exceeds both the Fed's expectations and the pay raises seen pre-COVID. The labor market remains tight, but competition to recruit and retain employees has waned from last year. The JOLTS report showed there are 8.8 million jobs open but unfilled. That equates to

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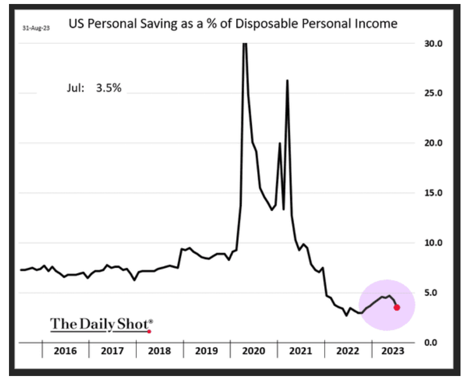
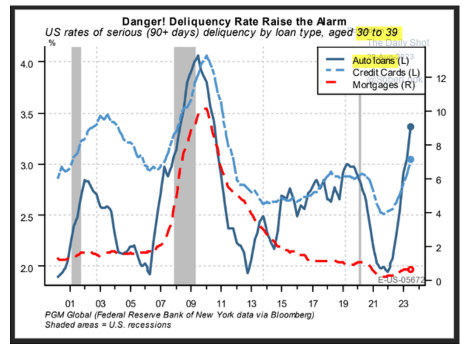
1.5 job openings for every unemployed person, a significant decline from the 2.1 jobs seen last fall.

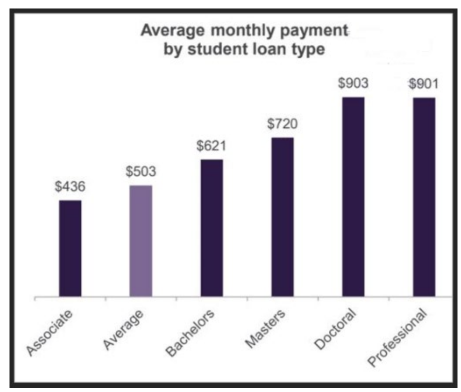
Consumer inflation ticked up slightly as prices increased 3.2% from one year ago. Core inflation that removes food and energy prices rose by 4.7%. PCE data, the Fed's preferred measure of inflation, also grew with total prices climbing 3.3%, while prices ex-food and energy rose 4.2%. The data presents a major challenge for the Fed. Inflation has slowed significantly from the high-water marks seen last year; however, the pace of decline is decelerating, especially in the service area of the economy.



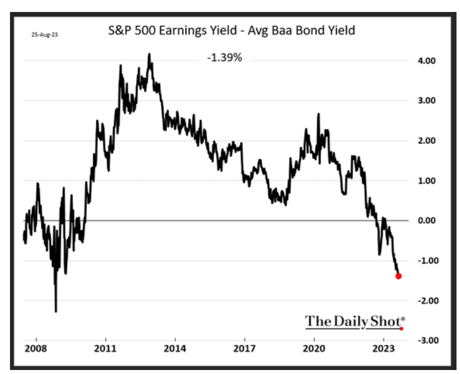
The data above shows wages are now growing faster than overall inflation, so the increase in real wages is fueling consumer spending. That was visible in the 1% increase in retail sales last month. However, not all is rosy with the consumer. The savings rate is 3.5%, well below pre-COVID levels. Credit card balances are at record amounts, and debt delinquency is increasing in both credit cards and auto loans, especially among people with lower credit scores. Younger consumers will face another headwind as student loan payments resume after more than three years of forbearance due to COVID orders from Presidents Trump and Biden.



Business investment is weak as higher interest rates dissuade business owners from further spending, especially for goods. The ISM Manufacturing PMI Index was in contractionary territory for a tenth straight month, while new orders have declined for 13 of the past 14 months. Services, meanwhile, continue to power the economy. The ISM Service PMI Index was 54.5, well into expansionary territory. Service based employment and new orders are also expanding, while prices paid for services accelerated to 58.9.



Collectively, the data shows the Fed is winning the battle with inflation. We appear to be entering the final stages of the rate hiking cycle. Some Fed governors have communicated they are done raising rates, but Chairman Powell has left the door open for one or two more quarter-point hikes should inflation reignite. With the central bank now in a holding pattern, investors are unsure how long it will take for inflation to return to 2%, along with the magnitude the economy needs to slow to obtain those levels. Clearly, the market is betting on a soft landing where inflation dissipates without triggering a recession.



Stocks are trading at 18.8x forward earnings estimates. This is up from 16.6x to start the year and above both the 5-year (18.6x) and 10-year (17.4x) averages despite the higher interest rate environment. The equity risk premium that compensates investors for the excess risks associated with stocks compared to bonds is historically thin. After three straight quarters of year-over-year earnings declines, analysts are modeling accelerating profit growth over the next four quarters. However, with the market trading at lofty forward valuations, it could be argued that plenty of good news has already been priced into the market. Given the recent climb in long-term bond yields, the market is vulnerable to downside volatility should the earnings projections fail to materialize.

At a time in which the risk-to-reward outlook appears challenging, we are focusing on quality companies with lower valuations, strong balance sheets, and growing dividend streams to enhance returns. We continue to slowly build our allocation to interest rate sensitive areas like utilities and REITs. Finally, we believe investors with fixed income allocations should lock-in attractive interest rates by purchasing high quality bonds along the intermediate portion of the yield curve that provide appealing total return profiles through elevated current income with future price appreciation potential.

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