

Investment Tally & Perspective

MAJOR ASSET CLASS RETURNS

	3rd Qtr. 2023	1-Year	3-Year	5-Year	10-Year
Equities					
S&P 500	-3.3%	21.6%	10.2%	9.9%	11.9%
MSCI EAFE	-4.1%	25.6%	5.8%	3.2%	3.8%
MSCI Emerging Markets	-2.9%	11.7%	-1.7%	0.6%	2.1%
Fixed Income					
Bloomberg US Aggregate	-3.2%	0.6%	-5.2%	0.1%	0.7%
Bloomberg US Corp Investment Grade	-3.1%	3.7%	-4.9%	-0.9%	1.9%
Bloomberg Emerging Markets Unhedged	-2.3%	7.6%	-4.2%	0.2%	2.1%
Other Assets					
Dow Jones Composite All REIT Index	-8.1%	-0.8%	2.7%	2.5%	6.0%
S&P GSCI	16.0%	10.9%	29.5%	5.6%	-2.5%
ICE WTI Crude Oil	28.5%	15.3%	31.2%	4.4%	-1.2%
Comex Gold	-3.3%	11.6%	-0.4%	9.3%	3.5%

Source: Capital IQ

All returns greater than one year are annualized

* The market indices discussed are unmanaged. Investors cannot directly invest in unmanaged indices

Market Activity - After a strong second quarter for stocks and bonds, financial markets took back much of the gains as they increasingly declined towards the end of the third quarter. The S&P 500 decreased by 3.3%, its first negative tally since Q3 last year. Bonds, as measured by the Bloomberg US Aggregate, also had a tough quarter. Yields on the 10-Year U.S. Treasury climbed steadily throughout the quarter – from 3.84% on June 30 to 4.58% on September 30 – while yields on longer-term notes approached levels last seen in 2007.

Economic Activity – Many of the trends we spoke about last quarter remain in place. The U.S. economy continues to show strength in the face of mounting interest rate pressures, as noted by the Atlanta Fed’s GDP Now forecast of 4.9% growth for the third quarter (this estimate is driven by growth in net exports and changes in private inventories, which can be volatile). Personal consumption expenditures alone are expected to contribute 2.5% to Q3 growth, which by itself is higher than estimates of the U.S.’s long-term structural growth rate.

So, what is driving domestic economic resilience? A still strong U.S. jobs market, wage gains, and excess savings are the primary factors. With the population growing 0.5% year over year, less than 100,000 net payrolls are required to be added each month to keep the unemployment rate steady. The last three months have seen average payroll increases of 266,000, signaling strong job growth. Wages, as measured by the Atlanta Fed Wage tracker, are 5.3% higher than one year ago—easily outpacing inflation of 3.7%. Though there are many methods for estimating excess savings, all measures show lower levels of savings today compared to 12 months ago. The U.S. inflation picture also continues to improve with the Fed’s preferred inflation gauge showing



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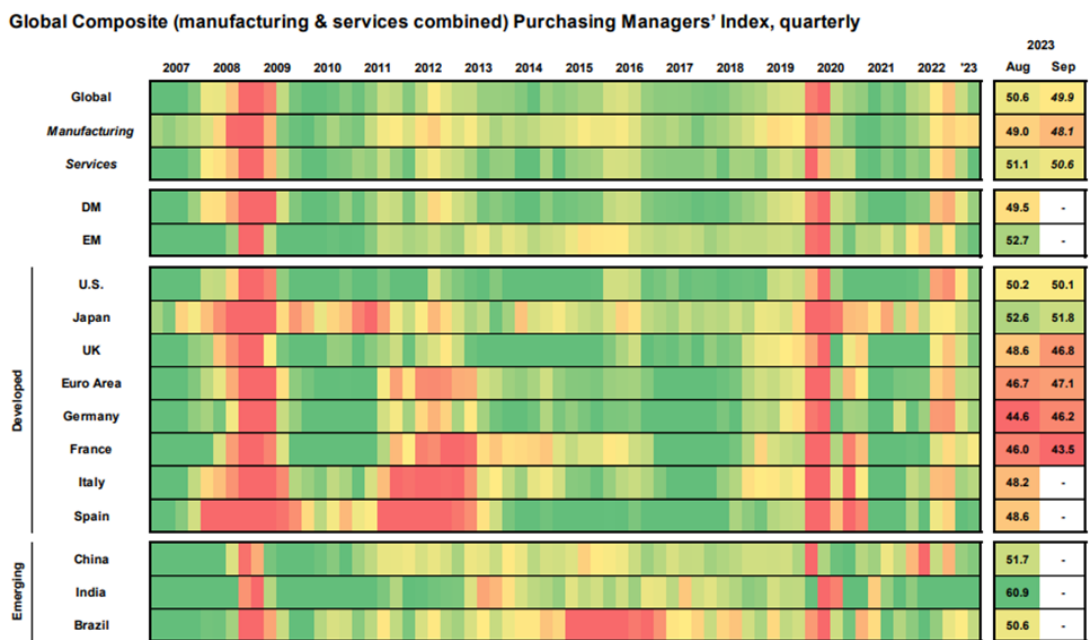
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slowing growth the last three months (an annualized rate of 2.2%). In general, we expect pricing pressures to continue moderating in the months ahead.

Globally, the picture is a lot less resilient, as can be seen in the table of purchasing managers indices (which combine manufacturing and services sectors) that are signaling slow growth or contraction. For reference, figures above 50 indicate expansion, while figures under this level signal contraction.



Source: Standard & Poor's, J.P. Morgan Economic Research, J.P. Morgan Asset Management. The Composite PMI includes both manufacturing and services sub-indices. The global, services and manufacturing figures for September are estimates by J.P. Morgan Asset Management. Heatmap colors are based on PMI relative to the 50 level, which indicates acceleration or deceleration of the sector, for the time period shown. Heatmap is based on quarterly averages, except for the two most recent figures, which are single month readings. Data for the U.S. are back-tested and filled in for 2007-2009. Data for Japan are back-tested and filled in for the first two quarters of 2007. DM and EM represent developed markets and emerging markets, respectively. Guide to the Markets - U.S. Data are as of September 30, 2023.

J.P.Morgan
ASSET MANAGEMENT

Source: JP Morgan

As evident, growth in Europe is quite marginal with the biggest economy, Germany, set to contract in 2023.

Monetary Policy – Expectations for the Fed Funds rate have shifted since our last update. In June, the market priced in a less than 2% probability the Fed Funds rate would exceed the 5.25%-5.50% range, the range it sits at today, by the end of the year (per CME Group). As of today, the probability of exiting the year at a higher level is about 30%. Expectations for Fed Fund rates as we exit next year (2024) have shifted from 4.00% in June to 4.75% today.

Other than the Bank of Japan and the Peoples Bank of China, global central banks are in a similar position to the Fed: Interest rates are at the highest level in decades largely due to long-tailed repercussions from the Pandemic that gave inflation a new life. Our sense is that the next significant moves in inflation and interest rates will be lower. The open question is whether the decline is gradual, as expected today, or more severe. The answer will be determined by economic activity and inflationary pressures. While we give it small odds, if inflation reaccelerates, then higher interest rates will be warranted.

Valuation & Sentiment – Due to the recent sell-off and stable earnings estimates, equities appear to be a better value today than last quarter. At 17.7x next twelve-month earnings, the S&P 500 is in line with its 5- and 10-year averages, though elevated to longer-term levels. Sentiment (a contrary indicator) is also shifting in a bearish fashion after spending much of the summer in bullish territory. Contrary to sentiment, fund flows are still showing investors putting money into equity funds. For the S&P 500, Q3 earnings are forecasted to decline 0.4%, the fourth consecutive decline in earnings per share (EPS) according to FactSet. Encouragingly, it is typical for earnings estimates to decline throughout the quarter, however, Q3 estimates have improved.

LINCOLN CAPITAL – INVESTMENT OUTLOOK & STRATEGY

In recent writings, we stated our view that, contrary to the consensus, the odds for a recession were low in 2023. As we look ahead to the initial months of 2024, we expect underlying strength to continue with low unemployment, and with inflation pressures trending downward. However, we anticipate an economic slowdown beyond the near term, perhaps in twelve to eighteen months. A major factor for slowing expectations may be traced to the Fed switch from an accommodative to restrictive monetary policy nearly two years ago (Fed actions generally take time to impact the economy—they work with a lag). Currently, the consensus view among economists is that Fed increases are done for this cycle or, perhaps, one more tightening is in order. Though we welcome interest rates returning to more normal levels, embedded in our concerns is the risk that the Fed may overplay their mandate to squash inflation resulting in an unneeded recession.

Related to our concern of a recession is the impact a recession would have on the real estate sector, which is undergoing deep changes for other factors. Owners of commercial real estate (mainly office and retail) are vulnerable to reduced demand for space, particularly as leases reach their termination dates. The massive change in the location of employees, from company offices/premises to hybrid/remote work at home, was inevitable. Yet the speed of the transition was accelerated by the Pandemic, which was a catalyst on steroids in shortening the time for these workplace changes to become widespread. With working from home now intractable in many businesses and organizations, reduced demand for commercial real estate works its way into banks and other entities that finance real estate. As lenders absorb their share of loan losses from companies turning in the keys, the net result is a tightening in bank credit availability, which reduces economic activity.

While the above has the potential to be a “body blow” to the economy, we do not envision it being another Great Recession (2007-2009) in terms of its severity and impact.

Interest rates serve as the bloodline in the economy, and primary assets – bonds, stocks, real estate – are priced with valuation metrics that reflect current and expected rates. For four decades (early 1980’s to early 2000s) interest rates vacillated, yet the longer-term trend was clearly a decline in rates from double digits to zero and below. In response to the economic shock from the Pandemic, central banks took unprecedented actions with federal governments to prevent the sharp recession from morphing into a depression with the net result of interest rates diving to historically low levels. In November 2021, nearly two years ago, the Fed changed direction 180° and began raising interest rates at the fastest pace in financial history. This unexpected speed caused market weakness in 2022 and continues to impact financial markets this year as well.

Though we much prefer lower interest rates and higher asset prices like everyone else, we are sanguine about returning to more normalized interest rates, and we view the process of financial markets adjusting to higher rates as a work in process, not a *fait accompli*. Bonds and stocks are fairly valued at present levels, and we continue to manage accounts with neutral allocations with a defensive bias.

CREDIT CARD, APPLE PAY, VENMO, OR CASH?

Buyers today have many options to choose from when it's time to check-out at the counter and online. As e-commerce continues to grow, the various payment methods have grown along with it, and it's important to understand the pros and cons of each.

Unsurprisingly, credit and debit cards continue to dominate the payment market according to the Federal Reserve. Credit cards provide the best perks to customers, as these companies make money off fees associated with each transaction, typically between 1.5% - 3.5% of the total payment. These fees are then used to fund travel points, cash-back, lounge access and other perks. Credit cards can be expensive if customers are unable to pay off the balance each month, carrying very high interest rates on unpaid balances. With the rise of interest rates beginning in 2022, the average annual credit card rate is over 24% according to LendingTree, up from 17% in 2021. Debit cards don't offer the same perks as credit cards, as the fees made on transactions are much less. Both credit and debit cards do offer fraud and payment protections.

The rise of digital wallets has made shopping from your phone easier than ever. Apple Pay and PayPal are two of the most well-known and have grown in usage through the past few years. A digital wallet is exactly that: A way to store multiple payment methods such as credit cards and cryptocurrency and access them all through a few clicks of your phone. While digital wallets make paying online easy with just a few clicks, recently more brick and mortar merchants, such as Walmart, Target, and Starbucks, have adopted the technology to allow customers to tap their phone at check-out to pay. However, not all small retailers have done the same. Customers are still able to earn the perks associated with the credit cards used. Although digital wallets are safer than traditional credit and debit card use due to their enhanced encryption, there is still a risk of this sensitive data being hacked.

Started as a method to pay family and friends, peer-to-peer payment apps such as Venmo and Zelle have become more popular. They move money faster than credit card payments and without the fees associated. Once a person hits send, the money is almost immediately authorized, which also makes it almost impossible to get back. These apps aren't as regulated as card payments, so it's advised to only be used to pay people you know and trust.

And finally, although the number of transactions using this method continues to dwindle, cash is still king for many businesses. Recently, more and more businesses are offering small discounts for customers using cash as this helps them avoid paying those transaction fees. According to the Federal Reserve Bank of San Francisco, only 18% of purchases were completed with cash, versus 31% five years ago.

Please view us as a resource for all your financial questions and needs, and as always, please contact us if we may be of assistance.

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