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MARKET COMMENTARY

Stock indices stumbled during the third quarter. Large cap stocks in the S&P 500 lost -3.27% during the quarter but their year-to-date return is still 13.07%. Small cap stocks in the Russell 2000 Index fell -5.13% during the third quarter reducing their year-to-date return to 2.54%. International stocks in developed markets were down -4.11% and emerging market stocks were down -2.93% making their year-to-date returns 7.08% and 1.82% respectively. The Barclays U.S. Aggregate Bond Index was also down since yields were higher; the index lost -3.23% for the quarter which erased its previous year-to-date gain and resulted in a -1.21% loss so far in 2023.

With the S&P 500 up 13% for the year, it appears that stocks are doing much better than they actually are. In reality, growth stocks have greatly outperformed value stocks and have a much higher weighting in the S&P 500 thereby skewing the performance. Comparatively, an equal-weighted S&P 500 index has returned just 1.7%. Growth stocks are up 25% year-to-date versus just 2.0% from value stocks. Technology, communication services, and consumer discretionary sectors posted year-to-date returns of 35%, 40%, and 27% respectively. The energy sector is the next best performer but is far behind with only a 6% return; 5 out of the remaining 7 sectors posted a negative return for the year so far.

Although the S&P 500 Index has gone up, earnings have not. First and second quarter earnings on the S&P 500 were down -3.4% and -7.1% respectively. Zacks is expecting third quarter to also be negative at -2.2%. That means that the advance in the S&P 500 was because of price/earnings multiple expansion. Multiples are once again above their long-term averages. Brian Wesbury of First Trust, and Strategas Research both estimate that the S&P 500 is above its current intrinsic value. On a positive note, Zacks is projecting that positive earnings will resume in the fourth quarter.

Recession fears cooled in third quarter; some analysts pushed their recession projections out to 2024 or even 2025. Further cooling recession fears is that unemployment is still near its 50-year low at 3.8% and personal income is rising, GDP growth for the second quarter was 2.1%. Consumer spending has held up even in light of inflation and higher interest rates. However, consumers are starting to struggle to keep spending at current levels. Savings are being depleted, credit card balances are rising and some people are even refinancing their homes to take out equity. Unfortunately, mortgage rates are higher now than their original loan which will add to their ongoing expenses. In addition, gas prices are higher and payments on student loans have resumed, further reducing spendable income.

Inflation has been coming down. The Core PCE inflation number which the Fed watches was 3.9% as of August, down from 4.7% in May. The Fed is projecting inflation to be 3.7% at year end and 2.6% at the end of 2024. Wesbury continues to be concerned about inflation but does note that the Fed has made progress; he thinks they may be able to reach their target as long as they don't cut rates too soon.

The Federal Reserve has been fighting higher inflation by aggressively raising short-term interest rates. After a pause in June, the Fed raised rates another 25 basis points in July of 2023 and then paused again in September. The Fed Funds rate is now 5.25% to 5.50%. The Fed funds rate peaked in 2007 at 5.41% and hasn't been higher than that since 2001. With inflation still elevated and employment strong, the Fed may raise again before year-end.

2023 BENCHMARK RATES OF RETURN

INDEX	THIRD QUARTER	YTD
S&P 500	-3.27%	13.07%
Russell 2000	-5.13%	2.54%
International	-4.11%	7.08%
Fixed Income	-3.23%	-1.21%
JPMorgan Diversified*	-3.26%	4.61%

*25% S&P 500 large cap stocks,10% Russell 2000 small cap stocks, 15% MSCI EAFE international stocks, 5% MSCI EME emerging market stocks, 5% REITs, 25% Barclays US aggregate bonds, and 5% each in short term Treasuries, high yield global bonds, and commodities.

We value our relationship with you, and we are always available to meet with you in person or by phone. Please do not hesitate to call or email us with any questions that you may have. Also, if your situation has changed, please contact your advisor so we can determine if any changes are needed in your account.

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Analysts had been projecting that the Fed would cut rates in 2024 which is why the yield curve was inverted. Now, the thinking is that rates will stay higher for longer prompting the move up in long-term yields.

The 10-year Treasury bond yield rose this quarter from 3.8% to 4.6%. This move resulted in negative returns for the Aggregate Bond Index during the quarter and it erased its prior gains for the year leaving it with a -1.21% return year-to-date. With short-term rates at attractive levels, money markets are yielding 5.2% or more. These money markets are very liquid and can be easily sold if money is needed for other security purchases or distributions. Even though short-term rates are higher, strategists are advising investors to increase the duration of their fixed income assets. If the Fed lowers rates, the short-end of the yield curve will be vulnerable and likely move lower than where the longer-term maturities currently are. They believe investors will be glad they locked in those rates for a longer period of time.

The outlook for the economy is still unclear. Congress managed to temporarily avoid a government shutdown but the issues have not been resolved. Recession fears have cooled but the market is priced for everything to go right. If earnings disappoint or if inflation is stickier or there is another unexpected shock, stock prices could be vulnerable. We may also see a rotation out of some of the high growth stocks into ones that haven't seen the big price increases and have been less loved but are reasonably valued. With interest rates remaining higher for longer, the growth stocks may be vulnerable unless they see strong earnings growth.

Diversification continues to be prudent. Also, the "target outcome" or "buffer" ETFs can add protection to portfolios and still provide upside potential if stock prices rise. Dividend income is also attractive in equity and premium income funds. In these funds, managers own dividend paying stocks and sell out of the money call options to collect extra income. The dividends help with total returns or with income needs depending on the account.

Measuring risk tolerance and investing accordingly is important in this environment. Timing the market or chasing returns may work in the short-term but is more difficult over longer periods. We use Nitrogen (formerly Riskalyze) software to help us measure your risk tolerance and make sure you have the appropriate risk in your accounts. If you would like to check or revisit your risk score or if you have any questions about your account, please do not hesitate to contact your advisor.

Important Client Update

Our priority is to provide high quality service to our clients that simplifies their lives. We like to take as much as we can off your plate and handle it for you. Since our founding, we have offered to vote client proxies so that the client doesn't receive all the mailings for the securities they own. Over time, the scope of many of the issues have changed and we recognize that our clients have many differing views on the issues and how proxies should be voted. Because we vote the proxies all the same as a block, we do not feel it correctly reflects how all clients would like their proxies voted. As of January 1st, we plan to no longer vote client proxies and let clients have the say in how to vote proxies. In addition, the increasing compliance complexity has helped us realize that our clients are better served if we direct our resources to areas more likely to impact client outcomes. We'll be reaching out with more information soon but please feel free to call your advisor with any questions.

Cambridge Advisors News

Check out our new website! The address is still www.cambridgeadvisors.net but we have overhauled it to make it more useful to prospective clients and easier to navigate. Existing clients have a direct link to the client portal and to their Schwab login. We hope you enjoy it and that you will share it with others who may benefit from our services.

Speaking of the client portal, many have not tried to access it but we encourage you to do so. It has up-to-date investment information on your accounts and there is also a document vault where information can be exchanged securely. Please reach out to your advisor so we can help you get access.

We continue to implement strategies to better serve our clients and to grow. We are currently upgrading some of our behind the scenes operations systems.

With the addition of our operations manager, John Goolsby, we are committed to remaining independent because we believe that is best for our clients. We appreciate the trust you place in Cambridge Advisors. If you have friends or family who would benefit from a relationship with Cambridge, please do not hesitate to share our contact info and our website. We are accepting new clients right now and want to help the people who are important to you. We waive our minimum for these referrals or offer the financial planning services on a stand alone basis. Thank you for your referrals!