Market Update

TOMPKINS Financial Advisors

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Fall 2023

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Economic Overview

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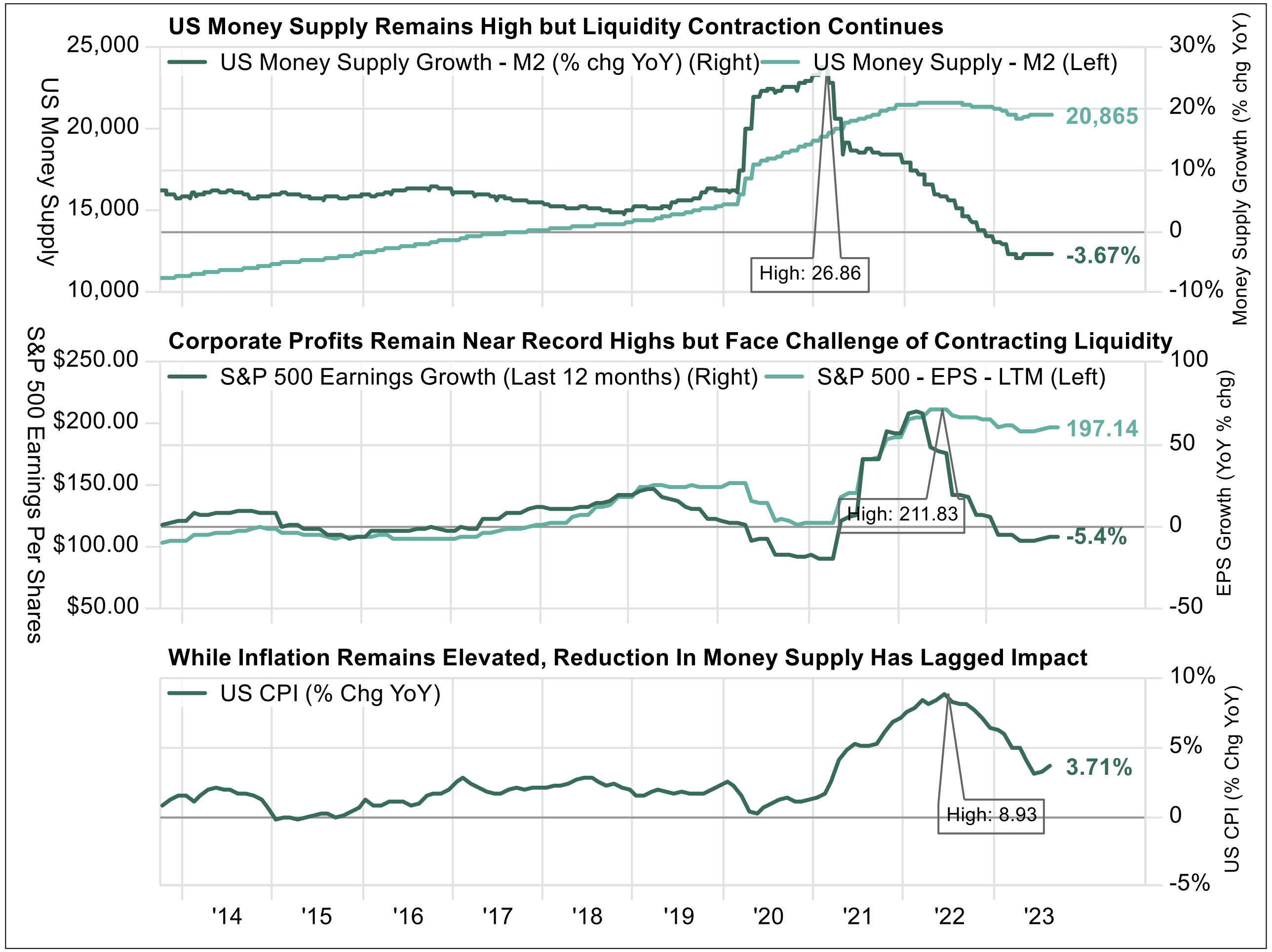
War Against Inflation Wages On

- For more than a decade, expansionary monetary policies allowed for money supply growth of 5%-10% per year. This peaked in Q1 of 2021 with an increase of almost 27% year-over-year. Money supply growth puts money in the hands of consumers and businesses, stimulating spending in the economy.
- Following a similar trend, corporate profits, which had also grown for much of the last decade, benefitted from the expansion of the US money supply.
- As the effects of stimulatory policies waned, the lagged effects of curtailing money supply growth and rising interest rates began to slow the pace of inflation.
- Although corporate profits and the US money supply both remain near record high levels, higher interest rates and persistent inflation present challenges for funding future growth projects. Consequently, business investors now demand returns above the mid-single digits that are available by owning lower risk assets such as short-term US Treasury bills.



Market Outlook

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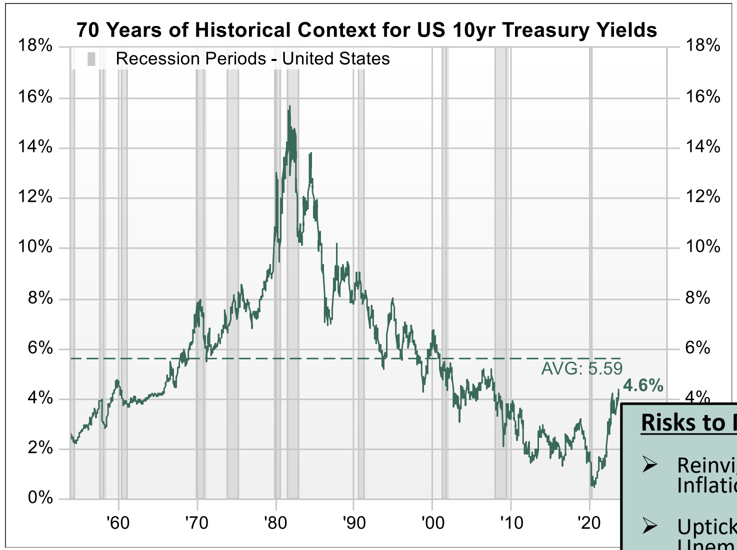


Not New, But Different

Following a pandemic-fed reset of the global economy, escalations of geopolitical conflicts, a stimulated US consumer and historically high inflation, a return to a more normal economic environment may feel *"new"* in many respects.

Interest rates, having increased more rapidly than any period in modern history, provide investors with a *"different"* set of opportunities unavailable for much of the last 30 years.

- As interest rates continuously declined in recent decades, many "Savers" earning less interest on their short-term fixed investments eventually sought higher returns by allocating capital into riskier assets such as equities, real estate, and crypto currencies.
- With yields increasing significantly recently, "Savers" can now earn positive real (inflation-adjusted) returns on short-term fixed income investments.
- Although interest rates are higher than they have been in recent history, over longer time periods they are just re-approaching their long-run historical averages.

Risks to Monitor:

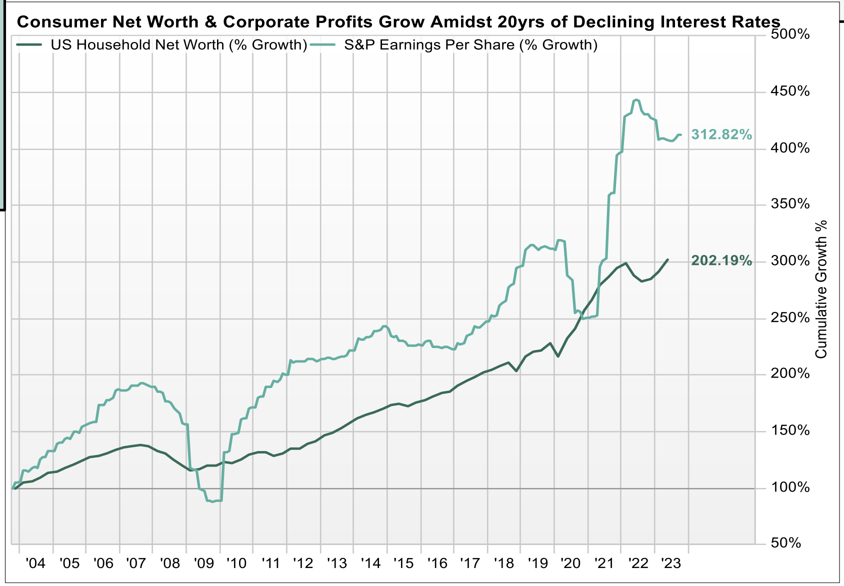
- ➢ Reinvigorated Inflation
- ➢ Uptick in Unemployment
- ➢ Escalation of Geopolitical Conflict(s)
- ➢ Contracting Liquidity in US Treasury Auctions

Resetting The Economic Backdrop

Declining Interest Rates supported the growth of both consumer balance sheets and corporate profits.

Compared to recent years of over-consumption, household spending is resetting toward more normalized levels.

As spending lessens and the prioritization of consumer expenses changes, those impacts are being reflected in the slowing growth of corporate profits.



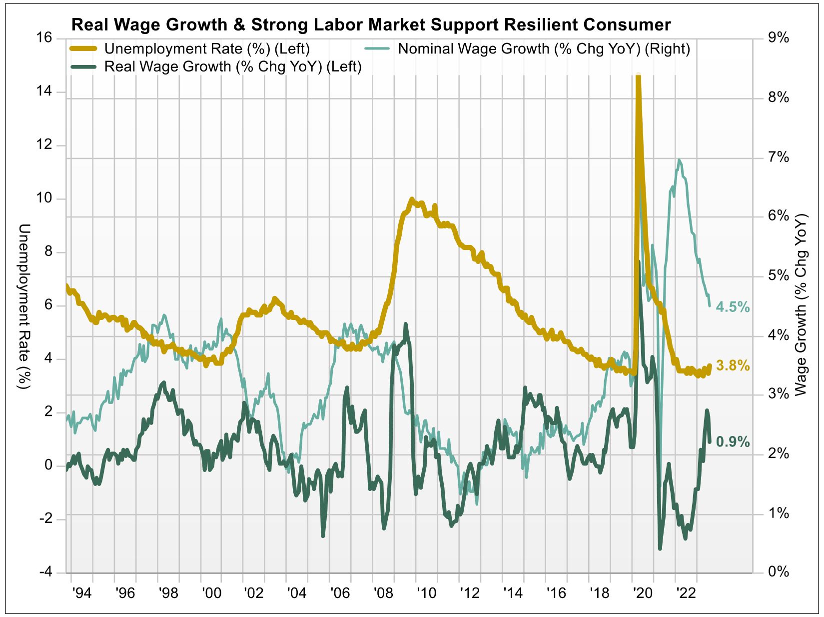
Investment Strategy Overview

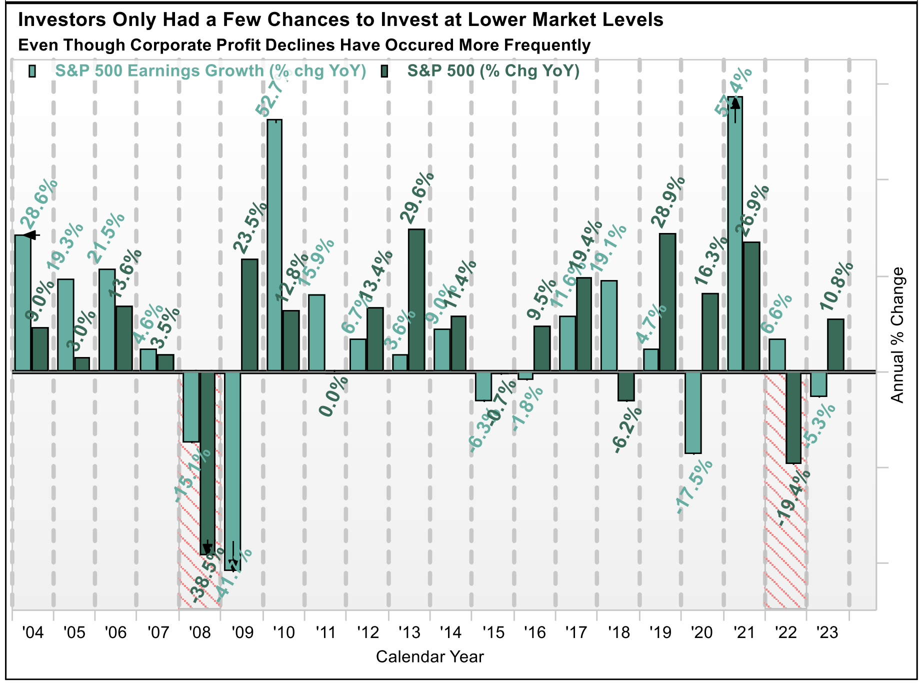
Cautiously Optimistic

Resilient US consumer continues to benefit as Unemployment Rate remains near historic lows. This has allowed many job-seekers to weigh multiple job offers within a highly competitive labor market.

As a result of continued labor shortages, companies face difficulties with finding qualified job candidates and continue to support positive wage growth across the economy.

Highly competitive labor markets, career mobility and rising real wages allow the US consumer to weather the current inflationary economic environment.





Selectively Opportunistic

As financial conditions benefitted from expansionary monetary policy for much of the last 20 years, periods of market volatility and pullbacks were few and far between before resuming new record highs.

Even during periods where earnings growth would moderate, stock markets would still move higher as valuations expanded.

Investors have had just a few opportunities in recent years to invest in high quality assets at levels below their respective record highs.

Portfolio Strategy: Fixed Income Markets

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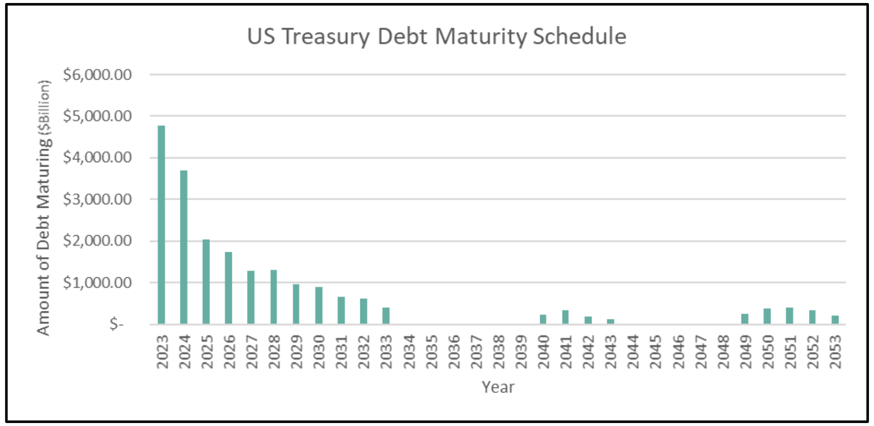
High Levels of Debt Being Issued to Fewer Buyers Necessitates Higher Yields

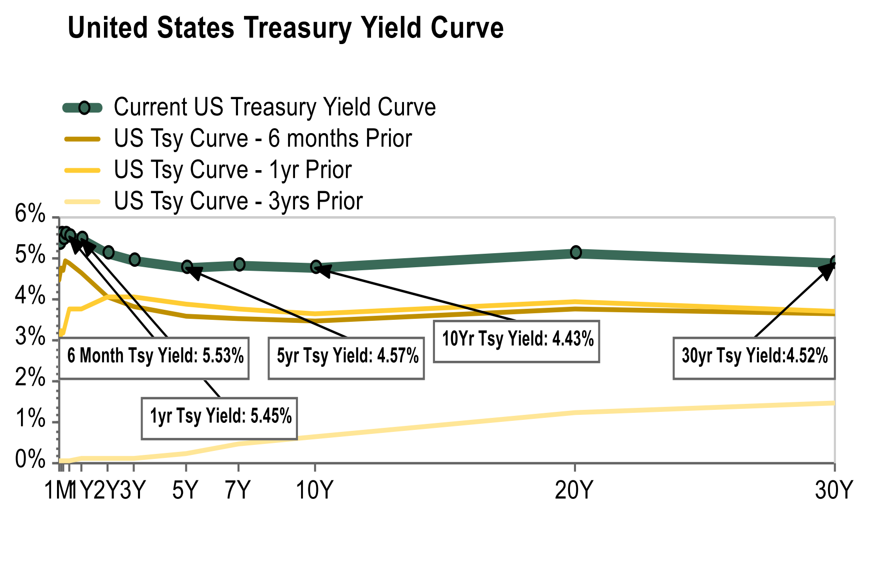
As globalization slowed to a halt post-pandemic, developed nations (ex-US) have been forced to focus their capital allocation priorities on combating inflation within their domestic economies instead of being large purchasers of longer-dated US Treasury Bonds.

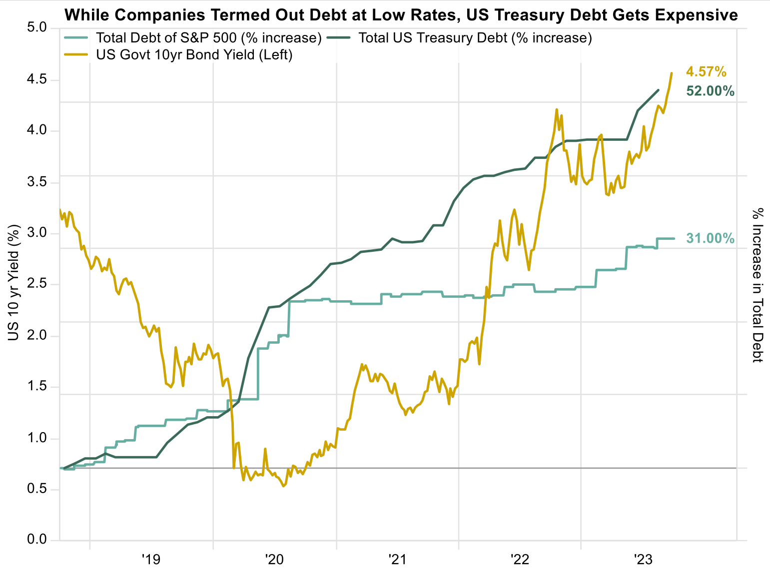
With dual headwinds of more than 50% of outstanding US Treasuries maturing over the next 3 years and a burgeoning US fiscal deficit, the US Treasury will be issuing a record amount of bonds at a point in time when the largest buyers are all undergoing some form of "quantitative tightening"

This presents a challenge as higher interest rates on longer term bonds may become necessary to attract incremental buyers, further increasing the US debt service cost, now exceeding 14% of US tax revenues.

While short-term rates had increased for much of the last two years, longer term yields have moved higher in recent weeks as markets digest enormous levels of debt issuance.







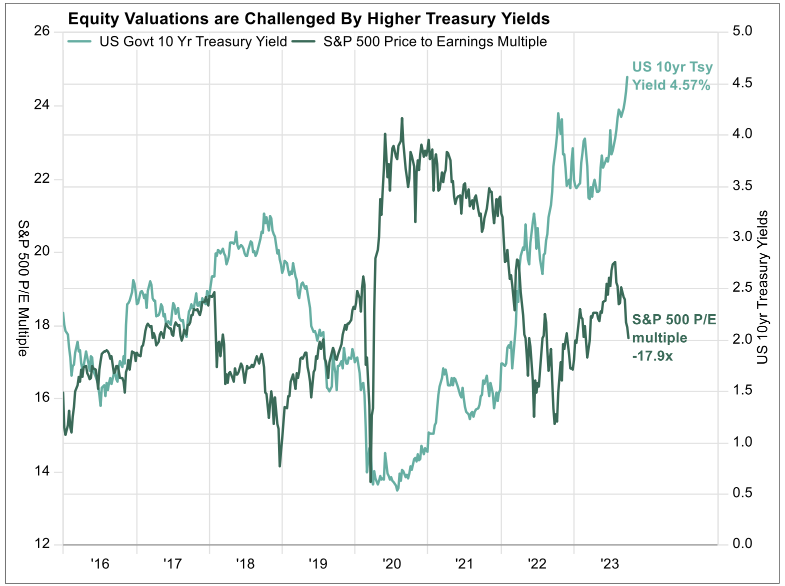
Portfolio Strategy: Equity Markets

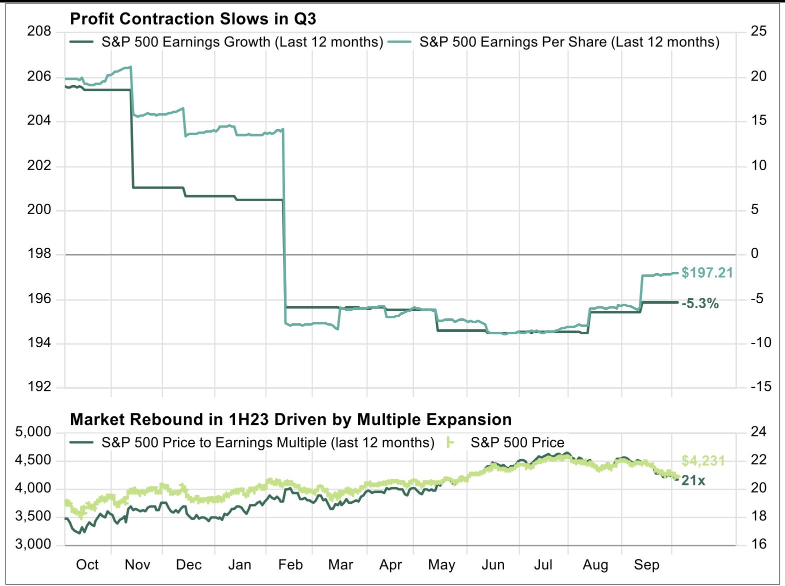
Earnings Growth Challenged by Rising Cost of Capital & Slowing Revenue Growth

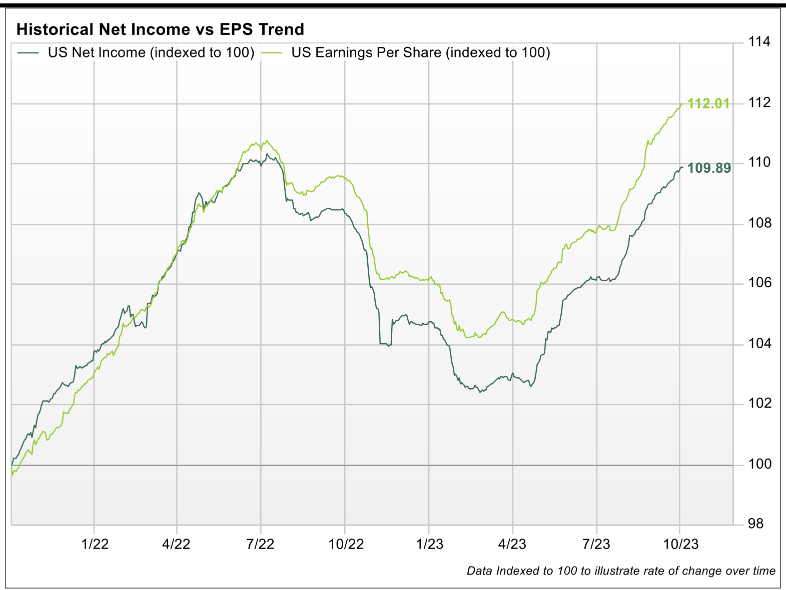
Companies are experiencing more difficulty passing higher prices on to customers who are increasingly selective on who and where they spend their money in today's higher inflationary environment.

Rising interest expenses and slowing sales growth present "new" management challenges for continued growth of corporate profits.

The recent trend in corporate earnings growth shows signs of resilience, having increased sequentially since the beginning of 2023. That said, stock buybacks account for increasing dispersion between S&P 500 companies' reported Earnings Per Share and Net Income, a financial tool which will become more difficult to support during periods of sustained negative earnings growth.







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