J.W. Burns & Company
Investment Counsel
Quarterly Update - October 2023

The Outlook Is Always Uncertain But Seasonal Tailwinds Ahead

"Doubt is not a pleasant condition, but certainty is absurd." - Voltaire

Dear Clients and Friends,

After a strong start to the third quarter in July, stocks cooled considerably in August and September. For the three-month period ending September 30, the S&P 500 Index was down -3.3%, international stocks dropped -4.5%, and the Vanguard Balanced Index fell -3.21%. Bonds continued to provide no shelter for the market's decline with the Barclay's Aggregate Bond Index down -3.22% – exactly in line with stocks.

Despite the August/September decline, overall, stocks continue to have a solid year, although exposure to "the magnificent seven" mega-cap technology companies – Apple, Microsoft, Google, etc. – has basically been a necessity for good performance. In fact, both the Equal Weighted S&P 500 Index and the Dow Jones Industrial Average are flat on the year due to reduced mega-cap technology exposure. As you have solid positioning in many of these large-cap growth stocks, we are pleased with both our absolute and relative performance.

There were a few culprits responsible for the third quarter's market decline, the primary being bond yields, which act as a drag on both stock valuations and long-term economic growth. The yield on a U.S. 10-year Treasury Note rose by 80 basis points during the third quarter to yield more than 4.8% – a level not seen since June 2007.[1] Also during the quarter, Fed Chair Jerome Powell presented a more hawkish outlook for interest rates, including a potential November rate hike and no cuts until mid-2024 – later than the market was expecting.

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Finally, while inflation has fallen sharply from its peak, oil prices increased significantly in the third quarter and recent inflation data has been mixed.

The bottom line: ***the inflation and interest rate outlook became more mixed in the third quarter and stocks revalued moderately lower as a result.***

Entering the fourth quarter of 2023, investors are digesting a variety of competing and sometimes contradictory economic data. On the positive side, consumer spending remains strong, unemployment remains supportive at 3.8%, and GDP growth in recent quarters has exceeded estimates, with previous readings being revised upward. On the other hand, household debt is increasing and is being hurt by higher interest rates. Student loan payments have resumed, the Israeli-Hamas conflict rages, and certain economic indicators are

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weakening. In fact, the ISM Manufacturing Index has posted 11 straight months of readings below "50"– which is considered contraction territory.[2]

These competing narratives are leading to greater uncertainty and angst amongst investors, including from the so called "experts" in the financial media. The bear case for stocks is usually compelling and easier to articulate - it sounds smart to be a skeptic.[3] But history shows that it has been far more profitable to hold stocks for the long term and avoid reacting to short-term economic challenges. After all, markets have always "climbed a wall of worry," as the Wall Street adage goes, and the hard truth is, ***the outlook is always uncertain.***

As I stated in our July client letter, we continue to believe there are a number of positive factors beyond mixed economic data points that can push stocks higher in the fourth quarter and into 2024. Specifically, overly defensive investor positioning/ample liquidity, better than expected corporate earnings, and favorable market seasonality are underappreciated tailwinds for equities in the months ahead.

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It is no exaggeration to say that the market's strong rally in the first half of this year caught most investors offsides. As I wrote in our January client letter, pessimism at the beginning of the year was at extreme levels, a solid contrarian indicator. It has been widely reported that large institutional investors – hedge funds, mutual funds, pension funds, etc. – are underexposed to stocks and will want to play "catch up" in the fourth quarter.

In fact, investor positioning overall remains negative. In the last 12 months, over $1.1 trillion has poured into money market funds, bringing that total to $6 trillion, an all-time record.[4] Assuming interest rates stabilize and turn even slightly lower next year, which we believe is likely, some of these funds will flow back to equities.

As I write this, the third quarter earnings season is kicking off and, as always, we will be focused on your portfolio companies' results and forward guidance. Although very early, so far 11% of companies in the S&P 500 have reported earnings, with 81% of them beating expectations by an average of 9%.[5] In fact, 2023 earnings overall have consistently come in above expectations, and we are in the camp that expects a reacceleration of earnings in 2024 – key to stock market performance.

Finally, it should be noted that historically, the fourth quarter of the trading year has been where the lion's share of positive equity returns has taken place. In fact, performance in Q4 has made up nearly 50% of annual returns over the past 70+ years, as the chart below illustrates.

So, we remain cautiously optimistic for the fourth quarter and into 2024. We remain focused on owning great growth businesses for the long run. Could we see heightened volatility and negative returns? Certainly. Yet, we have been consistent in our view that inflation will continue to cool, interest rate increases will end, and corporate profits will remain healthy. Should this continue, we think attractive returns are in store for us over the next 12 months.

Source: LPL Research, Bloomberg 09/28/23

The modern design of the S&P 500 Index was first launched in 1957. Performance before then incorporates the performance of its predecessor index, the S&P 90. Indexes are unmanaged and cannot be invested in directly. Past performance is no guarantee of future results.

Now let's get to some of your questions.

Q: How do you foresee the Israeli-Hamas conflict affecting my portfolio?

A: Let's be clear, the attack on Israel is tragic and heartbreaking.

From an investment standpoint, I am reminded by the Wall Street saying, "Buy at the sound of cannons, sell at the sound of trumpets." Thus far, I have been encouraged by the market's response to this event, and my best guess is that neither Israel nor its adversaries want a large-scale war at this time.

Obviously, if the conflict spreads significantly, it would have a negative effect on the economy, markets, and oil prices.

So, stay tuned.

Q: Money market funds and CDs are offering rates of over 5%. Isn't this a good place to be especially given the risks the equity market faces?

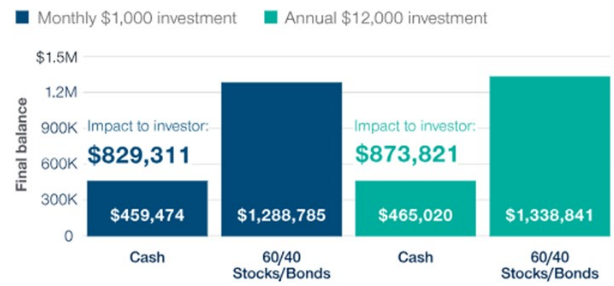
A: Money market funds, CDs and T-bills at 5% plus are a solid fixed income choice and an area to park funds for short-term liquidity needs. We always look at relative investment opportunities and these low-risk instruments can be part of structuring a balanced portfolio.

However, I strongly believe that a lumpy 8% - 10% (the historical return offered by equities) compounded over time is far better than a smooth 5%. I could even add that a lumpy 6.5% compounded over a 20-year time horizon provides a big difference in the level of wealth generated on a relative basis.

The fact is that a smooth 5% today may not be there a year from now, and if interest rates and inflation start trending lower next year, stocks could be a lot higher. You just don't know.

Below is a chart from T. Rowe Price that shows the significant wealth difference between a 60/40 portfolio vs. an all-cash portfolio.

Long-term opportunity cost (30 years ended June 30, 2023)



Sources: T. Rowe Price, created with Zephyr StyleADVISOR; S&P; Bloomberg Index Services Ltd. See Additional Disclosures.
Past performance cannot guarantee future results. It is not possible to invest directly in an index.
Chart is shown for illustrative purposes only. Stocks: S&P 500 Index, bonds: Bloomberg U.S. Aggregate Bond Index, and cash: Bloomberg 1–3 Month Treasury Bill Index. As of June 30, 2023.

Keep in mind, if this was an all-stock portfolio vs. cash, the difference would be even more remarkable.

So, my best advice is to stay the course with your quality equities. However, please contact us if you desire a higher fixed-income component, and we can craft an effective and appropriate asset allocation for you.

In closing, I know that these are challenging times, and it is tough to be positive when innocents are dying from several wars, as is happening now in the Middle East and Ukraine. But I will cite Larry Fink, the CEO of BlackRock, who I saw on CNBC last week.

Fink acknowledged short-term headwinds, but he said he was bullish because of the long-term trends in Artificial Intelligence, robotics, the upcoming infrastructure spending boom, and onshoring. He also touted the significant medical advances that are extending life in a transformational way with major breakthroughs in kidney disease, Alzheimer's, and obesity.

Relative to our earlier money market fund questions, Fink said he recommends that most investors have 80-90% of their assets in stocks or hard assets, so long as they know their time horizon. I agree with that.

He added "I think we spend too much time on the negatives, and I'm more optimistic than ever, even though we are facing near term obstacles."

To this I say, touché, Larry.

Thank you for your continued confidence and enjoy the fall!

Best Wishes,

Jim

James C. Burns, CFA
President & Chief Investment Officer

P.S. Many of our clients were impacted by the recent merger of TD Ameritrade and Charles Schwab, who combined platforms over Labor Day weekend. As we indicated earlier this summer, this ***changes nothing about your relationship with us. J.W. Burns & Company is still your investment advisor, and we continue to manage your account(s) with no interruption.***

There will undoubtedly be some learning curve, however, as the two companies smooth out their integration over the next several months. To that end, we wanted to make you aware of some best practices to keep in mind to make this transition as smooth as possible.

- **Fund Disbursements**: Schwab uses the industry standard "settlement date" for disbursements that required trades. In other words, if you call in to request funds, and we need to place trades to generate cash, the funds will not be disbursed until the trades settle – ***one to two days later. Please plan ahead***.
- **Overnight Processing of Checks**: Checks requested for overnight will be mailed (with tracking) within two business days. This also incurs a fee of $8.50 per check.
- **2023 Tax Documents**: Similar to how you received two September statements – one from TDA and one from Schwab – you will receive two 1099's for 2023 from each custodian. Please ensure you give both to your tax preparer and reach out if you need an extra copy. If you have created your Schwab Alliance log in, you will have ready access to all of this information as it becomes available.
- **Schwab Alliance**: We encourage you to go online and create your Schwab Alliance log in. This will allow you to view your investments, statements, tax documents and also make updates to personal information. Please take advantage of this.
- **Year End**: Finally, please plan ahead for any year-end items you want to complete such as required minimum distributions, charitable distributions, IRA contributions, etc. These items will need to be submitted earlier than normal this year to avoid a backlog at year end.

Charles Schwab has a long, solid track record and is the largest custodian for independent investment advisors, like us. We have had some clients custodied with Schwab for many years and have been pleased with their platform. We are confident that next year the transition will be fully complete and back to normal.

We sincerely appreciate your patience and understanding as we lead you through this transition.

1 *Reuters,* "Treasury Yields' Wrecking-Ball Surge Gets Fresh Fuel After Blowout Jobs Report,", 10/06/23

2 PR Newswire, "Manufacturing PMI at 4.9%, September 2023 Manufacturing ISM Report on Business,", 10/02/23

3 The Motley Fool, "Why Does Pessimism Sound So Smart?", 01/21/16

4 Bob Pisani of CNBC – 10/12/23

5 Yahoo! Finance: "Earnings season off to strong start despite 'uncertain macro' environment ahead.", 10/16/2023