

FORD WEALTH MANAGEMENT LLC

Independence • Integrity • Insight

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"It's really hard to tell the difference between being rally early and being wrong." – Barton Biggs, on economic and market predictions

"The floggings will continue until morale improves." – Unknown

Fellow Investors:

The recession watch continues. Will we have one, not have one, or did we already have one and just missed it? I attended a conference recently and one of the speakers expressed the opinion that rather than having a hard or soft landing, we may have no landing. To be honest, I'm still trying to figure out what exactly that means. Whatever the near future brings us, I predict it will not match any of the predictions of the professional predictors. As we have said many times before, each set of conditions is unique, and we have learned (or not) from prior experiences. Is the market overvalued? Will a recession torch our portfolios? What will the total impact of the Federal Reserve's action be and when will rates start to come down? Only time will answer those questions and we stand by our position that making pronouncements about the future is a fool's errand.

To review the year so far it has been a tale of two groups: the "magnificent seven" (AAPL, MSFT, AMZN, GOOGL/GOOG, TSLA, META) and everyone else. The S&P 500 was up 13.1% for the year to date to the end of the third quarter. Certainly, that is an improvement over last year's full year decline of 18.1%, although it does not fully make up for it. However, the magnificent seven above account for a year-to-date return of 19.0%, meaning the rest of the stocks in the index as a group are down 5.9%. These seven companies continue to increase the portion of the capitalization weighted S&P 500 they account for, now exceeding 27%. They also account for the current higher than average price/earnings ratio of the index as a whole, which stood at 17.8 times at the end of the quarter. This compares to a 27-year average of 16.6 times. However, the top ten in the index (adding BRK.B, XOM, UNH to the seven above) have a P/E ratio of 25.9 times, leaving the remaining 490 companies with a 16.8 times P/E ratio, much closer to the long-term index average. So perhaps the bulk of the market is not so overvalued?

Other equity market sectors showing positive year to date gains were developed markets (MSCI EAFE) with 7.6%, small caps (Russell 2000) at 2.5%, and emerging markets (MSCI EME) at 2.2%. Not great, but at least positive.

In fixed income, the continued rise in rates were a drag on government debt and higher quality corporate bonds measured by the Bloomberg US Aggregate index, although high yield bonds (Bloomberg High Yield Index) turned in a solid 5% gain and the Fed pushing up short-term rates over the past 18 months made cash an attractive asset. We have placed a fair amount in CDs over the past twelve months ranging from three months to 18 months with annualized yields in the 5.0% range.

The shock to investors last year was the coincidental sharp decline in both the stock and bond markets. To put this in perspective, 2022 was the first time a 60% equity/40% bond portfolio had a negative return because both stocks and

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bonds were down since 1974 and prior to last year it had only occurred twice since 1950. Perhaps we should take comfort in the fact that it is a rare occurrence and it was driven by the Fed's attempt to drive a stake into the heart of inflation, but that does not make us feel any better as we watch our portfolios recover.

Interest rates are indeed on everyone's mind and are a valid concern unless you are taking advantage of the high rates in CDs, short-term treasuries or money market accounts. The bigger effect is on the broader economy. We enjoyed negligible interest rates for a good long time and were truly spoiled, both consumers and institutional borrowers. High mortgage rates are a big drag on home sale activity, even as there is a housing shortage, as buyers face sticker shock on payments and potential sellers hesitate to give up their 3% mortgages to move up to a 7% mortgage. Higher consumer credit costs may also curtail spending, creating a drag on economic activity. So far we consumers have kept spending, as old habits are hard to break, but eventually we may see some belt tightening. Being two-thirds of the economy, consumers drive the economic train.

Speaking of belt tightening, the federal government is fast approaching the point where something has to be done. Of course, we have all heard this for most of our lifetimes, but the federal debt added in the last few administrations combined with the much higher rates to finance may be the tipping point. We shall see if anything gets done but based on the population's current faith in any government institution, do not hold your breath. Perhaps they will surprise us, or not. We must hope that inflating away the cost of debt service is not the ultimate path taken. Inflation is down, but not to the Fed's target of 2% and getting there may be harder than once thought or hoped. Consumer prices have increased a cumulative total of about 18% since 2021. Inflation being down does not mean prices are down, only that they are increasing at a lesser rate. We feel it at the grocery store, the gas pump and just about everywhere we spend money. It's painful. The market's expectations may not be as optimistic as the Fed in bringing inflation down to its 2% target as the ten-year treasury rate continues to rise toward 5%. The negative yield curve has flattened somewhat as the difference between the higher two-year treasury rate and the lower ten-year rate has narrowed, but not because of a lower two-year but a rising ten-year, indicating higher rates may be with us for a long time.

One of the risks of Fed action is that it takes time to work its way through the economy, which historically results in going too far. They may very well have done enough, or even more than enough already, to accomplish their goal with time, but historically the policy makers will continue until they see signs of desired outcome, which will likely result in overstepping. So, the floggings will continue.

Other signs of economic conditions are positive despite the rise in interest rates and hangover of inflation. Consumer sentiment has improved, and the job market remains strong. However, consumers are feeling the squeeze and do not like the economic direction of the country. If the Fed is determined to kill inflation by pushing the US economy into a full-fledged recession despite strengths, we may get that hard landing after all.

For planning and investment purposes, the current environment demands diligence. It is not a time to be complacent. By that we do not mean to suggest that we make changes based on each piece of news that crosses the wire but assess where we are relative to our goals and risk targets. Inflation should be considered as it can greatly affect needs in our retirement plan. Higher yields in fixed income change the dynamic for portfolio construction as do the risks in the

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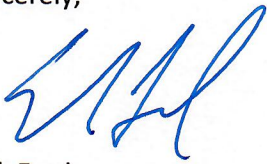
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concentration of returns in the equity markets. World events also can provide unexpected risks to assess. As this is being written, another war in the Middle East looks likely. That may bring further market uncertainty and higher oil prices. There is never a dull moment, although we may all crave dullness.

Sincerely,



Erik Ford

The S&P 500 Index, or the Standard & Poor's 500 Index, is a market-capitalization-weighted index of the 500 largest publicly traded companies in the U.S. It is not an exact list of the top 500 U.S. companies by market capitalization because there are other criteria to be included in the index.

The MSCI EAFE Index serves as a performance benchmark for the major international equity markets and includes companies in 21 countries in Europe, Australasia, and the Far East (East Asia).

The MSCI Emerging Markets Index captures large and mid-cap representation across 24 Emerging Markets (EM) countries. With 1,437 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country.

The Bloomberg Aggregate Bond Index is a broad-based fixed-income index used by bond traders and the managers of mutual funds and exchange-traded funds (ETFs) as a benchmark to measure their relative performance.

The Bloomberg US Corporate High Yield Bond Index measures the USD-denominated, high yield, fixed-rate corporate bond market. Securities are classified as high yield if the middle rating of Moody's, Fitch and S&P is Ba1/BB+/BB+ or below.

The Russell 2000 Index is a small-cap U.S. stock market index that makes up the smallest 2,000 stocks in the Russell 3000 Index. The index is maintained by FTSE Russell, a subsidiary of the London Stock Exchange Group.

M2 is the U.S. Federal Reserve's estimate of the total money supply including all of the cash people have on hand plus all of the money deposited in checking accounts, savings accounts, and other short-term saving vehicles such as certificates of deposit (CDs).

Index return data from JP Morgan Asset Management and YCharts. Indices mentioned are not managed and cannot be invested in directly.

Treasury yield data from YCharts.