June
2023

FORGE
PRIVATE WEALTH

Portfolio Blueprint

Monthly Talking Points

Macro View

This month brings us some of the same issues we have been facing this year in the macro environment, but with some new updates.

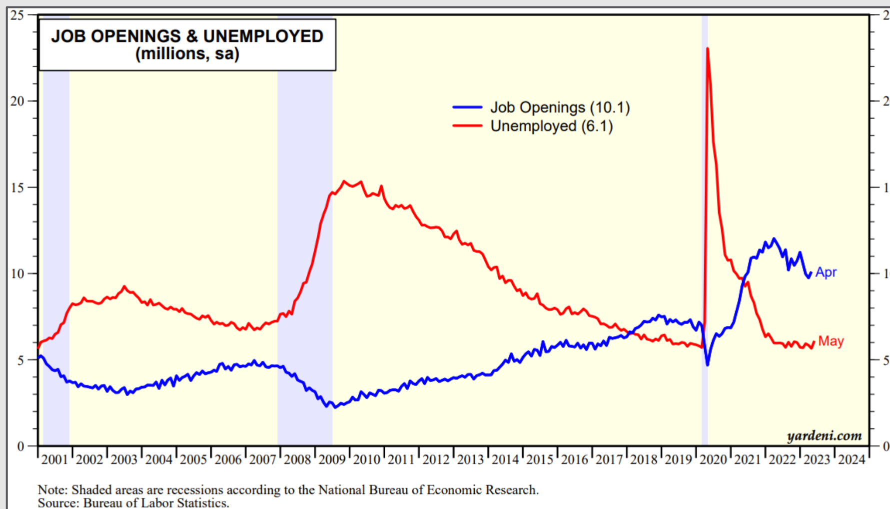
The Debt Ceiling

As of writing, the potential debt ceiling crises has been averted albeit temporarily. Assuming nothing drastic changes prior to print, here are the highlights:

- The debt ceiling is suspended until January 1, 2025, averting a catastrophic default, as policymakers continue to kick the can down the road. This means there is a very low chance of a government shutdown prior to the next election.[1]
- Clawback of Covid-19 relief funds and IRS spending to maintain funding for some nondefense discretionary programs.[2]
- Student loan payments are to start up again at the end of the Summer.[2]

Labor Market

The most surprising macro statistics lie in the labor market, as job growth has been resilient and very strong. Layoff announcements have hit the wire and have gotten attention, but labor continues to be very tight. As the chart below shows, the gap between unemployed and job openings (plenty of work available) is as wide as it has been in over the last 20 years.



Source: https://www.yardeni.com/pub/labormarket.pdf

1 https://www.nbcnews.com/politics/congress/debt-limit-bill-key-provisions-biden-mccarthy-deal-avert-default-rcna86664
2 https://www.cnn.com/2023/05/30/politics/whats-in-the-debt-ceiling-deal/index.html#:~:text=Some%20%24886%20billion%20will%20be,spending%20would%20have%20been%20protected

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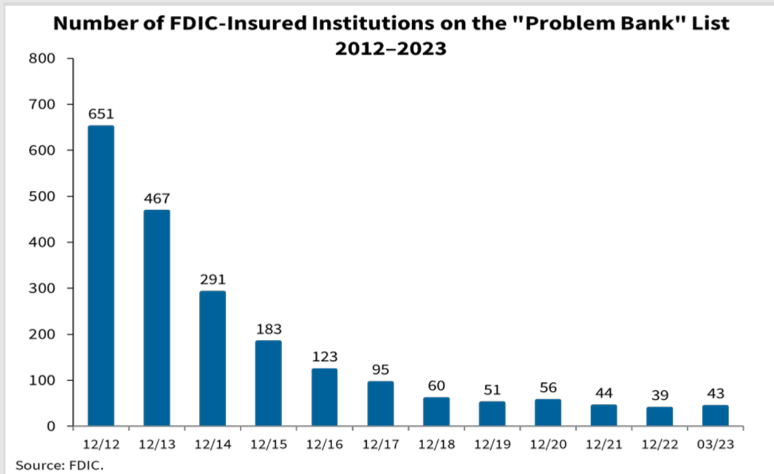
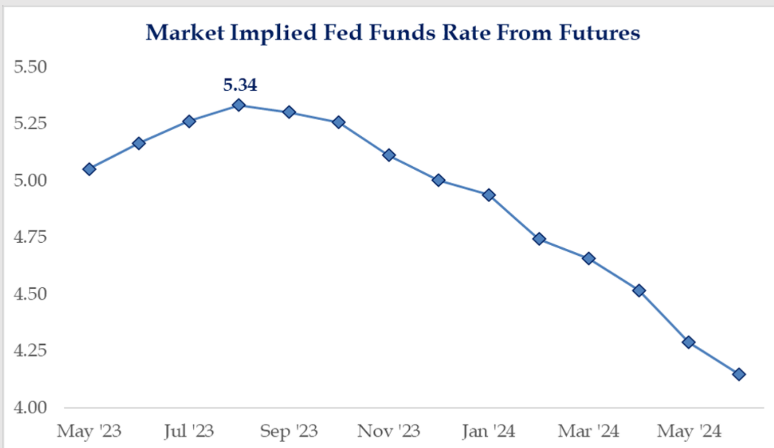


Source: Strategas



Source: Strategas

Bank Lending

Although the full effect of the regional bank crises is yet to be felt in the economy, we do know that lending standards are rising and the availability of credit from banks is falling.[3] Since regional banks are the "lubricant" which keeps the capitalist economic machine moving, this should continue to slow the economy. As the chart to the left shows, although the number of "Problem Banks" has fallen materially since December 2012, we notice that there has been an uptick this year as of the end of the first quarter. We expect to see a rise in banks deemed to be problematic, when second quarter statistics are released. The crises is not over, and if the Fed does raise rates this year we could see more banks put into "Problem" status.

The Fed

Although there appears to be a lot of wishful thinking that the Fed is finished with this round of tightening, the futures market has a different view. The Fed futures curve, which is as reliable as any indicator, is pointing to more tightening through the summer. As long as the job market continues to stay tight and "sticky" inflation persists, the Fed will continue on its path of higher rates.

3 https://www.reuters.com/business/finance/banks-tighten-credit-terms-see-loan-demand-drop-fed-survey-shows-2023-05-08/

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Conclusion

The conclusions reached by the Ashton Thomas Asset Allocation Team are:

- The economy is not presently in recession, but the risk of one within the next twelve months remains material.
- There will be continued risks to economic growth brought on by Fed policy, tightening credit conditions, and weaker corporate profits.
- Tight labor markets will continue to keep inflation pressures high.
- Inflation should come down slowly, but the Fed's stated goal of 2% annual inflation will remain challenging to achieve.

Index	Month-to-Date	Year-to-Date
S&P 500	0.43	9.65%
NASDAQ	7.73%	30.79%
Russell 2000	-1.09%	-0.66%
Russell 1000 Growth	4.56%	20.76%
Russell 1000 Value	-3.86%	-1.43%
S&P 600 Small Cap	-1.75%	-2.03%
EAFE (USD)	-4.23%	6.81%
Bloomberg Agg. Bond	-1.09%	2.46%
DJIATR	-3.17%	0.25%

Chart Source: Bloomberg LP (via subscription)

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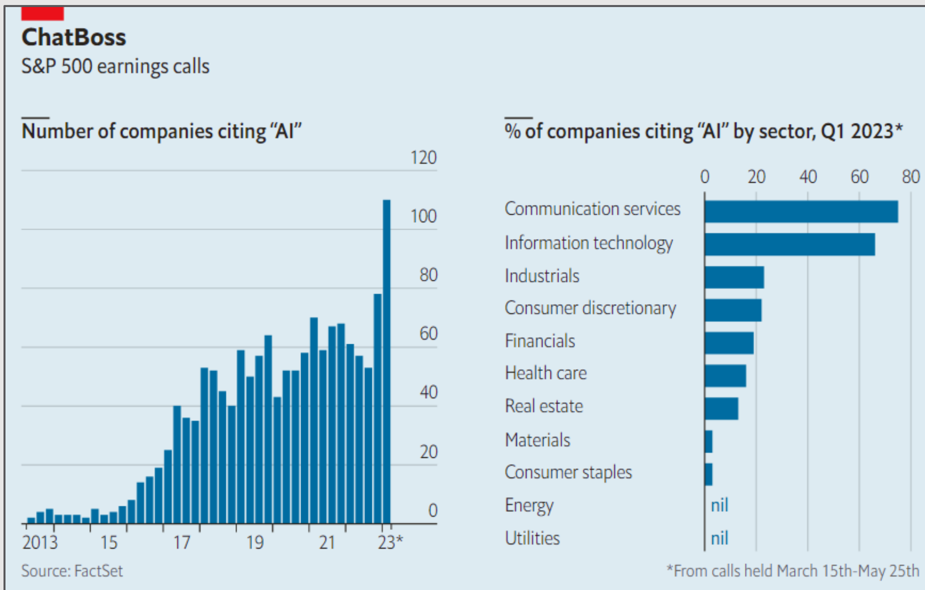
Equities

Against a decent earnings season, equity market participants are experiencing a very thin market profile defined as a few large, mega cap technology stocks dominating market returns. The few winners are experiencing a "double down" effect, as they continue to attract attention regardless of valuation.

The driver of what some are calling a "mania" is artificial intelligence (AI). As with the term "dotcom" in the 1990s, any publicly traded company which is remotely associated with AI or has mentioned the term on a conference call in the past quarter seems to be fair game for this current run.

As with the "dotcom" bubble, seasoned market participants have been here before. Some of the equities leading the charge seem to have reached to the point at which their valuations make no sense. As they continue to run, it leads index-sensitive managers to completely toss out any type of "standard" valuation measures, such as Price/Earnings and Price/Sales ratios. Managers whose compensation and careers depend on beating an index (versus managing wealth) have no choice but to buy and hold overvalued companies no matter what the fundamentals are telling them. Valuations are not good short-term timing tools, but as investors experienced in the early 2000s, nothing soars forever. To reiterate our stance, we have been here before and at some point (to be determined) the outcome does not translate into managing wealth.



Source: https://www.economist.com/business/2023/06/01/chief-executives-cannot-shut-up-about-ai

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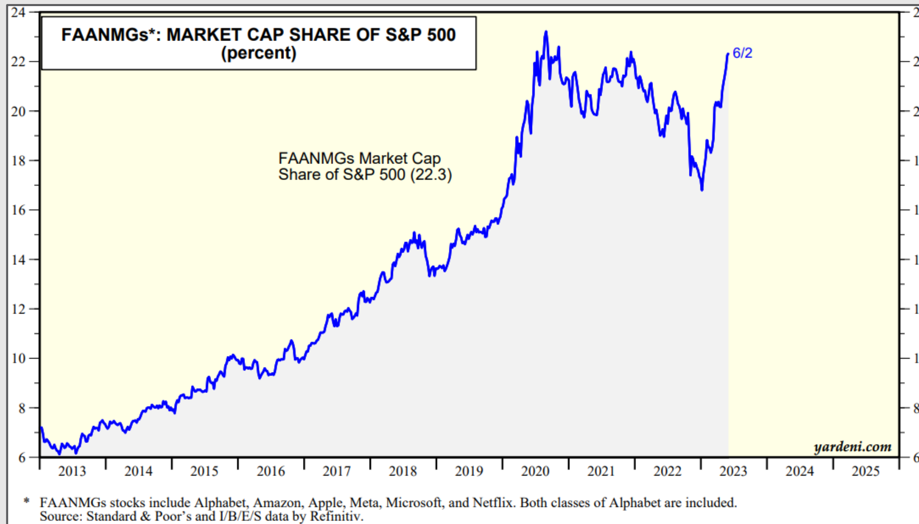

Source: https://www.yardeni.com/pub/yardenifangoverview.pdf

Annual S&P 500 Contribution of 10 Largest Weights During Positive Performance Years

Year	Top 10 as % of Total	S&P 500 % Perf.
2023 YTD	**95.6%**	**9.2%**
2007	78.7%	3.5%
2020	58.9%	16.3%
1999	54.5%	19.5%
2021	45.0%	26.9%
1998	36.8%	26.7%
1996	33.9%	20.3%
2017	33.3%	19.4%
2019	32.8%	28.9%
1991	28.6%	26.3%
2006	27.6%	13.6%
2016	26.6%	9.5%
2003	23.6%	26.4%
1995	22.3%	34.1%
2014	22.2%	11.4%
2004	21.1%	9.0%
2005	20.5%	3.0%
2010	19.6%	12.8%
2012	19.2%	13.4%
1997	19.1%	31.0%
2013	17.6%	29.6%
2009	15.5%	23.5%
1992	14.9%	4.5%
1993	12.2%	7.1%

Source: Strategas and Bloomberg

As the table shows, as of May 22, 2023, the largest market-cap stocks in the S&P 500 contributed 95.6% of the performance, which as of that date equaled 9.2% for the year so far. The next 450 contributed the remaining 4.4% of performance.

To further this analysis, just six technology and communication stocks comprise over 22% of the market capitalization of the S&P 500. The index-sensitive managers who do not own these stocks may be accepting a good deal of career risk in not doing so.

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Take Aways

The conclusions of the Ashton Thomas Asset Allocation Team are:

- Equity markets will continue to be volatile in light of higher interest rates and somewhat questionable earnings growth for the next twelve months.
- Investors in index funds are sometimes unknowingly taking large positions in stocks which have very little valuation support. We believe active management is preferable in this environment.
- These stocks certainly may continue running for long periods as we experienced in the dotcom bubble. However, when they reverse, it can be a quick and cruel reality check for those who do not follow any valuation methodology.
- Diversification is paramount and if an investor has a large/low cost-basis position in any of these issues, risk control and hedging should be discussed.

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Fixed Income

The month of April saw SIGNIFICANT volatility in fixed income markets. Much of the action in fixed income was dominated by economic news and headline news regarding regional banks and the debt ceiling, which appears to have been "resolved" for now.

Inflation worries seemed to subside a bit, as both the CPI and PPI printed lower and below consensus expectations. As both figures showed less inflation pressure, it was enough to partially convince the fixed income market that a June rate hike of 25 basis point was not in the cards, and the market began to slowly price in this possibility, with odds of a June hike at only 36% on May 31. With additional data showing slight easing in inflationary pressures within the manufacturing and services sectors later in the month, the Fed was provided all the ammo needed to pause in June without surprising the markets. In other words, we would not be surprised if there was no rate hike in June. It's safe to say the statement from the FOMC, along with Chairman Powell's Q&A, will be the most closely watched of 2023 thus far. Our opinion is that, if there is a pause in June, we are likely to see a rate hike in July.

Most interestingly, the GDP data released in May now shows a very real possibility of stagflation (simply defined as persistently high inflation coupled with low growth). We believe stagflation is a worst case scenario for the Fed. If they continue to raise rates to battle inflation–even though the "sticky" components such as wages, rents, and services are starting to ease with each CPI reading–they run the risk of causing a potentially severe recession. If the Fed pauses or even cuts rates, they run the risk of seeing inflation print higher (possibly in a runaway scenario), requiring a quick return to additional rate hikes. We believe this is exactly where the Fed and Chairman Powell did not want to find themselves.

We will end by focusing on the drama caused by the Debt Ceiling negotiations, which were resolved, albeit temporarily, by month-end. This drama saw spikes in near-term Treasury Bill rates – some as high as 6.5% (the June 13th and 15th maturities). These spikes were due to institutional holders liquidating positions in order to avoid a late payment or technical default. The spike washed through the entire fixed income market, and saw buyers purchase short-term Muni paper with Tax-Equivalent Yields (TEY) north of 6.7% (for those in the highest Federal tax bracket). We also saw yields upwards of 7.2% for California residents buying double-tax exempt Munis, rates not seen since late 2022, and quickly gobbled up by eager Muni buyers.

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Source: Bloomberg

Take Aways

- In the Corporate space – spreads are a tell-tale sign that a firm is in trouble before the rating agencies can downgrade. We are watching several sectors, including Banking and lower-rated consumer discretionary names that need financing. We are actively staying away from commercial real estate exposure, as it is the most-shorted segment of the market right now.[1] We should add that, although we may no longer be seeing a run on banks, we are seeing assets slowly "walked away from" regional banks and into money market funds (as the chart shows). Money market funds continue to set new all-time records each week in terms of total assets under management (AUM). If considering consumer discretionary, be mindful that the end of the student loan debt jubilee is near and will have a negative impact on purchasing power.
- In the Treasury space – we see friction, but we see much of the friction from the Debt Ceiling battle being eliminated – although the inversion (especially between 2yr-10yr has increased) persists, we recommend beginning to extend duration, if possible. T-Notes in the 2yr space are pricing firmly above 4.50% and the 3-yr Note is firmly above 4%.... opportunities to lock in risk-free rates ahead of potential cuts late in 2023 or early 2024.
- In the Muni space – we favor quality names and extending duration into the 3yr to 10yr space. We believe there are attractive opportunities there for yield pick-up, especially with continued volatility across the curve. We are actively staying away from Hospital and University paper, unless they are of superior quality and offer credit support.

1 https://www.reuters.com/business/finance/banks-tighten-credit-terms-see-loan-demand-drop-fed-survey-shows-2023-05-08/

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Inspiring You To Live Your Ideal Financial Life

The Gross Domestic Product (GDP) is a comprehensive measure of U.S. economic activity. GDP measures the value of the final goods and services produced in the United States (without double counting the intermediate goods and services used up to produce them). Changes in GDP are the most popular indicator of the nation's overall economic health.

All indexes referenced are unmanaged. The volatility of indexes could be materially different from that of a client's portfolio. Unmanaged index returns do not reflect fees, expenses, or sales charges. Index performance is not indicative of the performance of any investment. You cannot invest directly in an index. Consult your financial professional before making any investment decision.

The Standard & Poor's (S&P) 500 Index tracks the performance of 500 widely held, large-capitalization U.S. stocks.

International investing involves special risks such as currency fluctuation and political instability and may not be suitable for all investors. These risks are often heightened for investments in emerging markets.

The MSCI Emerging Markets Index captures large and mid cap representation across 24 Emerging Markets (EM) countries*. With 1,382 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country.

The MSCI EAFE Index is an equity index which captures large and mid cap representation across 21 Developed Markets countries* around the world, excluding the US and Canada. With 799 constituents, the index covers approximately 85% of the free float- adjusted market capitalization in each country.

The U.S. Dollar Index (USDX) is a relative measure of the U.S. dollars (USD) strength against a basket of six influential currencies, including the Euro, Pound, Yen, Canadian Dollar, Swedish Korner, and Swiss Franc. The index was created in 1973, but remains useful to this day.

The 10-year Treasury Note represents debt owed by the United States Treasury to the public. Since the U.S. Government is seen as a risk-free borrower, investors use the 10-year Treasury note as a benchmark for the long-term bond market.

The Consumer Price Indexes (CPI) program produces monthly data on changes in the prices paid by urban consumers for a representative basket of goods and services (Source: U.S. Department of Labor).

The Producer Price Index (PPI) program measures the average change over time in the selling prices received by domestic producers for their output. The prices included in the PPI are from the first commercial transaction for many products and some services.

The "core" PCE price index is defined as personal consumption expenditures (PCE) prices excluding food and energy prices. The core PCE price index measures the prices paid by consumers for goods and services without the volatility caused by movements in food and energy prices to reveal underlying inflation trends.

An exchange-traded fund (ETF) is a type of pooled investment security that operates much like a mutual fund. Typically, ETFs will track a particular index, sector, commodity, or other asset, but unlike mutual funds, ETFs can be purchased or sold on a stock exchange the same way that a regular stock can. An ETF can be structured to track anything from the price of an individual commodity to a large and diverse collection of securities. ETFs can even be structured to track specific investment strategies.

The NASDAQ Composite Index is a market capitalization price-only index that tracks the performance of domestic common stocks traded on the regular NASDAQ market as well as National Market System-traded foreign common stocks and American Depository Receipts.

The Russell 2000 Index measures the performance of the 2,000 smallest companies in the Russell 3000 Index, which represents approximately 8% of the total market capitalization of the Russell 3000 Index.

The Russell 1000 Growth Index measures the performance of those Russell 1000 Index companies with higher price-to-book ratios and higher forecasted growth values.

The Russell 1000 Value Index measures the performance of those Russell 1000 Index companies with lower price-to-book ratios and lower forecasted growth values.

The S&P SmallCap 600 Index is a stock market index established by Standard & Poor's. It covers roughly the small-cap range of American stocks, using a capitalization-weighted index. To be included in the index, a stock must have a total market capitalization that ranges from $750 million to $4.6 billion.

The Bloomberg Barclays U.S. 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 Dow Jones Industrial Average, or simply the Dow, is a stock market index that indicates the value of 30 large, publicly owned companies based in the United States, and how they have traded in the stock market during various periods of time.

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