Monthly Talking Points

Macro View

The February macro environment ended as a tale of two stories. Equity markets worldwide are telling us inflation, and thus rising rates, could be in the past. This has led to improved returns year to date. The contrary thesis worries about an "inevitable" recession which is not being factored in.

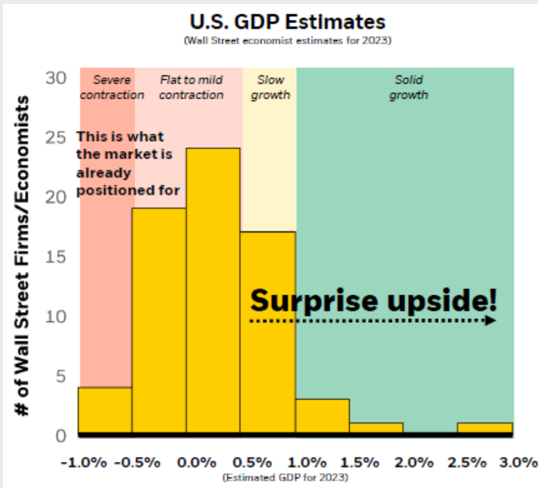

Chart Source: BlackRock via Subscription

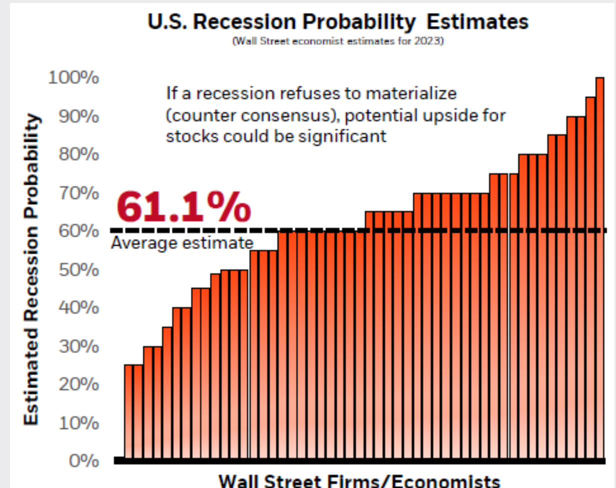

Chart Source: BlackRock via Subscription

Bad news already priced in? Asymmetric upside/downside risk makes us cautiously bullish on stocks

Source: Bloomberg, as of 12/16/2022. Estimates for U.S. GDP in 2023 are compiled by Bloomberg from 69 different Wall Street firms/economists. Estimates for U.S. recession probability in 2023 are compiled by Bloomberg from 51 different Wall Street firms/economists. GDP growth/contraction descriptions are for illustrative purposes only. Forward-looking estimates may not come to pass.. Gross domestic product (GDP) is the total monetary or market value of all the finished goods and services produced within a country's borders in a specific time period.

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Portfolio Blueprint

Monthly Talking Points

Here is a look at both sides of the equation:

- Developments that we worry about include commercial real estate, delinquencies, and defaults, soft state tax revenues, and shrinking corporate profits. Additionally, any hope of returning to the status quo in America's relationship with China seems to be dimming.

- Leading economists' average probability estimates for a U.S. recession stood at over 61% as of late 2022. (See chart referenced on page 1)

- The charts might seem dire, but further study suggests that, if in fact the consensus (as shown above via Wall Street Firms/Economists surveyed by Bloomberg) is incorrect and a recession does not occur, there are reasons for stocks to do quite well. Inflation is falling (albeit slowly), jobs are plentiful, and consumers are getting more confident.

- Although the magnitude and frequency of the Federal Reserve rate increases have slowed, it does not appear as if the Federal Reserve is done raising rates. We believe the restrictive policy will continue throughout 2023, as the Fed will refuse to make the mistakes of the 1970s where their "stop and go" policies led to prolonged inflation and economic weakness.[1]

- With the supply of labor meaningfully exceeding demand and leading to higher wages, we believe the Fed will continue its policy of attempting to address rising price levels before they get further out of hand.

- The Ashton Thomas view is that, if in fact, we do go through a recession in the U.S., there is a high probability the recession will be short, and shallow given recent data. A recession can be delayed, but the longer the Fed takes to extinguish rising prices the tougher it is for a soft-landing outcome with no recession. The Fed has an arbitrary 2% inflation goal, but we believe that they can live with a number somewhat higher.[2]

Index	Month-to-Date	Year-to-Date
S&P 500	-2.44	3.69%
NASDAQ	-0.37%	10.26%
Russell 2000	-1.81%	7.71%
Russell 1000 Growth	-1.19%	7.05%
Russell 1000 Value	-3.53%	1.47%
S&P 600 Small Cap	-1.23%	8.15%
EAFE (USD)	-2.09%	5.84%
Bloomberg Agg. Bond	-2.59%	0.41%
DJIATR	-3.94%	-1.13%

Chart Source: Bloomberg LP (via subscription)

1 https://www.vox.com/future-perfect/2022/7/13/23188455/inflation-paul-volcker-shock-recession-1970s
2 https://www.cnbc.com/2023/02/20/the-federal-reserves-2percent-inflation-targeting-policy explained.html#:~:text=The%202%25%20inflation%20target%20is,to%20the%20International%20Monetary%20Fund.

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Monthly Talking Points

"There are known knowns, things we know that we know; and there are known unknowns, things that we know we don't know. But there are also unknown unknowns, things we do not know we don't know."[3]

— Donald Rumsfeld, Known and Unknown

Equities

A good deal of our time in this business is making educated guesses of a number of different variables which affect asset prices. As our crystal ball is no clearer than anyone else's, we must "sometimes humbly" make predictions and realize where there is accuracy and where there is not. Going forward, we are considering the following theses:

- At the time of writing, almost all of S&P 500 fourth quarter earnings have been announced. In summary, revenues have been somewhat strong, helped by the inflationary environment in which some companies have been able to raise prices. However, actual earnings have fallen. It is safe to characterize this earnings season as "weak," but certainly not as weak as markets had anticipated. In the short term, we foresee more of the same, as some companies can continue to raise prices to combat rising costs. If rates continue to rise longer term, the largest risk is to weaker companies which will eventually need to refinance "cheap" debt at higher rates. We continue to stay invested in high quality, value-based companies with strong balance sheets. Although growth stocks have outperformed year-to-date, we believe this is a disconnect and the segment may be ahead of itself.

- Timing of markets is one of the most inaccurate exercises one can do. As we have expressed many times, most of the return in equity markets comes within small windows of time. A common mantra in investing circles is, "Rather than trying to predict highs and lows, it's important to stay invested through a full market cycle. Focus on the time you stay invested, not the timing of your investments."[4]

- Using history as a guide (not a guarantee of future results), post bear markets stocks have a tendency to rally rather quickly. As the following chart shows, post-bear-market rallies looked at one, three, and five years following the "trough" have consistently shown attractive returns. If this pattern continues, and most of the bear market damage has occurred to this point, longer term, the U.S. stock market has a high probability of coming back strongly

- We have observed over the years that investors with a disciplined contrarian bent to their decision process can do well over time. One way to be contrarian is to look at consumer sentiment as published by The University of Michigan, an index which is followed by market prognosticators and observers. Using history as a guide, if one looks back to 1971, investors who committed to markets at the very worst times, as measured by confidence, significantly outperformed those who committed during the "best" times when consumers were happy and confident. Twelve months after each peak and trough, returns from investing at the least confident times outperformed those of the most confident times. (See chart below) Will this continue? None of us know with complete certainty, but as of this writing, the last University of Michigan Consumer Sentiment gauge was 67.0, up from 59.7 at year-end 2022. [5]

- What we do not know is if the cyclical bottom in sentiment has been reached. What we do know is that, historically, returns off low values of this indicator can be attractive over a long enough time horizon.

3 https://www.goodreads.com/work/qoutes/14287473-known-and-unknown
4 https://www.capitalgroup.com/individual/planning/investing-fundamentals/time-not-timing-is-what-matters.html
5 http://www.sca.isr.umich.edu/tables.html

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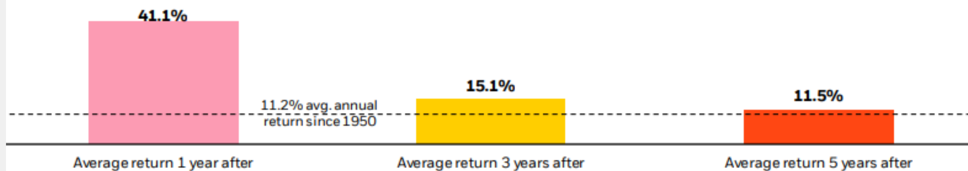
Portfolio Blueprint

Monthly Talking Points

BULL MARKET REBOUNDS

Anatomy of bull market rebounds

Average performance following a bear market
Since 1950, 11 bear markets



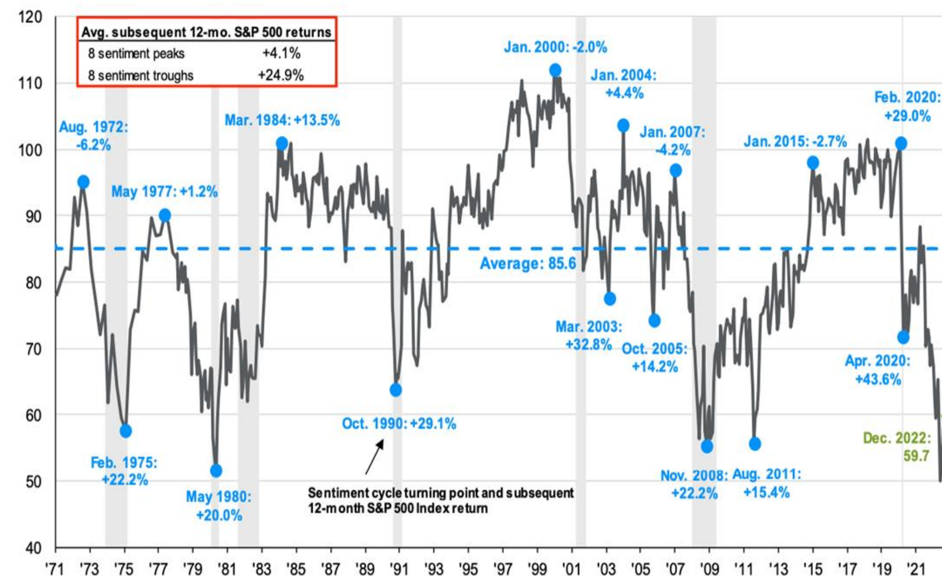
Rebounds from bear markets since 1950

Bear Market Low	10/22/57 -21.5%	6/26/62 -28.0%	10/7/66 -22.2%	5/26/70 -36.1%	10/3/74 -48.2%	3/6/78 -19.4%	8/12/82 -27.1%	12/4/87 -33.5%	10/9/02 -49.1%	3/9/09 -56.8%	3/23/20 -33.9%	10/12/22 -25.4%
Return needed to break-even	27.3%	38.8%	28.5%	56.4%	93.1%	24.1%	37.2%	50.4%	96.6%	129.5%	51.3%	34.1%
Days to break-even	233	299	143	451	1,462	366	58	414	1,166	1008	101	?
1-yr after	31.0%	32.4%	32.9%	43.7%	38.0%	12.6%	58.3%	22.5%	33.7%	68.6%	77.8%	?
3-yr after	15.2%	16.7%	8.3%	15.9%	15.8%	14.3%	22.4%	16.4%	15.5%	10.4%	?	?
5-yr after	9.9%	11.9%	6.4%	5.5%	12.0%	2.1%	26.6%	17.4%	15.0%	7.9%	?	?

Morningstar as of 1/31/23. Stock market represented by S&P 500. Stocks PR Index. Principal return only, dividends not included. Past performance does not guarantee or indicate future results. Index performance is for illustrative purposes only. You cannot invest directly in the index.

Chart Source: BlackRock via Subscription

Consumer Sentiment Index and subsequent 12-month S&P 500 returns



Source: FactSet, Standard & Poor's, University of Michigan, J.P. Morgan Asset Management.

Chart Source: JP Morgan Asset Management via Subscription

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Portfolio Blueprint

Monthly Talking Points

Asset Allocation Commentary

Occasionally markets, no matter where they are located, offer opportunities to buy companies at reasonable prices. Presently, we are seeing these opportunities internationally.

- With the dollar potentially peaking off the October 2022 highs, history tells us both emerging and developed international markets could benefit. If in fact, we have seen “peak dollar,” this should continue. (See BlackRock chart)
- If one thinks we have seen interest rates peak, this also bodes potentially well for international exposure. Currency will have a tendency to move to where real rates are relatively higher. If U.S. rates do stabilize, we believe cross-border currency transactions will move towards Europe and emerging markets and should find their way into investments like stocks.
- Finally, corporate earnings and margins abroad have been much more resilient to the global economic slowdown. Year-to-date, this has led to opportunities in non-U.S.-equity markets..

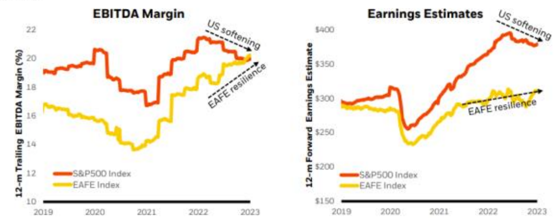
U.S. dollar peaks historically coincide with Emerging Market rallies

A relative peak in the strength of the US dollar could make Emerging markets assets unusually attractive

Chart Source: BlackRock via Subscription

Overseas corporate earnings withstand deluge of woes, show growing strength

Our analyst estimates revisions signals, based on company-level data, suggest potential opportunity within developed markets outside of the U.S



Relative earnings resilience further convinces us to move overweight international DM stocks

Chart Source: BlackRock via Subscription

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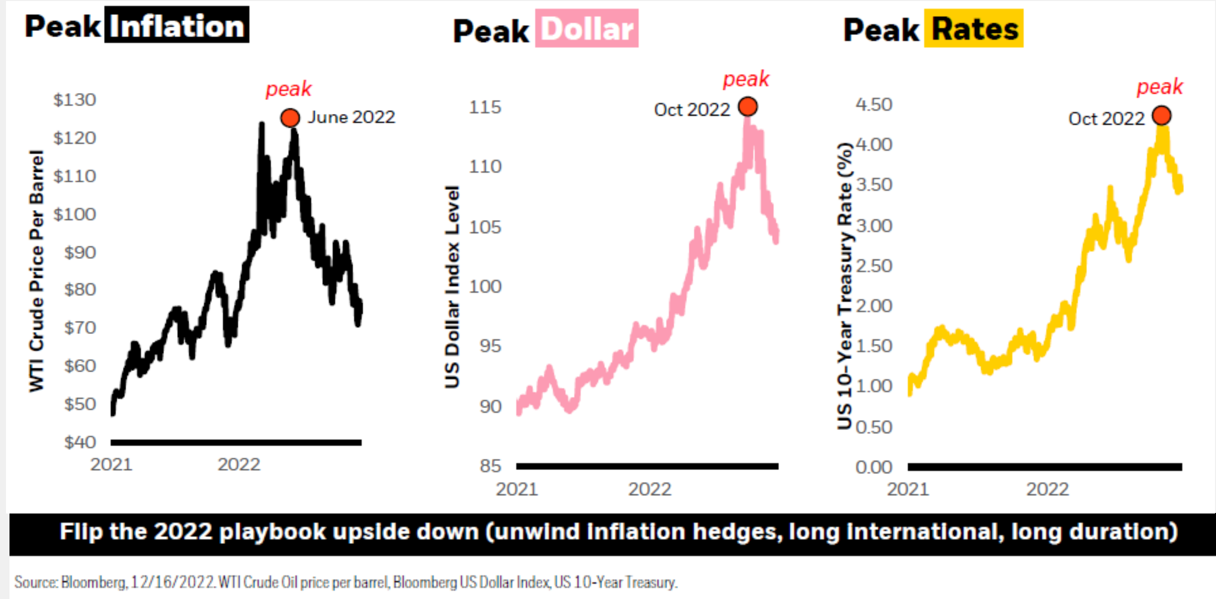
Ashton Thomas Asset Allocation Views

U.S. Equity – Slight underweight with a value tilt due to slow earnings growth and valuations.

International Equities – Normal weights to developed and (non-China) emerging markets. Normal weight to China on reopening but we remain with the view that China is a "timing" market and not a strategic hold.

Small and mid-cap equity – Underweight. Continued inflation is a major concern for small businesses. Earnings outlooks in these categories are much more negative than normal, especially in light of increased labor costs. If in fact the U.S. does go into recession, smaller companies tend to underperform larger companies as the economy slows.



Source: Bloomberg, 12/16/2022. WTI Crude Oil price per barrel, Bloomberg US Dollar Index, US 10-Year Treasury.

Chart Source: BlackRock via Subscription

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Portfolio Blueprint

Monthly Talking Points

Fixed Income

We had a busy and exciting February in the bond market, as yields spiked with the realization that "higher for longer" from the Fed was not just a talking point, but a reality that seemed to be fully embraced by the Treasury yield curve. The biggest moves were in the "belly" of the curve (2-year to 10-year maturities), with rates pushing higher because inflation and the job market (wages) continued to print hotter than expected.

Inflation

By far, the three economic prints that moved rates and fixed income markets were:

- A hotter-than-expected Consumer Price Index (CPI)
- A hotter-than-expected Producer Price Index (PPI)
- A hotter-than-expected Personal Consumption Expenditures (PCE), which seems to be the Fed's current favorite inflation gauge

All three reversed previous gains and printed higher. Although the "volatile" components, such as food and energy were small contributors, the "sticky" wages, rents, and services remained elevated or gained and are proving difficult for the Fed to bring back down to their preferred levels.

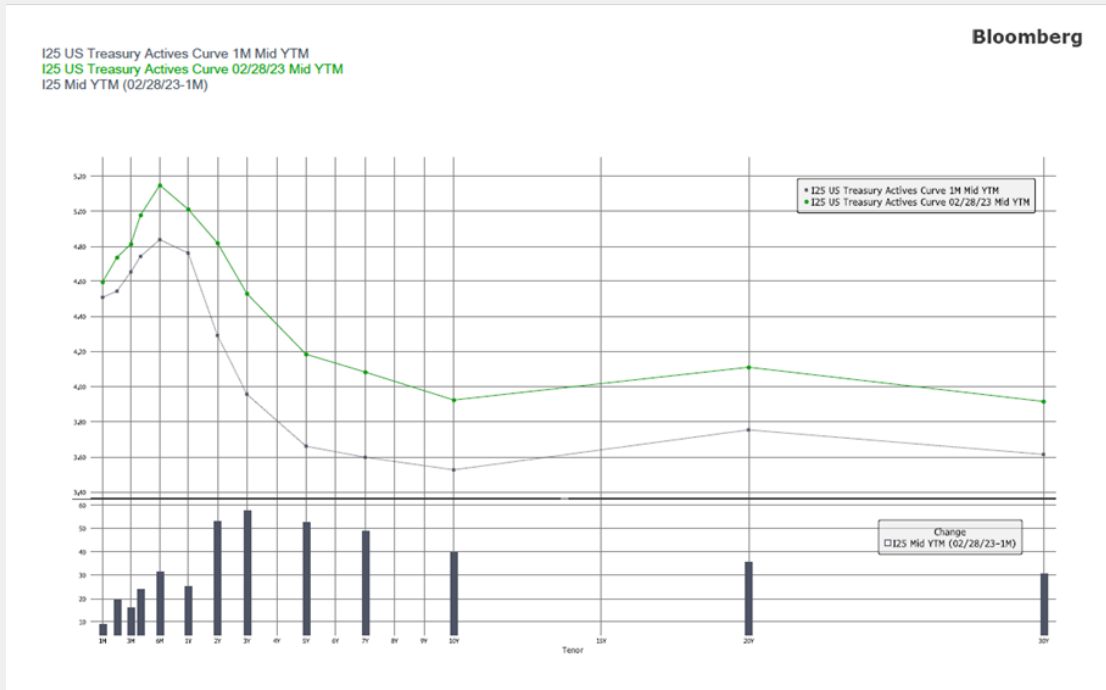

Chart Source: Bloomberg LP, via Subscription

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Monthly Talking Points

Going Forward…

- We favor individual names and CUSIPs over ETFs. Having bonds mature at regular intervals to organically take advantage of steadily rising rates produces higher returns and income, in addition to knowing when and how much will come due. Certainty in this market is a major advantage.
- We favor starting to increase duration in fixed income portfolios. As of February 28, 2023, the yield on the 2-year Treasury Note was 4.8158%, while the Dividend Yield of the S&P 500 was 1.56%. This is worth noting, especially when taking risk into consideration (Data via Bloomberg – Provided in Overview).[1][Bloomberg, LP]
- We believe the Federal Open Market Committee (FOMC) will hike rates by 50 basis points at the March meeting, 25 basis points at the May meeting, and 25 basis points in June. We are still of the opinion that the terminal rate will be 6% or above before the Fed pauses, especially if the Fed remains serious and vigilant about fighting inflation.
- We would encourage fixed-income investors to take advantage of rates as they rise and to extend duration, especially in the 2-year to 10-year range (the "belly" of the curve). Perhaps this should not be done all at once, but certainly should be considered as we get closer to 6% on the Discount Rate.

CPI chart

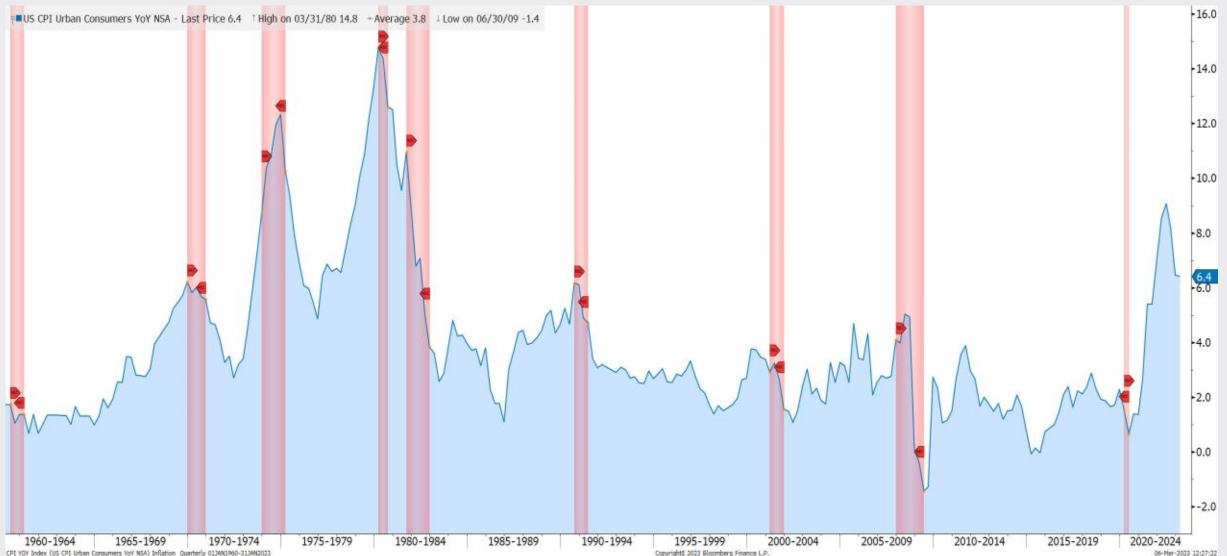

Chart Source: Bloomberg LP, via Subscription

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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.

"West Texas Intermediate" (WTI) oil is a benchmark used by oil markets, representing oil produced in the U.S. It is based on oil at a large tank and pipeline hub in Cushing, Oklahoma. Like Brent oil, WTI is priced as a light oil, but it doesn't have the same global reach.

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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Forge Private Wealth
https://forgepw.com/
Main: 602-732-4745

8383 Greenway Blvd, Suite 600
Middleton, WI 53562

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