ACCESS FINANCIAL SERVICES, INC.

Quarterly Review and Outlook

October 11, 2023

Third Quarter, 2023

Index Returns as of Sept. 30, 2023	3 Mo.	6 Mo.	12 Mo.
US STOCKS			
S&P 500 Index TR (large-cap stocks)	(3.27)	5.18	21.62
Dow Jones Select Dividend Index TR	(3.69)	(6.13)	4.84
NASDAQ 100 Index TR	(2.92)	11.95	34.95
Russell 2000 Index TR (small-cap stocks)	(5.13)	(0.19)	8.93
FOREIGN STOCKS			
MSCI EAFE Net Total Return Index (US$)	(4.11)	(1.28)	25.65
S&P Europe 350 Index Net TR Index (US$)	(4.90)	(2.17)	29.46
MSCI Japan Net Total Return Index (US$)	(1.59)	4.73	25.92
MSCI Emerging Markets Net TR Index (US$)	(2.93)	(2.05)	11.70
COMMODITIES & CURRENCIES			
US Dollar	3.17	3.58	(5.30)
Euro	(3.08)	(2.45)	7.87
Gold	(3.68)	(6.13)	11.32
Oil (West Texas Intermediate)	29.99	22.12	18.71
Bloomberg Galaxy Crypto Index	(12.74)	(14.55)	9.53
BONDS			
Bloomberg US Aggregate Bond (inv. grade)	(3.23)	(4.05)	0.64
Bloomberg US Treasury 20+ Year	(13.00)	(15.07)	(10.78)
Bloomberg US Treasury Inflation Notes: 1-10 Yr	(1.00)	(2.41)	2.11
Bloomberg Municipal Bond	(3.95)	(4.05)	2.66
Bloomberg US Corporate	(3.01)	(3.37)	3.65
BBgBarc US Corp. High Yield Bond	0.46	2.21	10.28
Bloomberg Global Aggregate Treasuries	(4.17)	(6.51)	1.01

Source: Bloomberg and Morningstar

As shown in the table above, most risk assets declined during the third quarter, 2023 after a strong first half of the year. While the Fed lifted short term interest rates again in July, it was longer term interest rates that moved most materially higher (Chart 1) resulting in losses across the high quality bond universe. The longest maturity bonds being hit particularly hard with a loss of 13%. The decline from its recent high in 2020 is largest in the history of the Bloomberg US Long Treasury Index (Chart 2) which goes back to January 1972.

At this point, however, with the ten year US Treasury bond yield at 4.55% as of September 30, the risk/reward of owning longer duration bonds has improved. As Table 1 illustrates, further increases in the US ten year Treasury bond yield would result in limited losses from here. In contrast, a decline in the ten year yield – which would be quite plausible in a recession scenario – would result in pretty attractive gains.

Within the US stock market, only communication services (of which Alphabet/Google makes up 41% and Meta/Facebook makes up 19% of the sector) and energy stocks posted positive returns (Chart 3) this quarter.

Chart 1: Term Structure of Interest Rates (Yield Curve)

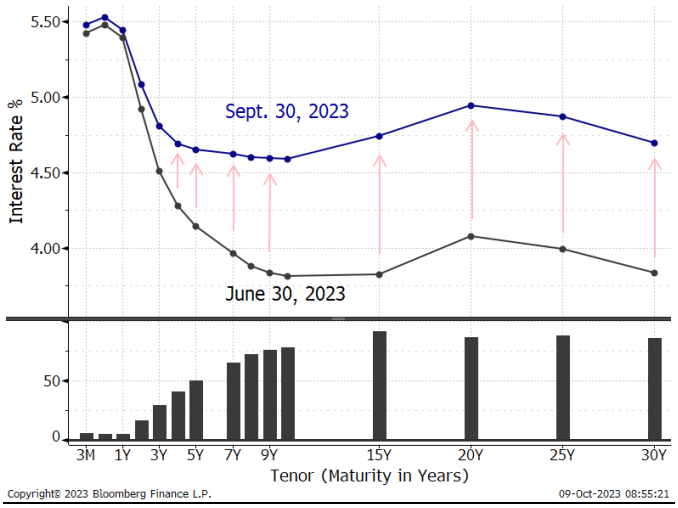


Chart source: Access Financial Services using Bloomberg Software & Data

Chart 2: Bloomberg US Long Treasury Index

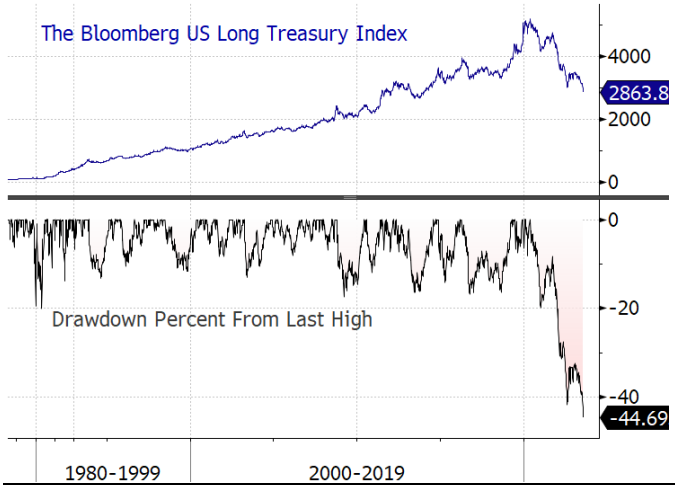


Chart source: Access Financial Services using Bloomberg Software & Data

Oil prices, after falling between mid-2022 and mid-2023, have recovered some of their losses as Saudi Arabia and Russia joined hands to curb supplies and drive crude prices higher. Between June 30 and September 30, Oil (west Texas intermediate) climbed from $70.64 to $90.79 per barrel. This in turn lifted energy shares which outperformed the S&P 500 (SPX) by 15.5% over this period.

While many of the largest technology related stocks declined during the third quarter, it still feels like this corner of the stock market has been whistling past the graveyard this year. The year to date return for the "Magnificent Seven" index (Table 2), which makes up 28% of the SPX, has been 84% while the

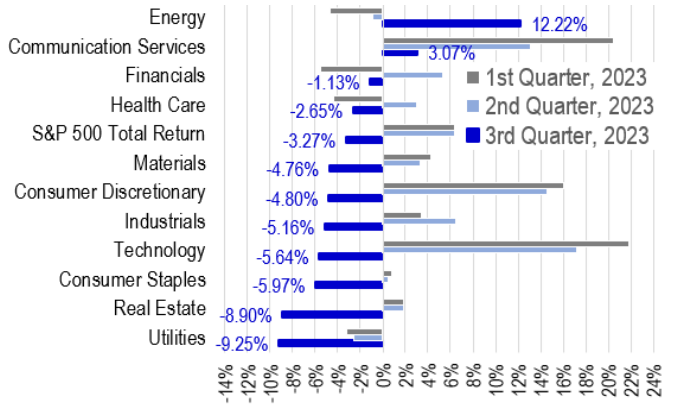
equal weighted SPX is up just 2% (Chart 4). In fact, most broad based indices have generated low single digit returns this year (Table 3).

Table 1: Implied 10 Yr. Treasury Bond Return

If 10 Year Treasury Yield Moves To...	...The Implied 1 Year Return Will Be
6.0%	-6.2%
5.5%	-2.5%
5.0%	1.1%
4.5%	4.8%
4.0%	8.5%
3.5%	12.1%
3.0%	15.8%
2.5%	19.4%
2.0%	23.1%
1.5%	26.8%
1.0%	30.4%

Source: BCA Research

Chart 3: S&P 500 Sector Returns



Source: Access Financial Services using data from Bloomberg

Table 2: Magnificent 7 Index & Stock Returns

	Third Quarter	Year-to-Date
Magnificent Seven Index (seven stocks below)	-1.39%	83.90%
Alphabet (Google)	9.32%	48.32%
Meta Platforms (Facebook)	4.61%	149.47%
NVIDIA	2.83%	197.76%
Amazon.com	-2.49%	51.33%
Tesla	-4.41%	103.13%
Microsoft	-7.28%	32.56%
Apple	-11.73%	32.33%

Source: Access Financial Services using data from Bloomberg

Table 3: Other Broad Based Index Returns

	Third Quarter	Year-to-Date
Russell 2000 Index (small companies)	-5.14%	2.51%
S&P 400 Mid Cap Index	-4.20%	4.24%
MSCI EAFE (developed foreign markets)	2.83%	-4.04%
MSCI Emerging Markets	-2.85%	2.07%

Source: Access Financial Services using data from Bloomberg

The price/earnings ratio of the Magnificent Seven is 43.8, whereas the SPX is 19.6 and the equal weighted SPX is 15.6.

Chart 4: Magnificent 7 vs. S&P 500 Equal Weighted Index

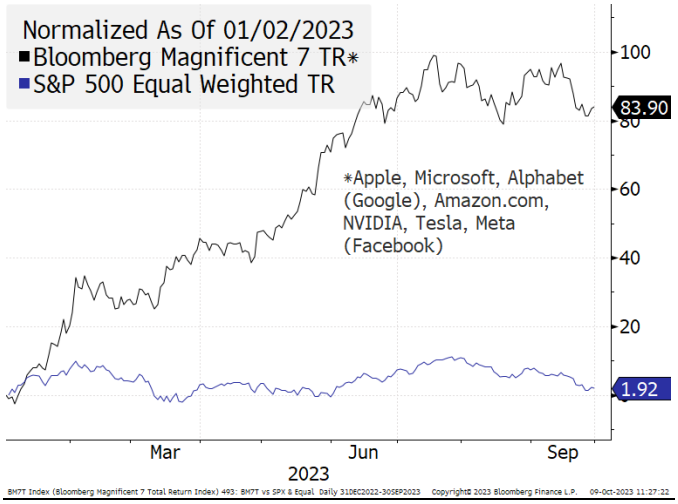


Chart source: Access Financial Services using Bloomberg Software & Data

Normally, during periods of rising interest rates, stocks with the highest valuations underperform those with lower valuations (Chart 5). Technology related companies trade on very long term growth expectations, which means changes in interest rates have a greater impact on the discounted present value of their future cash flows than for slower growing companies. As a result, technology related stocks tend to outperform in environments where interest rates are falling – the opposite of the environment we find ourselves in today.

Chart 5: 10 Yr. Treas. Yield & Growth vs. Value Stocks

Chart source: Access Financial Services using Bloomberg Software & Data

As the largest technology related US companies have posted strong gains this year despite high inflation and significantly higher interest rates, many have concluded that this time is different and that the resilience of many coincident macroeconomic indicators mean a soft landing is a foregone conclusion after a summer in which inflation trended lower, the job market remained strong, consumers kept spending, and the housing market has remained strong. Maybe, but as Warren Buffett said, "what we

learn from history is that people don't learn from history."

Over the past 18 months, we have seen one of the most aggressive coordinated increases in global short term interest rates in history. Now that we are reaching the end of the tightening cycle, many have taken their prior recession calls off the table. This growing confidence that there will be a soft landing not only downplays time tested recession signals, but also ignores the long lags in monetary policy transmission into the economy.

Most investors understand that monetary policy works with long and variable lags. We also know that humans are, by nature, impatient. This combination tends to cause history to repeat itself.

Since the early 1980s, consensus predictions that the economy would achieve a "soft landing" have preceded each of the past four recessions and the current level of US gross domestic product (GDP) growth was observed just before the 2008-2009, 2001, 1969-70 and 1948 recessions. GDP was 9.3% before the 1960 recession. One lesson from history is that when everyone expects a soft landing, we should brace for impact.

Though it is impossible to predict with certainty, the evidence still indicates that the recession so many were predicting earlier this year is more likely to have been delayed than avoided all together and will arrive in 2024.

One reason most economists fail to anticipate recessions comes down to the way forecasting works. It typically assumes that what happens next is just a linear extension of what has already happened. Recessions are non-linear events which the human mind has difficulty with.

An example of this is the unemployment rate. As we have pointed out in the past, it either barely moves, or it surges. And, whenever the three month average rate of unemployment has increased by more than one-third percent, a recession has followed (Chart 6). The Fed's latest forecast is for the unemployment rate to drift higher from 3.7% to 4.1% in 2024 – a continuation of the current trend which would probably see the US avoid a recession.

Much of the soft landing argument is grounded in the ongoing strength of consumer spending. Unfortunately, using history as a guide, the US consumer keeps spending right up to the brink. Complicating matters further is the emergency pandemic money drop which is impacting economic growth in ways that have no historical precedent and will influence the economy as its impact fades. We need to consider how and by what degree this has lengthened the lags between interest rate hikes and their ultimate impact on the economy.

Chart 6: US Unemployment Rate

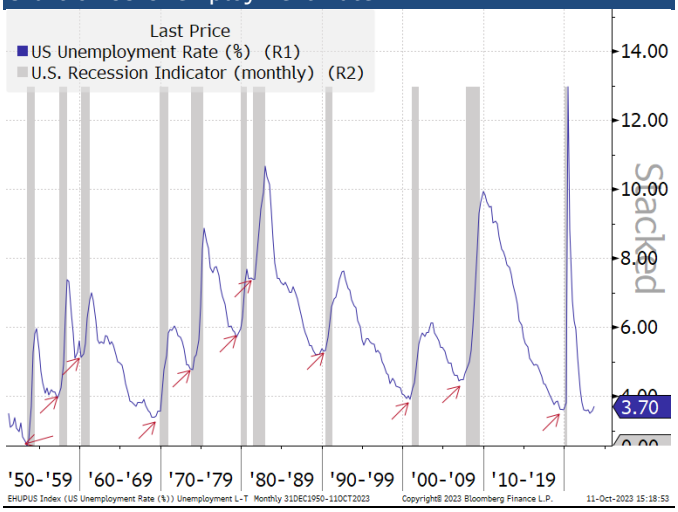


Chart source: Access Financial Services using Bloomberg Software & Data

Pandemic related fiscal stimulus of about $5 trillion between 2020 and 2021 led to a sizable increase in disposable income in the US at a time when social distancing led to a significant drop in household spending. The result was that savings rose rapidly and to much higher levels than in previous recessions.

The accumulated difference between actual savings and the pre-pandemic trend is shown in Chart 7 below.

Chart 7: Aggregate Personal Savings

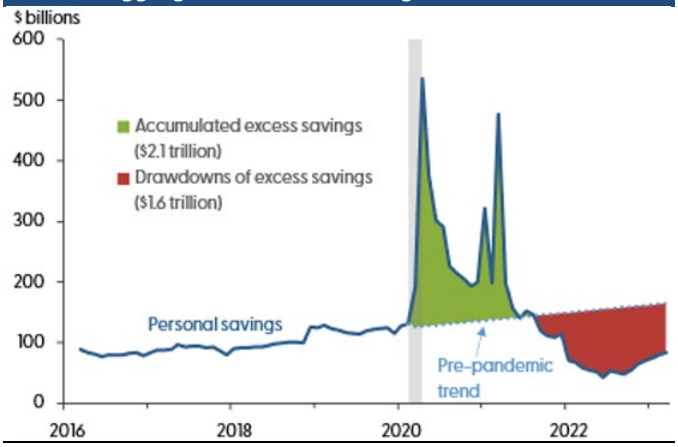


Chart source: Federal Reserve Bank of San Francisco

An important consideration is how the emergency pandemic policy measures will influence the economy as their impact wanes, and how much longer this influence will persist. It seems probable that the measures taken by our fiscal and monetary leaders during the pandemic have lengthened the time between the tightening of monetary policy and economic slowing.

Above baseline income accrued at the lower ranges of the income distribution as only the bottom seven

deciles (single and married-filing-jointly taxpayers with annual taxable income less than or equal to $75,000 and $150,000, respectively) were eligible for the three rounds of economic impact payments that summed to $800 billion. The other wave of fiscal transfers to households came in the form of supplemental federal unemployment insurance benefits totaling around $750 billion and were disproportionately paid to unskilled services workers who bore the brunt of pandemic related unemployment, offsetting $300 billion of lost wages.

The Federal Reserve Bank of San Francisco estimates that the aggregate stock of excess savings will likely be depleted by the end of September. Bloomberg calculations find that the poorest 80% of the population now have less cash than they did before the pandemic. Also revealing is that credit card delinquency rates (30+ days overdue) have grown from around 4% in 2021 to around 8% currently and are expected to be 10% by year end. Trends in the auto loan market are similar. JPMorgan Chase, Citigroup and Wells Fargo, will join Bank of America in posting roughly $5.3 billion in combined third quarter net charge-offs, the highest for the group since the second quarter of 2020 according to data compiled by Bloomberg.

The bottom line is that the resilient economic growth and positive surprises over the last 12 months have likely been grounded in the excess savings built up during the pandemic. The end of the moratorium on student loan repayments (which many estimate to exceed $50 billion per quarter) and high consumer debt and interest rates (Chart 8) could cause US consumers to change their spending habits in a reversal of what we have experienced over the last few years.

Chart 8: Consumer Savings & Credit

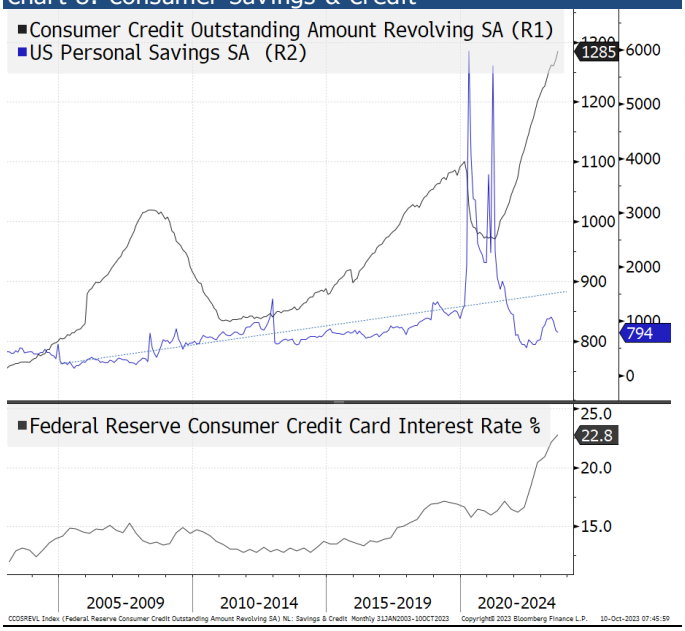


Chart source: Access Financial Services using Bloomberg Software & Data

For economists and market strategists, the past few years have provided a lesson in humility as forecasting models that worked well in the past have missed the mark – at least for now.

Nevertheless, to disregard the indicators that have been reliable for decades (Charts 9 – 12) still seems premature. This time the cycle may not actually be different; it just may be longer.

Chart 9: NY & Cleveland Fed Recession Indicators

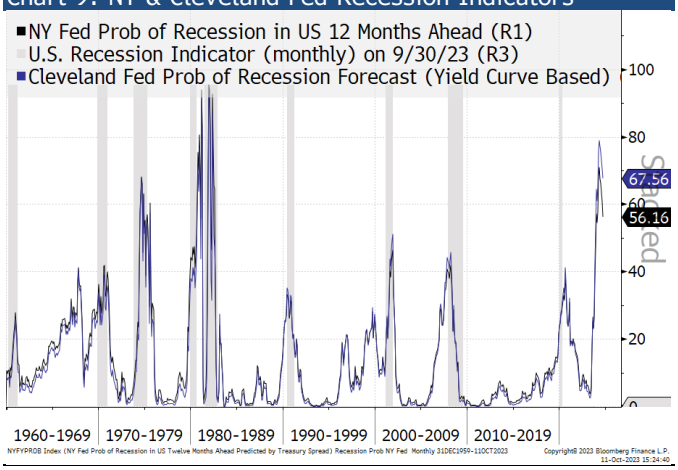


Chart source: Access Financial Services using Bloomberg Software & Data

Chart 10: Leading Index & Lending Standards

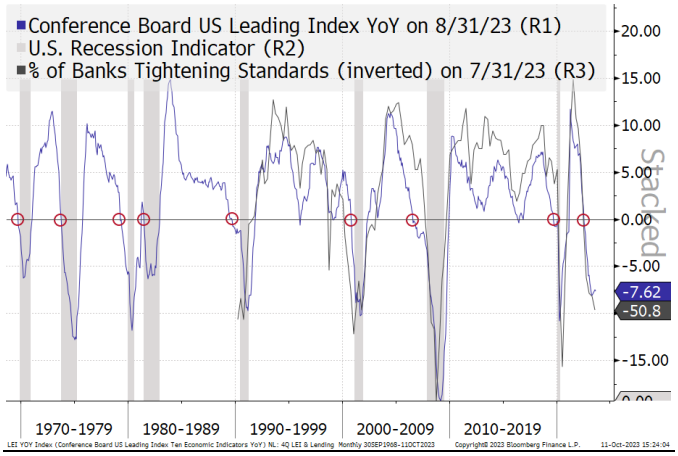


Chart source: Access Financial Services using Bloomberg Software & Data

Chart 11: Federal Funds Rate

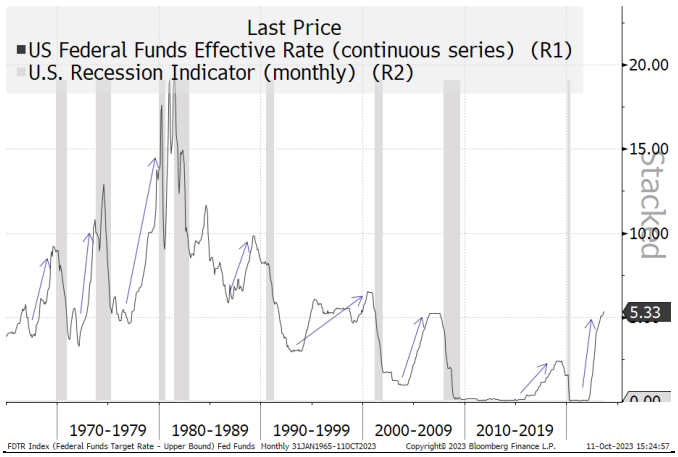


Chart source: Access Financial Services using Bloomberg Software & Data

Chart 12: Treasury Curves

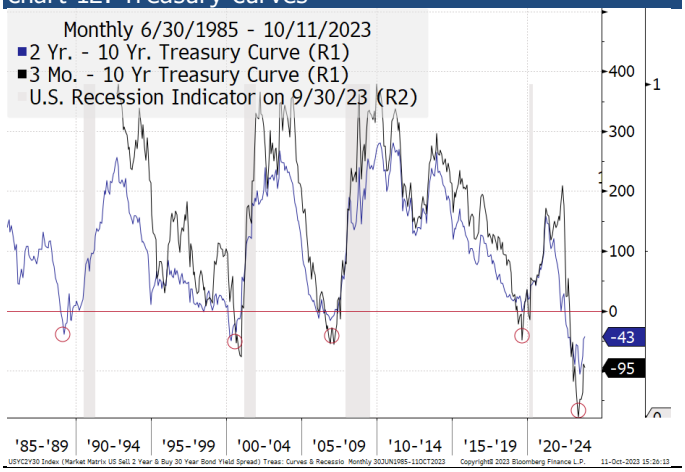


Chart source: Access Financial Services using Bloomberg Software & Data

A soft landing remains possible, but most reliable indicators of recessions provide good reasons for caution.

Beyond our cautious outlook for the economy, we remain guarded in our outlook for global stocks. While relatively high valuations (Table 4) in a high interest rate environment is unusual, we can also add the combination of rising oil prices and appreciating US dollar. This "growth tax" is illustrated in Chart 13 below (shown inverted).

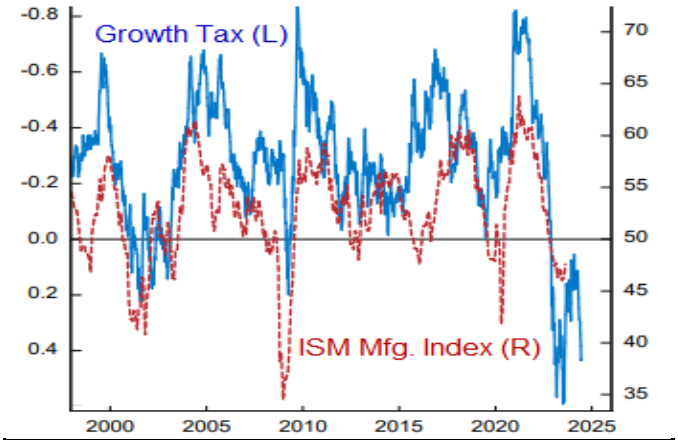
Table 4: S&P 500 Valuation Metrics

	S&P 500 Index		Median Stock	
Valuation Metric	**Current**	**Historical Percentile**	**Current**	**Historical Percentile**
Market Capitalization / GDP	233%	97%	N/A	N/A
Enterprise Value / Sales	2.7	97%	3.0	95%
Enterprise Value / EBITDA	13.7	93%	13.3	94%
Price / Book	4.4	92%	3.3	94%
Cyclically Adjusted P/E Ratio (CAPE)	27.8	88%	N/A	N/A
Cash Flow Yield	6.3%	87%	6%	94%
Forward P/E	19.0	87%	17.2	80%
Free Cash Flow Yield	3.7%	60%	4%	60%
Median Absolute Metirc		**90%**		**94%**
Yield Gap vs. Real 10 Year Yield	3.4%	88%	3.8%	83%
Yield Gap vs. Investment Grate Bonds	-0.5%	84%	0.0%	81%
Yield Gap vs. 10 Year Treasury	1.1%	78%	1.6%	54%
Median Relative Metric		**84%**		**74%**

Source: Goldman Sachs

We have been underweight stocks and other risk assets in our clients' accounts throughout the year. And while the SPX has posted a year to date return of 13.1% as of September 30, the gain has been driven by a small handful of the largest US companies – all of which are related to the excitement around the artificial intelligence productivity miracle narrative. Most other areas of the stock and credit markets have been stagnant this year (Chart 14).

Chart 13: Growth Tax



Growth tax is a combination of the US dollar, oil price & interest rates
Chart source: Alpine Macro

Chart 14: Year to Date Returns for Various Risk Assets

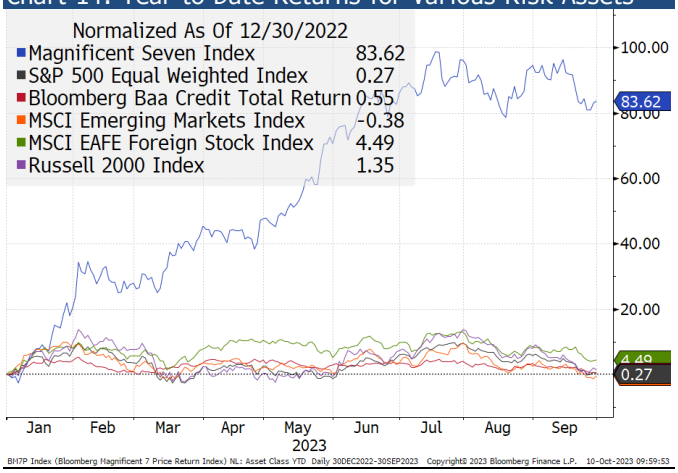


Chart source: Access Financial Services using Bloomberg Software & Data

Without a doubt, I regret missing out on the massive move to the upside in these seven largest stocks (which have essentially moved sideways during the third quarter). With that said, our clients' US stock allocations are generally up by 6% to 9% this year to date. This compares pretty favorably to many broad based indices.

In January, we noted that emerging markets (EMs) should benefit from low valuations, stronger activity in China, high commodity prices, low valuations, and monetary policy easing. And, that combining these factors with a weak earnings outlook in developed markets improved the relative appeal of emerging markets stocks as a source of diversification.

For shorter horizons, emerging market stocks exhibit a much lower correlation to the SPX than non-US developed markets (Table 5). While less of a desirable feature in benign macro environments, the low correlation limits projected portfolio losses when the world economy is at the threshold of a recession.

Table 5: S&P 500 1 Year Weekly Correlation					
Developed Foreign	Emerging Markets	Chile	Latin America	Brazil	China
71.6%	52.7%	51.9%	26.4%	10.3%	2.0%

Source: Access Financial Services using data from Bloomberg

EM stocks have not fared all that well so far this year, trailing their developed market counterparts by 5.6%, but Latin America stands out as the only region having outperformed developed markets over this period (Chart 15).

Chart 15: Y-T-D Emerging Market Returns

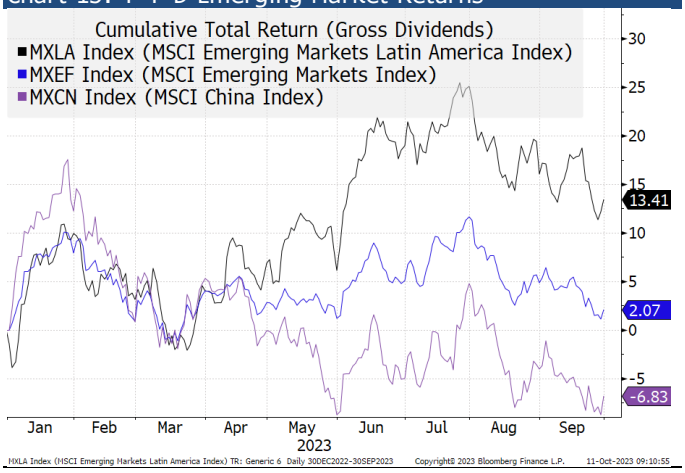


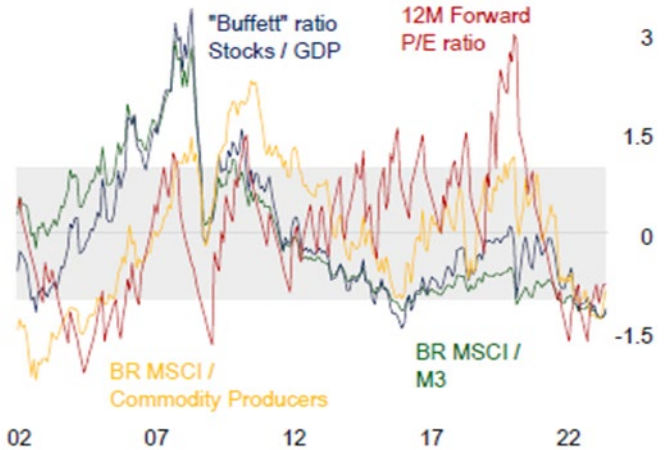
Chart source: Access Financial Services using Bloomberg Software & Data

Latin America – especially resource rich South America – looks particularly attractive given its low valuations, exposure to China, low exposure to the technology sector, and the potential for aggressive interest rate cuts. When valuations in Brazil are as low as they are today (Charts 16 and 17), the Brazilian stock market typically returns around 20% over the next twelve months versus 8% at "normal" valuations. Further, even when growth in Brazil weakens, when valuations are low, the Chinese economy is strengthening and the Brazil Central Bank (BCB) is lowering interest rates, the Brazilian stock market's average return is 27% over the next twelve months.

In assessing the likelihood of a rebound in valuations, it helps to understand what drove valuations to current lows. BCB policy and, to a lesser extent, weakening growth expectations played a strong role in dragging valuations down since 2021. As such, it follows that a loosening of monetary policy in Brazil should favor the country's stock valuations. Most forecasters believe that the BCB will cut rates by another 400 basis points (four percentage points) over the next 12 months in addition to the 100 basis points of cuts implemented since late July (Chart 18). Importantly, it is likely that the BCB will cut rates faster and more aggressively compared to its regional peers and the Federal Reserve.

The exposure of South American stocks to raw materials also increases their appeal versus other EM equity markets and a tight oil market balance should keep prices supported over the coming year.

Chart 16: Brazilian Stocks Trade at a Discount



Note: Chart shows various valuation metrics for Brazilian equities, expressed as standard deviations. The shaded gray area indicates +/- 1 standard deviations. Source: Numera Analytics.

Chart 17: P/E & P/B Ratio for Brazilian Stock Market

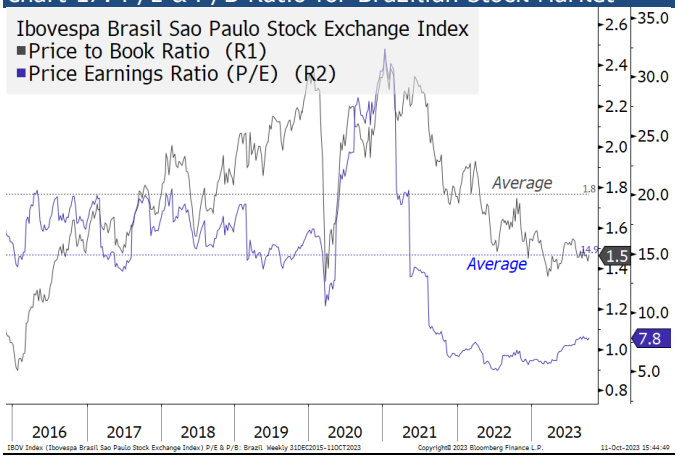


Chart source: Access Financial Services using Bloomberg Software & Data

Chart 18: Brazilian Central Bank Rate & Inflation

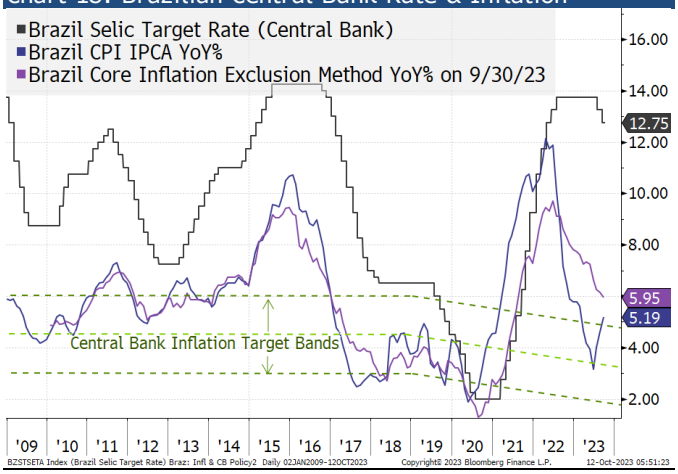


Chart source: Access Financial Services using Bloomberg Software & Data

Looking ahead, we see a strong likelihood of positive returns from Brazilian stocks over the next year relative to developed market stocks. This makes

Brazil one of the most attractive major EMs. We have been buying the iShares MSCI Brazil exchange traded fund (ETF) since late April for our clients.

The situation in Chile is similar to Brazil in many ways. The country is a strong resource producer – the largest copper producing country and the second largest lithium producing country (Australia produces the most). Chilian stock market valuations are also very low (Chart 19) and the country's debt to GDP ratio is among the healthiest in Latin America.

Chart 19: P/E & P/B Ratio for Chilian Stock Market

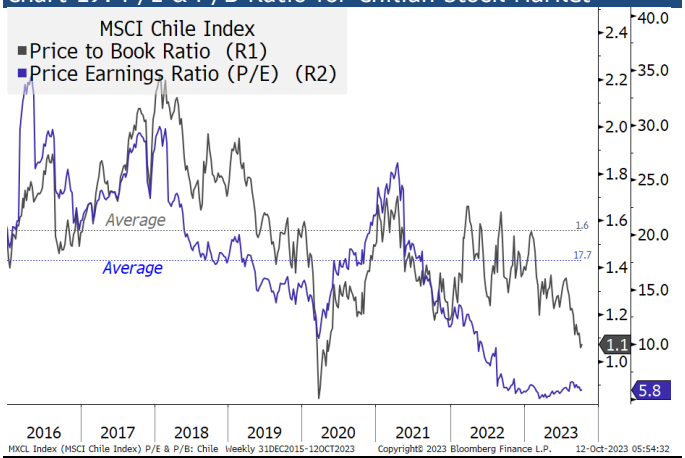


Chart source: Access Financial Services using Bloomberg Software & Data

Chile's economy is expected to return to growth next year of around 2% according to estimates compiled by Bloomberg, after shrinking about 0.2% this year. And, as with Brazil, inflation rates are declining and the monetary authorities have lowered interest rates by 175 basis points (Chart 20) with a further decline to 5% over the next year expected.

Chart 20: Brazilian Central Bank Rate & Inflation

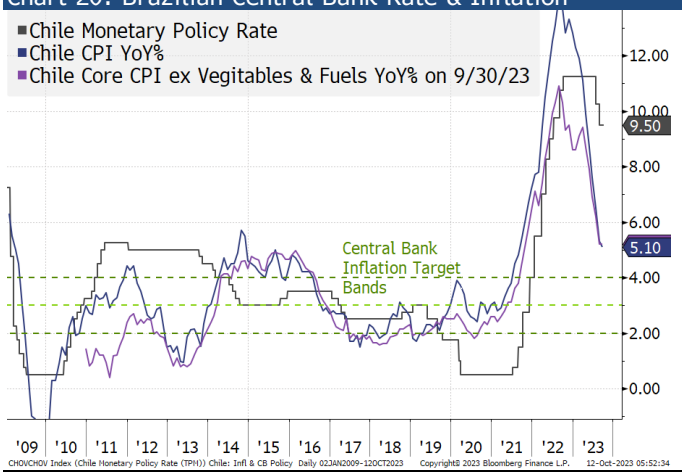


Chart source: Access Financial Services using Bloomberg Software & Data

Chile is ahead of other Latin American and EM economies in its business, inflation, and monetary cycles. We have been buying the iShares MSCI Chile ETF since mid-September for our clients.

Overall, our clients' allocation to stocks is about 15% lower than "normal" (i.e., a portfolio with a "normal" stock allocation of 60% is now closer to 51%: 60% - 15% of 60% = 51%). Our clients' stock allocations are overweight large companies with low valuations. The 15% that would normally be allocated to stocks is invested in money market funds currently yielding between 5.25% and 5.40%. Our clients' bond allocations are in-line with our target neutral allocations, but with a shorter duration than the overall bond market. This has resulted in better returns than the Bloomberg US Aggregate Bond Index.

Thank you for your continued confidence. It means a great deal to all of us. Please do not hesitate to contact me if you would like to discuss any of this in more detail.

Brant Kairies
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