ACCESS FINANCIAL SERVICES, INC.

January 12, 2024

Quarterly Review and Outlook

Fourth Quarter, 2023

Index Returns as of Dec. 31, 2023	3 Mo.	6 Mo.	12 Mo.
US STOCKS			
S&P 500 Index TR (large-cap stocks)	11.69	8.04	26.29
Dow Jones Select Dividend Index TR	10.17	6.11	1.53
NASDAQ 100 Index TR	13.79	9.31	44.64
Russell 2000 Index TR (small-cap stocks)	14.03	8.18	16.93
FOREIGN STOCKS			
MSCI EAFE Net Total Return Index (US$)	10.42	5.88	18.25
S&P Europe 350 Index Net TR Index (US$)	11.17	5.73	20.02
MSCI Japan Net Total Return Index (US$)	8.19	6.47	20.32
MSCI Emerging Markets Net TR Index (US$)	7.87	4.71	9.93
COMMODITIES & CURRENCIES			
US Dollar	(4.56)	(1.53)	(2.11)
Euro	4.41	1.20	3.12
Gold	11.60	7.48	13.10
Oil (West Texas Intermediate)	(18.59)	5.83	(6.91)
Bloomberg Galaxy Crypto Index	75.57	53.21	139.56
BONDS			
Bloomberg US Aggregate Bond (inv. grade)	6.82	3.37	5.53
Bloomberg US Treasury 20+ Year	12.92	(1.76)	2.15
Bloomberg US Treasury Inflation Notes: 1-10 Yr	4.71	1.99	3.90
Bloomberg Municipal Bond	7.89	3.63	6.40
Bloomberg US Corporate	8.50	5.15	8.52
BBgBarc US Corp. High Yield Bond	7.16	7.66	13.45
Bloomberg Global Aggregate Treasuries	8.10	3.59	4.18

Source: Bloomberg

2023 was a humbling year for professional forecasters who widely anticipated economic growth would stall in response to aggressive monetary policy tightening. Weak growth prospects and hawkish central bank policy, in turn, led us and many other strategists to predict another disappointing year for risk assets (Chart 1). As shown in Chart 2, even the most optimistic forecasters predicted a low probability that economic growth would reach potential as the Federal Reserve (Fed) underwent its most aggressive interest rate hiking cycle since Paul Volker served as chairman of the Fed between 1979 and 1989.

Table 1 shows 2024 year end projections for the S&P 500 Index (SPX) made by analysts tracked by Bloomberg. This year's projections range from +9% to -12% with an average of 1.2% and a standard deviation of 5.8%

After a challenging 2022, risk assets staged a strong recovery in 2023 as economic growth surprised to the upside benefiting from strong consumer spending. While high inflation continued to weigh on confidence, households have continued drawing down their pandemic boost in savings keeping consumption elevated.

Chart 1: S&P 500 Index Predicted Annual Change at the Beginning of Each Year

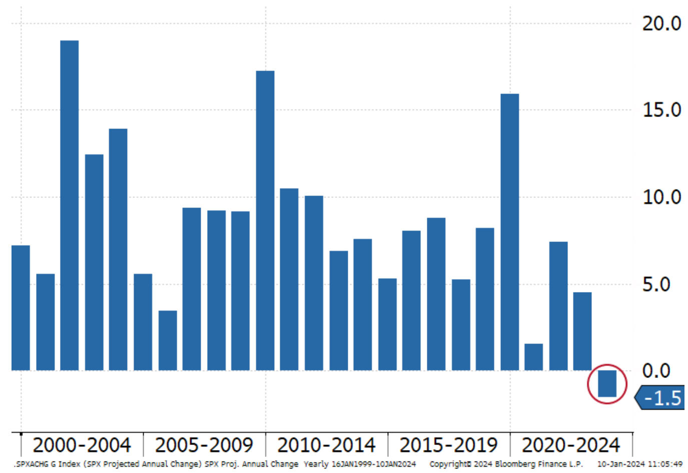
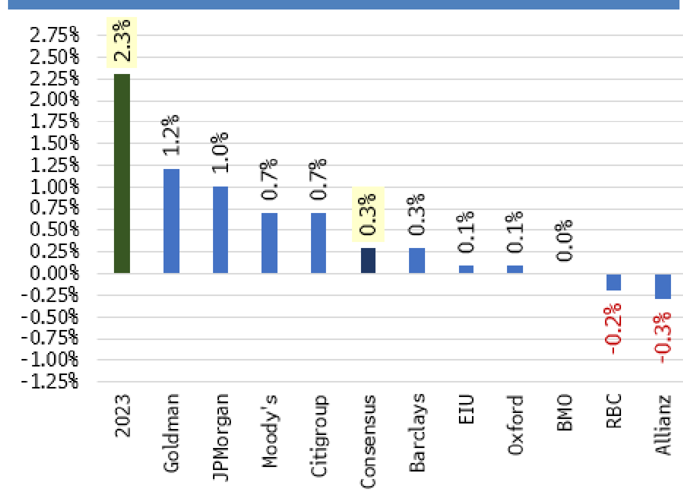


Chart source: Access Financial Services using Bloomberg Software & Data

Chart 2: US 2023 Growth Forecasts as of Dec. 2022



Source: Numera Analytics using data from Consensus Economics; 2023 is the full year 2023 estimate

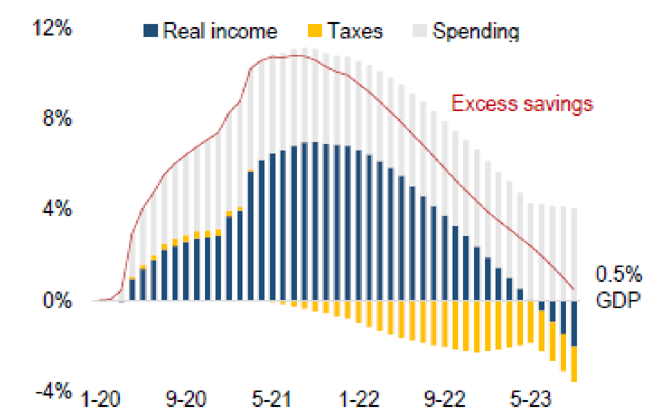
Chart 3 plots household savings versus its pre-pandemic path. Consumers had $900 billion of excess savings in early 2023 (4.5% of GDP). By September, this figure dropped below $100 billion as households compensated for still weak purchasing power. Further, those outside the wealthiest 20% of the country have run out of extra savings and now have less cash on hand than they did when the pandemic began according to the latest Federal Reserve study of household finances (Chart 4).

Table 1: 2024 S&P 500 Targets

Firm	2024 Target	Implied Change	2024 EPS	P/E	As Of
Oppenheimer	5,200	9.0%	240	21.7	12/11/23
Fundstrat	5,200	9.0%	240	21.7	12/07/23
Goldman Sachs	5,100	6.9%	237	21.5	12/18/23
Deutsche	5,100	6.9%	250	20.4	11/27/23
Citi	5,100	6.9%	245	20.8	12/12/23
BMO Capital Markets	5,100	6.9%	250	20.4	12/06/23
RBC	5,000	4.8%	232	21.6	11/22/23
HSBC	5,000	4.8%	236	21.2	12/13/23
BofA Securities	5,000	4.8%	235	21.3	12/19/23
Ned Davis Research	4,900	2.7%	229	21.4	12/05/23
UBS	4,850	1.7%	225	21.6	12/11/23
Barclays	4,800	0.6%	233	20.6	11/28/23
Societe Generale	4,750	-0.4%	230	20.7	11/09/23
Evercore ISI	4,750	-0.4%	215	22.1	01/10/24
Stifel	4,650	-2.5%	221	21.0	12/19/23
Wells Fargo	4,625	-3.0%	235	19.7	11/27/23
Scotiabank	4,600	-3.6%	227	20.3	12/11/23
Morgan Stanley	4,500	-5.7%	229	19.7	11/13/23
BNP Paribas Exane	4,500	-5.7%	226	19.9	12/21/23
Cantor	4,400	-7.8%	225	19.6	11/20/23
JP Morgan	4,200	-11.9%	225	18.7	11/29/23
Average	4,825	1.2%	233	20.7	

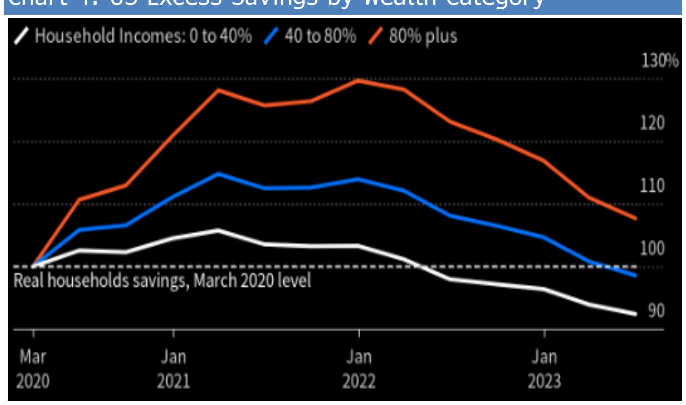
Source: Access Financial Services using data from Bloomberg

Chart 3: Excess Savings vs. Pre-Pandemic Path (GDP %)



Source: Numera Analytics using data from Bureau of Economic Analysis

Chart 4: US Excess Savings by Wealth Category



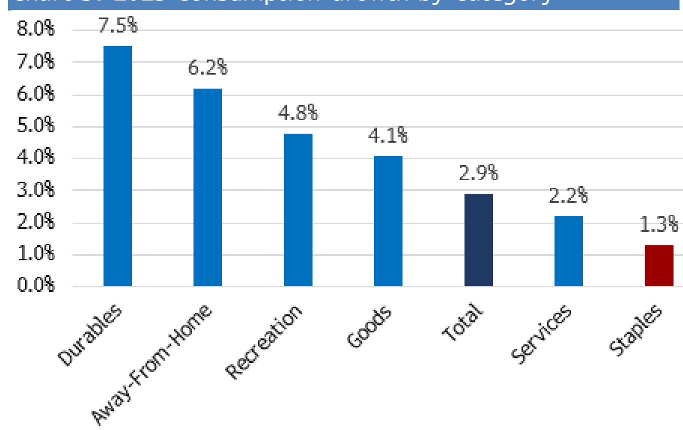
Source: Bloomberg using data from the Federal Reserve

Most of the savings drawdown went to discretionary items. This favored cyclical over defensive stocks, entirely reversing cyclicals' dismal returns in 2022.

Although monetary tightening continued to weigh on valuations and cyclicals are generally more vulnerable to elevated interest rates, cyclical growth stocks nevertheless benefited from low financial stress, AI enthusiasm, strong consumption growth and 'soft landing' optimism.

In contrast, defensive sectors posted negative earnings growth with few upside surprises. These narrower margins reflect consumers prioritizing spending on durables and away-from-home services at the expense of necessities. Chart 5 shows annualized consumption growth by category since December 2022. While total spending grew 1 point faster than its long term average, spending on staples grew 1.5 points below trend.

Chart 5: 2023 Consumption Growth by Category



Source: Numera Analytics using data from Bureau of Economic Analysis

Besides behavioral factors, an important driver of weak basic consumer goods spending growth has been higher inflation levels. Prices of food and beverages, for example, have increased 21% since early 2021, 6 percentage points higher than overall consumer price inflation (CPI), and twice as much as consumer durables. This high inflation pressured households to either limit their purchases or shift towards cheaper off brand products which hit sales of the premium brands of SPX companies.

As shown in Chart 6, and as we have discussed in the prior two quarterly outlooks, the largest seven stocks in the SPX by market capitalization (the "Magnificent 7") were the source of most of 2023's strong US stock market performance. Between January 1 and October 31 (dashed line on Chart 6), the Magnificent 7

(Mag. 7) increased 78% while the SPX excluding the Mag. 7 had a total return of 0.85% and the equal weighted SPX return was -2.24%. So, excluding the Mag. 7, the projected annual change for the SPX at the beginning of 2023 (-1.5%) wasn't too far off the mark for the first ten months of the year.

Chart 6: 2023

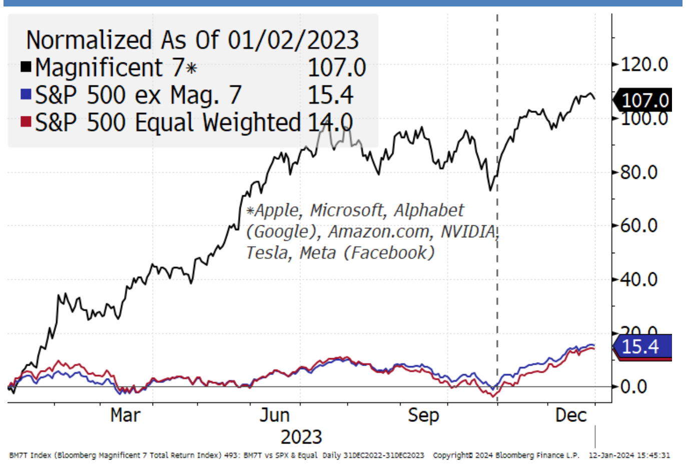


Chart source: Access Financial Services using Bloomberg Software & Data

The outperformance of the Mag. 7 can be attributed to a number of factors, but most obviously it comes down to earnings growth and change in valuation. Chart 7 shows that earnings per share (EPS) growth for the Mag. 7 was 87.9% during 2023 whereas EPS declined 9.8% for the rest of the companies in the SPX. Using the price/earnings ratio (P/E) as a measure of valuation, we find that the valuation for the Mag. 7 expanded by 63.9% during 2023 while the SPX ex-Mag. 7 increased by 15.5% (Chart 8). By the end of 2023, the Mag. 7 made up 27.4% of the SPX (Chart 9).

Chart 7: Earnings Per Share

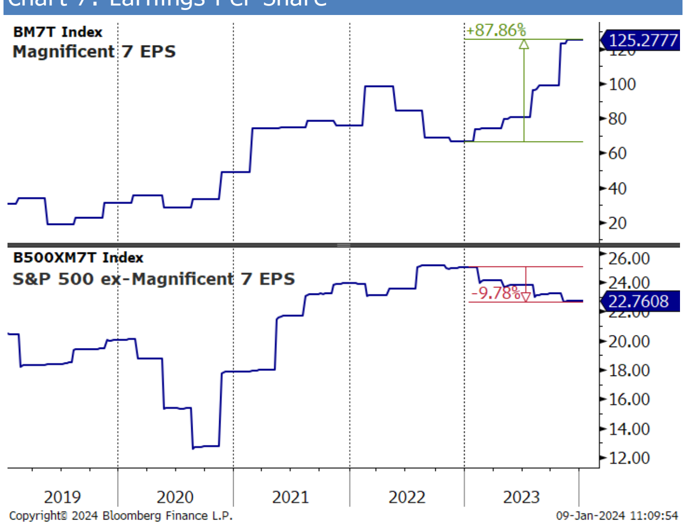


Chart source: Access Financial Services using Bloomberg Software & Data

Chart 8: Price to Earnings Ratio

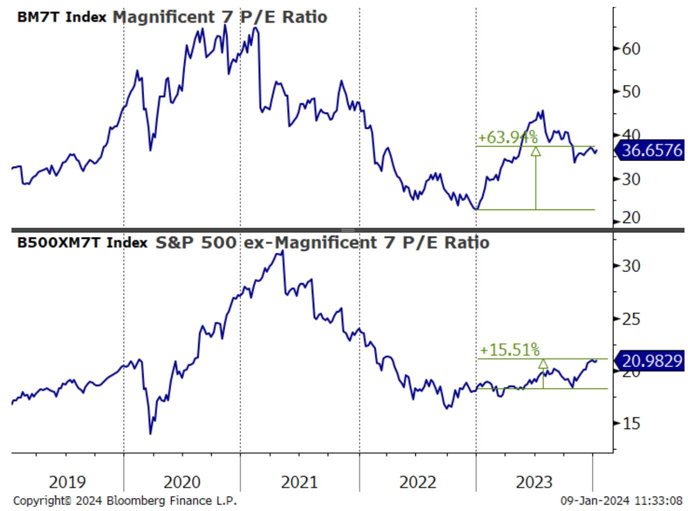
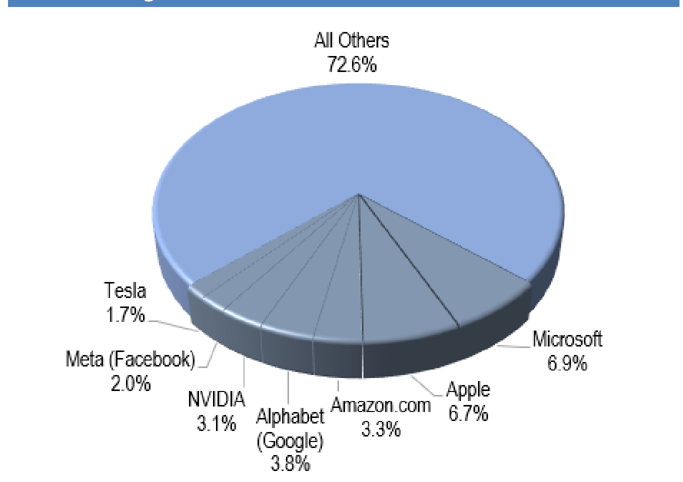


Chart source: Access Financial Services using Bloomberg Software & Data

Chart 9: Mag. 7 Accounts for 27.4% of the S&P 500



Source: Access Financial Services using data from Bloomberg

While the overall US stock market rallied strongly in November and December (SPX: +16%), the rally finally expanded beyond the very largest companies with the equal weighted SPX up 19% and the Russell 2000 Index of small capitalizations companies gaining 22.4% (Chart 10). This was positive for our clients' portfolios because our US equity holdings are much closer to being equal weight than market capitalization weighted.

Risk assets love improving liquidity and the year-end rally was propelled by investors' strengthening conviction in the soft economic landing narrative and its implications for interest rates and liquidity. Chart 11 illustrates the market's expectations for the fed funds rate for tenors out to 2028 on October 26 and December 31. During this period, expectations for Fed easing over the following 12 months went from 0.50% (two rate cuts of 0.25%) to 1.50% (six rate cuts of

0.25%) (Chart 11) and yields on US Treasuries dropped by a full percentage point over much of the maturity spectrum (Chart 13). The Fed's own forecast calls for three 0.25% rate cuts during 2024.

Chart 10: Stock Performance – Nov. & Dec. 2023

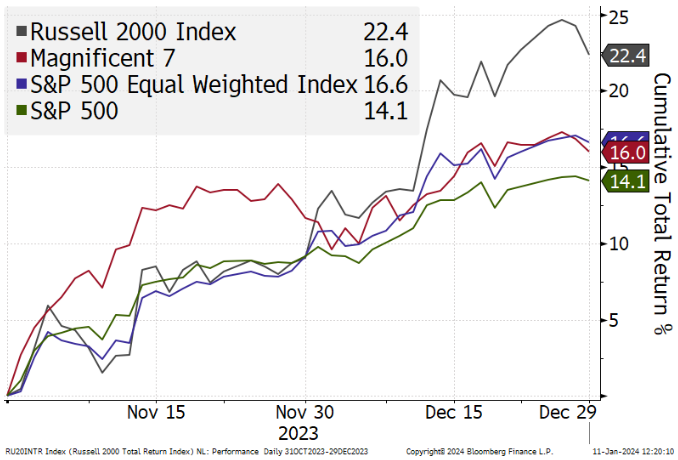
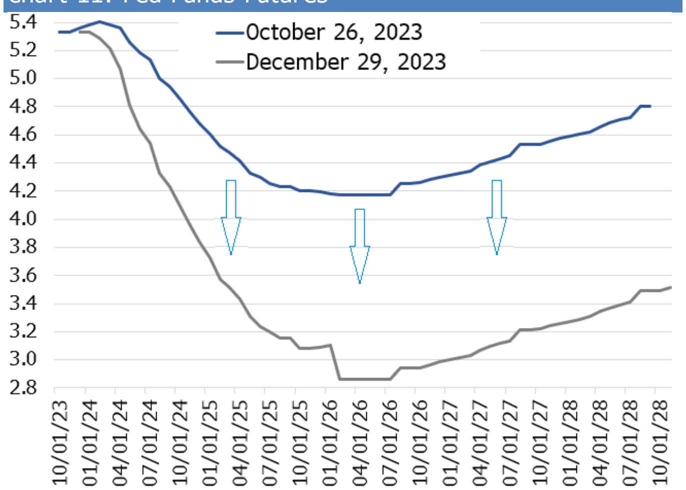


Chart source: Access Financial Services using Bloomberg Software & Data

Chart 11: Fed Funds Futures



Source: Access Financial Services using data from Bloomberg

Chart 12: Tightening/Easing Priced Over Next 12 Mo.

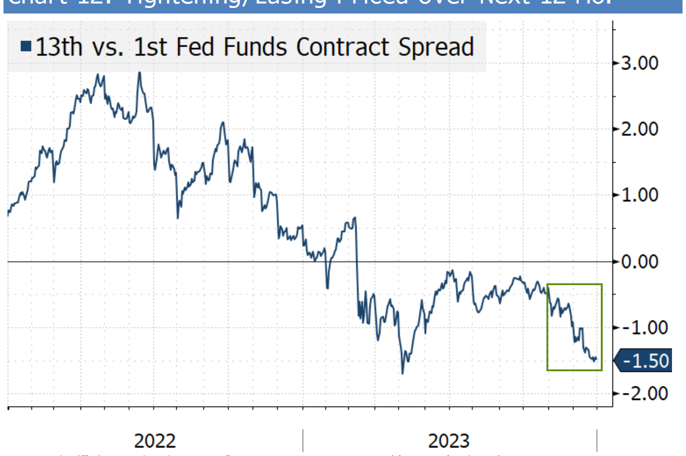


Chart source: Access Financial Services using Bloomberg Software & Data

Chart 13: Term Structure of Interest Rates

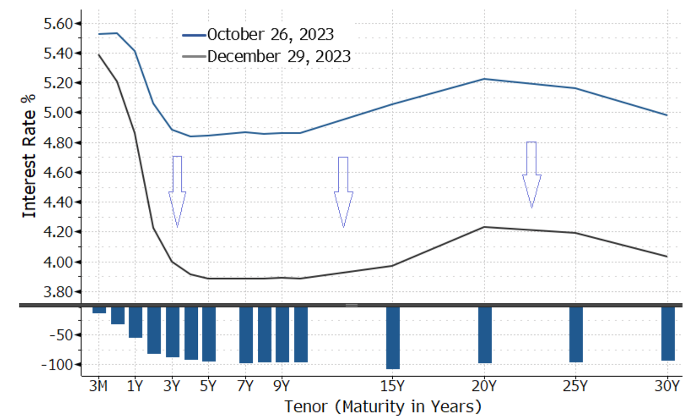


Chart source: Access Financial Services using Bloomberg Software & Data

The result of the large drop in interest rates was that stocks and bonds rallied sharply during the last two months of the year. Chart 14 illustrates the performance of the Bloomberg US Aggregate Bond Index (Agg.) during the last two months of 2023 (+9%) as the ten year US Treasury bond yield dropped from 5.0% to 3.9% - a decline of 22%. The Agg. has an average maturity of 8.5 years. The Bloomberg US Long Treasury Index, with an average maturity of 22.7 years, gained 19.5% during the same period.

Chart 14: Bloomberg US Aggregate Bond Index

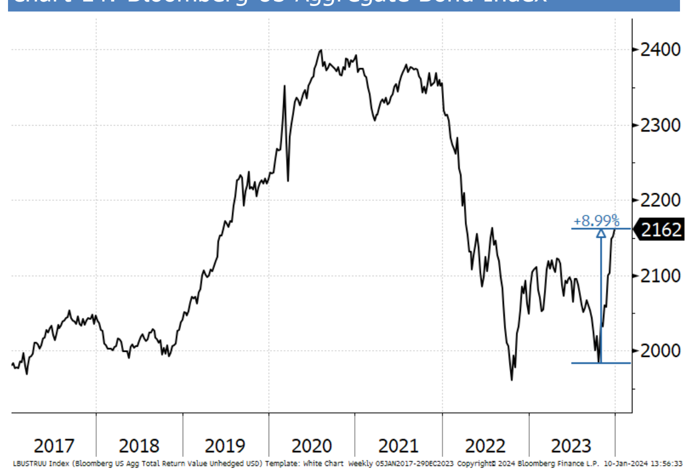


Chart source: Access Financial Services using Bloomberg Software & Data

The near term implication of the Fed's 'dovish pivot' at its December press conference and the market's bet on six rate cuts this year are likely to be bullish for risk assets as investors have become quite enthusiastic about US macro prospects, expecting the Fed to start easing without a recession. With risk assets rallying into year-end, unemployment still at very low levels and inflation coming down (Chart 15), it is hard not to jump on board this ship.

Chart 15: Inflation

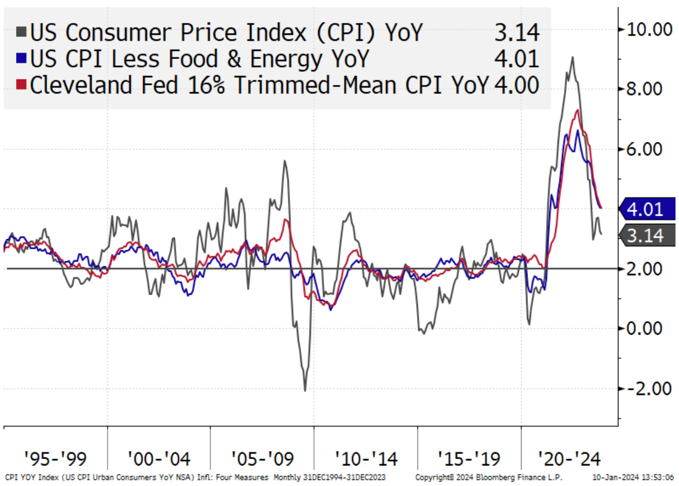


Chart source: Access Financial Services using Bloomberg Software & Data

With most recession indicators still warning of a downturn, the optimism may be premature. This is consistent with the fact that late cycle regimes rarely result in a soft landing, particularly when Fed policy is as restrictive as it is today.

While resilient activity this year has allowed recession fears to fall by the wayside with investors and corporations growing increasingly confident that the worst has passed for the US economy, our research suggests that a goldilocks type soft landing – while not impossible – is less likely than investors believe.

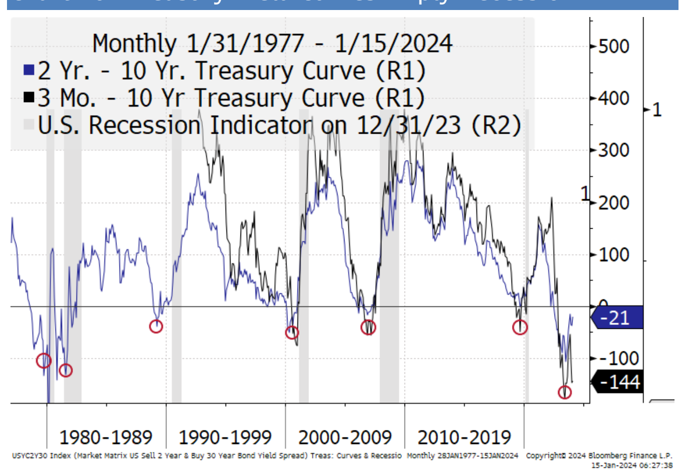
As discussed above, growth benefited from strong consumer spending. This, in turn, reflected two pandemic-related tailwinds: strong job creation by contact services, and high pandemic savings. Consumers have now largely burnt through their excess savings, eliminating a key source of support in a context of elevated borrowing costs.

The fact that policy rates have peaked and unemployment has bottomed suggests the economy is nearing the end of its expansionary cycle. This kind of late cycle environment has occurred six times since the Fed started to prioritize price stability under Paul Volker in the early 1980s. Only in 1995 did Greenspan's Fed achieve a soft landing, with every other episode (1980, 1990, 2000, 2007 and 2019) resulting in a downturn. Macro conditions resemble these five episodes more than they did in 1995.

One key distinction is that Fed policy is much more restrictive, as illustrated by the fact that real (inflation adjusted) rates are 300+ basis points (3%) above the level consistent with full employment – the widest interest gap in five decades. Similarly, many recession signals were not flashing red in early 1995, whereas they are today.

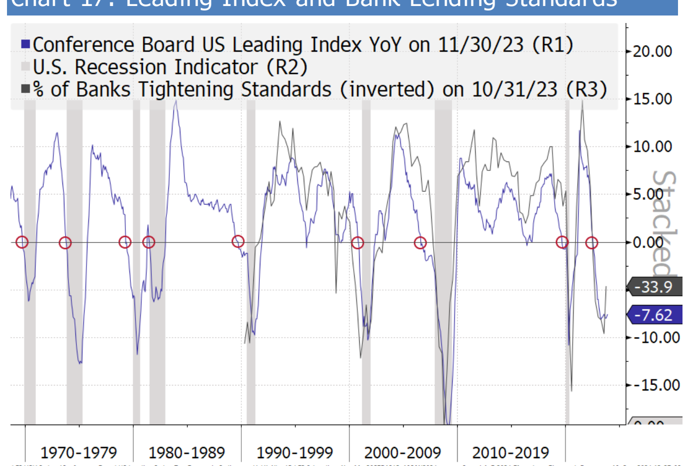
The most worrying indicator is the inversion of the Treasury yield curve, the only indicator with no false positives in the past fifty years (Chart 16). This term spread has been negative for a year, matching its average lead time ahead of previous economic downturns. The Conference Board's Leading Economic Index (LEI) is also deeply negative and banks have significantly tightened lending standards since mid-2022, whereas the LEI barely crossed the zero line and credit supply was ample during the mid-1990s (Chart 17).

Chart 16: Treasury Yield Curves Imply Recession



Shaded areas indicate recessions
Chart source: Access Financial Services using Bloomberg Software & Data

Chart 17: Leading Index and Bank Lending Standards



Shaded areas indicate recessions
Chart source: Access Financial Services using Bloomberg Software & Data

While consumer spending exceeded expectations in 2023, this seems unlikely to be repeated in 2024. The most likely outcome is for consumption to grow well below trend. The current consensus is for spending growth of 1.2%, but past Fed hikes, a lack of excess savings, and tight credit supply implies a low probability of spending surprising the consensus to the upside.

Another factor fueling soft landing optimism is a sizeable reduction in pricing pressures, with headline CPI inflation falling from 6.5% in December 2022, to just over 3.4% in December 2023. So far, progress on the inflation front has less to do with the strength of the economy than with lower raw material prices and improved supplier delivery times. For example, prices of consumer durables are down 1.6% YoY despite very strong demand.

Now that supply chains have normalized and oil prices have come down, further declines in inflation require weaker cyclical conditions. As discussed above, past Fed hikes should lower demand for discretionary items. This limits the probability of a resurgence of goods inflation, even if sellers have exhausted logistics tailwinds.

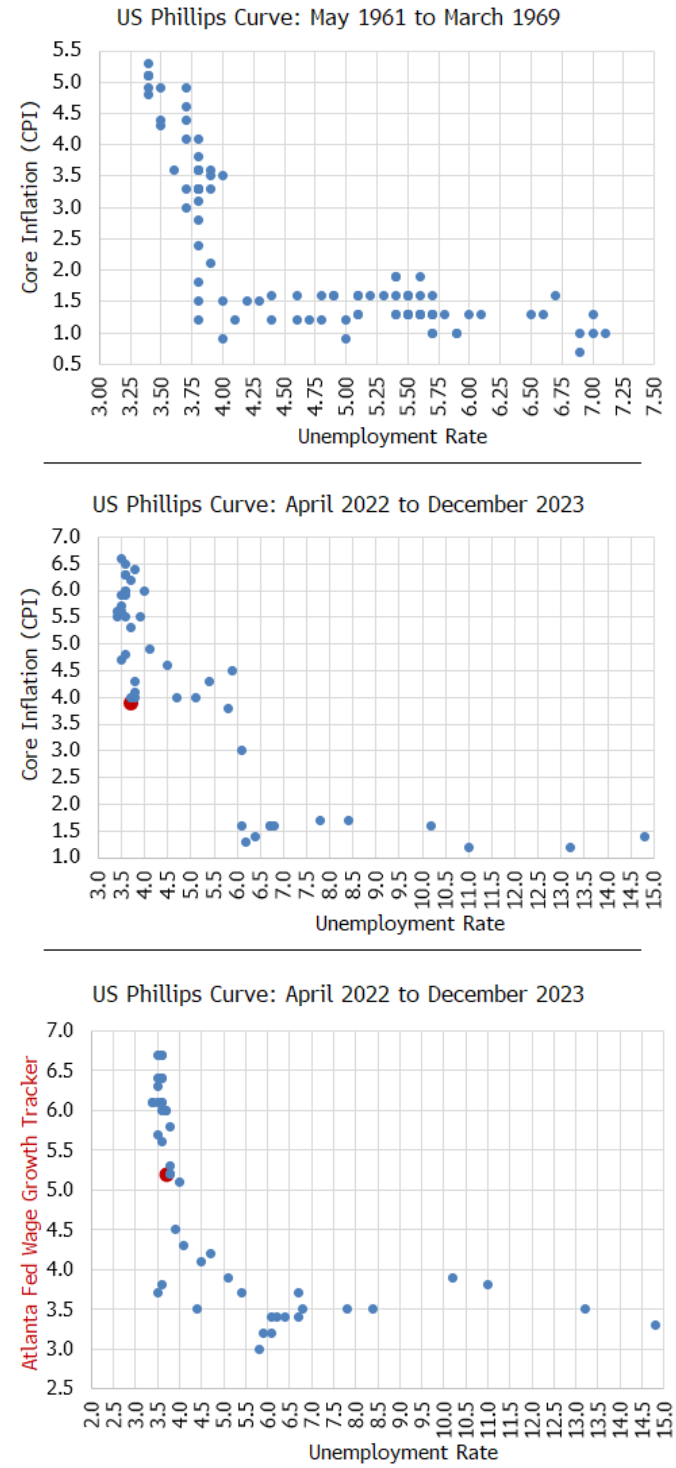
As long as investors remain optimistic about the macro outlook, risk assets retain an edge. Even so, the fact that markets have priced in six Fed interest rate cuts during 2024 reduces the upside potential for stock valuations from here.

Once growth stalls, equities will lose their edge. Historically, large cap stocks have declined around 10% in the year after policy rates peaked and unemployment bottoms out.

For growth to stall, all that is necessary is for tight monetary policy to push down labor demand as there is a nonlinear relationship between inflation and unemployment. This nonlinear relationship has been visible throughout history and appeared most recently during the pandemic (Chart 18).

While many point to the decline in job openings without a significant increase in layoffs as proof the fight against inflation can be won without suffering an economic downturn, companies rarely flip straight from hiring to firing. They usually go from hiring to hiring freeze while the number of job openings declines resulting in those that have been laid off finding it harder to find new employment.

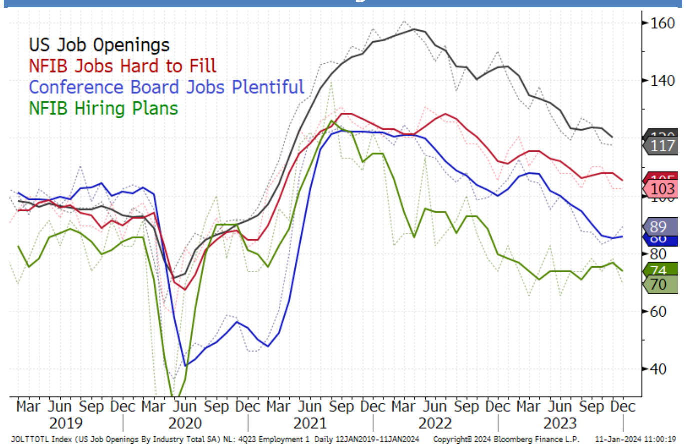
Chart 18: The Non-Linier Relationship Between Inflation and Unemployment



Source: BCA Research and Access Financial Services using data from Bloomberg

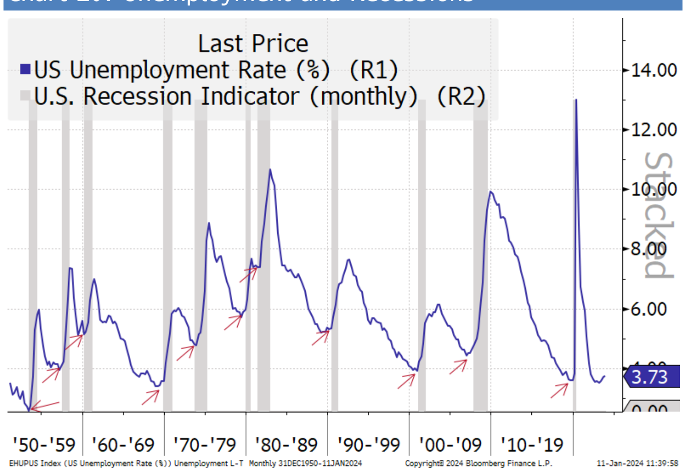
This appears to be the case lately as the number of people that have been laid off that cannot find another job has been trending higher and the number of available jobs is declining (Chart 19). This is important because, as we have noted in the past, unemployment rarely just ticks up. Once it starts to rise, it keeps going up as the negative feedback loops take hold. Households see jobs disappearing and rein in spending. Companies see consumers retrenching and cut capital expenditures and hiring plans. The result is that there has never been a time when the three month rate of change in unemployment has increased by more than one-third percent without a recession following (Chart 20).

Chart 19: Job Market is Cooling



Dotted lines are monthly data; solid lines are 3 month moving averages
Chart source: Access Financial Services using Bloomberg Software & Data

Chart 20: Unemployment and Recessions



Shaded areas indicate recessions
Chart source: Access Financial Services using Bloomberg Software & Data

Just as water turns into ice when its temperature falls enough, the economy will suffer once all the job openings that have insulated it from recession are depleted.

Critically, these phase transitions – wage inflation falling to its 'kink' in the Phillips curve[1] illustrated in Chart 18 and unemployment accelerating to the upside will occur when investors least expect it because just before these phase transitions, everything looks good – inflation is near target and unemployment is low – the exact description of a soft landing. But what most investors do not realize is that at this point, the risk of a recession goes up, not down.

Normally over 500 basis points of Fed rate hikes would have done much more economic damage. That they have not is principally due to the government running the largest peacetime, non-recessionary deficit ever. Also, because rates rose so fast, the full lagged effects of the policy tightening have yet to hit the economy. The Chicago Fed estimates that about one-third of the impact from past rate hikes on real GDP and over half of the impact on aggregate hours worked still lie ahead.

The reaction function of governments, not just in the US, has changed in recent years. With voters' rising expectations of what their governments should shield them from – job loss, ill health, high energy prices, the consequences of bad choices, etc. – it is becoming increasingly difficult to see how governments can rein deficits back in to pre-pandemic norms as long as the majority of voters enjoy the ever expanding benefits of government profligacy.

Before the mid-2010s, the US fiscal deficit moved in line with the unemployment rate. But around 2015, when the Fed started raising rates for the first time since the GFC, the fiscal deficit rose even as unemployment continued to fall. Spending had become overtly pro-cyclical.

According to Peter Bernholz, in *Monetary Regimes and Inflation*, every high- and hyper-inflation episode of the 20th century was preceded by substantial government expenditures funded by large central bank balance sheets. The US is not currently facing hyperinflation, but it should come as no surprise if inflation remains persistently elevated in this environment. While there seem to be very few who believe this outcome is likely, if inflation *is* on its way back, bond yields will rise (bond prices down), stocks will fall, and credit will worsen.

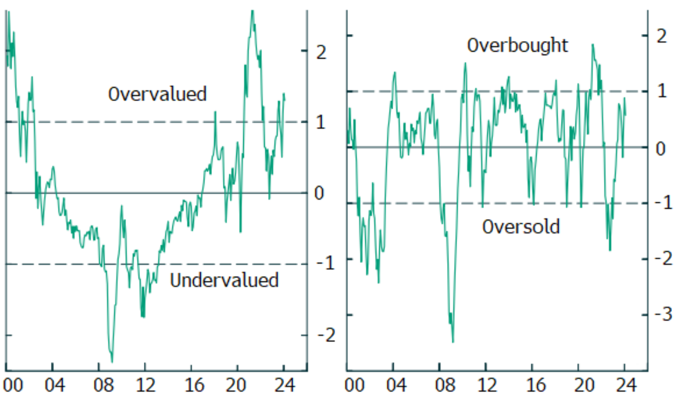
Although it has had little persistent observable impact on financial markets, geopolitical risk is also a growing concern.

[1] The Phillips curve is an economic model, named after Bill Phillips, that correlates reduced unemployment with increasing wages in an economy.

The fact that risky assets had a very good year in 2023 does not invalidate the gradual erosion of global stability taking place as a result of the failure of US engagement with Russia, China, Iran and others. Failures of engagement point to a new strategy of containment. However, the US is not in a position to implement this strategy because of the upcoming elections, so outside powers will attempt to prevent US efforts at containment before it occurs.

2024 is critical because US domestic political divisions are reaching a climax. Washington will be distracted, inviting foreign powers to exploit opportunities. Geopolitical uncertainty, and the risks associated with it, will rise in this context. This increased uncertainty presents a negative or downside risk for financial assets in an environment where the US stock market has become quite rich and technically overbought, which implies it is ripe for a correction (Chart 21).

Chart 21: US Stock Market Valuation and Technicals

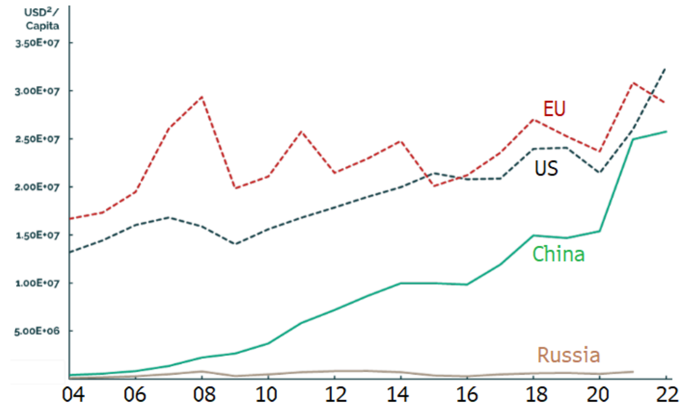


Source: BCA Research

Although the US is the leading actor in economic and military terms, it cannot dictate to others and the ability of China, Russia and others to disrupt the world should not be underrated. China's raw capability shown on Chart 22 means it cannot be bullied or suppressed without a high likelihood of a war in the Asia Pacific region, a high long term risk in the Taiwan Strait. Even though Russia is negligible in measurable power, it has already proven that it can shake up the world by launching the war in Ukraine. Something similar can be said for Iran and North Korea because of their asymmetric military capabilities.

US policy uncertainty, which stems from extreme levels of political polarization, will bleed out into the rest of the world with the likely result being a downward spiral of domestic and global instability. A simple measure of US polarization – the gap between Republicans and Democrats in their approval of the president – is near its peak.

Chart 22: BCA Research Military-Industrial Power Index



Index formula: manufacturing output multiplied by manufacturing output per working age person. This approach assumes that power ultimately depends on the raw capability of waging war (manpower and industrial power) multiplied by the efficiency of making war (industrial power per working person).
Source: BCA Research

US foreign policy is likely to turn more hawkish in general in 2025 under Biden or Trump because both would be serving their second term as president and the US will need to respond to its challengers and try to reassert its global leadership. Foreign countries that recognize this point have an opportunity to act first.

The bottom line is that domestic polarization and uncertainty will invite both foreign and domestic challenges. The most likely outcome is a negative feedback loop for global stability in 2024.

It is probably unsurprising that we are less bullish on risk assets than most of the talking heads. While we expect stock prices to be stable to higher over the near term as inflation continues to fall and the labor market remains strong, things look dicier as the year progresses and a recession still seems more likely delayed than derailed.

Being underweight the Mag. 7 in 2023 was a headwind to our clients US stock returns relative to the market capitalization weighted stock indices. Generally speaking, our US stock allocations produced returns in the 17% to 20% range – not as good as the SPX's 27% return, but quite a bit better than the equal weighted SPX return of 14%.

While we have not been overweight foreign stocks, our clients' foreign stock returns have outperformed the MSCI EAFE foreign stock index meaningfully while the performance of our clients' bond allocations were pretty much in line with the Bloomberg US Aggregate Bond Index.

Historically, peaks in market concentration like we see with the Mag. 7 today have coincided with peaks in stock prices. As the economy cools, we think investors will favor less aggressive positioning and shift investment flows away from 2023's big winners into more defensive assets. If this turns out to be true, we expect our clients' US stock allocation to hold up well as safety trumps aggressiveness when things turn sour. As a result, we are not inclined to get more aggressive at this point.

Unless inflation reaccelerates to the upside, the recovery in high quality fixed income securities (bonds) – which is where most of our clients' fixed income investments are – should persist (Chart 23).

Chart 23: Long Term Treasuries with Drawdown

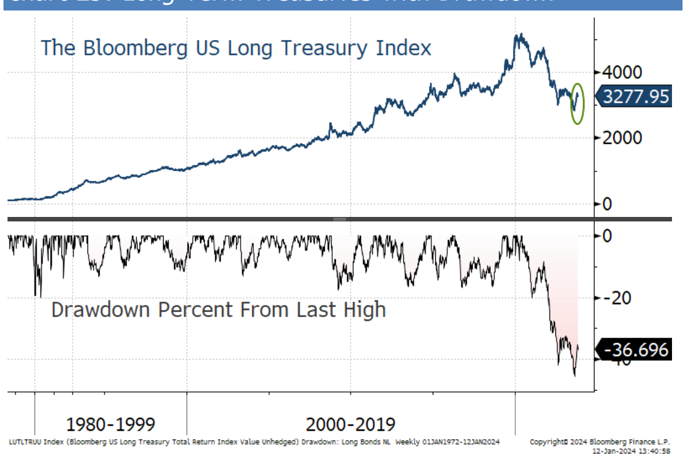


Chart source: Access Financial Services using Bloomberg Software & Data

The best opportunity for outperformance, in our view, is in emerging markets (EMs). Over the near term, EM assets benefit from a weak US dollar and bullish global risk sentiment. As high beta investments[2], both are vulnerable to global selloffs, but EM assets have a history of recovering faster than developed markets following recessions (Chart 24).

Whether the Fed eases monetary policy or not, it is unlikely it will tighten. The end of the Fed hiking cycle has historically been good for emerging market (EM) risk assets.

Chart 24: EMs Recover Faster Than DMs Post Recession

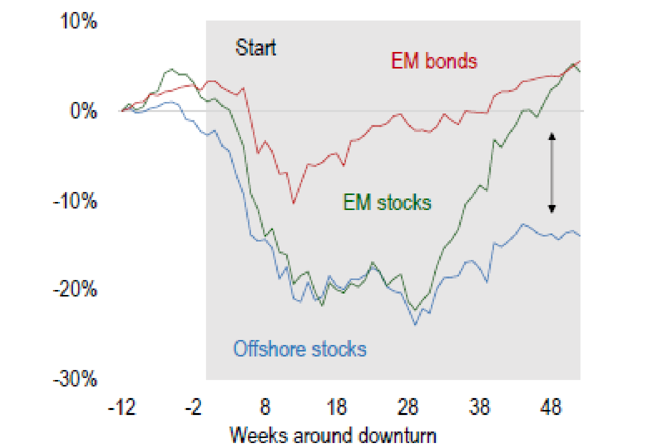
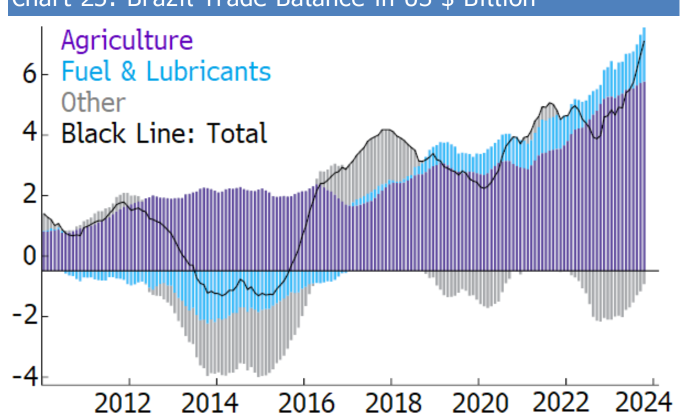


Chart compares the average performance of EM assets and DM offshore stocks before and after the start of US recessions since 1990.
Source: Numera Analytics

As we laid out last year, EM stocks should benefit from low valuations, stronger activity in China, higher commodity prices, low valuations, and monetary policy easing. And, that combining these factors with a weak earnings outlook in developed markets improves the relative appeal of emerging markets stocks as a source of diversification.

We continue to favor Latin American stocks and have been building positions in Brazilian (an agricultural powerhouse – Chart 25) and Chilian (the largest copper producing country and the second largest lithium producing country) stocks where inflation has been falling, interest rates are being taken down and valuations are particularly attractive (Charts 26 – 28).

Chart 25: Brazil Trade Balance in US $ Billion



Source: Clocktower Group

[2] Beta is a measure of a stock's volatility in relation to the overall market

Chart 26: Brazilian Central Bank Rate & Inflation

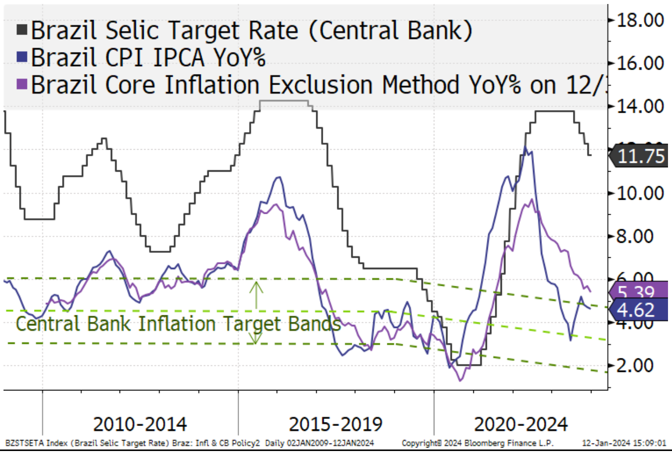


Chart source: Access Financial Services using Bloomberg Software & Data

Chart 27: Chilian Central Bank Rate & Inflation

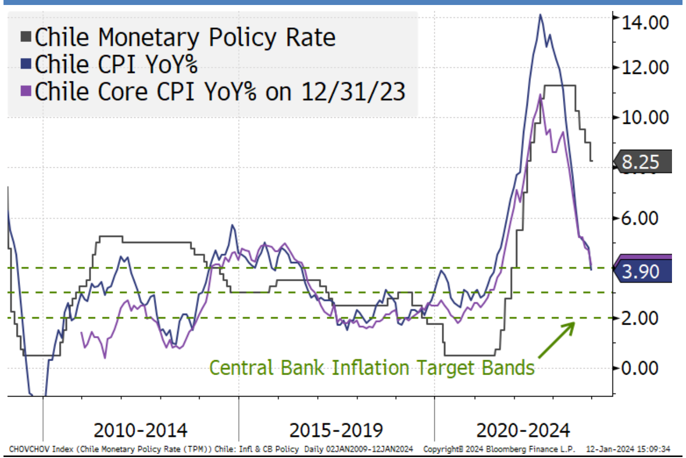


Chart source: Access Financial Services using Bloomberg Software & Data

Chart 28: P/E Ratio for Brazilian & Chilian Stock Market

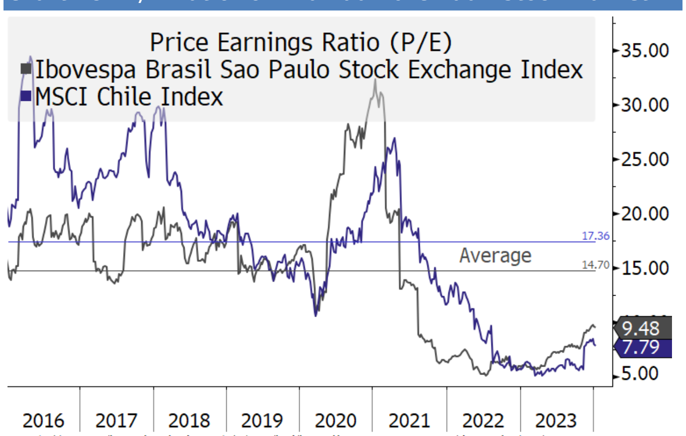


Chart source: Access Financial Services using Bloomberg Software & Data

Indonesia, the largest nickel producing country, is also on our radar. Even though its central bank has yet to cut interest rates, inflation has been trending down and valuations are attractive (Charts 29 – 30). The country is steadily building out its nickel processing capabilities and is moving up the value chain in the global battery industry.

Chart 29: Indonesian Central Bank Rate & Inflation

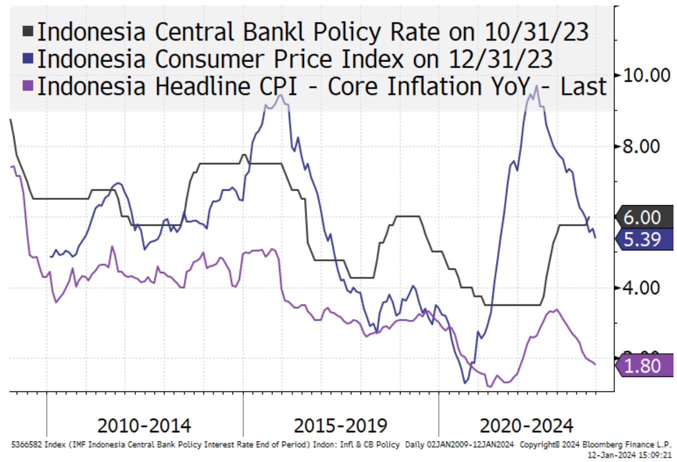


Chart source: Access Financial Services using Bloomberg Software & Data

Chart 30: P/E & P/B Ratio for Indonesian Stock Market

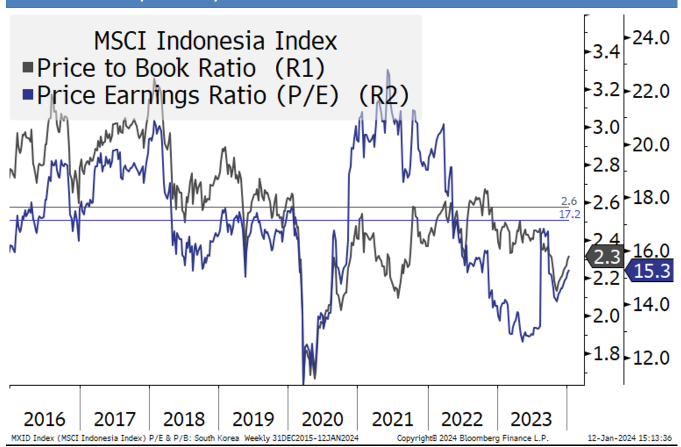


Chart source: Access Financial Services using Bloomberg Software & Data

We wish all our clients a happy and prosperous 2024 and thank you for the confidence you have placed in us. Please do not hesitate to contact me if you would like to discuss any of this in more detail.

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