ACKERMAN
CAPITAL MANAGEMENT

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ACM QUARTERLY MARKET COMMENTARY – THIRD QUARTER 2023

Capital Markets

Interest rates are back on the rise. The yield on the ten-year U.S. Treasury surpassed its peak level of last year, finishing the third quarter around 4.5%. In October, that momentum continued with the yield recently touching 5.0%. Not surprisingly, the stock market has not been keen on this recent jump. Prices retreated in August and September and global stocks finished the quarter down 3.7%. The market continued to fade into October, and the correction from the end of July peak just recently surpassed 10%. Including the October action, global stocks are still up about 6% on the year, but both aggregate and municipal bond returns are down about 2% year-to-date.

Economic and Markets Outlook

In our previous quarterly commentary, our interpretation of the strong economic data and the corresponding behavior of the capital markets was "…any recession is further away than you think and/or any economic slowdown will be milder than you think. Inflation may be stickier than you think. Do not dismiss the possibility of a rare 'soft landing' scenario." That message was confirmed with rates accelerating higher last quarter and the recent 3Q real GDP coming in near 5%. This should leave no doubt that the Fed will soon resume hiking short-term interest rates in an effort to slow economic momentum. The Fed's favorite measure of inflation, core PCE, remains elevated, and the last thing the Fed wants to see is core PCE heading back up. We came into 2023 with a recession bias and worried about a retest of last year's lows market lows, but we pivoted away from that view after the second quarter developments. Yet at the same time, we still doubted that stock prices would perform particularly well as higher interest rates would keep valuations in check. That expectation appears to have been correct so far, with one caveat. Seven large stocks (Alphabet, Amazon, Apple, Meta, Nvidia, and Tesla), which have been given the moniker the "Magnificent Seven," have performed very well this year, driven by excitement over the potential of artificial intelligence. Due to their size, these stocks have kept major indices nicely positive year-to-date. Absent those seven stocks, both U.S. and global stocks indices would effectively be flat this year. We believe that the narrow advance of the stock market is unsustainable. Under ideal circumstances, it is possible that the rest of the market could start catching up, but history tells us that this condition is more likely a sign of poor technical health and a precursor to some sort of market correction.

Portfolio Management

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In recent months, we have made tactical adjustments to our portfolios as our value/trend models react to the changing market environment. We are again in a somewhat defensive position with equity allocations below respective targets. Within our equity portfolio, as compared to the global benchmark, we are still modestly overweight intentional value stocks, while also keeping pace with the benchmark's heavy inherent bias to large U.S growth stocks. Our fixed income allocations are also below targets allocations. Within our fixed income portfolios, we continue to reduce our sensitivity to interest rates and have added more exposure to high-quality corporate bonds. For better or for worse, the renewed weakness in bonds has also made it possible for us to engage in tax-lass harvesting among our municipal bond holdings. We have increased our exposure to inflation sensitive assets, adding more commodity exposure, a new position in energy stocks, and short-term TIPS (in taxable portfolios.) Meanwhile, in our tax-advantaged portfolios, we have increased our exposure to alternatives by another percent or two.

Looking Forward

Our outlook is largely unchanged from last quarter. From a longer-term secular standpoint, we think it is likely that we have entered a new macroeconomic paradigm. Gone are the days of zero interest rates without any worrisome inflation consequences. Whatever the new baseline for interest rates, it will be higher than that of the last fifteen years. Generally, this should keep equity multiples in check and bond yields may well provide a more competitive return versus the equity market than in years past. Under such a regime, value stocks could also certainly experience a long-awaited renaissance. From a shorter-term cyclical standpoint, the Fed will continue to restrict monetary policy until an economic slowdown of some variety sufficiently cuts into current inflationary pressures. Unless the slowdown is of the rare "Goldilocks" kind, it would not be surprising to see the stock market struggle a bit over the next year. Meanwhile, bonds should fare well as some moderation in interest rates could tack on some price appreciation to the already attractive yields.

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