Buckingham
STRATEGIC WEALTH

Q4 2023

Quarterly Outlook

Perspectives on Markets and Economic Conditions

Portfolio allocations and investments are not adjusted in response to market news or economic events; however, we evaluate and report on market and economic conditions to provide our investors with perspective and to put portfolio performance in proper context.

Too Early to Declare Victory Against Inflation

Main Takeaway

Inflation has started to cool off, and real economic growth continues to be stronger than most forecasters were predicting to start the year. As economic growth has remained strong, those predicting a recession this year were likely incorrect. However, there are clouds on the horizon, and the biggest longer-term threat to economic growth is the U.S. government's mounting debt relative to GDP.

Top Risks

Consumer spending could come under pressure as pandemic-level savings are depleted and student loan payments restart. Since the Federal Reserve started tightening, auto loan and credit card delinquencies have increased, suggesting that some consumers may be overextended. Global inflation remains elevated, and with a trend toward deglobalization, slowdowns internationally have been more pronounced, especially in China. Oil prices have increased sharply over the past three months as OPEC+ countries have cut production.

Sources of Stability

Core inflation is trending down, and although it remains above the Fed's 2% target, the U.S. economy will likely avoid a recession in 2023. The labor market is still strong with historically low unemployment. The Fed is likely near the end of its tightening cycle, and although markets still see the possibility of one additional rate hike, the economy continues to deliver strong results. The services sector continues to be expansionary. Fiscal policy remains accommodative despite the strong economy and restrictive rates.

ECONOMIC SPOTLIGHT:

What's the Practical Impact of the U.S. Debt Downgrade?

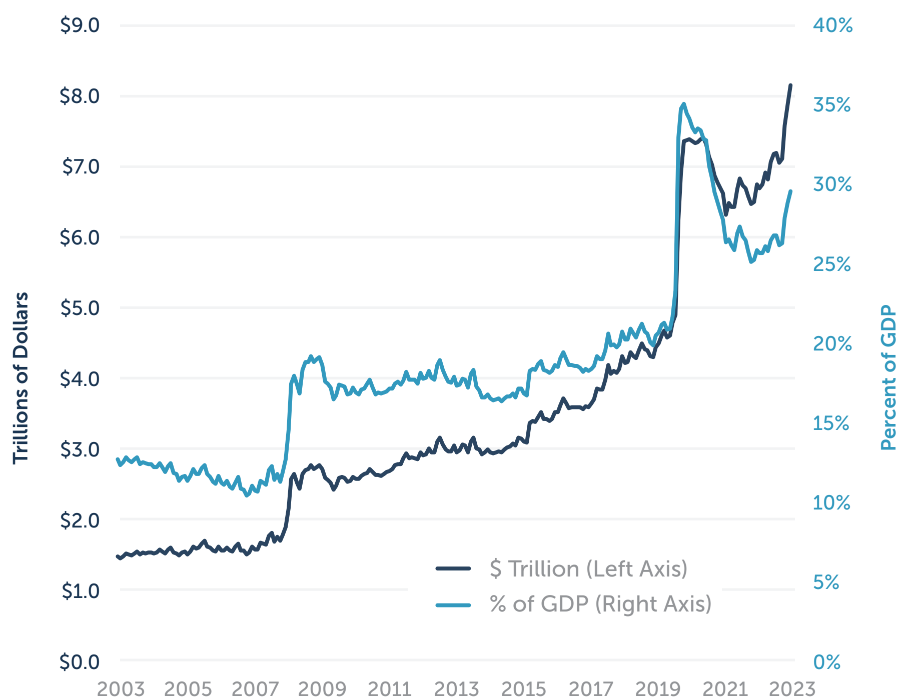
Many criticized the downgrade of the U.S. government's debt as unnecessary.

On Aug. 1, 2023, Fitch downgraded the U.S.'s long-term foreign-currency issuer default rating to 'AA+' from 'AAA', its highest possible rating. The credit rating agency cited deteriorating fiscal conditions, weaker governance, as well as an underfunding of Social Security, Medicare and Medicaid (along with an aging population) as justification. This was the second time in history that a rating agency has lowered the U.S. debt rating, following Standard & Poor's downgrade to 'AA+' from 'AAA' in 2011.

Market reactions to the news were muted. Both stock and bond markets were slightly down, but bonds recovered the following week. And practically, the downgrade does not have much of a near-term impact.

This is a signal, however, that the U.S. is not invulnerable to deteriorating credit conditions and downgrades. Over the longer term, if foreign investors lose confidence in the U.S. government's ability, or willingness, to repay its debts, they may choose to sell a portion of their Treasury debt, putting upward pressure on interest rates. And with 31% of federal debt maturing over the next 12 months, higher rates could continue to exacerbate the U.S. government's deficit problem.

Treasury Debt Due Within the Next 12 Months



Sources: Treasury.gov. and S&P Global, the Monthly GDP Index.

Key Areas to Watch

Economic Growth

While GDP for the third quarter won't be released until November, the Atlanta Fed's GDPNow model estimate for real GDP growth is 4.9% as of Sept. 27.[1] This expectation for growth is higher than expected earlier in the year and indicates that the Fed's policy has not been sufficiently tight to cool the economy, as the federal funds rate has been below the nominal growth of GDP and until recently was even below the rate of inflation.

Inflation Trajectory

Through August, CPI grew at 3.7% on a year-over-year basis. Core CPI (which excludes the more volatile food and energy sectors) grew at 4.4% on a year-over-year basis.[2] These numbers are lower than earlier in the year, though are still well above the Fed's long-run 2% target.

Monetary Policy

With economic growth as strong as it is, markets are currently priced for the Fed to maintain the current federal funds rate target (between 5.25% and 5.50%) through January 2024. However, markets are pricing in a 34% chance that the Fed will need to hike rates again before the end of the year.[3]

Fiscal Policy

Economists have been raising concerns that the U.S. government debt burden is reaching unsustainable levels. Fitch, a leading provider of financial data and research, forecasts a fiscal deficit of 6.6% of GDP in 2024 and a further widening to 6.9% of GDP in 2025.[4] Furthermore, disagreement around fiscal priorities is threatening a shutdown in Washington.[5] The debt burden and fiscal strife will likely limit Congress' ability to respond to future contractions in the economy with fiscal stimulus.

Key Areas to Watch (Cont.)

Labor Market

Labor markets remain tight but show some signs of softening. Quit rates, which measure the percentage of employees voluntarily leaving their job, have fallen to the lowest level since 2021 at 2.3%.[6] Unemployment stayed at a historical low of 3.8% in September, but higher rates are starting to have an impact: there were 9.6 million job openings in August, down from the March 2023 peak of 12 million.[7] Furthermore, a prolonged auto strike could create additional challenges for the auto supply chain.

Consumer Spending

Higher interest rates are making credit more expensive, and banks have tightened their lending standards, making credit less available. We've seen an increase in delinquencies for credit cards and auto loans, as well as an uptick in businesses filing for bankruptcy protection.[8] Tighter credit conditions, rising delinquencies and student loan payments resuming will likely curtail consumer spending in the quarters ahead.

Housing Market

The market for first-time homebuyers is expected to remain a challenge. The supply of homes is low due to years of sluggish construction, keeping pressure on prices and rents. Meanwhile, current homeowners with an existing mortgage don't have much incentive to sell. A 30-year fixed-rate mortgage is at 7.2% as of Sept. 21, the highest since May 2001.[9] At the end of June, about 39 million U.S. homes had a mortgage rate below 4.375%, more than 73% of outstanding mortgages in the U.S.[10]

Global Economy

The U.S. economy faces headwinds from slower global economic growth, particularly the Chinese economy, the second largest in the world. Among the reasons is China's aging population, resulting in fewer workers to support retirees.[11] Trade tensions have led to a slower growth in exports, and fragility in the property sector have added to uncertainty for the Chinese consumer.

Economic and Market Snapshot

Stock markets continue to watch the Fed and are beginning to accept that it will likely keep rates higher for longer. Although the likelihood of entering a recession in 2023 has declined to basically zero, growth prospects remain constrained by higher costs of labor and capital as well as a higher likelihood that consumer spending will continue to decline.

In the bond market, yields remain elevated, presenting a nice opportunity for high-quality income for investors.

Key Economic Indicators*

Real GDP Growth (%)

Core CPI (%)

Consumer Sentiment

Unemployment Rate (%)

Jobs Added (Thousands)

Major Asset Class Returns*

Q3 2023

		Quarterly Return	Past 12 Months
Stocks			
U.S. Stocks	▼	-3.3%	20.5%
International Stocks	▼	-4.0%	23.0%
Emerging Markets Stocks	▼	-2.1%	13.2%
Bonds			
U.S. Government Bonds	▼	-0.8%	1.3%
Global Bonds	▲	0.6%	2.7%

*See Appendix on page 8.

Investment Planning Implications

Where do markets go from here?

Tighter consumer budgets and tight labor markets could lead to weaker corporate profits. With the resumption of student loan repayments, the dwindling pandemic savings and tighter credit conditions, consumers may be forced to cut back on discretionary spending. Although many businesses have pre-emptively tightened budgets, this could trickle to less revenue and profits for some companies.

Expect increases in company defaults and losses, especially in sectors more susceptible to higher interest rates. Companies will have more trouble accessing new capital or rolling over existing loans given the tighter credit conditions. The equity and debt securities of higher-quality companies are likely to perform better in such an environment.

Valuations suggest a breadth of expected returns going forward. Although growth stocks typically trade at higher multiples than value stocks, the spread between value and growth stocks is near all-time highs. Although this can't reliably be used to time the markets, this suggests value stocks have a higher expected return going forward.

What are the investment planning implications?

Plan for a market downturn. Two of the worst four declines in the S&P 500 over the last 30 years have happened in the last 36 months. We know another decline is going to happen, we just don't know when. Work with your advisor to write out a plan for how you want to respond to the next downturn.

Be mindful of interest rate risk. Although long-term bonds are alluring to lock in these high interest rates, keeping your bond portfolio on the short to intermediate side helps to mitigate the overall risk in the portfolio. Longer-term bonds have larger swings in value as interest rates change.

Consider alternative sources of risk and return. Bonds serve as the bedrock of the portfolio, and stocks serve as an engine of growth. Given the headwinds to economic growth and corporate profits, investors could consider a small allocation to alternative sources of risk and return. Areas such as private credit, reinsurance and market-neutral factor funds, if implemented correctly, could be additive to the overall portfolio.

About the Buckingham Team

Larry Swedroe

Head of Financial & Economic Research

In his role and as a member of Buckingham's Investment Policy Committee, Larry regularly reviews the findings published in peer-reviewed financial journals, evaluates the outcomes and uses the result to inform the firm's formal investment strategy recommendations.

Kevin Grogan, CFA, CFP®

Chief Investment Officer

Kevin is a member of Buckingham's Investment Policy Committee and helps lead the firm's investment strategy, portfolio management and fixed income teams. He has co-authored three books on investment topics and enjoys educating others on concepts that will have a tangible effect on their financial lives.

Blerina Hysi

Director, Fixed Income

Blerina works with fixed income and advisory teams to help construct and maintain customized bond portfolios, with an eye toward finding the best way to implement comprehensive financial plans. Her duties include fixed income analysis, bond trading and building tailored, client-focused portfolio solutions.

Daniel Campbell, CFA

Investment Strategy Advisor

Dan helps clients and advisors understand and implement an evidence-driven investment strategy. He has a demonstrated ability to understand complex investment topics, but he gets the most energy from conversations with individuals and families in pursuit of financial freedom.

Additional economic and investment resources are available at **buckinghamstrategicwealth.com/resources**

Buckingham's Investment Policy Committee (IPC) is a committee for Buckingham Strategic Wealth, LLC and Buckingham Strategic Partners, LLC (collectively Buckingham Wealth Partners) and not a committee for independent members of the Buckingham Strategic Partners community.

Appendix

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[1]Federal Reserve Bank of Atlanta. GDPNow™. Retrieved Sept. 28, 2023.

[2]Bureau of Labor Statistics. Consumer Price Index Summary, August 2023. Retrieved Sept. 28, 2023.

[3]CME Group. CME FedWatch Tool. Retrieved Oct. 5, 2023.

[4]Fitch Ratings. Fitch Downgrades the United States' Long-Term Ratings to 'AA+' from 'AAA'; Outlook Stable. Aug. 1, 2023.

[5]Reuters. US government shutdown bad for country's credit, warns Moody's. Sept. 25, 2023.

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[6]Bloomberg. US Job Openings Decline to 8.83 Million, Lowest Since Early 2021. Aug. 29, 2023.

[7]Bureau of Labor Statistics. Employment Situation Summary — September 2023 and Job Openings and Labor Turnover Summary — August 2023. Both retrieved on Oct. 6, 2023.

[8]Apollo. Outlook for Regional Banks. Aug. 12, 2023.

[9]Freddie Mac, 30-Year Fixed Rate Mortgage Average in the United States, retrieved from FRED, Federal Reserve Bank of St. Louis; Sept. 28, 2023.

[10]FA Magazine. Rates On Savings Accounts Are Higher Than Millions Of Mortgages. Aug. 8, 2023.

[11]Wall Street Journal. Is China Past Its Peak? Aug. 15, 2023.

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Major Asset Class Returns: The index representation for the Major Asset Class Returns is as follows: U.S. stocks are represented by the Russell 3000 Index, international stocks by the MSCI World ex U.S. IMI Index, emerging markets by the MSCI Emerging Markets IMI Index, U.S. government bonds by the Bloomberg Government Intermediate Total Return Index, and global bonds by the FTSE World Government Bond 1-5 Year Index. Past performance is not a guarantee of future results. Indexes are unmanaged baskets of securities that are not available for direct investment by investors. Index performance does not reflect the expenses associated with the management of an actual portfolio. Information from sources deemed to be reliable, but its accuracy cannot be guaranteed.

Key Economic Indicators: Sources: Bureau of Economic Analysis (BEA) for real GDP growth. Real GDP is the annual rate of change of real gross domestic product, seasonally adjusted. Bureau of Labor Statistics (BLS) for core CPI. The core consumer price index (CPI) is the annual rate of change, seasonally adjusted, and excludes food and energy. Consumer sentiment is from the University of Michigan's consumer sentiment index. Unemployment rate is reported by the BLS, and jobs added is based on nonfarm payroll employment reported by the BLS. Retrieved from FRED, Federal Reserve Bank of St. Louis. For all indicators, the boxed number reflects the latest reading, and the line above the box shows the change since the last update. The shaded areas reflect normal readings compared to history (based on the 25th-75th percentile of historical measures), while areas outside the dark blue reflect more extreme readings compared to history. The ranges are based on the percentile values of historical readings for each economic figure. The lowest number reflects the 5th percentile value, the bottom of the blue range reflects the 25th percentile, the top of the blue range is the 75th percentile, and the highest value reflects the 95th percentile. All ranges are based on the full period available. To account for population and employment growth, the ranges presented for jobs added are based on the percent change in employment numbers, using December 2022 as the base year.