# FORTHRIGHT PARTNERS, LLC

## INVESTMENT LETTER, 3RD QUARTER 2023

### EXECUTIVE SUMMARY

*What happened to Goldilocks? Nothing is just right anymore.*

*Stock market gains remain narrow. Growth stocks – too hot? Rest of the market – too cold?*

*Higher for Longer: more headwinds for the economy and asset prices.*

*Diversification makes sense when valuation measures diverge.*

*Continue to add to intermediate bonds.*

### WHAT HAPPENED TO GOLDILOCKS?

Not too long ago, four years to be exact, we were basking in the Goldilocks moment of low unemployment, low inflation, low interest rates and a booming stock market. Then COVID happened. The economy caught a cold and subsequently became feverishly hot, the supply chain was too cold and prices became too hot. Nothing has been "just right" except for artificial intelligence and weight loss drugs.

In an environment dominated by geopolitical, interest rate and inflation uncertainties, the allure of limitless advancement promised by artificial intelligence is just too good to ignore. While there continues to be lively debate about the potential benefits and dangers of artificial intelligence, ranging from curing all diseases to the ending of humanity, companies have not wasted any time to monetize this technology. Numerous AI-enabled products have been launched and AI start-ups are spreading like wildfires.

As for diabetes/weight-loss drugs such as Ozempic, Wegovy and Mounjaro, they are supposedly the magical elixirs that not only guarantee a slimmer America, but will dramatically reduce heart ailments, liver diseases, joint pains and even demand for junk food. Never mind that these are expensive life-long treatments that are not widely covered by insurance yet. Assuming our healthcare system can afford these drugs, we will all soon live a long and healthy life in an AI-enhanced world that is neither too hot nor too cold (AI will make sure of that). No wonder the stocks of AI and obesity drug companies have been so hot, and the rest of the market has been so cold.

***"What's hot today isn't likely to be hot tomorrow. The stock market reverts to fundamental returns over the long run."***

Warren Buffett

### BE CAREFUL WHAT YOU WISH FOR

The stock market has traditionally been the weakest in September. This past September was no different. Blame it on Wall Street's perverse logic: good news on Main Street (strong economy and labor market) is bad news on Wall Street. Even though the Federal Reserve did not raise interest rates in its September meeting, its projections for one more possible rate hike and for interest rates to stay ***higher for longer*** were enough to sour investors' risk appetite. The Federal Reserve Board now expects economic growth to continue in the next three years, with unemployment rate hovering 4% and inflation rates subsiding to 2% by 2026. This is pretty much a Goldilocks soft-landing scenario investors had hoped for. But to investors' dismay, the Federal Reserve Board believes it can land on this Goldilocks outcome by maintaining high interest rates, NOT by lowering interest rates.

***"Ask five economists and you'll get five different answers – six if one went to Harvard."***

Edgar Fiedler, economist and former Assistant Secretary of the Treasury for Economic Policy

## DON'T FIGHT THE FED

Whether the Fed's ***higher for longer*** approach will lead to the Goldilocks soft-landing scenario is anyone's guess, but this approach has definitely led to higher long-term interest rates. The 10-year bond yield surged from 3.8% to 4.6% in the past quarter and 30-year mortgage rates are now approaching 8%.

If increasing interest rates from near zero to 5.5% failed to sufficiently slow down the economy, ***higher-for-longer*** may just do the trick. The longer higher borrowing costs linger, the more challenging the economic landscape. Housing affordability is at record lows and while consumer spending has been strong, increased credit card debt may be an indication that the average consumer is getting tapped out. Inflation has trended lower, but volatile food and energy prices may mean inflation is higher for longer as well. In short, the proverbial wall of worry is getting harder and harder to climb. Tight monetary policies present headwinds, not tailwinds, for the stock market.

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***"The stock market is filled with individuals who know the price of everything, but the value of nothing."***

Phillip Fisher, investor and author of *Common Stocks and Uncommon Profits*

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## A TALE OF TWO CITIES

It was the best of times for the S&P 500 Index, it was the worst of times for almost everything else. Broad equity indices lost 3-4% in the third quarter. However, year-to-date, the S&P 500 Index still sports a 13% gain while the average stock is up less than 2%. The S&P 500's stellar return can primarily be attributed to the Magnificent Seven (Apple, Microsoft, Alphabet, Amazon, Nvidia, Testla and Meta), which account for almost 30% of the Index. They sell at an average of 33 times forward earnings and have an average year-to-date gain of 88%. On the other hand, US mid-cap stocks are selling at roughly 15 times earnings and international stocks at 13 times.  Can such performance dispersion persist?

## PORTFOLIO POSITIONING

Our overall strategy has remained largely unchanged. We continue to have a slight underweight in stocks because of valuation and macro-economic concerns. We still believe automation and electrification will deliver solid long-term growth. Thus, we look to add positions in these areas that are reasonably priced. Maintaining a globally diversified portfolio has not been rewarded, but we believe it makes sense as global trade will change but not cease. In the emerging markets area, we are leaning towards a China-light approach in an attempt to limit geopolitical risks. The investment landscape changes constantly, but our positioning is driven by our long-term views, not short-term noises.

In perfect hindsight, we started adding to intermediate bonds (3 – 5 years) a couple months too soon. No one can time interest rates perfectly. We will continue to trim Treasury Bills and money market funds to add to bonds as higher long-term bond yields make them more attractive.

As always, please do not hesitate to contact us if you have any questions.

## CONTACT INFORMATION


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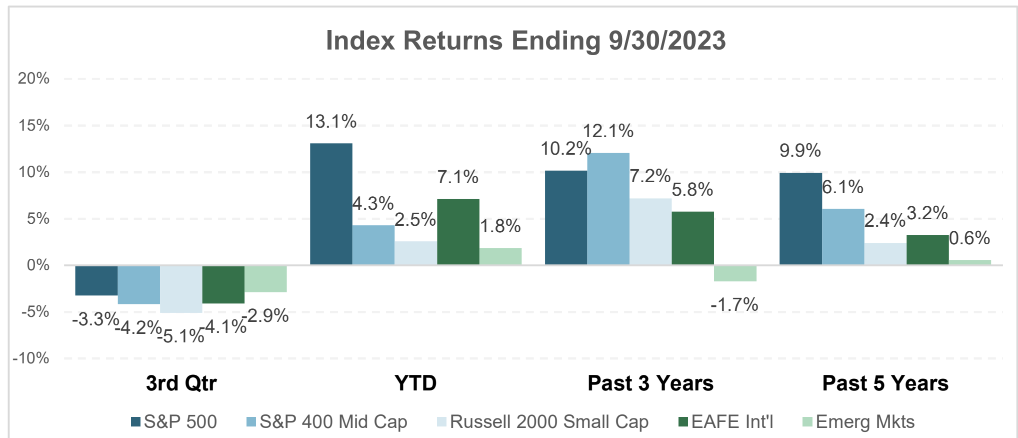
# THIRD QUARTER 2023 MARKET HIGHLIGHTS

## Stocks – Large cap US stocks continue to outperform.



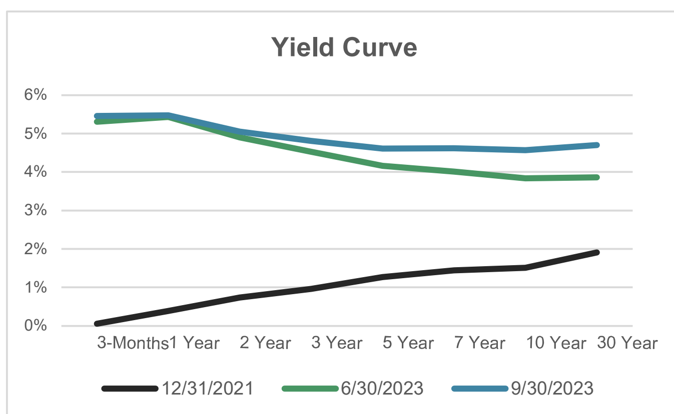

- Global stock markets declined in the third quarter admidst rising long-term interest rates.
- While the S&P 500 Index gained 13% in the past nine months, the average US large cap stock rose less than 2%. By contrast, the average developed international stock gained almost 6% year-to-date.
- Within the S&P 500 Index, only energy and communications stocks posted gains in the past three months, all other sectors lost ground. The real estate and utility sectors were particularly hard hit; both declined over 9% because of rising interest rates.
- The Russell 1000 Growth Index is up almost 25% year-to-date while the Russell 1000 Value Index is up barely 2%. This performance difference is amongst the highest in history.

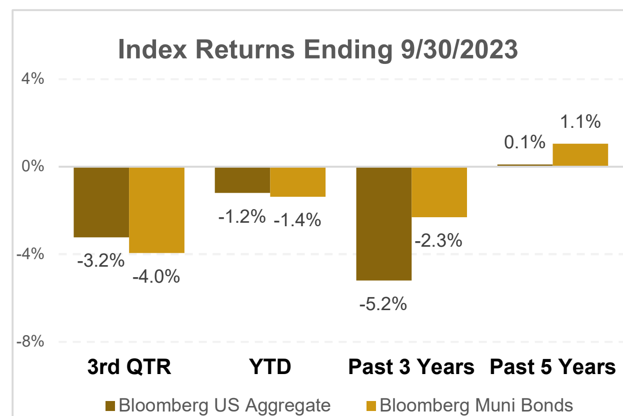
## Bonds – Higher for Longer!

- While the Federal Reserve Board did not raise interest rates in September, its expectations for 2024 short-term rates have risen from 4.6% to 5.1%. *Higher for Longer* has caused a sell-off in the bond markets, resulting in lower bond prices and higher yields.
- With 10-year treasury yields surging from 3.8% to 4.6% over the past three months, bond indices saw a ~3% loss in the quarter, erasing all earlier gains and causing a slight loss for the year.

| | 2 Year Bond Yields | 10 Year Bond Yields |
|---|---|---|
| 12/31/2022 | 4.4% | 3.9% |
| 3/31/2023 | 4.1% | 3.5% |
| 6/30/2023 | 4.9% | 3.8% |
| 9/30/2023 | 5.1% | 4.6% |

- As shown below, the yield curve has become less inverted in the third quarter, as long-term rates rose by a larger margin than short-term rates.




## Debt (data from the International Monetary Fund)

- After the pandemic, US government debts have risen to levels not seen since World War II. As of the end of 2022, US government debts stood at 110% of the nation's Gross Domestic Product (GDP).
- Global debt (public, household and non-financial corporate debt) declined slightly in 2022 but still stood at $235 trillion or 238% of global GDP.