Investment Perspective

The S&P 500 (SPX) increased 21% through July and the outlook was positive. Since then, the SPX has declined 10%, and some indices flipped negative year-to-date. What happened? Faster economic growth combined with increasing Treasury issuance to finance the rising U.S. budget deficit put upward pressure on longer term interest rates. Specifically, the 10-year Treasury yield gained 26% to 5.02% recently. In addition, Hamas attacked Israel, Israel declared war on Hamas in Gaza and there is concern of a widening conflict. What factors will impact the economic and investment outlooks today?

The Fed hopes to engineer a "soft landing" with lower inflation, but there are risks that higher interest rates may generate a "hard landing"

Long term investors expect a strong central bank with tough inflation fighting credentials to preserve the purchasing power of money and foster healthy financial markets. The current Federal Reserve Board led by Chair Jerome Powell has been aggressive in raising the short-term federal funds rate 525 basis points (bps) with 11 hikes over the past 18 months -- an unprecedented pace of tightening and a 22-year high. This restrictive stance is uncomfortable as the stock market gyrates with higher interest rates. However, investors will benefit from this inflation fight with the prize of lower inflation. The Fed hopes to engineer a "soft landing" with lower inflation, but there are risks that higher interest rates may generate a "hard landing." We believe the monetary tightening process is nearing an end and the equity markets will rebound significantly as investors discount an incrementally more accommodative monetary outlook in 2024. A summary of year-to-date index returns for the period ending September 30 is as follows:

Dow Jones Industrials	2.7%	Russell 2500	3.6%
MSCI EAFE	7.6%	S&P 500	13.1%
NASDAQ Composite	27.1%	Wilshire 5000	12.5%

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GLOBAL ECONOMY

Worldwide growth expectations for 2023 and 2024 remain modest at approximately 2.5% this year and lower in 2024. Inflation is decelerating around the world, except in Japan where they are encouraging some inflation after an extended period of deflation. China is experiencing slower than expected growth, albeit at a 4.5-5% rate which is still twice the rate of global growth. Excessive real estate debt combined with a slowdown in foreign investment and manufacturing is having a negative impact. Nevertheless, the Chinese government is stimulating the economy to meet a targeted 5% growth rate. The weakness in China is impacting Western companies that sell products and services to China. Overall, worldwide growth is tepid with some recent improvements that suggest less risk of downside than previously expected.

The U.S. economy is growing faster than expected. After two quarters of negative growth in the first half of 2022, the economy gained approximately 2.5% over each of the last four

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quarters and 4.9% in the September quarter. Consumer spending rose 4% last quarter supported by a healthy labor market. For example, the unemployment rate is 3.9% while the labor force is gradually expanding, and payrolls are growing at a respectable 2.1% pace. However, the recent U.S. economic strength is not sustainable and economists are forecasting slowing growth through mid-2024.

Economic activity in the services sector expanded in October for the 10th consecutive month as the services PMI registered 51.8

Non-residential construction is growing due to the federal CHIPS and Inflation Reduction Acts to promote semiconductor plant construction and infrastructure development. Spending on software and technology continues to be a contributor to growth as does government spending. Related to this government spending, the federal deficit was $1.6 trillion for the 2023 fiscal year ended September or approximately 6% of GDP. From a manufacturing perspective, activity levels are soft but not dire. Economic activity in the services sector expanded in October for the 10th consecutive month as the services PMI registered 51.8. However, credit card spending data suggests a slowdown at retailers for hard goods. The purchasing managers index (PMI) for manufacturing registered 46.7 in October, signaling economic contraction. Employment and wage gains are both slowing. The COVID-19 relief for student loan payments ended in September and this will tighten some household budgets. Residential construction and sales are also weakening. Overall, the U.S. economy may be strong enough to prompt the Fed to tighten further, but it is a delicate balance as some data series are moderating.

CONFLICTS & CONSEQUENCES

On October 7, Hamas attacked Israel from Gaza by air, land and sea in a coordinated assault. Approximately 1400 men, women, and children were killed, over 3400 wounded and 230 taken hostage. As a result, Israel declared war on Hamas, cut off electricity, food and water to Gaza, and is attacking Hamas facilities and leadership in Gaza. In response, Iran and Hezbollah in Lebanon have threatened Israel and Hezbollah initiated some attacks in northern Israel. Of historic note, the Hamas attack occurred on the 50th anniversary of the Yom Kippur War, which was a short battle precipitated by the invasion of Israel by Egypt and Syria in 1973. The U.S. has pledged to support Israel and moved two aircraft carrier strike groups, fighter squadrons, missile defense systems and troops to the area. There have also been drone and missile attacks against U.S. forces in Iraq and Syria. In response, the U.S. launched strikes against Iranian groups in Syria. There is significant risk of escalation and the world is growing more tense and conflicted geo-politically. President Biden visited Israel on October 19 to discuss this problem and announced a humanitarian aid agreement from Egypt to Gaza with $100 million in funding for assistance to civilians in Gaza and the West Bank.

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The Russian/Ukraine war is continuing with increasing intensity. Casualties are heavy on both sides with an estimated 300,000 Russian troops killed and wounded and 200,000 for Ukraine. Ukraine is making slow progress with their counteroffensive to regain territory in the southeast. It has increased attacks on Crimea, and Russia is attacking grain storage facilities on the western border and Ukraine's infrastructure. This war is expanding with no end in sight. NATO and the U.S. remain committed to supporting Ukraine for as long as it takes. Pilots are training to fly F-16 fighters with planes supplied by NATO countries in the months ahead. These conflicts

pressure the U.S. military weapons supply infrastructure because of the high rate of attrition. The U.S. and NATO are under pressure to rebuild inventory levels across a wide array of weapon systems despite the short supply of important electronic components and raw materials. Given this backdrop, we expect strong demand for advanced military supplies for the foreseeable future.

FEDERAL RESERVE POLICY & INFLATION

Monetary policy remains restrictive, and the central bank is advocating a "higher for longer" approach to deal with the sticky nature of inflation

The Fed left interest rates unchanged on November 1 and will remain data dependent with respect to future changes to monetary policy. Although inflation is improving from over 8% a year ago, the pace of progress is slowing, and the level remains above the Fed's target of 2%. As a result, monetary policy remains restrictive, and the central bank is advocating a "higher for longer" approach to deal with the sticky nature of inflation. Headline inflation as measured by the consumer price index (CPI) was up 3.7% y/y in September. Core inflation (CPI excluding food and energy) rose 4.1% y/y and the Fed's preferred measure of inflation, the core personal consumption expenditure price index (PCE), excluding food and energy, increased 3.7% y/y. This is a favorable trend.

The Fed's most recent hike was 25 basis points in July, which increased the fed funds rate to 5.25-5.50%. This was the 11th hike since March 2022 totaling 525 bps - the steepest pace of tightening within 18 months. The end of this hiking cycle is near unless inflation remains sticky in the months ahead. Bond vigilantes have repriced the 10-year Treasury yield to a 4.50-5.00% range, given the combination of inflation worries, federal deficit spending and Fitch's downgrade of U.S government debt. This will slow borrowing and apply downward pressure on the economy. Furthermore, "quantitative tightening" (QT), which started in June 2022, is shrinking the Fed's balance sheet approximately $1 trillion per year. The QT process removes a systematic buyer of bonds and adds upward pressure on yields. Monetary policy will remain restrictive for at least several more quarters unless there is substantial improvement in inflation. OPEC oil production has increased the past three months after a period of cutbacks, but prices have stabilized because of the Middle East conflict. This may have a positive impact on inflation in the months ahead. We expect short and long-term interest rates will remain elevated over the intermediate term.

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CORPORATE PROFITS

The outlook for corporate profits growth is constructive as earnings have exceeded expectations throughout 2023. The year started with forecasts of a modest decline in SPX profits, but investors now expect modest gains. Businesses are experiencing above-average revenue growth due to a combination of fundamental demand and higher prices. Profitability is better than expected despite margin pressure in some industries. Wall Street forecasters estimate earnings per share (EPS) of $221 for the SPX this year, compared to $219 in 2022. This current view is substantially better than some gloomy forecasts last winter of $185 in earnings. Looking ahead, strategists expect EPS of $245 in 2024 which represents 12% growth. The combination of fundamentally resilient demand, a strong labor market, decelerating inflation and a sound financial system suggest businesses can continue to grow. But it is early to have high confidence in 2024 projections. Risks that

might interrupt this expected profit growth include an unexpected downturn in demand, further deterioration in China's economy, spiking oil prices, higher financing costs and a pullback in capital spending.

INVESTMENT OUTLOOK

The outlook for stocks and bonds is heavily dependent on improving inflation and the direction of monetary policy. Assuming inflation moves closer to the Fed's 2% target over the next 6-12 months, monetary policy should become less restrictive fueling a rally in stocks and bonds. On the other hand, if inflation does not improve, the Fed's "higher for longer" policy will persist, and act as a headwind on investment returns. We believe the end of this monetary tightening cycle is approaching and investors will quickly discount a change in the central bank's posture. Currently, the SPX is valued at 17.8x next year's earnings estimate versus its long-term average of 16.6x. Despite the market's recent volatility, we advocate adding to equities in advance of this potential shift in sentiment. Stock prices may appreciate significantly when sentiment improves. There is substantial cash on the sidelines to fuel a market rebound. Yes, it can be frustrating, but "time in the market is more important than timing the market."

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Currently, there is a narrowness (lack of breadth) in the stock market which is a sign of concern and risk aversion. The major indices have segmented into two-tiers with the "Magnificent Seven" (Amazon, Apple, Google, Meta, Microsoft, Nvidia, Tesla) representing the popular group and everything else suffering from neglect. These seven stocks comprise 30% of the total market capitalization of the SPX, which is a historic level of concentration. The average year-to-date price return for these seven stocks is 91%. This compares to -1.6% for the average stock in the SPX on an unweighted basis. Essentially, the overall investment environment has been more challenging than the major indices indicate. Given these dynamics, there is a significant opportunity for investor sentiment to improve which will broaden investor interest and lead to a constructive period for equities, especially for small and medium-sized growth companies.

Patience and discipline are required as equity prices reflect the risks ahead. Goldman Sachs notes U.S. equities typically rally following peak hawkishness. For example, since 1965, after the peak in 2-year Treasury yields in the past 11 tightening cycles, the SPX typically rallies by 8% in the following three months and 23% in subsequent 12 months. Also, since 1945, the SPX has gained 21% on average two years after a peak in inflation and 28% without a recession. We believe the stock market is positioned for a strong rebound once the Fed tightening ends. Until then, we are amidst a challenging environment marked by swings in sentiment, narrow investor interest and volatility. From a capital markets and corporate liquidity perspective, the financial markets are functioning efficiently with no obvious signs of stress or illiquidity. This is positive given the QT process and the tighter money stance of the Fed. To support this point, the banking system and financial markets absorbed the Silicon Valley Bank (SIVB) crisis effectively as contagion was limited to a few weak links in the banking system. SIVB did not prove to be a Bear Stearns/Lehman crisis as many speculated. From an underwriting perspective, global capital raised from IPOs in the initial nine months of 2023 amounted to $90 billion across

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975 offerings, a 29% decline in value from the same period last year. In North America, equity capital issuances amounted to $113 billion and grew 42% year over year in this period. Looking ahead, global and U.S. capital raising is likely to increase in 2024 with a favorable impact on the financial markets.

Broadly stated, the average listed equity is somewhat neglected because there is competition for the investment dollar from either 5% short-term government bonds or the popular "Magnificent Seven" stocks. It is our perspective that we will be successful by focusing on fundamental factors, such as growth, profitability, positive cash flow, a strong balance sheet and quality businesses. With patience, ACM's strategy of owning quality small and medium-sized growth companies will produce above-average returns in the years ahead. The current period will eventually transition to another leg of positive returns due to the dynamic long-term opportunities available in the U.S. economy.