



Lynx Capital Group Ltd

Disciplined Strategic Investment Management

<http://www.lynxcap.com>

Market outlook as of October 2023

“The arithmetic makes it plain that inflation is a far more devastating tax than anything that has been enacted by our legislatures. The inflation tax has a fantastic ability to simply consume capital.”

Warren Buffet - is an American business magnate, investor, and philanthropist. He is currently the chairman and CEO of Berkshire Hathaway. As a result of his immense investment success, Buffett is one of the best-known fundamental investors in the world.

September was one of the worst months for stocks since December 2022, with the Russell 3000 Index down almost 5%. Several headwinds resurfaced with stronger than expected inflation numbers, weakening economic data and ongoing strike activity due to a very tight labor market. October has also begun on a rocky note with government gridlock and a savage attack on Israel requiring a robust response.

The U.S. Federal Reserve (Fed) chair Jerome Powell's attempt to secure a soft landing for the U.S. economy may have an even greater difficulty than airline pilot Sully Sullenberger's attempt to achieve a smooth landing on the Hudson River in 2009. Lessons from previous cycles suggest that “sticking” the landing is a challenge. Once the U.S. economy begins to slow in response to the Fed's tightening, it usually declines into a recession. We believe that a mild U.S. recession prior to the end of 2024 is the most likely outcome, although the complexities caused by the pandemic make forecasting extremely difficult at best.

The Federal Reserve reiterated that they expect to keep interest rates “higher for longer” until inflation moves sustainably towards their 2% target. The Fed also suggested that one more rate hike is possible in November. In response both long- and short-term rates moved sharply higher with yields reaching 15-year highs. The unemployment rate of just 3.8%, the lowest since the late 1960s, is resulting in very tight labor markets. The consumer has also defied gravity this year and powered the economy to very solid growth through the third quarter. More than likely the U.S. unemployment rate needs to rise above 4% for the inflation rate to get to the Fed's 2% target.

The Fed: more progress on CPI than wages

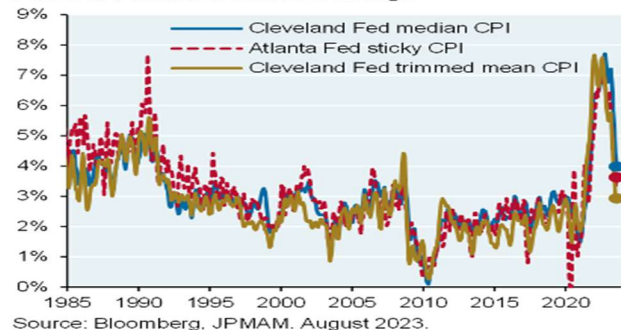
Wage inflation remains sticky

Percent, y/y



US consumer price inflation measures

Percent, 3 month annualized change



The key theme this year by far was for stocks in the AI (artificial Intelligence) area. AI is not new and has been around for a number of years. (IBM's smart computer "Watson" was introduced in 2013!). This has resulted in the markets becoming extremely bifurcated this year with a small amount of technology doing very well due to AI (artificial intelligence) themes while the overall market has languished. Since the beginning of 2022 winners have been defensive sectors like value and healthcare/pharmaceutical stocks up 7.6%. Bonds have had a tough time due to the rapid rise in interest rates, but now look a lot more compelling as we think we are close to a peak in rates. The chart below shows that 5 stocks out of 500 account for 24% of the S&P 500 Index. This is very concentrated performance, and in the past was a sure sign of future underperformance.



Source: Strategas Research, 05/26/2023.

Valuations of these stocks are also at extreme levels showing the difference between the top and bottom quintiles (20%) also at extreme levels. (see chart below).



Goldman Sachs Research, 2019.

Below is a table of returns since the beginning of 2022 showing that investing is a **long-term** process, and chasing the flavor of the day rarely works. Since the beginning of 2022 large cap healthcare\pharmaceutical stocks (our largest weighting) have been the best performer. Technology, while doing very well in 2023, was cremated in 2022 losing 32.6% in 2022.

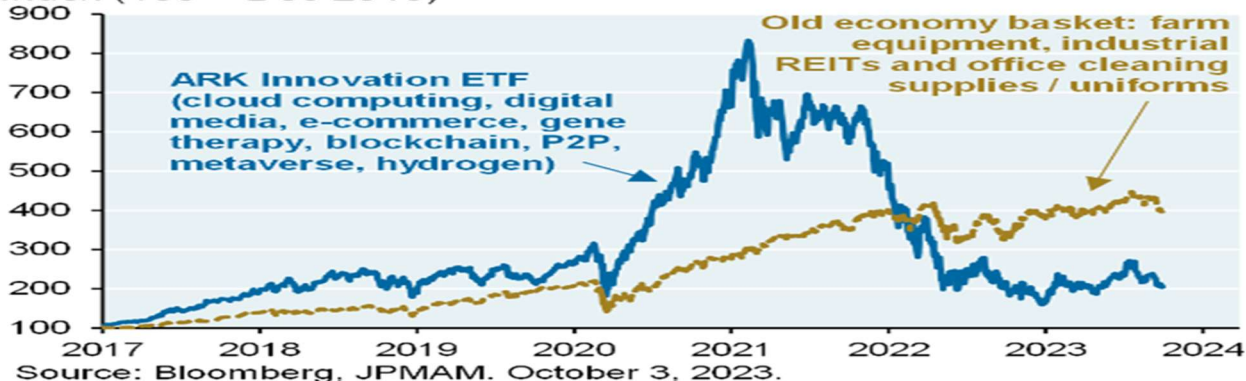
Returns are as of October 13 th 2023	Returns since 2022	2023 YTD
S&P 500	-6.6%	14.1%
Equal Weighted S&P 500	-11.0%	0.7%
Technology Stocks	-7.1%	37.8%
Large Cap Value	1.4%	7.2%
Large Cap Growth	-15.2%	20.3
Financials Large Cap	-1.5%	-12.0%
Pharmaceutical (Healthcare) Large Cap	7.6%	4.9%
Small Cap	-21.5	-1.3
Gold	5.3%	5.4%
Corporate Investment Grade Bonds	-21.3%	-1.25%

As further evidence of investors chasing the newest and latest investment fad verse the “old world” have NOT outperformed and in fact have way underperformed. (See Chart Below)

Really nervous

The Tortoise and the Hare

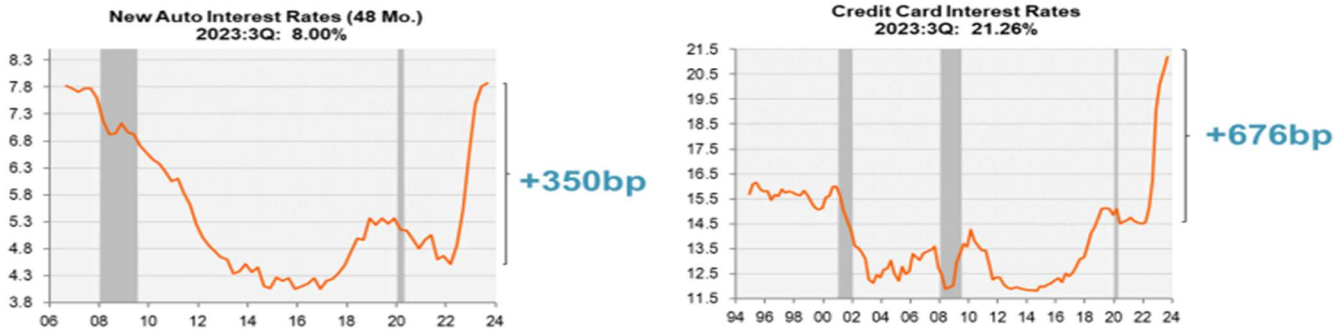
Index (100 = Dec 2016)



Whether the economy has a soft or hard landing (recession) is still anyone’s guess, but the odds are looking more likely that we will get a mild recession in 2024. Valuation (except for the technology sector) overall are not expensive. Additionally, bank lending standards remain restrictive and higher interest rates on debts and credit cards are leading to weaker capital spending and retail sales. Uncertainty over oil due to Middle East instability can also become a headwind. Overall leading economic indicators are pointing to a slowdown. A strong U.S. dollar also imposes drag on corporate profits, especially companies exporting most of their products or services.

As we move into the fourth quarter, tailwinds for the consumer will fade and headwinds could begin to build as we expect further pain from rising gasoline prices and resumption of student loan payments. Credit card delinquencies at the aggregate level are not alarming, but they are rising rapidly for lower income borrowers as borrowing rates hit their highest level on record at 20.7% in May 2023. (Chart below, Piper Sandler)

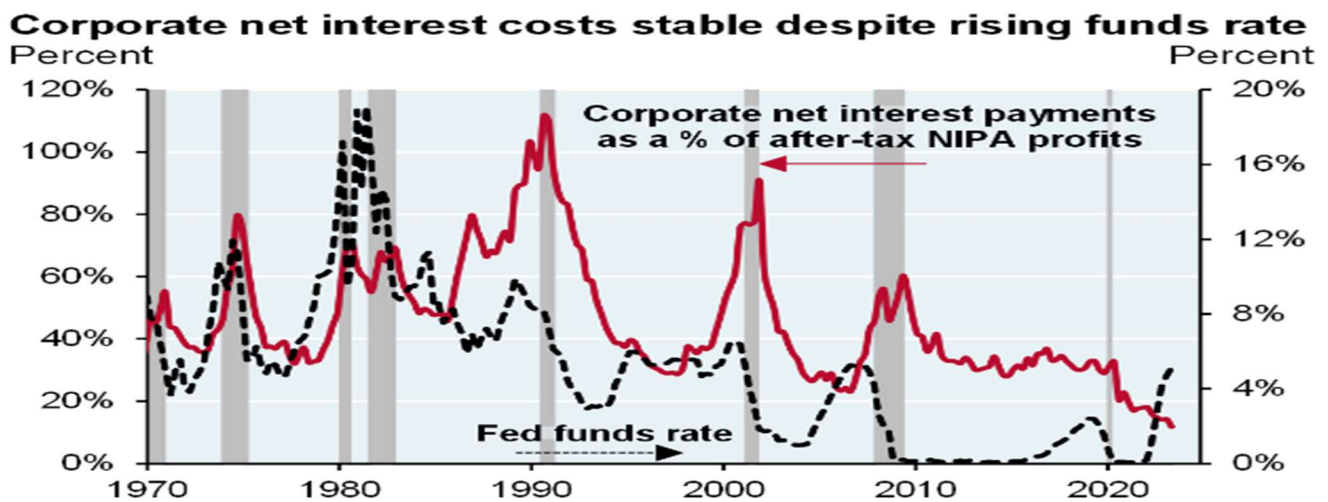
Auto And Credit Card Delinquencies Are Set To Soar!



While still relatively small in number, corporations that have borrowed heavily are starting to feel the effects of higher interest rates. Some even have interest expenses that are already greater than their cash flow from operations (“Zombie Companies”). The National Energy Assistance Directors Association reported that 20 million households are behind their utility bills, up 17% from 2022. Hotter summers and colder winters have driven up energy usage and significantly increased utility bills. With consumer spending set to slow, more delinquencies are likely on the way.

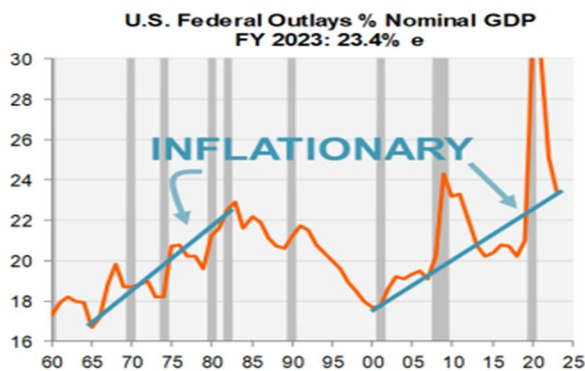
On the positive side, most farsighted corporations and individual households locked in low interest rates. (see chart below).

Corporations got the memo and locked in lower rates



Source: Bloomberg, JPMAM. Q2 2023.

Government stimulus and Federal outlays are still highly stimulative and are on track to be 23% of GDP here in 2023 - highest since 2009, when nominal GDP was declining, and unemployment was soaring. Today, nominal GDP is growing, and joblessness is still well below 4%. The 10-year treasury hit 5% recently but is still relatively low compared to past interest rates. (See charts on next page (Piper Sandler))



Amid this backdrop of Fed tightening, gridlock in congress, 2 foreign wars, and the stage we are in the current investment cycle, value and sentiment process favor a slightly cautious approach to U.S. markets, with opportunities in quality equities. Within equities, we prefer the “quality factor”, which tracks stocks that have low relative debt and stable earnings growth. Our portfolios are biased towards value but do own a decent amount of growth stocks (including companies exposed to AI). We believe for long-term investors, the value discipline, especially with a dividend yield, should be very competitive in the present market environment going forward.

Research suggests that equities provide an improved cash-flow income yield (return) over time verse fixed income of corporate bonds of equivalent issuers. Capturing this potential is particularly important in a world where investors must generate real returns above inflation to achieve their long-term financial goals. Both stocks and bonds are superior to cash, as current high interest rates are unlikely to endure, according to Fed projections.

We continue to focus on high-quality dividend growers with pricing power regardless of the market backdrop. The sharp compression in the valuation of higher-growth stocks has created an opportunity to add some new names to the portfolio. Healthcare/Pharmaceutical stocks, which are often prized for their defensive characteristics, has underperformed so far this year, trades at a price-to-forward-earnings ratio of 16.5x, based on 2024 earnings estimates—a 5.5% discount to the S&P 500 benchmark’s valuation. The sector also offers attractive FCF (Free Cash Flow) yields compared to the market, with decent dividends for income.

It is always advisable to review one’s individual circumstances and tolerance for risk. If any of your financial circumstances have changed, or you want to adjust your portfolio’s risk profile we always encourage you to contact us should you want to make any changes to your portfolio allocation.

As always, please feel free to contact us with any questions or concerns.

Brian Chait

President, October 18th, 2023

Each year Lynx Capital Group files a Form ADV Part 2A. The Form ADV Part 2A defines our business, key personnel and business relationships. If you wish to receive our Form ADV Part 2A and or a copy of our Privacy Policy, please contact us and we will gladly mail or email you a copy.