The Bottom Line - Q2 2023

THE BOTTOM LINE

SECOND QUARTER : 2023

BUFFALO FINANCIAL QUARTERLY NEWSLETTER

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SUMMER

BY JEREMY I. BECK

The First Quarter Buffalo Financial Newsletter included a few bold predictions for 2023, specifically in regards to the Federal Open Market Committee path of future interest rate hikes. In December of 2022, the average of economists surveyed pinned the Federal Funds Rate in the 4.75 to 6.25% Range by the end of 2023. With such a wide variety of outcomes (4.75%, 5.00%, 5.25%, 5.50%, 5.75%, 6.00% & 6.25%), there was indeed confusion among even the brightest minds. We felt the Federal Reserve would raise rates three times in 2023 and finally pause (or pivot) at their meeting on June 14th. As of May 15, there have been a total of three hikes in the Federal Funds Rate, with all eyes on the next FOMC Meeting on June 14th.

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What does this mean for the equity markets in the United States? Simply put, this will alter the landscape of the equity markets for a considerable period of time. When investors are faced with a major investment decision, we are programmed to achieve maximum returns with the least amount of risk possible. If the expected returns of the S&P 500 were the same as a FDIC Certificate of Deposit (CD), most investors would flock towards a CD in light of the risks in the equity markets. If the Federal Reserve were to pause or cut interest rates, this would automatically make the stock market more attractive.

Wall Street is on the edge of their seat as we are eager to see the Federal Reserve wind down their aggressive rate-hiking cycle. History shows that the stock market has climbed 16.9% on average in the 12 months following the last hike in a Fed rate cycle. Assuming May 3rd was indeed our last hike in this cycle, I would expect the collective sigh of relief we have all been anticipating.

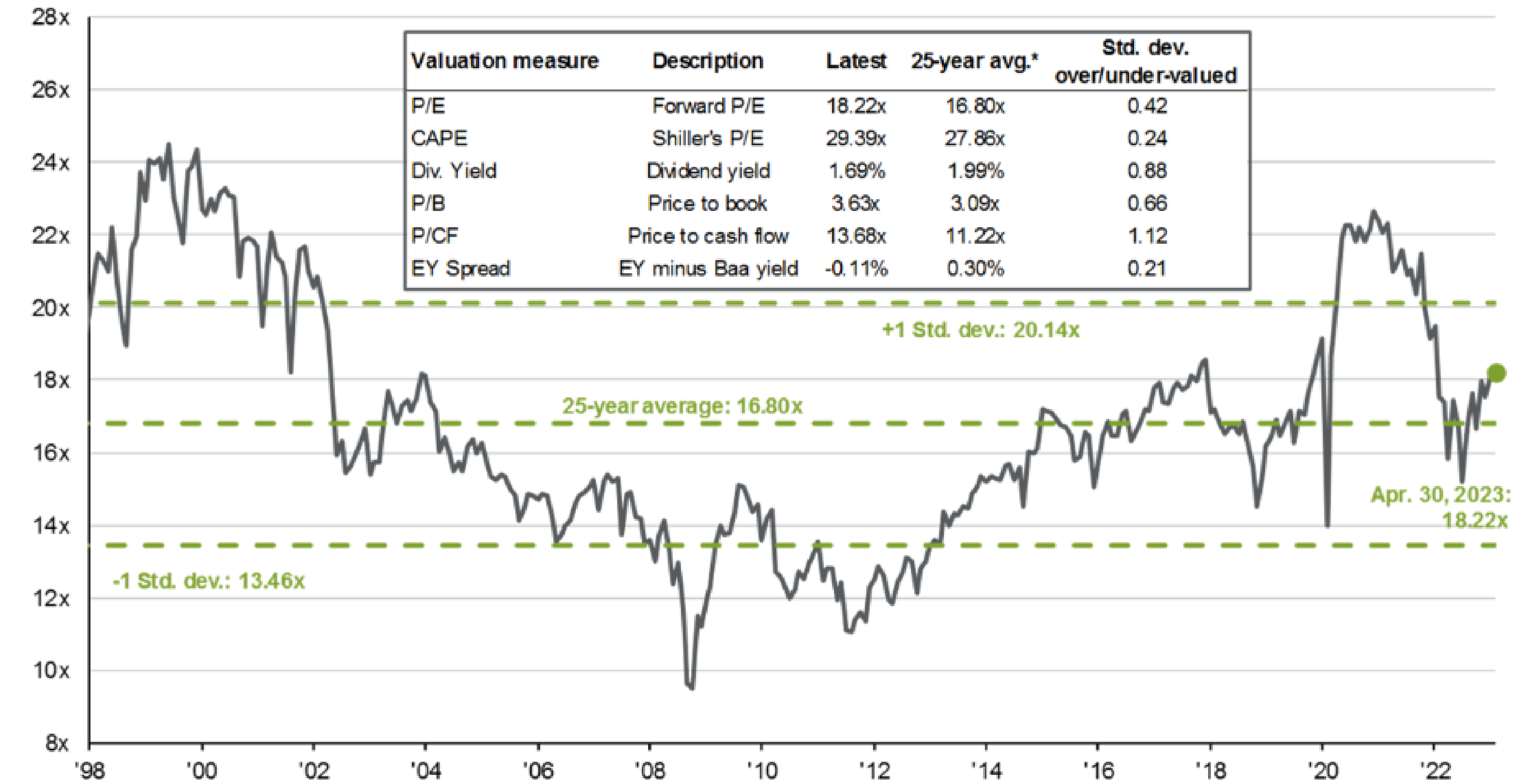
Some may argue that inflation has remained persistent, the War in Ukraine appears to have no end in sight and a potential recession could derail any potential recovery in the equity markets. I disagree. As we've stated in the past, the stock market tends to climb a wall of worry. Simply put, history shows that the stock market can continue to rise, even when faced with economic uncertainty and negative news. The reason is because investors are willing to buy equities when they believe the long-term outlook for the economy is positive.

Looking ahead:

According a report from Refinitiv, 77% of earnings reports have beat analysts' earnings expectations and Q1 earnings results were revised upward. Also, companies reported their earnings 7.2% above expectations, the highest "surprise rate" since Q3 of 2021. Refinitiv further forecasts 9.9% and 9.6% growth for Q4 2023, and Q1 2024 respectively.

When looking at the Chart below from J.P. Morgan Asset Management, the Forward P/E Ratio for the S&P 500 is currently 18.2x. As earnings continue to increase at a rate faster than stock market prices, this multiple will continue to move lower, approaching the 16.8x twenty five year average.

S&P 500 Index: Forward P/E ratio



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A famous quote on the U.S. stock market is "I will tell you how to become rich. Close the doors. Be fearful when others are greedy. Be greedy when others are fearful." — Warren Buffett

Our View

Many investors have been waiting to buy market dips, and the opportunity may finally present itself in June, 2023. There is a wide bifurcation in valuations of many equities and we would strongly suggest focusing on low P/E, high quality companies.

As always, it's good practice to dollar cost average into high quality positions when we feel the market has finally bottomed. Dollar cost averaging is a strategy to manage price risk when you're buying stocks, exchange-traded funds (ETFs) or mutual funds. Instead of purchasing shares at a single price point, with dollar cost averaging you buy in smaller amounts at regular intervals, regardless of price.

Hopefully, on June 14th, Jerome Powell will make the right choice and opt for a pause, creating an ideal start to the summer season.

Stay Safe - Jeremy I. Beck

FIXED INCOME OUTLOOK Q2 2023

BY MATTHEW J. PITROLA

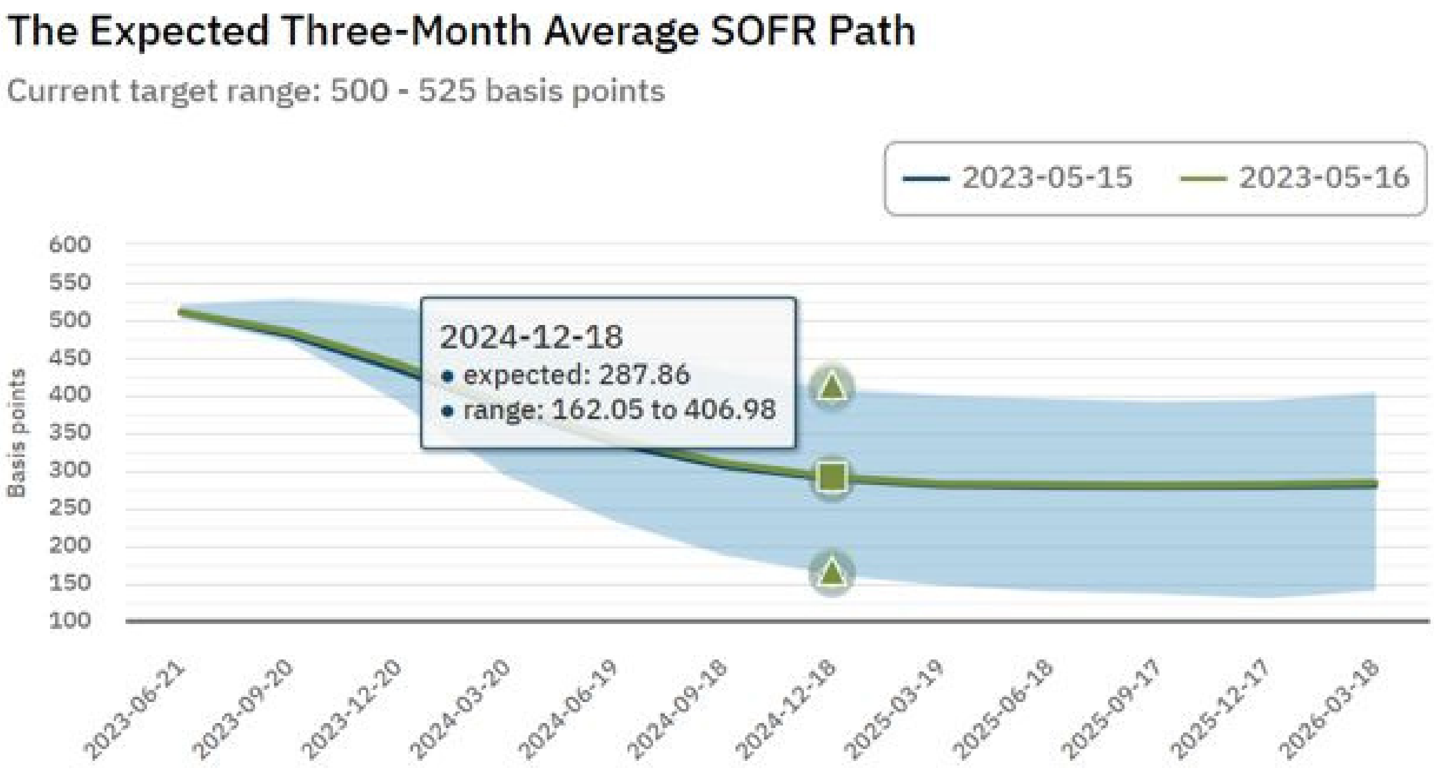
As highlighted in The Buffalo Financial First Quarter Newsletter, investors have experienced the fastest pace of interest rate hikes in over 30 years. This has caused immense volatility for fixed income investors throughout 2022 and has even led to three banks failures through the first five months of 2023.

With the Effective Federal Funds Rate now between 5.00% - 5.25% we believe that the Federal Reserve has reached sufficiently restrictive territory. With inflationary metrics continuing to trend lower and the U.S. economy still showing signs of strength, the hope of a "soft landing" for the U.S. economy continues to grow. This is a positive tailwind for equites as Jeremy highlights above, and this also creates a unique opportunity for fixed income investors to capture the highest yields on fixed income securities in over 15 years.

The Future Path of Interest Rates:

Currently, Wall Street is factoring in a pause from the Federal Reserve at the upcoming FOMC meeting on June 14th. Moreover, there is growing support for the possibility of interest rate cuts by the end of 2023. Analysis of data provided by the Atlanta Federal Reserve reveals a projected downward trend in the Effective Federal Funds rate through 2026. Specifically, the anticipated range for year-end 2024 is 1.62% to 4.06%.

FIGURE 1: The Future Path of Interest Rates



Source: Atlanta Federal Reserve

THE EFFECTS ON FIXED INCOME HOLDINGS:

Certificate of Deposits:

CD investors have been able to capture yields on short duration CDs (Three month - One year) of nearly 5.00% for almost 6 months. This has been a rewarding time for investors who want to earn a reasonable rate of return on their investments in the safest manner possible. With the expectation that interest rates have peaked or will peak in the next few months, I believe this is a prudent time for CD investors to extend their maturities on their CD holdings. With interest rates on 3-year CDs near 4.65% and rates on 5-year CDs near 4.50% as of 05/17/2023. This could be one of the last opportunities to capture rates above 4.50% for moderate duration CDs.

FIGURE 2: CERTIFICATE OF DEPOSIT RATES - 05/17/2023

U.S. Treasury Rates | Municipal Bond Rates | Corporate Bond Rates | CD Rates

CD Rates

Last Updated: 05/17/23 17:00 ET

Maturity	Yield	Yesterday	Last Week	Last Month
3 Month	5.20	5.20	5.15	4.95
6 Month	5.20	5.20	5.15	4.95
9 Month	5.25	5.25	5.20	4.95
1 Year	5.25	5.15	5.15	5.00
2 Year	5.00	5.00	4.90	4.75
3 Year	4.65	4.65	4.65	4.55
5 Year	4.50	4.50	4.50	4.40

Source: ICE BondPoint, Inc.

Corporate Bonds and U.S. Treasuries:

In the realm of corporate bonds, our viewpoint remains centered on high-quality investment grade options. Although the likelihood of an immediate U.S. recession has diminished, we advise against investing in junk bonds due to their vulnerability to a decline in U.S. demand. Investing in investment grade corporate bonds offers advantages due to the inverse correlation between interest rates and bond prices. The significant increase in rates throughout 2022 resulted in the worst performance ever recorded for investment grade corporate bonds, as noted by CNBC in the excerpt below.

FIGURE 3: 2022 RETURNS ON U.S. BONDS

Returns on U.S. bonds hit new historic lows in 2022

	2022 return	Previous worst-performing 12-mo. period	Return
Intermediate-term U.S. Treasurys	**-10.6%**	Oct 1994	**-5.6%**
Total bond	**-13.1%**	Mar 1980	**-9.2%**
Long-term U.S. Treasurys	**-29.3%**	Mar 1980	**-17.1%**
Long-term investment grade	**-27%**	Jan 1842	**-22.9%**

Table: Gabriel Cortes / CNBC
Source: Analysis by Edward F. McQuarrie, professor emeritus, Santa Clara University

FIXED INCOME OUTLOOK - CONT'D

As interest rates are anticipated to decline by the end of 2024, we believe that now is an opportune moment to capitalize on historically low prices in this sector. For investors who are comfortable with higher risk, we recommend exploring investment grade corporate bonds, while for those who prioritize safety, we suggest researching U.S. Treasuries.

Preferred Stock:

The final fixed income opportunity that I would like to highlight is in the preferred stock space. While preferred stock investing is inherently riskier than investing in investment grade corporate bonds or U.S. Treasuries, there is a clear opportunity to capture high yields while also having a chance for price appreciation if rates head lower over the next 24 months. The iShares Preferred Stock Index (PFF) declined -18.37% over the course of 2022 and has a trailing 12-month yield of 6.46%. For investors who are looking to diversify their fixed income holdings, preferred stock is an area of opportunity.

Summary:

Although the last 18 months have been a volatile experience for fixed income investors, opportunities are abundant following the declines of 2022 and the stage is currently set for positive returns into 2024 for those who are patient.

We will continue to monitor remarks from Jerome Powell and the FOMC as these are the major factors that will affect fixed income investors' decisions over the coming months.

THE IMPORTANCE OF ADDING BENFICIARIES

BY JACOB B. WOOD

Although many individuals recognize the significance of having a will to address their estate, they often overlook the importance of designating beneficiaries for their investment accounts. However, this step is crucial in the overall financial planning process. In the following paragraphs, we will outline a few compelling reasons for naming beneficiaries on your accounts.

What are account designations?

When it comes to retirement accounts, we suggest naming primary and contingent beneficiaries to your accounts. A primary beneficiary is the individual who you would like to receive your assets in the event of your passing. They will be the first in line to receive the assets in your retirement account. A contingent beneficiary is the second individual in line to receive the assets in your retirement account. Most individuals name a spouse as their primary beneficiary. While it is very rare for both spouses to pass away simultaneously. Adding a contingent beneficiary to your accounts helps ensure that your assets pass to individuals that align with your current goals.

What does Per Stirpes mean?

Per stirpes is a legal term that describes how your assets are divided and distributed. In Latin, per stirpes simply means “by branch.” If you wish to distribute assets to your children first, and then to their children should they pass away before you do, you have in essence set up your Will or Trust per stirpes.

So, if your estate is set up to be distributed “per stirpes” and a Beneficiary dies, each named, living Beneficiary would receive their original portion of your estate. Any heirs of the deceased Beneficiary would split that portion of the inheritance equally.

What is a TOD?

The transfer on death (TOD) designation lets someone receive assets at the time of their benefactor's death without going through probate. A TOD designation also lets the account holder or security owner specify the percentage of assets each person receives, which helps the executor distribute the person's assets after death. This is often the designation attached to “non-qualified” assets. Allowing you to name beneficiaries on all of your nonretirement holdings.

BUFFALO FINANCIAL

THE IMPORTANCE OF ADDING BENFICIARIES CONT'D

BY JACOB B. WOOD

Why should I add beneficiaries to all of my accounts?

1. You can simplify the probate process.

Having a named beneficiary can make probate, the process of administering a deceased person's will, much smoother. Probate involves many steps for appointing an executor and distributing the decedent's assets. By adding a beneficiary to your accounts you can save your heirs time and money by not having to open estate accounts for all of your assets.

2.Your beneficiaries trump your will.

When it comes time to distribute assets, the executor relies on beneficiary designations to determine the heir of an account before following what's written in a will. "If an account is titled and has a beneficiary associated with it, it will always supersede the will."

3.You can avoid family fights.

Naming a beneficiary and staying on top of your affairs not only helps speed up the process of dealing with your estate, but it also helps family members avoid fights about inheritance.

With designated beneficiaries, your wishes are clear to family members after your death, so they won't have to question which assets were intended for whom. Plus, there can be multiple beneficiaries named with a percentage of the assets designated for each. Having designated percentages also helps to ensure that funds are distributed according to your intentions.

4. Bottom line

The small but important step of naming a beneficiary on your accounts can save time and money and prevent confusion after your death. Naming beneficiaries makes the probate process simpler and ensures assets are distributed according to your wishes.

Make sure to consider all different types of accounts when naming beneficiaries, so none are left behind. It's also a good idea to keep the accounts' heirs updated and change beneficiary designations to reflect life and relationship changes.

BRAD MCMILLAN MARKET COMMENTARY

Debt Ceiling Crisis: Breaking Down the Worst-Case Scenario

Times are getting scary again. Between the debt ceiling, which is the crisis of the day, and everything else that is out there, people are starting to crack. With the Ukraine war still underway and with worries about China, inflation, and a recession, the debt ceiling looks like just the thing that could finally sink the ship. Even though we have done quite well so far and continue to, the worry is always that the next big thing will be the last straw.

Could Happen Vs. Will Happen

Honestly, it could be. We can not absolutely rule that out. The worst-case scenario is something that could happen. But there is a big difference between could and will. There is a big difference between "there are risks and some bad things could happen, but there are also good things we can do to fix the bad situation" and "let's go straight to the worst case." Today, I want to talk about the worst case, why some are fixated on it, and why it will not happen.

Taking the Worst Case Seriously

Let's take the worst case seriously: Congress refuses to raise the debt ceiling. Some U.S. obligations go unpaid. The standoff drags on indefinitely, leaving more and more damage in its wake. Eventually, bond buyers realize they will never be paid and abandon the U.S. dollar and debt. Economic collapse ensues. Certainly, all things considered, this is a bad outcome. But let's take each step and think about the solutions that could happen.

First, Congress— after a lot of theatre—has always raised the debt ceiling at the last minute, when a deal is cobbled together that lets both sides claim victory. That remains the most likely solution at this point. Indeed, negotiations are underway for just that outcome. Problem solved.

But what if Congress doesn't agree? Then we get the second-order solutions, the 14th Amendment argument, the trillion-dollar coin, the consol bonds, and so forth. All of these are less-than-ideal but reasonable (more or less) solutions that can, at a minimum, buy more time for a solution. And depending on how it goes, one may actually be that solution.

And if that doesn't work? The Treasury will do its best to prioritize payments, making sure the critical ones do get paid. Given that, the government can and will minimize the damage. It will be real damage, to be sure, but not the worst-case catastrophe the headlines are screaming about. Problem not solved, but damage limited to a point where things carry on.

DEBT CEILING CRISIS: BREAKING DOWN THE WORST-CASE SCENARIO CONT.

But what if some obligations get defaulted on anyway? Here, the question really is not whether they will be paid, but when. A late mortgage payment, while certainly not ideal, is not equivalent to getting your house foreclosed. The U.S. can and will pay its bills, even if that payment is delayed. As long as we can pay the bills, a technical default will not lead to that worst-case scenario.

What if Congress still doesn't come to an agreement? That is when we hit the worst-case scenario. That is what the headlines are jumping to—and that is what people are really worried about.

Assessing the Potential Damage

How likely are we to get to that point? During all this time, remember, the economic damage and the market damage are mounting. Constituents and campaign donors are calling their congresspeople to complain. The headlines are getting worse and worse. At some point, Congress will be forced to blink, as we have seen several times before.

On one hand, the question is how much damage will happen before Congress does so. History suggests not much, but there could be some. We will see. But the real message is that in none of these cases is the worst case actually going to happen. History suggests a deal will be cut, with no or minimal damage. But even if that doesn't happen, there are multiple off-ramps at each stage that allow the situation to be salvaged. What could happen will not happen.

We Have Seen This Before

In the financial crisis, we could have had global collapse, but everyone eventually pulled together to prevent that. In the pandemic, we could have had U.S. economic collapse, but everyone eventually pulled together to prevent that. In previous debt ceiling confrontations, we could have had the catastrophe everyone is predicting today, but eventually everyone pulled together to prevent it. You get the idea.

So, there are two takeaways here. The worst case will not happen because a solution will be worked out. That's the good one. But the not-so-good one is a final word added to that sentence, which is "eventually."

A solution will be worked out—eventually.

Brad McMillan, CFA, CAIA, MAI, Commonwealth Financial Network

BUFFALO FINANCIAL UPDATE

While we actively grow our office and team, our unwavering belief in giving back to the community remains steadfast.

We have a number of exciting charity events in the summer and fall of 2023.

- Tuesday, May 30th - 117 Holes for golf at Crag Burn to benefit Oishei Children's Hospital
- Sunday, July 2nd - 1st Annual Buffalo Financial Disc Golf Tournament to Benefit Children's Hospital.
- Saturday, September 23rd - 1st Annual Buffalo Financial Golf Tournament at Chestnut Hill to Benefit Children's Hospital.

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Thank you to everyone that donated to our 117 Holes of Golf to Benefit Children's Hospital! Team Beck raised $30,600 in our eight week campaign!

In total, over $324,000 was raised for the Oishei Foundation. Thank you again!!!