The Bottom Line - Q3 2023

THE BOTTOM LINE

THIRD QUARTER : 2023

SUMMER

BY JEREMY I. BECK

The S&P 500 has achieved a remarkable rally, reaching a peak not seen in 15 months. Wall Street's optimism, fueled by the Federal Reserve's potential easing of its monetary tightening measures, has contributed to this surge. If history is any indicator, the index could experience a significant surge if the last Federal Reserve Rate hike is indeed in our rearview mirror.

According to data from FactSet, the S&P 500 has historically performed exceptionally well in the 12 months following the last six instances of the Federal Reserve concluding its tightening cycles. The average gain during these periods was 16.8%, significantly surpassing the index's historical annual

BUFFALO FINANCIAL QUARTERLY NEWSLETTER

TABLE OF CONTENTS

Summer • P. 2 - 4

Fixed Income Outlook • P. 5 - 8

The Importance of Effective Cash Management • P. 8-9

Brad McMillan Outlook • P. 10

News & Events • P. 11

SUMMER - CONT.

return of 12%. A potential 16.8% increase would propel the S&P 500 from its current level of around 4,400 points to a level above 5,100. This surge would surpass the index's previous all-time high of 4,793, which was achieved in December 2021.

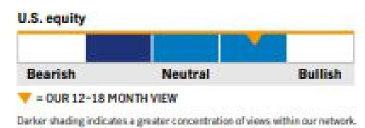
Investors widely anticipate that the Federal Reserve will maintain the current federal funds rate of 5.25% to 5.50%, which was increased at the FOMC meeting on July 26, 2023. The last rate hike was their 11th interest rate hike over the past 12 meetings. Investors are overwhelmingly hopeful that this was the final rate hike of the cycle, according to the Chicago Mercantile Exchange Group's FedWatch tool.

The Federal Reserve initiated its current campaign of tightening measures in March of the preceding year. This approach was adopted to combat inflation, which had surged to its highest point in 41 years during the previous summer. A common measure of tracking inflation is the Consumer Price Index (CPI), which exploded in 2022 by increasing 9.1% year over year, the largest increase since November, 1981. Recent data indicates a significant decline in consumer prices after months of limited progress. Inflation currently stands at 4% on an annual basis, marking its lowest level in over two years, yet still notably higher than the central bank's 2% target.

Positive Historical Indicators:

Even in the scenario of a reversal in the Federal Reserve's course, historical data still supports a bullish outlook for investors. Following the first pause (though not necessarily the last) in the four tightening cycles since 1990 (1995, 2000, 2006 & 2018), the S&P 500 gained an average of 18.9% over the subsequent 12 months. Furthermore, after the conclusion of the prior six hike cycles, the S&P 500 recorded a remarkable 46.2% gain over a three-year period! Considering the S&P 500 has an average historical return of 9.4%, the pump could be primed for substantial gains over the next few years, assuming inflation continues to abate as corporate earnings continue to rise.

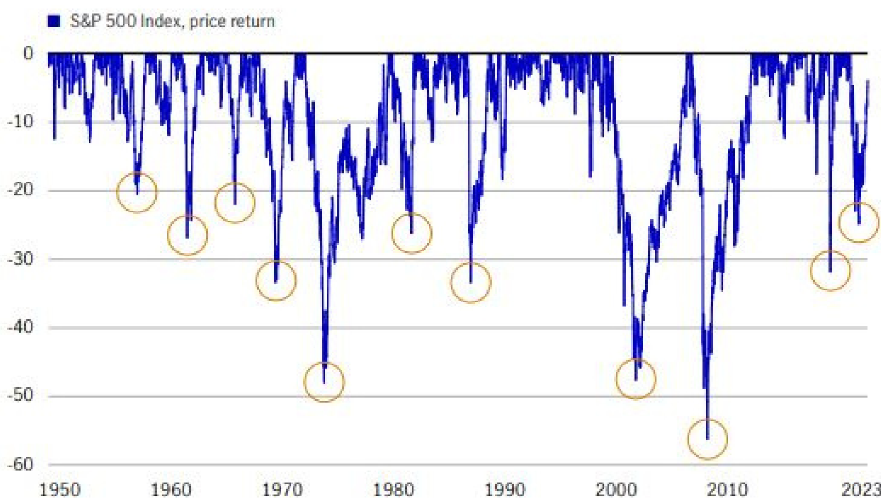
Bear markets can be painful, but they often create opportunities



"History suggests that investors can improve their returns by embracing risk at a time when others are selling."

Manulife Investment Management

The S&P 500 Index has declined by 20% or more 11 times since 1950



Using a bear market as an entry point has historically paid off

S&P 500 Index bear markets (declines of 20% or more) since 1950

Market peak	Peak-to-trough decline	1 year from trough	3 years from trough (annualized)
8/3/56	-20.47%	36.96%	13.15%
12/8/61	-26.87%	33.35%	17.45%
2/11/66	-21.97%	32.87%	8.38%
11/29/68	-33.33%	39.79%	12.86%
1/5/73	-47.99%	37.87%	15.69%
11/28/80	-22.19%	40.54%	18.78%
8/21/87	-33.34%	21.39%	12.90%
3/24/00	-47.59%	28.64%	15.35%
10/12/07	-56.24%	66.63%	26.08%
2/14/20	-31.81%	53.97%	20.76%
1/3/22	?	?	?
Average	**-34.18%**	**39.20%**	**16.14%**

Source: FactSet, as of 7/31/23. The S&P 500 Index tracks the performance of 500 of the largest publicly traded companies in the United States. It is not possible to invest directly in an index. Past performance does not guarantee future results.

SUMMER - CONT.

A famous quote on the U.S. stock market is "Courage taught me no matter how bad a crisis gets ... any sound investment will eventually pay off." — Carlos Slim Helu

Our View

Despite the positive outlook, there are concerns in the market. The S&P 500 has registered a 14% year-to-date increase and a remarkable 25% surge since the previous fall. This has led to a valuation metric, the price-to-earnings (P/E) ratio, of approximately 25—a considerable deviation from the historical average of around 17. Experts, including Morgan Stanley's top strategist Michael Wilson, express reservations about this valuation, suggesting that a Fed pause might have tactical consequences. This could lead the market to accurately assess the implications of lower inflation for corporations: a weakened consumer sentiment. Morgan Stanley's projection of the S&P 500 sitting at 4,200 by the same time next year implies a 4% decline.

One notable statistic is that the S&P 500 gained a remarkable 22.5% on average in the 12-month period immediately following past tightening campaigns, excluding the dot-com stock bubble burst at the turn of the millennium. This performance metric points to the potential for the S&P 500 to reach nearly 5,400 in the aftermath of the current campaign's conclusion, representing a striking 54% increase from its 2022 low of 3,492. It's currently a horse race between prices for the stocks in the S&P 500 vs. earnings for the same companies. If earnings can rise faster than prices, this will compress the P/E ratio of the S&P 500, building a solid foundation for further gains.

Stay Safe - Jeremy I. Beck

FIXED INCOME OUTLOOK Q3 - 2023

BY MATTHEW J. PITROLA

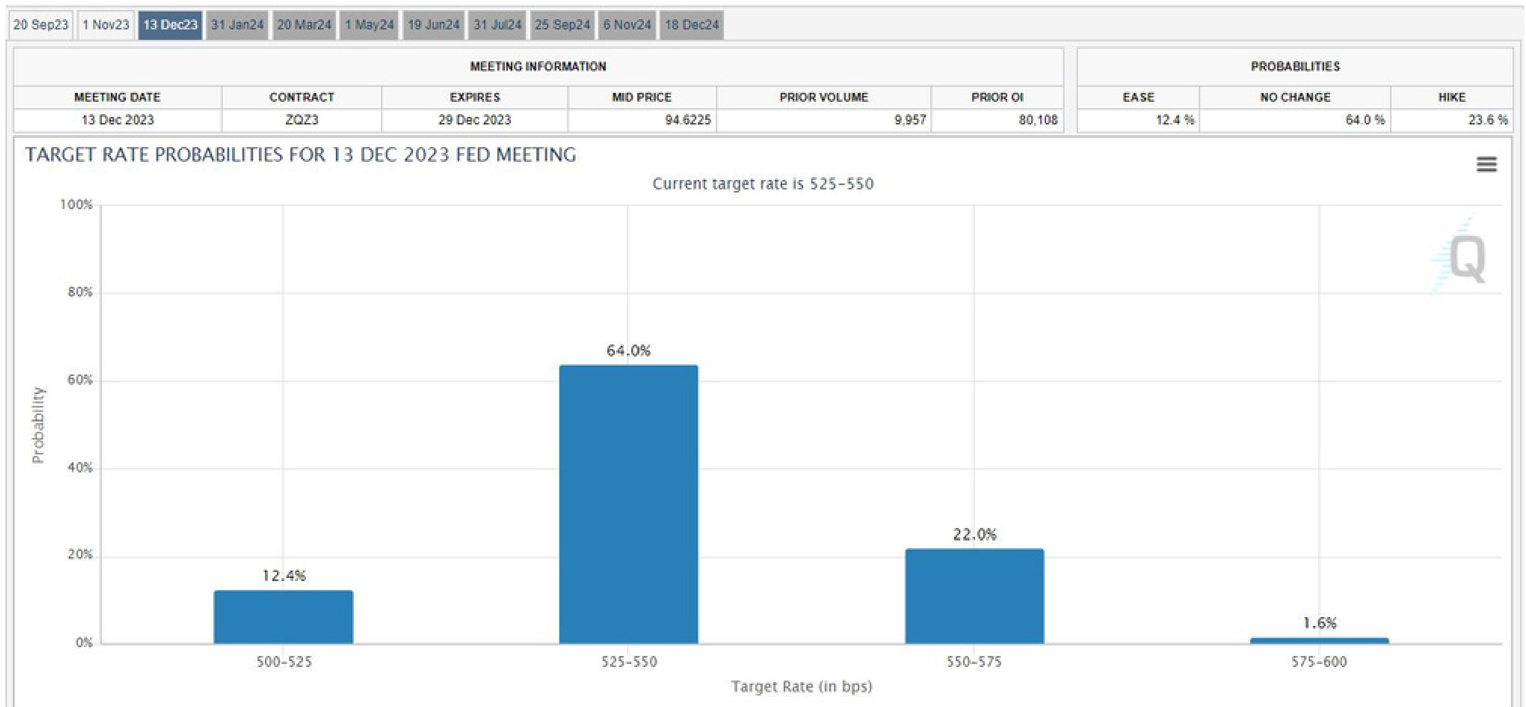
The bull market in bonds that started in November of last year experienced a tough second quarter. This started with a flight-to-quality in the first quarter, driven by concerns over a regional bank crisis.

Subsequently, throughout the second quarter financial markets recognized that despite persistently high inflation and low unemployment, central banks were unlikely to deviate from their mission to combat inflation by reducing interest rates.

As we enter the third quarter, the pace of economic expansion is moderating, yet inflation remains at levels too elevated for central bankers to halt their course of rate hikes — for now. The ongoing debate about whether central banks will or won't increase rates persists. For U.S. central banks, the magnitude of these rate hikes is becoming smaller, and some meetings are being skipped. These actions indicate that most of, if not all of the rate increases are in the past and that any future hikes will be more nuanced adjustments.

The current probability of another interest rate hike by the end of 2023 sits at just 23.60% as of August 10th, 2023.

FIGURE 1: Interest Rate Hike Probability through year end 2023.



MEETING INFORMATION						PROBABILITIES		
MEETING DATE	CONTRACT	EXPIRES	MID PRICE	PRIOR VOLUME	PRIOR OI	EASE	NO CHANGE	HIKE
13 Dec 2023	ZQZ3	29 Dec 2023	94.6225	9,957	80,108	12.4 %	64.0 %	23.6 %

Source: CME Group

FIXED INCOME OUTLOOK Q3 - 2023

Bond performance following the last Federal Reserve interest rate hike:

While it is true that the economic horizon is clouded by geopolitical events. Bonds have reached a level where historical returns look extremely attractive for investors. We are feeling more comfortable extending duration now that we have a much clearer view as to what to expect from the Federal Reserve over these next few quarters. Examining the trailing 1 year returns of various fixed income investments after the Federal Reserves final interest rate hike over the last 4 hiking cycles. You will see a common theme, outsized positive returns.

The average 1 year return over the last 4 cycles for the Bloomberg Aggregate Bond Index is 11.52%.

Investment Grade Corporate Bonds see an even healthier rebound, with the average 1 year return being 14.07%.

FIGURE 2: HOW DO BONDS PERFORM 12 MONTHS AFTER THE LAST FED HIKE?

Sources: Vanguard Calculations using FactSet data and Bloomberg indexes.

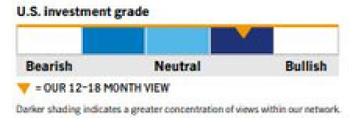
These figures might catch investors off guard, especially considering the past two years of poor bond performance. However, upon closer examination, investment grade corporate bonds are trading at valuations that we haven't seen since the great financial crisis of 2008.

The low valuation, high yields, and the possibility of the end of this rate hiking cycle being within the next several months make the risk of adding investment grade corporate bonds to your portfolio worthwhile. The attached chart on the follow page shows the Bloomberg U.S. Corporate Investment Grade Index's price level compared to valuations during 2008.

FIXED INCOME OUTLOOK - CONT'D

FIGURE 3: INVESTMENT GRADE CORPORATE BOND VALUATIONS

Investment-grade corporates are trading at prices and yields not seen since the global financial crisis



"What we get paid to own the average investment-grade bond has increased significantly over the past year." Manulife Investment Management

High-quality corporate bonds have rarely traded at valuations this low

We prefer higher-quality corporates with yields in the 4%–5% range, especially A-rated issues

Bloomberg index/segment	Yield to maturity (%)
U.S. Corporate AAA	4.65
U.S. Corporate AA	4.86
U.S. Corporate A	5.29
U.S. Corporate Investment Grade	5.45
U.S. Corporate BAA	5.72
U.S. Credit/Corporate High Yield BA	7.02
U.S. High Yield Corporate	8.39
U.S. Credit/Corporate High Yield B	8.43
U.S. Credit/Corporate High Yield CAA	13.05

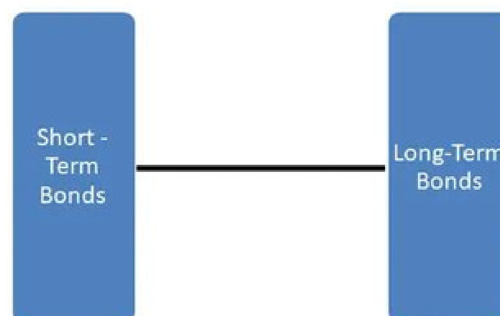
Source: FactSet, as of 7/31/23. The Bloomberg U.S. Corporate Investment Grade Index tracks the investment-grade, fixed-rate, taxable corporate bond market. It is not possible to invest directly in an index. Past performance does not guarantee future results.

John Hancock Investment Management | Market Intelligence 22

How to allocate going forward:

While the last two years have been painful, the stage has been set for exceptional fixed income returns for the next several years. With interest rates being elevated, yields in the treasury and corporate bond space have become meaningful. And the protection that investors once craved from these assets has been restored. Over the coming months, investors should be increasing their appetite for duration.

We feel that a "bar - bell" approach to the fixed income portion of your portfolio is the way to position. With 50% of the barbell focusing on short duration maturities (0-5 years) to gain access to the highest yielding portion of the market. But also having another 50% targeting intermediate holdings with maturities (7 - 10 years.) In order to achieve price appreciation on your investment if interest rates fall over 2024 - 2025.



Bonds are subject to availability and market conditions; some have call features that may affect income. Bond prices and yields are inversely related: when the price goes up, the yield goes down, and vice versa. Market risk is a consideration if sold or redeemed prior to maturity.

THE IMPORTANCE OF EFFECTIVE CASH MANAGEMENT

BY JACOB B. WOOD

Effective cash management is a vital aspect of financial planning for both individuals and businesses. While traditional savings accounts have long been a default choice for parking surplus monies, there are more sophisticated and potentially lucrative alternatives available. Among these alternatives, utilizing Certificates of Deposit (CDs), money markets, and US Treasuries can offer enhanced benefits that extend beyond what regular savings accounts typically provide.

Certificates of Deposit

Certificates of Deposit (CDs) are time-bound deposits that offer a higher interest rate than traditional savings accounts. By locking in a specific term, ranging from a few months to several years, investors can earn a predictable return on their investment.

Moreover, CDs are often insured by the Federal Deposit Insurance Corporation (FDIC) up to $250,000 per depositor, per institution. This FDIC insurance provides an extra layer of security, making CDs a compelling option for risk-averse investors. However, it's important to note that early withdrawals from CDs may incur penalties, so they are better suited for funds that can remain untouched for the agreed-upon period.

Money Markets

Money markets excel in offering both stability and liquidity, making them an optimal financial choice. These accounts provide easy access to funds, catering to individuals and businesses requiring quick liquidity. Short-term securities underpinning money market funds enable hassle-free withdrawals without significant penalties. Unlike longer-term investments, money markets ensure swift access to funds without waiting for maturity or enduring withdrawal constraints.

Money market funds maintain a steady net asset value of $1 per share, emphasizing their stability amid market fluctuations. This blend of liquidity and stability, along with the potential for higher returns than traditional savings, solidifies money markets as a compelling cash management solution.

An investment in a money market fund is not insured or guaranteed by the Federal Deposit Insurance Corporation (FDIC) or any other governmental agency; although the fund seeks to preserve the value of the investment at $1 per share, it is possible to lose money. Non-bank deposit investments are not FDIC- or NCUA-insured, are not guaranteed by the bank/financial institution, and are subject to risk, including loss of principal invested.

This material is intended for informational/educational purpose only. And should not be considered as investment advice, a solicitation, or a recommendation to buy or sell and security or investment product. Please contact your financial professional for more information specific to your situation.

THE IMPORTANCE OF EFFECTIVE CASH MANAGEMENT CONT.

BY JACOB B. WOOD

Our Approach

Buffalo Financial offers a unique strategy by combining Certificates of Deposit (CDs) and money markets within a single account, alongside the effective technique of laddering CD maturities. This approach can enhance your return while offering liquidity, providing more opportunity for growth than a regular savings account. By strategically allocating funds between CDs with varying maturities of 1, 2, and 5 years, investors can potentially enjoy higher yields from the CDs' fixed-term returns. Additionally, the competitive interest rates of money markets further enhance the earnings potential. This diversified approach not only can enhance yield but also maintains ample access to funds as CDs mature at different intervals. Our comprehensive solution in cash management accounts provides a perfect balance between yield, liquidity, and flexibility.

Average U.S. Savings Account

Yield: 0.42%
Annual Interest on $250k: $1050

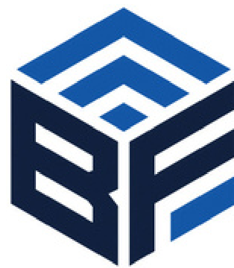
Source: https://smartasset.com/checking-account/average-savings-account-interest

Buffalo Financial Cash Management Account

- 30% Money Market Fund
- 30% 1 Year CD 5.30%
- 30% 2 Year CD 5.10%
- 10% 5 Year CD 4.55%

Total Yield: **5.031%**
Annual Interest on $250k: **$12,577.50**

This is a hypothetical example and is for illustrative purposes only. No specific investments were used in this example. Actual results will vary.



BUFFALO
FINANCIAL

Investments are subject to risk, including the loss of principal. Some investments are not suitable for all investors, and there is no guarantee that any investing goal will be met. Past performance is no guarantee of future results. Talk to your financial advisor before making any investing decisions.

Certificates of deposits (CDs) typically offer a fixed rate of return if held to maturity, are generally insured by the FDIC or another government agency, and may impose a penalty for early withdrawal.

BRAD MCMILLAN MARKET COMMENTARY

Is Inflation on Its Way Back Up?

July's inflation data came in pretty much in line with expectations. Headline inflation was up 0.2 percent for the month and 3.2 percent for the year. Core inflation (excluding energy and food) was up 0.2 percent for the month and 4.7 percent for the year. So far, so good. At 0.2 percent per month, that would mean an annual inflation rate of between 2 percent and 3 percent. Pretty good, yes?

Too Early to Panic

You will see arguments today that no, it's not good at all. The reason given will be that we saw headline inflation tick up from 3 percent to 3.2 percent on a year-to-year basis; therefore, inflation is on its way back up. Don't believe it. First, the increase is due to base effects, in that inflation 12 months ago was lower. Pure math, not a spike. Second, the more important number, core inflation, continues to tick down. When you look at the solid monthly results and the continued improvement in the core numbers, it is way too early to panic. But that doesn't mean inflation can't keep rising. So perhaps we should worry about that? Here, too, the news is better than it looks.

Shelter Inflation Matters

The current numbers are significantly influenced by high rates of shelter inflation. This is a lagging indicator, which doesn't yet reflect declines in rental rates. Once we take shelter out, which was all of services inflation, the core number was actually -0.1 percent last month, and the annual rate was 2.5 percent. And when you look at the path of shelter inflation over the next several months, that should turn from a big positive factor to potentially even a negative one. This makes it reasonable to look at inflation excluding shelter as an indicator of where we are headed.

Positive Data Points

There are other encouraging data points as well. Core goods prices were down 0.3 percent last month. Used vehicle prices are expected to drop 6 percent to 7 percent over the next several months. Airline fares are down significantly for the second month in a row. In other words, while inflation is still too high—and the headline number ticked up on a yearly basis—the underlying trends remain very favorable and even potentially on track to get to the Fed's target rates in the next year or so.

The Risks

The big risk in the short term is energy prices, which are moving up. But current pricing would still leave considerable room for lower inflation overall. Wage growth is another potential risk. But, again, at present levels, it is not a problem. There are other concerns as well, but again even in aggregate, they are modest compared to the positive trends.

Trends Remain Favorable

So, is inflation headed up on a sustained basis? Not likely, based on the data as of today. We did see a tick-up on the headline number, and you may well hear a lot about that. But the trends remain very favorable, and it is nothing to worry about.

Remain calm and carry on.

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

BUFFALO FINANCIAL UPDATE

Let us know if you are interested in our 1st Annual Buffalo Financial Charity Golf Classic! 100% of proceeds benefit Oishei Children's Hospital!

THE 1ST ANNUAL BUFFALO FINANCIAL CHARITY FALL CLASSIC

September 23rd
Saturday | 1:30 Shotgun Start

Chestnut Hill
1330 Broadway, Darien, NY

RSVP Today!
Email: tyler@buffalofinancial.com
or call Tyler @ 716-949-8382

$150 One Golfer or **$550** Foursome

INCLUDES:

- Steak Dinner & Lunch with Beverage
- Unlimited Range Access Prior to Tee Off
- Door Prizes
- Gift Bag @ Check-in
- 50/50 Raffle
- Chinese Auction
- Longest Drive
- Closest to the Pin
- 1 Hour Open Bar During Dinner
- Beverage Cart will be Around Throughout the Tournament

HOLE SPONSORSHIP AVAILABLE FOR ONLY $100!

BUFFALO FINANCIAL

**4990 TRANSIT ROAD
DEPEW, NEW YORK 14043**

PHONE: 716-771-1888
FAX: 716-771-1991

OPERATIONS:
TRISH@BUFFALOFINANCIAL.COM

EVENTS:
TYLER@BUFFALOFINANCIAL.COM

www.buffalofinancial.com

Securities and advisory services offered through Commonwealth Financial Network®, Member FINRA/SIPC, a Registered Investment Adviser.
Fixed insurance products and services are separate from and not offered through Commonwealth Financial Network®