The Bottom Line - Q4 2023

THE BOTTOM LINE

FOURTH QUARTER : 2023

BUFFALO FINANCIAL QUARTERLY NEWSLETTER

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OVER THE HORIZON

BY JEREMY I. BECK

This year has posed an unusual array of challenges for investors, and more could be in store. The major stock market indexes are still up in 2023, powered by a thin slice of technology stocks, but have been losing ground rapidly. Bond yields have risen sharply, topping 5% on some government debt. The economic outlook is uncertain, the U.S. government has been in turmoil, and wars and conflict are spreading across the globe.

William Priest, executive chairman and co-chief investment officer at Epoch Investment Partners in New York, who

OVER THE HORIZON - CONT'D

participated in Barron's "Big Money Poll", observes a remarkable state of chaos in the world today. The chaos is encompassing financial markets, politics, and more. Among the professional money managers surveyed by Barron's this fall, there is no prevailing sentiment. Of those polled, 38% express optimism about the future of equities in the coming year, while an equal 38% adopt a neutral stance, leaving the remaining 25% identifying as bearish.

It's rare so such a wide dispersion in opinions among the brightest minds on Wall Street.According to a recent article in Barron's, the Big Money respondents project a 15% gain by the end of 2024, while the bears expect a 4% decline. It's always a good idea to look at the projected earnings for the S&P 500, then divide by current price of the S&P 500 to determine the forward P/E ratio of the market. If the forward P/E ratio is well above it's historical average, the stock market may very well be overvalued. If the forward P/E ratio is well below it's 20 year average, there may be a healthy rebound in prices. The chart below from JP Morgan shows the forward P/E to the historical average (Figure 1 below):

Figure 1: JP Morgan Asset Management

S&P 500 valuation measures

GTM | U.S. | 5

S&P 500 Index: Forward P/E ratio

Valuation measure	Description	Latest	25-year avg.*	Std. dev. Over-/under-Valued
P/E	Forward P/E	17.83x	16.76x	0.32
CAPE	Shiller's P/E	29.53x	27.73x	0.29
Div. Yield	Dividend yield	1.69%	1.98%	0.85
P/B	Price to book	3.61x	3.10x	0.63
P/CF	Price to cash flow	13.54x	11.27x	1.03
EY Spread	EY minus Baa yield	-0.78%	0.33%	0.58

Source: FactSet, FRB, Refinitiv Datastream, Robert Shiller, Standard & Poor's, Thomson Reuters, J.P. Morgan Asset Management.
Price-to-earnings is price divided by consensus analyst estimates of earnings per share for the next 12 months as provided by IBES since October 1998 and by FactSet since January 2022. Current next 12-months consensus earnings estimates are $241. Average P/E and standard deviations are calculated using 25 years of history. Shiller's P/E uses trailing 10-years of inflation-adjusted earnings as reported by companies. Dividend yield is calculated as the next 12-months consensus dividend divided by most recent price. Price-to-book ratio is the price divided by book value per share. Price-to-cash flow is price divided by NTM cash flow. EY minus Baa yield is the forward earnings yield (consensus analyst estimates of EPS over the next 12 months divided by price) minus the Moody's Baa seasoned corporate bond yield. Std. dev. over-/under-valued is calculated using the average and standard deviation over 25 years for each measure. *P/CF is a 20-year average due to cash flow availability.
Guide to the Markets – U.S. Data are as of September 30, 2023.

J.P.Morgan
ASSET MANAGEMENT

The Price-to-Earnings ratio (P/E) serves as a straightforward tool for assessing whether a security is overvalued or undervalued. For instance, if a stock is priced at $100.00 with yearly earnings of $5.00, the P/E ratio stands at 20. If historical data indicates that the stock typically trades at a P/E of 11, it suggests that the current P/E may be excessively high. Conversely, a P/E ratio well below the historical average may signal that a security is undervalued. As of October 28, 2023, the forward P/E ratio for the S&P 500 is 17.89, while its 25-year average stands at 16.76. Applying this straightforward measure, it becomes apparent that the stock market is slightly overvalued.

OVER THE HORIZON - CONT'D

Nonetheless, the S&P 500 comprises a diverse range of companies, spanning from high-growth giants like Amazon and Google to more conservative, high-dividend-paying entities like JP Morgan and Procter & Gamble. In the same way we examined the broader stock market, we can assess the potential outperformance of Large Cap Growth stocks compared to their Large Cap Value counterparts by scrutinizing their respective forward P/E ratios (as illustrated in Figure II below):

With Large Cap Growth (upper right corner of chart above) having a P/E ratio of 29.8% over their 20-year average, 2024 may very well be an uphill climb for large cap stocks. According to the Barron's Roundtable, 2/3 of the Big Money respondents say value investing will outperform growth stocks in the next twelve months.

Slightly under half of the poll respondents believe that the current levels of the U.S. stock market indicate overvaluation. This prompts the question: What presents the most substantial risk to the stock market in the upcoming year? Analysts are divided, with some expressing concerns about a potential recession while others are closely monitoring the possibility of rising interest rates.

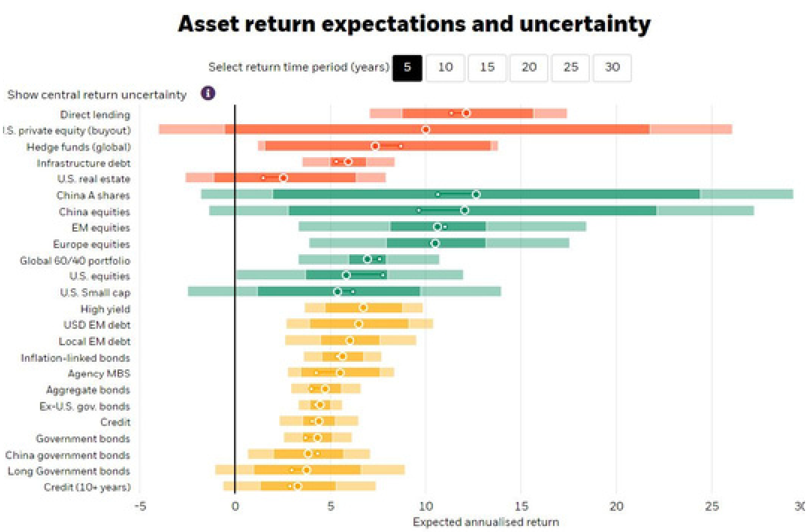
The coming year is fraught with uncertainties, including geopolitical tensions in the Middle East and Ukraine (did I mention we have a Presidential Election?). While markets often navigate challenges with resilience, we anticipate modest gains for the S&P 500 in 2024, given the mild overvaluation and additional risks. According to BlackRock Institutional Capital Market Assumptions, the S&P 500's average return is projected to be roughly 6.00% annually over the next five years, in contrast to its long-term historical average of 9.1%.

Figure 2: Asset Class P/E Ratios

Current P/E as % of 20-year avg. P/E

	Value	Blend	Growth
Large	100.0%	114.6%	129.8%
Mid	91.8%	93.1%	115.8%
Small	84.0%	89.8%	93.8%

Figure 3: BlackRock Expected Returns



When examining Figure 3 provided by BlackRock, you'll observe U.S. equities positioned near the center of the chart. The anticipated central return hovers around 6.00%, encompassing a range of uncertainty spanning from a lower band of 4.00% to an upper band of 8.00%. Given the prevailing average one-year FDIC Insured CD rate of approximately 5.5%, it's natural to question the risk-to-reward balance between stocks and bonds. This concern is valid. As previously mentioned, our outlook for equities in 2024 leans heavily towards dividend-paying, high-quality value stocks over growth stocks. Furthermore, we recommend an above-average allocation to fixed income instruments with appealing yields to capitalize on the existing interest rate landscape.

As always, we extend our warmest wishes for a safe and unforgettable holiday season for you and your loved ones. - Jeremy I. Beck

SLOW ECONOMIC GROWTH? NO PROBLEM

BY MATTHEW PITROLA

During the third quarter, the Federal Reserve's message of keeping interest rates "higher for longer" resonated with investors. Particularly impacting maturities along the intermediate to longer end of the yield curve. The 10-year U.S. Treasury yield increased from 3.86% on June 30th to 4.57% by September 29th.

The main factors behind the rise in longer duration interest rates can be broken down into 3 themes:

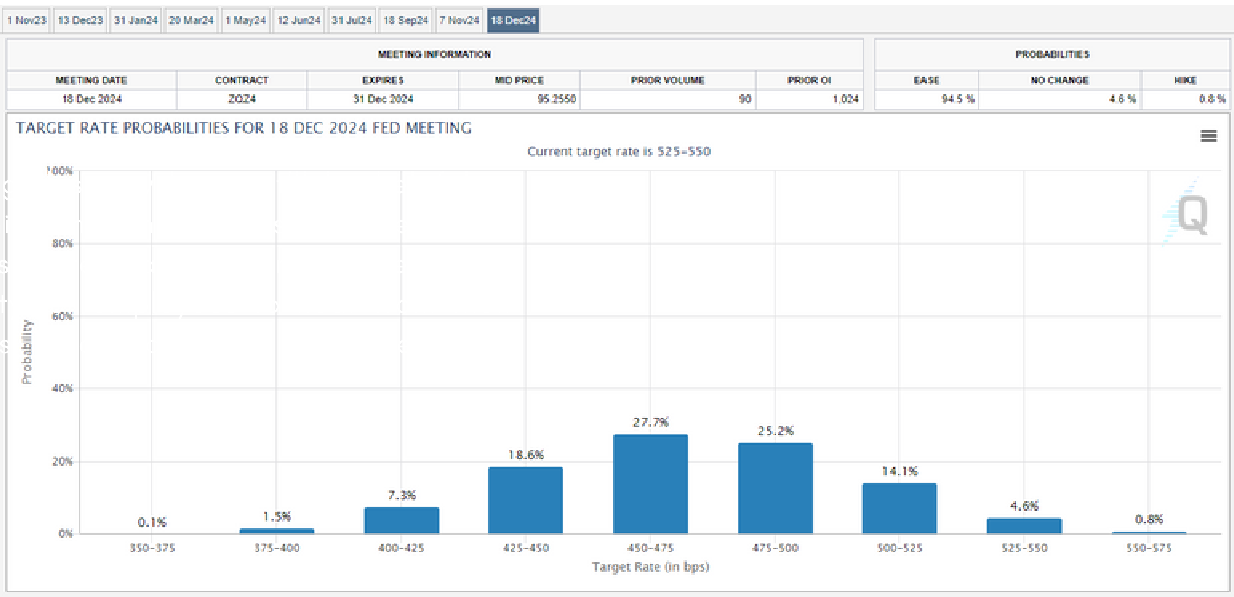
- **Economic Strength:** Better than expected growth figures have reignited the debate that the long run neutral policy rate set by the Federal Reserve should be higher.
- **Over Supply of Treasuries:** Treasury debt issuance to fund deficit spending has been much higher than expected, while at the same time international demand for U.S. debt is down.
- **Rising Term Premium:** With the recent U.S. debt downgrade and growing deficit spending, there is increased concern over fiscal stability in the U.S. Causing investors to demand a higher yield on their bonds.

This seems to be an appropriate adjustment in the bond markets, given the uncertainty surrounding economic data for the next few quarters. Although economic growth has shown resilience and inflation pressures have been subsiding, it is still too soon for the Federal Reserve to consider altering their interest rate policies.

The primary concern with an early shift in Federal Reserve policy is the risk of a sudden inflation surge, which could prompt the Fed to resume its prolonged cycle of interest rate hikes, potentially leading to a recession.

Our perspective is that interest rates will likely remain unchanged through year end 23, and unchanged throughout the first half of 2024. This would serve as a precursor to potential future interest rate cuts in the in the second half of the year.

As of now, the market is currently pricing in 2-3 interest rate cuts by year end 2024.



SLOW ECONOMIC GROWTH? NO PROBLEM - CONT'D

2024 EXPECTATIONS FOR FIXED INCOME:

Whether 2024 delivers a soft landing for the U.S. economy or whether we have a recession materialize. Fixed income is positioned to benefit in either scenario.

Historically, yields tend to fall after the last Federal Reserve rate hike, generating significant price appreciation for those that were buyers when rates were near their top.

If a soft landing does materialize over the course of 2024, meaning the labor market stays robust, economic growth meets expectations and inflation continues its path down to 2.00%. You can expect the Federal Reserve to begin to unwind current policy and indicate lower rates in the future.

If the U.S. economy does enter recession in 2024, meaning that unemployment rises, economic growth does slow, and inflation comes down because of lack of economic activity. You can also expect the Federal Reserve to begin to unwind current policy and indicate lower interest rates in the future.

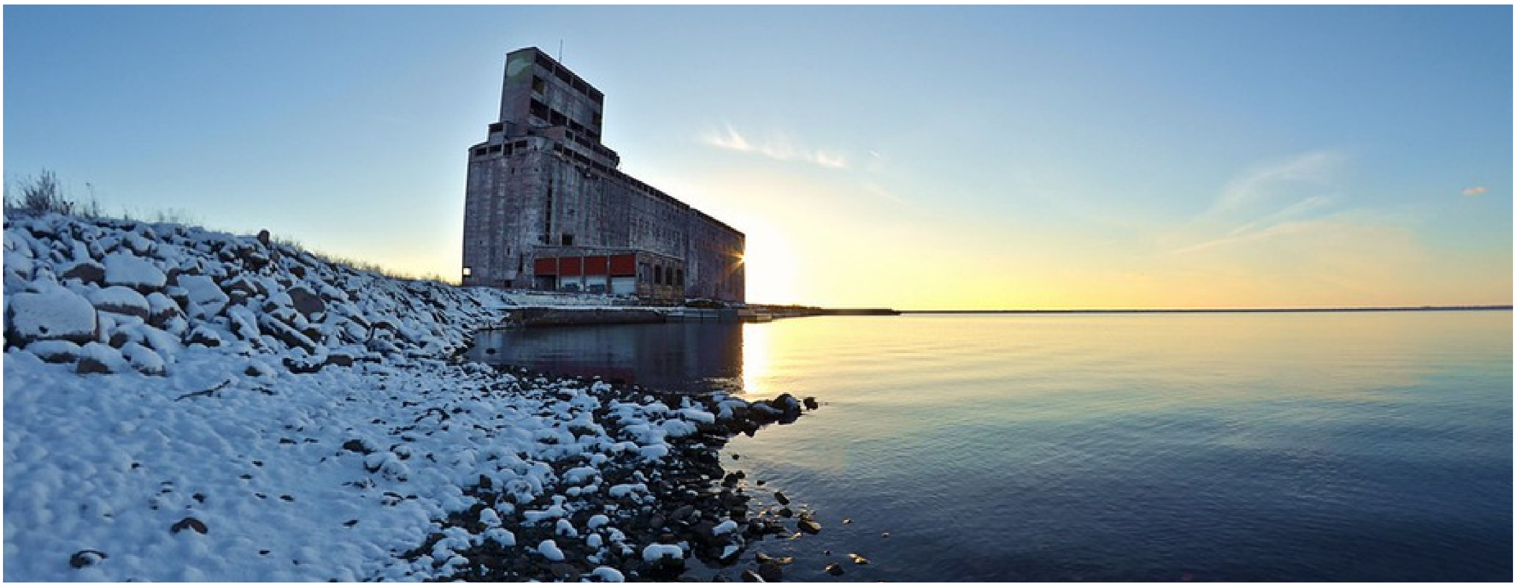
The major risk that we see currently for fixed income investors would be an unwelcomed surge in inflation data, this would inevitably force the Federal Reserve to re-implement tightening measures and raise rates further which would hurt fixed income investors to a small extent.

FIXED INCOME RISK REWARD ANALYSIS:

After several years of interest rate hikes, most investors are familiar with the inverse relationship between bond prices and interest rates. I wanted to closely examine the current risk / reward for bond investors after the massive reset that we have had in the bond market over the last 24 months. I will be using (AGG) The iShares U.S. Aggregate Bond ETF for this illustration.

Step number one is to find a bond funds “effective duration.” Which is a measure of a bond funds sensitivity to interest rates.

For this example, AGG has an effective duration of roughly 5.90 years. This means that for every 1.00% increase or decrease in the yield on the 10 Year U.S. Treasury yield. You can expect the price of AGG to fluctuate by 5.90% in either direction. Let’s examine a few different scenarios for 2024 below:



SLOW ECONOMIC GROWTH? NO PROBLEM-CONT'D

RISK / REWARD - EXAMPLE EXAMINING (AGG) CONTINUED:

Scenario 1: The 10 - Year Treasury yield rises to 5.90%. (Bad back drop for bonds):

Let's assume that in 2024 inflation surges and this forces the Federal Reserve to push rates higher. This causes the 10-year yield to rise by 1.00%, taking rates on the 10 Year from 4.90% today to 5.90% in October 2024.

This would cause AGGs price to decline by 5.90%. This price decline does not factor in the yield that an investor would receive over the course of that year for holding the security. The current yield on AGG is 4.82% (APY). Even after a dramatic increase in yields throughout the course of 2024 your position would be down just over 1.00% after yield.

With bond rates being high, investors can manage risk much easier than they could at the interest rate lows of 2020.

Scenario 2: The 10 - Year Treasury yield remains unchanged. (Moderate back drop for bonds):

For the second scenario, lets assume that the economy stays resilient, but inflation does not meet the Federal Reserves 2.00% target and rates stay unchanged over the course of the year. Causing the 10 - year Treasury yield to stay relatively flat at 4.90%.

This would cause AGG to have minimal price movement throughout the year and you would collect 4.90% in interest over the course of 2024.

Scenario 3: The 10 - Year Treasury yield falls to 3.90%. (Good back drop for bonds):

For the final scenario, let's assume that a recession does materialize in the U.S. in 2024. Growth in the U.S. inevitably slows, and this causes inflation to hit the Federal Reserves target level of 2.00%. Causing the Fed to cut rates to spur economic growth and the 10 Year Treasury yield falls by 1.00% from 4.90% to 3.90%.

This would cause AGGs price to rise by 5.90%. This combined with the 4.82% in yield an investor would receive over the course of the year would result in an over 10.00% annual return.

With that being said, the backdrop for bonds is great.

Yields are attractive and the risk / reward opportunity in fixed income has not be this great for over 15 years,

If you are concerned about the economy or the state of the world with the flare up in geopolitical tensions, there are options available for protection and income seeking investors alike.

I hope you all have a great Holiday season!

END OF YEAR CHECKLIST FOR BUISNESS RETIREMENT PLANS

BY JACOB WOOD

Year-End Contributions

In December, it's crucial to verify that all employee contributions, including regular salary deferrals and any catch-up contributions, are up to date. This ensures that employees' retirement savings are on track. Additionally, for employers offering matching or profit-sharing contributions, it's important to make any required contributions by the end of the year. This helps fulfill your commitments to employees' retirement benefits. Timely contributions are essential not only for employees' financial well-being but also for maintaining the plan's tax-advantaged status and compliance with IRS regulations. Ensure that contributions made by employees are accurately reflected in their accounts and that the plan is in compliance with contribution limits set by the IRS. Keeping a close eye on these items helps prevent potential compliance issues and also supports the financial wellbeing of your workforce.

Compliance Review

As the year draws to a close, it is always a good idea to review your plan documents. Ensure they align with current IRS and DOL regulations and that they accurately reflect the plan's current operations. Compliance with regulatory changes is crucial for the plan's continued tax-advantaged status in order to avoid potential penalties or legal complications. If any revisions are needed in your plan documents to comply with new regulations or changes in your plan's operation, it's best to address these before year-end. This review can serve as a proactive step to maintain the plan's integrity and protect both employees' retirement assets and your business's financial interests. Seeking guidance from legal or financial professionals is advisable to ensure compliance and avoid common pitfalls.

Fees and Expenses

Third most, it's a good practice to review your plan's fees and expenses to ensure they remain reasonable and in line with ERISA guidelines. High fees can erode employees' retirement savings over time, so keeping these costs in check is vital. Comparing fees with industry standards and considering cost-effective investment options can help protect employees' assets. Regular fee assessments, and shopping your plan with companies like Buffalo Financial support the plan's long-term success and the financial well-being of your employees without foregoing any quality of service.

END OF YEAR CHECKLIST FOR BUISNESS RETIREMENT PLANS - CONT'D

Annual Notifications

Don't forget to provide employees with essential annual notices, such as the Summary Annual Report and the Safe Harbor Notice, if applicable to your plan. These notifications help keep employees informed about the plan's performance, fees, and any potential changes that may affect their retirement savings. Providing these notices in a timely and transparent manner supports trust and engagement among your employees. Accurate and timely notifications also fulfill legal requirements and contribute to the plan's overall compliance. Ensuring that employees receive these documents is a simple but important step in managing your 401(k) plan effectively.

Compliance Calander

As a business owner, consider creating a compliance calendar for your 401(k) plan to track important dates and activities throughout the year. This simple but effective tool can help you stay organized, ensuring that you meet all regulatory deadlines and obligations. A compliance calendar might include deadlines for annual testing, IRS Form 5500 filing, employee communications, and plan reviews. By following this calendar, you can plan proactively, stay in compliance, and maintain a well-managed 401(k) plan for your employees.

Vesting

Accurate vesting schedules are essential for your retirement plan. They determine when employees gain full ownership of employer contributions, safeguarding their savings. Ensuring clear communication about vesting can boost employee satisfaction and retention, promoting trust and compliance. Review and communicate any vesting changes or updates to participants at year-end for a well-managed plan

Have a Wonderful holiday season and Go Bills!! -Jacob Wood

BRAD MCMILLAN MARKET COMMENTARY

Curbed Appeal for Would-Be Homebuyers

Being a "forever renter" is an idea many millennials (myself included) have been grappling with in recent years. Buying a home, once considered a milestone on the adulting journey, feels more out of reach than ever for some of us. I know I'm not alone in this feeling, as there are plenty of would-be homebuyers to share in my woes.

So, let's take a look at some of the barriers to homeownership now and whether there is reason to believe circumstances may change in the future or if some of us will be tenants for eternity.

Barriers to Buying

High prices: Perhaps the most obvious hurdle to buying a house is the cost. Nationally, median home prices have gone up nearly 250 percent in my lifetime (I'm in my early 30s) and more than 25 percent since the start of 2020. This upswing is even more pronounced in the Greater Boston area that I call home, where the median single-family home price for July was $910,000!

Granted, the statewide median price is closer to $640,000. While that number may be more within reach for some, location is a major contributor to quality of life. As such, many may opt to rent in a prime spot rather than buy in an area that is not as close to work, family, and friends.

Interest rates: With rates remaining elevated as the Fed continues its efforts to combat inflation, mortgage rates are also on the high end. The average rate on a 30-year fixed mortgage is 8 percent (according to Bankrate). That may not seem out of the norm to anyone who purchased a house prior to 2000. But it is well above the average of the decades since then, with mortgage sizes also dramatically larger.

Using the $910,000 median price for the Boston Metro area and applying a 7.5 percent rate on a 30-year fixed mortgage, the monthly payments would be around $5,100 after a 20 percent downpayment and before taxes and insurance. Compare that to one year earlier when the median price was around $840,000 and national mortgage rates were around 6 percent.

At that time, the monthly payment would have been closer to $4,000. Not only are the absolute levels something to balk at, but the pace at which they've increased has many would-be homebuyers feeling left in the dust.

CURBED APPEAL FOR WOULD-BE HOMEBUYERS

Relative value: Aside from the standalone price tag that comes with buying a home, another consideration is the relative value of renting versus owning. Looking outside of the Greater Boston area, renting seems to be a pretty good value proposition around most of the country. According to Redfin, there are only four major metro areas in the U.S. where it is cheaper to buy than rent. Outside of Detroit, Philadelphia, Cleveland, and Houston, the average home costs roughly 25 percent more per month to own versus rent.

The value of accumulating equity in a home is a key detail that isn't captured in that comparison. Nonetheless, many potential buyers are still waiting for that ownership premium to shrink significantly before pulling the trigger on a home purchase.

For now, a 25 percent rental "discount," along with avoiding the headaches that come with homeownership, seems well worth it.

Reasons for Optimism?

Of course, the housing market is regional. States like Massachusetts and California are notoriously expensive to live in. Still, the story is relatively similar across the country if you're comparing each region to itself at an earlier point in time. No matter how you slice it, homeownership is less attainable now than it has been in decades, and that won't change until the underlying market conditions begin to shift. While the clouds hang heavy over the heads of many would-be buyers for now, there is reason for hope!

Eventually, interest rates will begin to normalize, and the lower rates will make mortgages more accessible. In turn, we'd expect to see more owners putting their homes on the market, and that increased inventory should encourage moderation in overall prices.

In the meantime, existing homeowners can continue to enjoy historically high levels of equity amid the stubbornly elevated home prices. As for me, I'll be living the renter's life but keeping a watchful eye on evolving conditions.

BUFFALO FINANCIAL: FEEDMORE WNY FOOD DRIVE!

We are extremely thankful to all of our friends, clients and local businesses that helped us collect over 128 pounds of food for the local FeedMore WNY Food Drive.

Financial advisor Jake Wood was the lead in the food drive, travelling around Buffalo to collect all of your generous donations. A special thank you to Diane Kenjockety for donating over 30 pounds of dry goods for our neighbors in need.

It has been estimated that over 27 dinners will be provided with all of your generous donations!

UPCOMING SEMINARS AND EVENTS

INVESTMENT SEMINAR & COCKTAIL PARTY AT SALVATORE'S ITALIAN GARDENS!

THURSDAY NOVEMBER 16TH. ARRIVE BY 6:00PM, FIRST PRESENTATION BEGINS AT 6:15 PM.

SALVATORE'S ITALIAN GARDENS - 6461 TRANSIT ROAD, DEPEW NEW YORK.

SPECIAL PRESENTATION FROM BLACKROCK TITLED "MEGATRENDS" BY ANNA VERHAEGEN FOLLOWED BY "2024 EQUITY & FIXED INCOME OUTLOOK" BY JEREMY BECK OF BUFFALO FINANCIAL.

COCKTAILS AND HORS D'OEUVRES WILL BE SERVED!

Seating is limited!
Email haley@buffalofinancial.com or call 716-771-1888 to RSVP today!