Aptus Quarterly Market Update – Q3 2023

Equity Markets Review

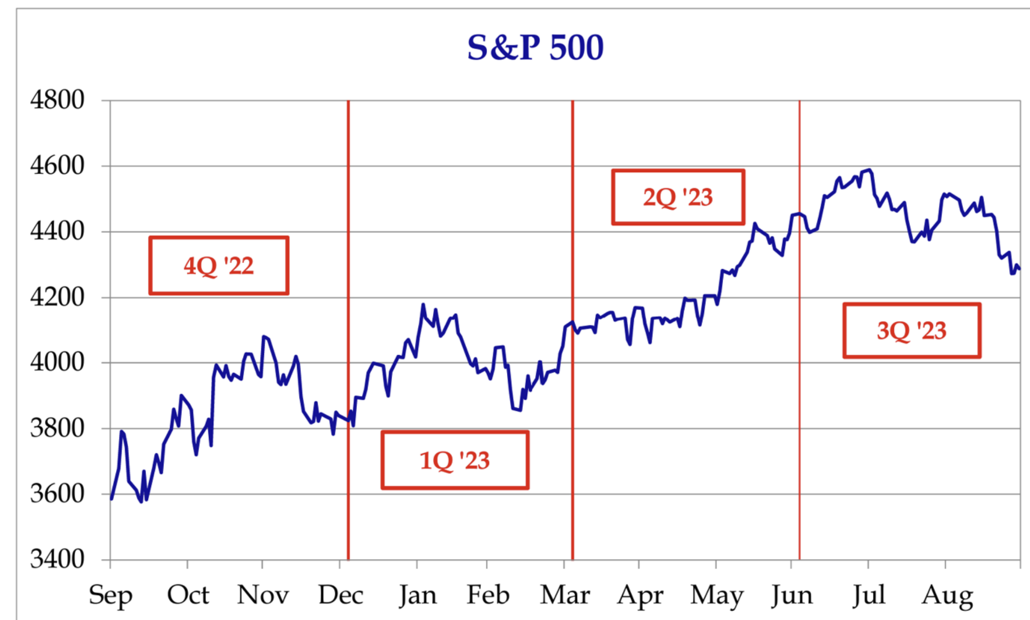
A Market in Review – Q3 2023

Globally, YTD Equity Performance Has Been Dramatically US-Biased, But Mostly In First 5 Months: Performance in the first 5 months of the year were heavily US-biased as the equity market seemed to price in most of the China recovery weakness and perceived AI benefit to US equities. Performance this summer was more mixed, as the US continued to lead performance (with broader cyclical sectors outperforming), while most other country indices treaded water as global investors seemed to ebb and flow between weak China data, and likely China stimulus all summer. Moving forward, given their YTD underperformance, the interest rate sensitive areas may in fact be the pain trade.

All Eyes on Rates: The 10-year fell to its year-to-date low on April 6th at 3.28%. At quarter end, its value rested at roughly 4.63%. In less than six months, the yield on the 10-year Treasury note has risen by over roughly 135 basis points.

EPS Estimates May Help Explain Equity Market Strength In '23: Though off the highs forecasted roughly a year ago, '23 EPS estimates have increased slightly, encouraging equity markets to trade higher. However, it seems that few institutional investors are buying into this reversing trend, choosing instead to camp out in the largest, most liquid names that have worked year-to-date. This is proving to further exacerbate the lack of market breadth. The Magnificent 7 have contributed to 97% of the S&P 500's YTD return.

Market Sentiment was All About "Immaculate Disinflation": This quarter's narratives included falling inflation and stable growth (termed "Immaculate Disinflation"), as well as a resilient consumer (strong labor market and spending).



Source: Strategas, Data as of 9/30/2023

	1M	QTD	YTD	1-YR	3-YR	5-YR	10-YR
S&P 500	-4.77%	-3.27%	13.06%	21.59%	10.13%	9.90%	11.90%
NASDAQ	-5.77%	-3.94%	27.11%	26.13%	6.64%	11.46%	14.59%
Dow Jones Industrial	-3.42%	-2.10%	2.73%	19.18%	8.62%	7.14%	10.79%
MSCI EAFE	-3.38%	-4.04%	7.63%	26.37%	6.37%	3.84%	4.42%
MSCI EM	-2.61%	-2.85%	2.07%	12.06%	-1.40%	0.89%	2.44%
U.S. Barclays Agg.	-2.54%	-3.23%	-1.21%	0.64%	-5.21%	0.10%	1.13%
Investment Grade Bonds	-3.40%	-4.30%	-0.44%	3.70%	-5.90%	0.89%	2.38%
High Yield Bonds	-1.22%	0.37%	5.30%	9.84%	1.30%	2.45%	3.62%

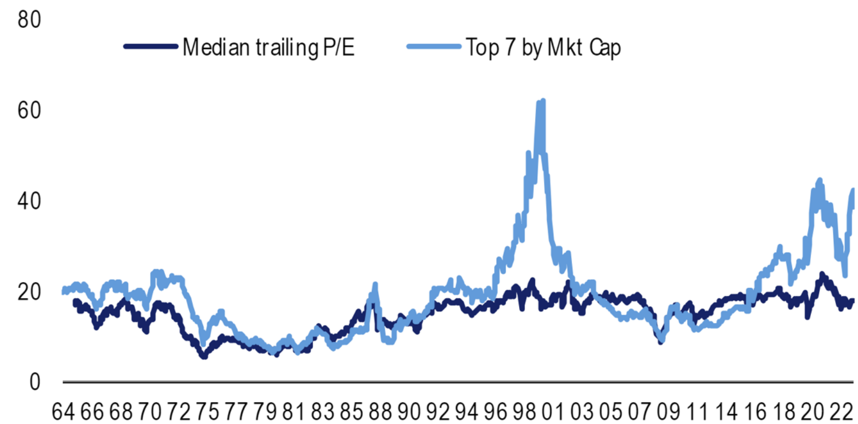
Source: Bloomberg. Data as of 9/30/2023. Returns include Dividends. Returns over 1YR are Annualized.

Composition of Returns

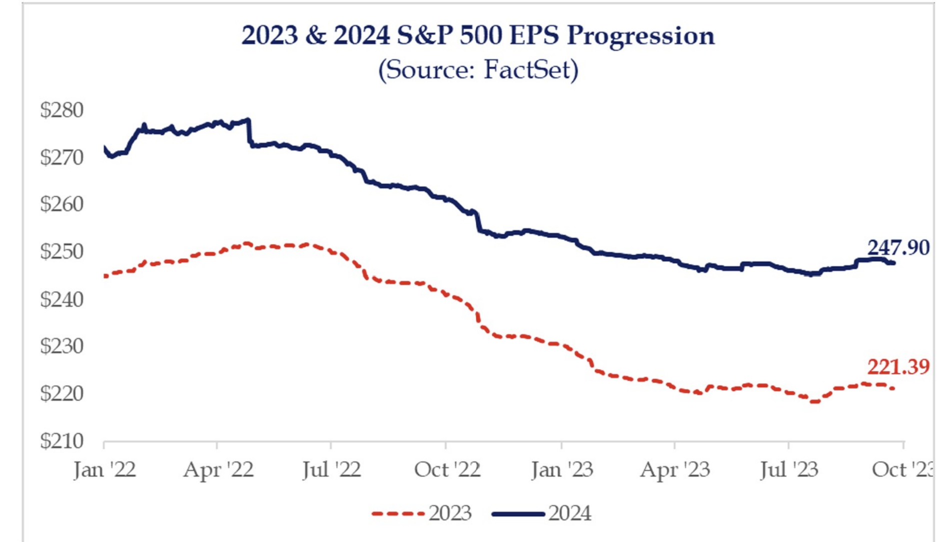
The Known: Dividend Yield **+ The Unknown:** Growth Rate **+/- Market Sentiment:** Valuation Change **= TOTAL RETURN**

Exhibit 5: The index is expensive, but the average stock is not

S&P 500 median trailing P/E vs. top 7 P/E (1986-8/23)



Source: BofA, Data as of 9/30/2023



Source: Strategas, Data as of 9/30/2023

Underneath the Market's Hood

What Worked and What Did Not Work in the Market?

The Dangers of Price Chasing – The Equity Volatility Tax is Extreme

- Performance YTD has been almost a mirror image for tilts/exposures versus last year. Unless investors swapped their allocation to the inverse exposure at the beginning of the year, they would be behind YTD, but still ahead since YE '21.
- The so-called "Magnificent Seven," which have driven the market, have a story that is impossible with which to argue – a new technology that promises to transform business controlled by companies that, by and large, hold tons of cash and are in no way capital constrained. It is likely to take years to fully determine whether AI is revolutionary or evolutionary, but in the absence of significantly higher long-term interest rates it may not make much of a difference to the likes of Microsoft, Apple, Google, Amazon, and Facebook. They have the time and the capital to get the benefit of the doubt.

Volatility Tax Underneath the Hood in '23

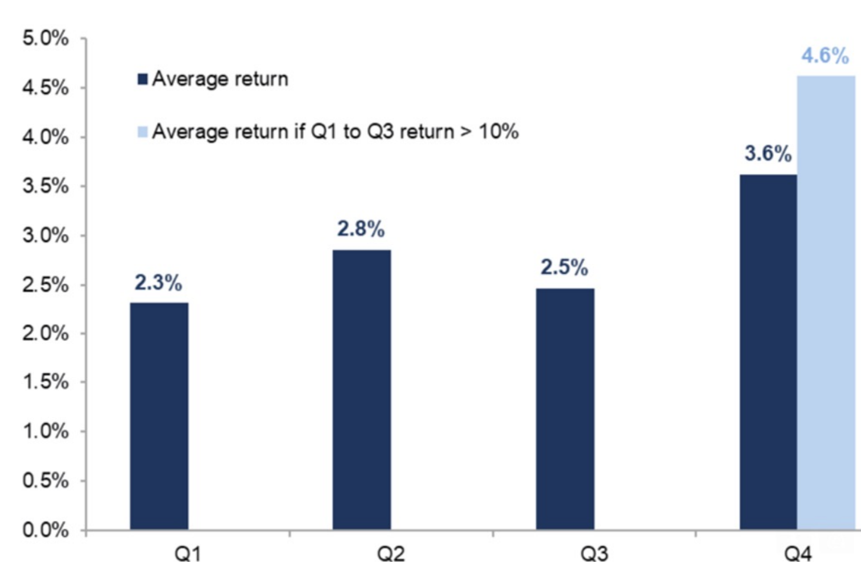
	2022	2023*	*Sorted* 21-Month**
Large Value	-5.25%	7.54%	1.89%
Dow Jones Industrials	-7.02%	2.73%	-4.48%
MSCI EAFE	-13.86%	7.63%	-7.29%
S&P 500	-18.34%	13.06%	-7.68%
S&P 500 Equal Weighted	-11.62%	1.69%	-10.13%
NASDAQ	-32.93%	27.11%	-14.75%
Large Growth	-29.41%	18.10%	-16.63%
MSCI EM	-19.20%	2.07%	-17.53%

Source: Bloomberg, Aptus, Data as of 9/30/2023

*Sorted by 21-Month Return. *YTD Performance Through 9/30/23, ** Cumulative Return*

...Enter Stage Left – Positive Market Seasonality

- Since 1900, 123 years of data (1900-2022), the average Q4 return for the S&P 500 is +3.6% (exceeding +2.3% in Q1, 2.8% in Q2, and 2.5% in Q3).
- Since 1900, the average Q4 return for the S&P 500 when Q1 – Q3 exceeds > +10% going into Q4, is +4.6%. Currently, the S&P 500 is +12.1% Year-to-date.
- Since 1985, the median return for the NASDAQ for the month of October is +2.73%.



Source: Goldman Sachs, Data as of 9/30/2023

Where is the Market Focusing?

It has been a "Pick Your Own Narrative" type of market. And right now, the market is in a state of macro discord, as it appears that returns have solely been focusing on earnings expectations right now, bypassing some deterioration at the Macro Level.

Driver of Market: Micro (Company-Specific) > Macro (Economic Data)

- *Macroeconomics Show that a Lot of Things are "Decelerating" – Not all of Which are Bad*: Many macro trends continue to be in deceleration mode: inflation (CPI/PPI), ISM Manufacturing, loan demand to name a few. The only things that haven't been decelerating have been the 7 tech stocks. Macro is being held together by jobs, capex, and the consumer.

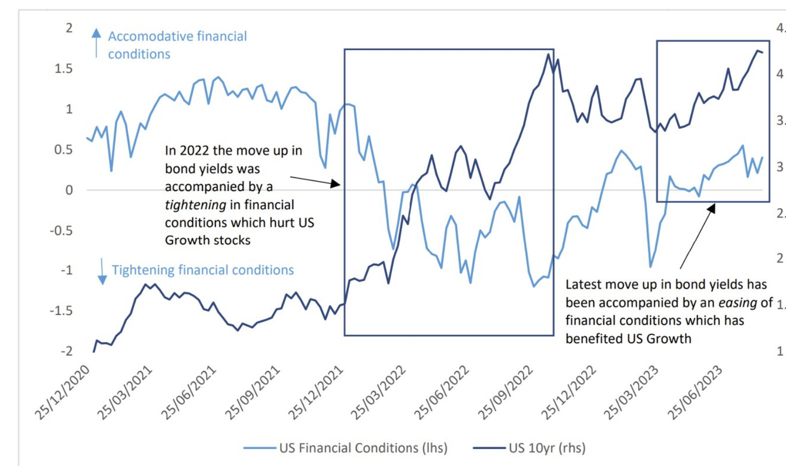
- *Earnings Showing Resiliency*: Very few factors have as high of a monthly correlation with equity returns than the change in the next twelve months ("NTM") consensus EPS. So, its not surprising that the market has been heading higher since February, as earnings expectations have been quite resilient.

Source: Raymond James, Data as of 9/30/2023

Why Haven't Rates Hurt Growth Stocks and Valuations?

- In less than six months, since its April 6th bottom, the yield on the 10-year Treasury note has risen by over roughly 115 basis points. Yet this has not derailed the US Growth trade as one may have expected given that rising yields crushed growth stocks in 2022. *Why?*
- *Why?* Because the drivers of the move higher in bond yields have been much different this year vs. last year.

1) Bond yields this year have likely risen due to the market's improved perception of economic growth potential. Bond yields rose last year because of inflation and expected rate hikes.
2) Financial Conditions have actually eased this year in spite of higher yields, whereas they tightened significantly last year. The US Growth factor has been more closely linked with financial conditions.



Source: Bernstein, Data as of 9/30/2023

Market Outlook – FY 2023

After a year where investors had to “*Curb Their Enthusiasm*”, the market continues to grapple with multiple problems; luckily, valuations and interest rates can create an environment where there is a light at the end of the tunnel.

We believe that ’23 will see a transition in where the market will focus its attention: *Inflation to Growth Frustration*

1. The Fed’s Success on Anchoring Inflation

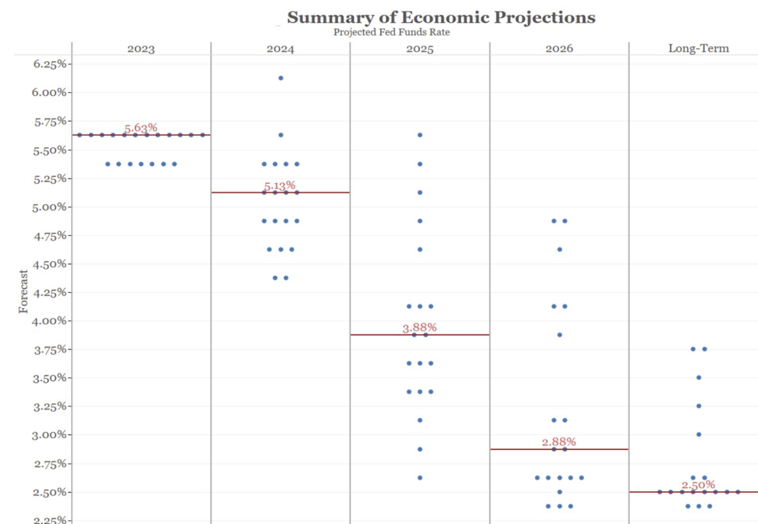
The market is likely coming closer to the final stages of the Fed’s tightening move. Over the last year and a half, there have been nearly 500bps of short rate tightening. Add to that, $95B/per month in Quantitative Tightening, the Fed can now choose patience in watching the long and variable lags associated with this very aggressive tightening.

We believe that a Fed policy pivot will have nothing to do with Wall Street, rather, it will come from successfully anchoring long-run inflation expectations.

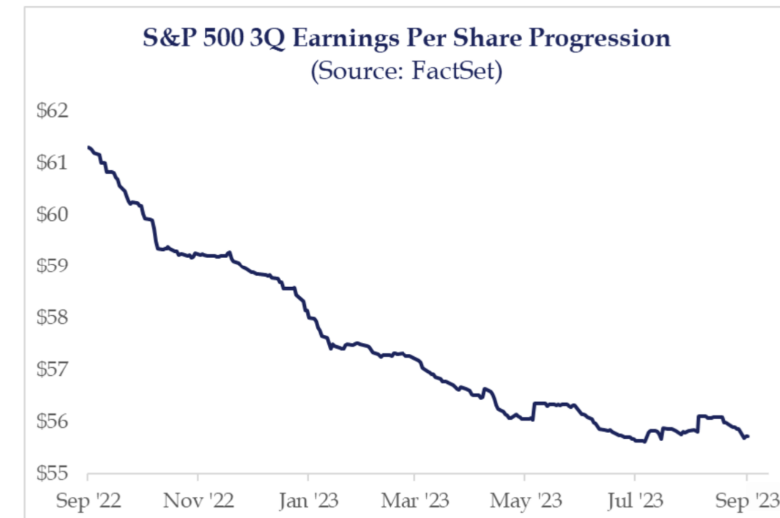
2. The Possibility of an Earnings Recession

As the market transitions and policy from the Fed becomes clearer, we believe that investors will ultimately shift their attention to slowing growth.

We know that a robust economy is fundamental to achieving healthy returns from financial markets – everything from monetary policy, to interest rates to company earnings are linked to this. Ultimately, we believe the market will start to discount the potential for a decline in earnings estimates, as inflation will turn into growth frustration.



Source: Bianco, Data as of 9/30/2023



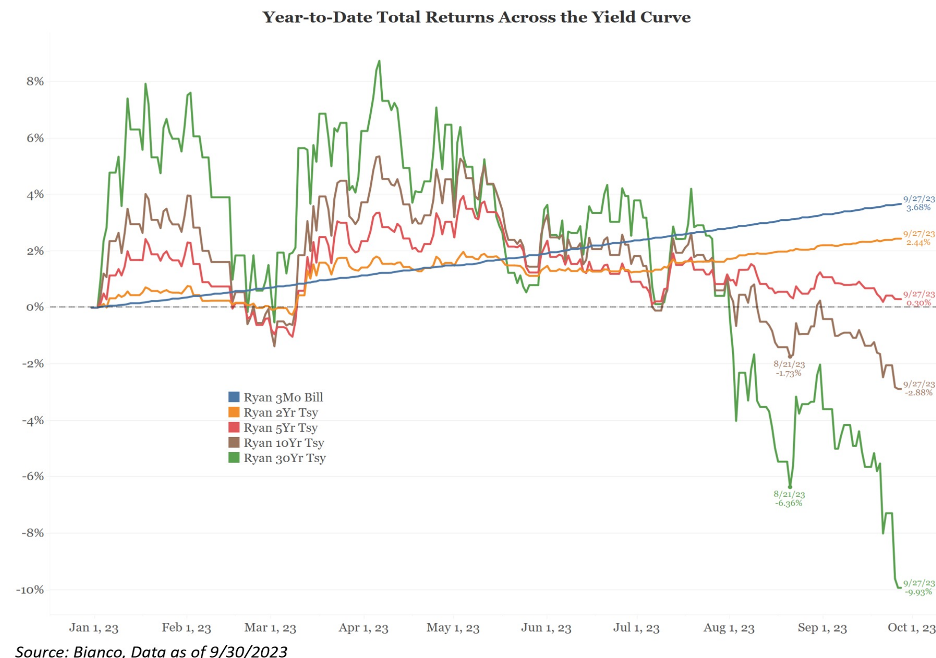
Source: Strategas, Data as of 9/30/2023

Fixed Income Markets Review

A Bond Market Review – Q3 ‘23

What Happened in Q3 ‘23? Bond returns for '23 took a turn for the worse this quarter with the Aggregate Index down -3.23% in Q3 and -1.21 % YTD. Long end yields were volatile with the 10YR Treasury yield rising 81bps in Q3 while the front end was more stable, the 2YR Treasury yield rose 22 bps. The blood bath within high quality, mid to long duration bonds continued for another quarter.

Long Duration Fixed Assets Continue to Face Headwinds in Inflationary Periods - Market participants continue to favor taking duration risk within portfolios. We remain cautious of duration risk and are uncertain as to whether or not the upside in the next economic downturn is worth the near-term risk and mark-to-market volatility. Unless the economy experiences a hard landing or faces unforeseen market calamity, the probability of the Fed cutting rates back to zero is low. In all likelihood, the era of ZIRP and quantitative easing (QE) is likely over.



Source: Bianco, Data as of 9/30/2023

	1M	QTD	YTD	1-YR	2-YR	3-YR	5-YR	10-YR
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U.S. High Yield Bonds	-1.22%	0.37%	5.30%	9.84%	-2.74%	1.30%	2.45%	3.62%
iShares 20+ Year Treasury Bond	-7.95%	-13.10%	-9.00%	-10.72%	-21.45%	-16.65%	-3.39%	0.58%
International Bond Index	-1.26%	-1.03%	2.59%	3.19%	-4.69%	-3.13%	0.66%	
U.S. Treasury TIPS	-0.18%	0.43%	1.92%	3.24%	0.11%	1.90%	2.80%	1.71%

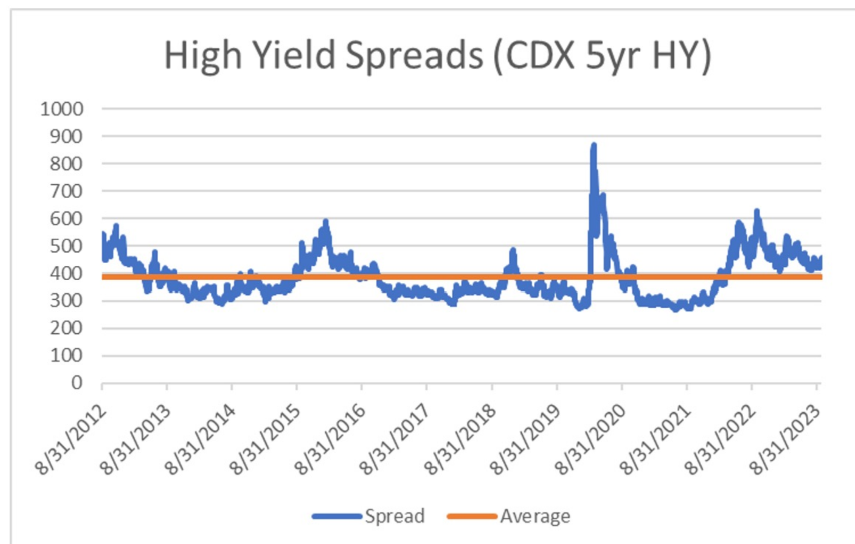
Source: Bloomberg. Data as of 9/30/2023. Returns include Dividends. Returns over 1YR are Annualized.

The Fundamental Bond Backdrop

All Quiet on the Credit Front

Spreads have continued to be a focus of ours as we currently believe that they are pricing in a lot of optimism. At the beginning of the year, spreads started to widen as the market was focusing on the instability of the banking sector. Yet, the past two quarters, alongside the equity markets, spreads once again started to tighten.

Credit spreads have been falling, yet macro headwinds are building. We believe that spreads are too tight, given the clouds on the horizon. Consumers are feeling the pinch, firms are less able to cover interest costs, and the yield curve is flashing red. At this stage in the cycle, we think that credit offers a poor risk-reward reliant on the Fed's generosity; a preemptive pivot in the face of sticky inflation.



Source: Aptus Capital, Bloomberg, Data as of 9/30/2023

What is the Yield Curve Telling Us? In a nutshell, an inverted yield curve hints at a recession when rate cut expectations outweigh the term premium. Historically, an inverted yield curve has typically presaged bad outcomes for the market, i.e., a recession. But, the re-steepening of the yield curve is usually the signal the recession is coming, and we don't appear to be there just yet. Of course, this could change quickly.

The Market is Witnessing a "Bear Steepener": While rates have moved up drastically the last couple weeks, the trend higher remains clear. Yields are through 4.50% and technically we could see them getting to the 5.10-20% range. The surprise of the quarter has been that the yield curve continues to (bear) steepen. Bear steepeners are unusual in the real world but keep us on high alert as they are typically late cycle phenomenona.

What is a Bear Steepener? A bear steepener is the widening of the yield curve caused by long-term interest rates increasing at a faster rate than short-term rates.

Source: TS Lombard, Data as of 9/30/2023

Bond Outlook – FY 2023

When Do Bonds Begin to Look Attractive? Until bonds can yield a higher rate than Inflation, the asset class will continue to lose money safely. We believe that the bond outlook will remain bleak, until yields increase, or inflation decreases to a level that is more sustainable.

Areas of Potential Opportunity – Finding Yield in New Spaces: For the first time in a long time, the treasury market is giving investors some sort of yield. In fact, we believe that there is going to be a competition for capital, as the percentage of stocks with yields greater than the 10YR Treasury is returning to it's pre-GFC levels. Less than 10% of the stocks in the S&P 500 have a yield > 10YR Treasury.

Any Area That Worries Us? Given the cracks that have started showing up in economic data and that the Fed's stated intent is to curb inflation by tightening financial conditions, we believe the credit sensitive side may be a difficult place to hide.

Understanding that credit spreads are wider than where we started the year, we believe that there could be more pain to come, as the slightly higher juice (coupon) being paid won't be worth the squeeze.

Average U.S. 10-Year Yield by Decade

Decade	Yield
1930s	2.97%
1940s	1.99%
1950s	2.94%
1960s	4.69%
1970s	7.51%
1980s	10.59%
1990s	6.64%
2000s	4.41%
2010s	2.36%
2020s	2.12%

Source: Strategas, Data as of 9/30/2023

Yield Curve Inversion

- Let's look at a seven-decade study of the yield curve and how it relates to the business cycle and equity market performance. First, the work shows that inversions (using the 10s/1s Treasury spread) have preceded recessions by 7 to 25 months with an average lag of 14 months.
- Results:

1) Half of the recessions over the last seven decades (meaning five out of 10) featured a lag of one year or longer. Since we are currently 13 months into inversion, it is woefully premature to presume the yield curve has given a false signal and the fabled soft landing is in the bag.
2) Second, post-inversion equity market rallies are not uncommon especially as growth slows and a "soft landing" appears to be unfolding. On average, equity markets tend to rally double-digits in the immediate aftermath of an inversion. Critically, however, in nearly seven decades, there has never been a post-inversion equity rally that was not completely reversed going into subsequent recessions/bear markets.

How Long Until the Recession?

When the 3-month to 10-year yield curve inverts for **10 consecutive trading days**

Date of Inversion	Consecutive Trading Days Inverted	Date of Next Recession	Calendar Days to Next Recession
1/10/1969	24	Dec-69	325
6/14/1973	177	Nov-73	140
12/8/1978	91	Jan-80	389
11/7/1980	102	Jul-81	236
6/6/1989	30	Jul-90	390
7/31/2000	135	Mar-01	213
8/1/2006	217	Dec-07	487
6/6/2019	41	Feb-20	268
11/22/2022	***299***	***????***	***????***
Average	**111**		**311**

1/10/1969 = Inverted for 24 calendar days, went positive for 33 days, then inverted again for 53 days

6/6/1989 = Inverted for 30 calendar days, went postive for 9 days, inverted again for 26 days

6/6/2019 = Inverted 41 consecutive trading days, went positive for 1 day, then inverted again for 67 days (through October 10)

Source: Ned Davis, Data as of 9/30/2023

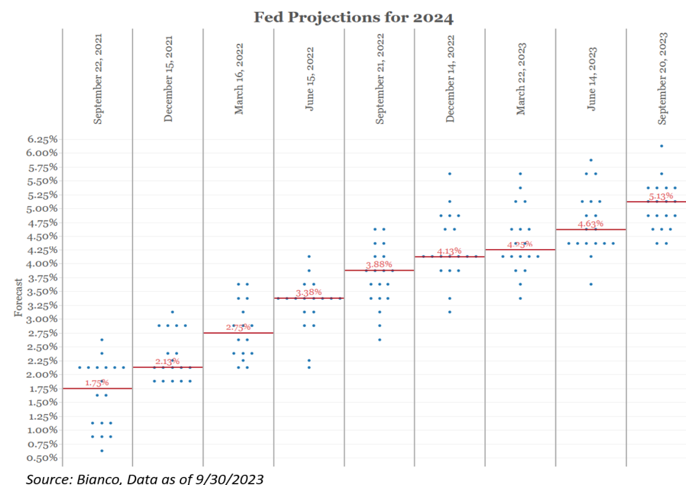
Important Topics of Discussion

The Fed’s Dual Mandate

The Fed’s Dual Mandate has Started to Duel Each Other. The Fed’s Dual Mandate is:
1) Price Stability, and 2) Maximizing Employment

Price Stability (Inflation)

- Inflation continues to be on everyone’s mind right now as prices in the U.S. are rising at a pace not seen in 40 years.
- This is where the Fed started to act in 2022. When the Fed raises interest rates, it becomes more expensive for people and businesses to borrow money, so they buy less stuff, demand goes down and that (eventually) brings prices down.
- The problem is that the Fed has had to increase interest rates at the third fastest rate ever; the initial “transitory” reading kept them continually behind that ball in terms of what extreme measures would have to be taken to keep inflation anchored.



Source: Bianco, Data as of 9/30/2023

Maximizing Employment

- The market has started to see some cracks in the labor environment, but it remains a “choose your own narrative” type of environment.
- There has never been a recession that did not witness a material increase in the unemployment rate. The longer a tight labor market is allowed to persist, the greater the chances it becomes a constant source of upward inflation. So, while the tight labor market was only a small contributor to the inflation of 2021/2022, it could become a source of constant upside pressure in the future.

RATE CUTS WITH UNEMPLOYMENT BELOW 4% ARE HISTORICALLY RARE

Dates Of Fed Funds Rate Cuts When Unemployment Is Below 5%

Date	Fed Funds Rate (%)	Size of Cut (bps)	Unemployment Rate (%, sorted)	Inflation Rate (%)	Date	Fed Funds Rate (%)	Size of Cut (bps)	Unemployment Rate (%, sorted)	Inflation Rate (%)
10/30/2019	1.75	-25	3.5	1.7	9/29/1998	5.25	-25	4.5	1.6
3/3/2020	1.25	-50	3.5	2.3	11/17/1998	4.75	-25	4.5	1.5
3/16/2020	0.25	-100	3.5	2.3	10/15/1998	5.00	-25	4.6	1.5
7/31/2019	2.25	-25	3.7	1.8	8/21/2001	3.50	-25	4.6	2.7
9/18/2019	2.00	-25	3.7	1.7	9/18/2007	4.75	-50	4.6	2.0
1/3/2001	6.00	-50	3.9	3.4	10/31/2007	4.50	-25	4.7	3.5
1/31/2001	5.50	-50	4.2	3.7	12/11/2007	4.25	-25	4.7	4.3
3/20/2001	5.00	-50	4.2	3.5	9/3/1973	9.00	-200	4.8	7.4
4/18/2001	4.50	-50	4.3	2.9	9/17/2001	3.00	-50	4.9	2.7
6/27/2001	3.75	-25	4.3	3.6	3/18/2008	2.25	-75	4.9	4.0
5/15/2001	4.00	-50	4.4	3.3					

Source: Strategas, Data as of 9/30/2023

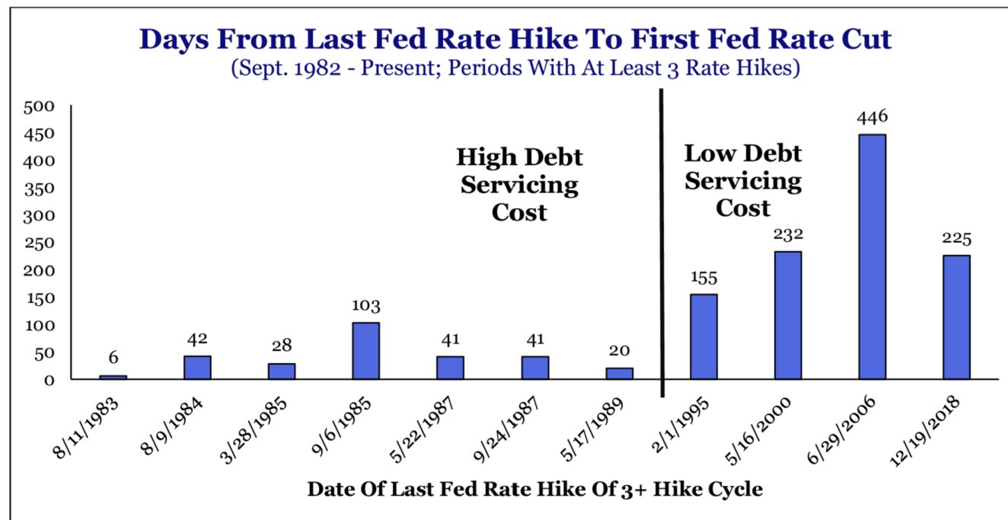
Historically, when Monetary Policy is restrictive, spending tends to drop. Thus, companies don’t sell as much stuff and make less money. They react by slowing hiring or laying off people. Bottom line, raising interest rates can be really hard on jobs… except in this cycle so far. Thus, begin the duel.

Tug-of-War Between Monetary & Fiscal Policy

We believe that the direction and level of interest rates moving forward is important to the market.

Monetary Policy (Restrictive): Can the Gov't Strong Arm the Fed?

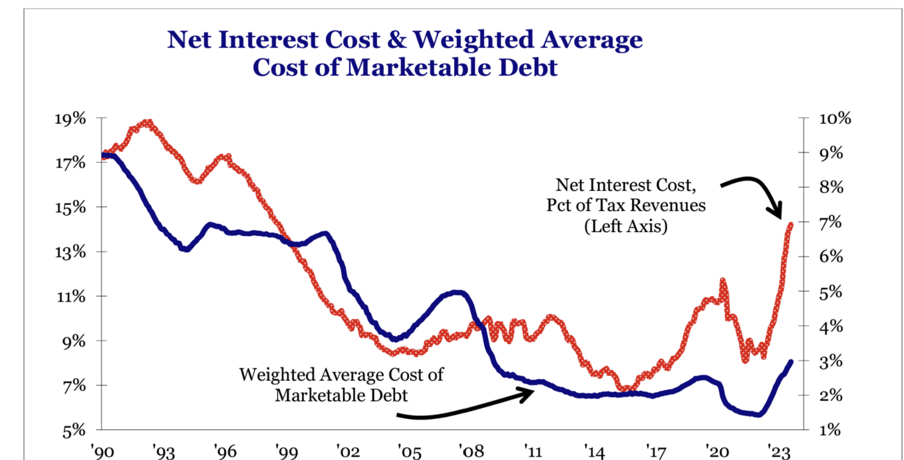
- If investors look at how long the Fed has been able to keep interest rates higher after pausing (without cutting), the average is ~10/11 months. But there appears to be a timing difference depending on the Treasury's debt servicing cost.
- Interestingly, with low debt servicing cost, the Fed was able to keep rates higher for longer. But when debt servicing costs were high, like they are today, the Fed's ability to keep rates higher lasted just a couple of months.



Source: Strategas, Data as of 9/30/2023

Fiscal Policy (Expansionary): Will there be Austerity in Washington, D.C.

- Over the next 12 months, the U.S. Gov't will have to refinance over 30% of its debt. Meaning, that they would prefer if rates were to be lower because their effective interest expense would be more palatable. Yet, this rhetoric flies in the face of what Jerome Powell and the Fed have been conveying to the market.
- Not only that, but during election years, spending tends to not slow down, thus increasing the overall debt load. Over the past 12 months, the US budget deficit increased $800B, despite an economy near full employment. A common theme is that the rapid deficit increase is helping to prevent a recession. And no doubt the recent increase in discretionary spending at the federal level has added about 0.3% to the 2.6% real growth rate of the US in the past 12 months. State and local governments added an additional 0.4%.
- The weighted avg. coupon rate of ~2.0% will most likely increase.



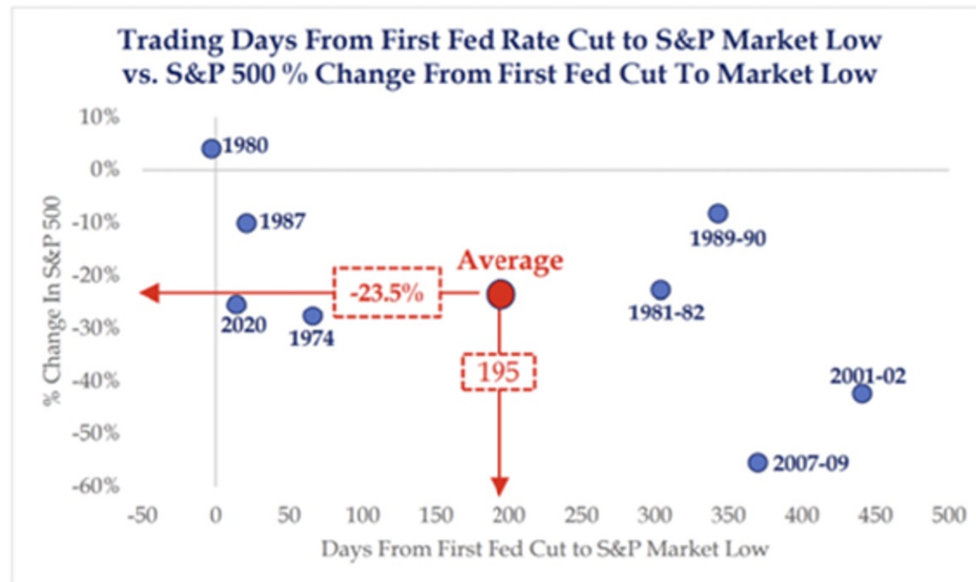
Source: Strategas, Data as of 9/30/2023

A Rebel Without a Pause

Fed Policy Continues to Take Center Stage, as the Market has endured one of its Fastest Hiking Cycles in History.

Recent Fed Policy – "Another Skip"

- In their September '23 Meeting, The FOMC updated their interest rate projections via the "Dot Plot". The most interesting news about the projections is what they tell us about the Fed's reaction function. The bottom line is that if we can get core PCE onto a consistently lower path, then this "skip" from the last meeting could turn into a full-fledged "pause." That's where we were back in March. If, however, core inflation keeps to its sticky ways and continues to trend towards the new Fed forecast of 3.9%, 25bps in additional hikes are headed our way. It's that simple.
- *Is a Fed Pivot In Store?* Over the last quarter, the market continued to grapple with Fed policy expectations – will the Fed continue to fight inflation, or will it pivot to maintain market stability? The market has rallied on the latter (alongside "immaculate disinflation"), but a pivot hasn't historically led to positive market returns. Conceptually, the Fed only pivots because it's in the middle of a recession.



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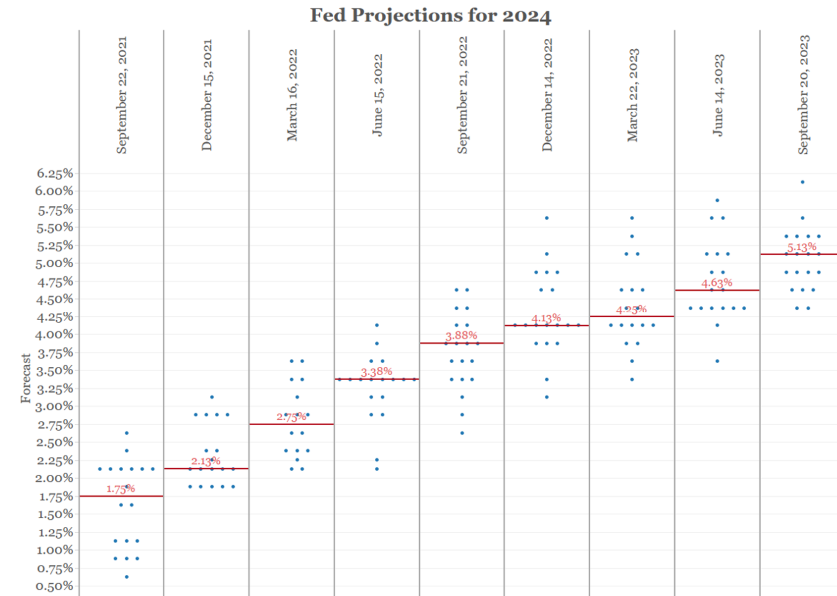


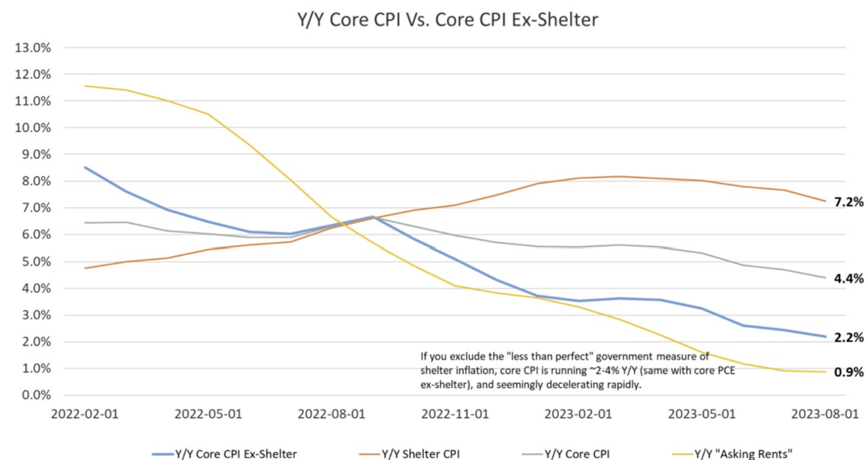
Source: Bianco, Data as of 9/30/2023

The Inflation Picture

CPI Continuing To Come Down – The Game Will Soon Switch From Timing The Pause, To Determining Whether A Soft Landing Is Achievable At 5%+ Fed Funds.

Fed Utilizes Data that is Biased to the Past – Where Do We Currently Stand?

- Although the recent CPI print seemed to be a yawner for the bond/equity markets, core CPI ex-shelter continues to improve, and is very close to 2%. This will likely pick up in Q3 as health care assumptions are changed, so this metric is overstating the inflation improvement, but even adjusting for that, except for shelter (which even the Fed knows will be 2%-ish by late 2024 due to apartment supply trends), core inflation is likely running 2.5%-4% y/y, down from ~6-7% a year ago, without a single job loss, just letting the supply side heal.
- *Inflation Elsewhere* – Unlike Europe, the Fed is very restrictive, and seems intent on staying so for some time, so generally a much more hawkish monetary stance on this side of the Atlantic vs. Europe, essentially the opposite of the last 20 years.

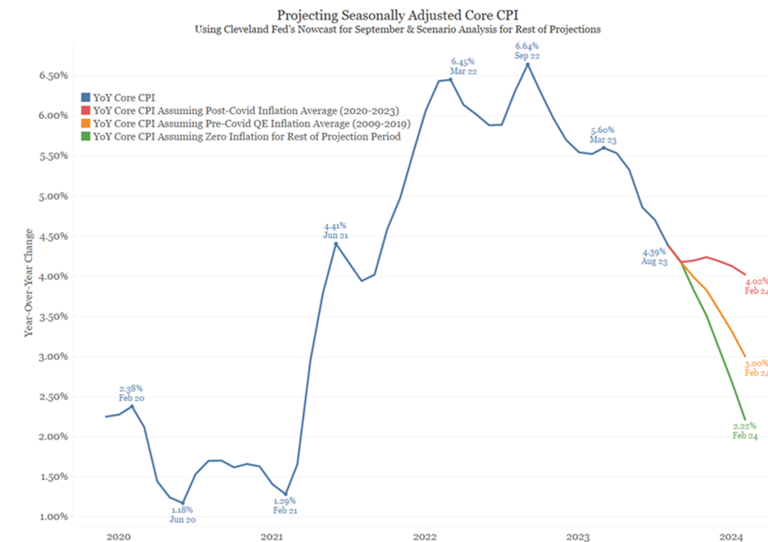


Source: Raymond James, Data as of 9/30/2023

On the Other Side of the Equation, Monthly Headline CPI Comps are Becoming More Difficult

- One of the biggest questions bothering investors is: *how will the market react to inflation data once comps become much easier?* If inflation proves to be stickier-than-expected alongside easier comps, which start in July, then the data will look more structural.

- If investors look at comps within Core CPI, then comps look comparable, as inflation has been stickier when economists exclude food and energy.



Source: Bianco, Data as of 9/30/2023

Will the Consumer Shrug?

Market invests In the CHANGE in the near term, and the LEVEL in the long term.

The Positive – The Absolute Level of U.S. Household Net Worth Remains Strong Showing the Strength of the Consumer

- Consumer balance sheets are well positioned to deal with an adverse shock or continued inflation. Household assets rose by $3.1T in Q1 '23, driven by gains in financial assets.
- On the liability side, the share of household debt balances that were current (rather than late) was 97.4%, which is close to an all-time high showing that debt-service & financials obligation ratios are both below pre-COVID levels.

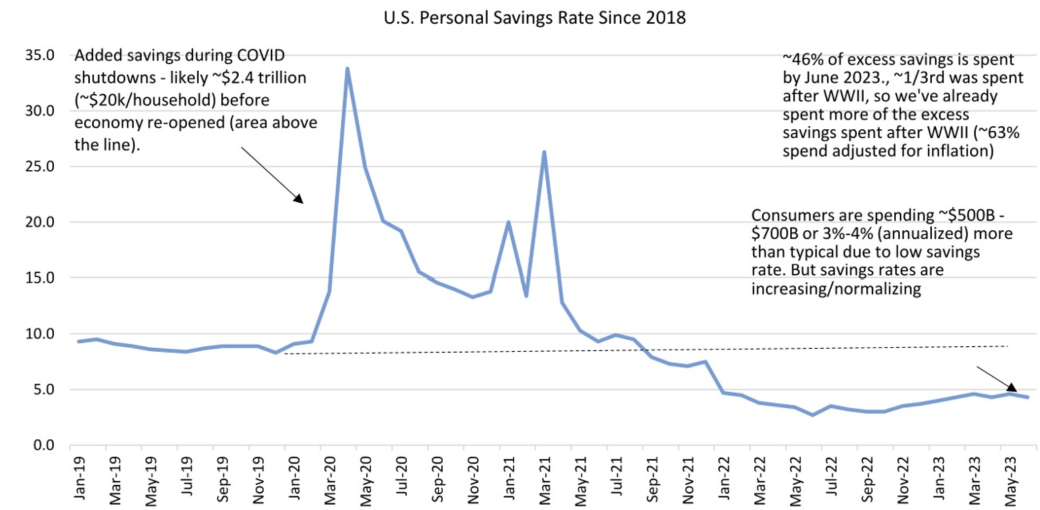
The Negative – Spending on the Heels of the Savings Rate

- Since Q4 2019, consumer spending has increased +26%, while personal income has increased 21% and disposable personal income has increased 20% creating a condition of "excess spending".
- Spending in excess of income has led to a lower savings rate, which has been hovering between 4-5% all year, above 2-3% range last summer, but below ~8% pre-pandemic level of savings. Savings rates should continue to normalize, providing a modest headwind to consumer spending all else being equal.

U.S. Household Net Worth ($T)

	Current Q2 2023	Previous Peak	Since Previous High (%)	Q1 2020	COVID 16-QTR Change (%)	Q2 2013	10-YR Change (%)
Total Assets	$ 174.60	$ 171.20	1.99%	$ 127.10	37.37%	$ 90.08	93.83%
Deposits	$ 17.80	$ 17.90	-0.56%	$ 14.30	24.48%	$ 9.50	87.37%
Total Stock Inv.	$ 44.50	$ 42.20	5.45%	$ 26.50	67.92%	$ 18.58	139.50%
Other Fin'l Assets	$ 11.11	$ 10.58	5.01%	$ 9.57	16.09%	$ 7.92	40.28%
Real Estate	$ 44.50	$ 42.10	5.70%	$ 30.50	45.90%	$ 19.40	129.38%
Other non-Fin'l Assets	$ 43.68	$ 43.28	0.92%	$ 36.67	19.12%	$ 27.21	60.53%
Less: Total Liabilities	$ 20.14	$ 18.60	8.26%	$ 16.60	21.31%	$ 13.90	44.90%
Total Net Worth	$ 154.46	$ 152.60	1.22%	$ 110.50	39.79%	$ 76.18	102.75%

Source: Federal Reserve, FRED, Data as of 9/30/2023



Source: RJ, Data as of 9/30/2023

The Good, The Bad, The Ugly

The GOOD / The BAD / The UGLY

The Good

The U.S. Consumer Continues to be Resilient

We believe the aggregate consumer remains flush with cash, and the once pent-up demand continues to be unleashed, which has allowed the U.S. economy to be very resilient. The average U.S. Household is worth 35% more than pre-COVID. Consumer balance sheets are also well fortified.

Labor Market Remains VERY Resilient

There has never been a recession that did not witness a material increase in the unemployment rate, which remains "stubbornly" below 4%. And while the labor market does appear to be slowly weakening, it has thus far remained very resilient, with respectably high wage growth as well.

The Bad

Inflation is Persistent, Though Peaking?

The magnitude of the policy actions used to counteract deflation may, in the end, be hugely inflationary. Higher-than-expected inflation tends to be a major headwind to equity valuations, but it appears that inflation has peaked for now. For markets, how the Fed chooses to address inflation is as important as the inflation itself. The battle isn't over, as services and wage inflation continue to be "sticky".

Fed Policy Collateral Damage

The yield curve officially inverted in 2022, creating speculation of a recession. This means caution in communication by the Fed to avoid the mistakes of the Yellen Fed and the "stop-and-go" policy from the '70s. The Fed's number one goal is to anchor inflation, even if it puts the economy into a recession. With this, there may be some collateral damage in parts of the speculative market, as we've already seen in the banking sector.

The Ugly

Inflation Transitioning to Growth Frustration

Earnings expectations for the S&P 500 have only come down 9.1% in '23. Anecdotally, margins continue to compress at the corporate level, but have not yet been represented in overall analyst's future expectations. We believe that if earnings were to significantly drop (for reference, they tend to fall ~20% during a recession), the market could follow, as lower revenue could mean lower earnings.

Risk of a Recession – Hard Landing

An inverted yield curve has preceded almost every recession, though it has difficulty on properly calling the timing. The yield curve is the most inverted it's been during this cycle. If consumer spending starts to slow, the economy could witness a stagflationary environment where inflation is structural, growth is slowing, and unemployment increases. Adding to that pressure, it seems that Central Banks are content to tighten until labor markets weaken.

Asset Allocation

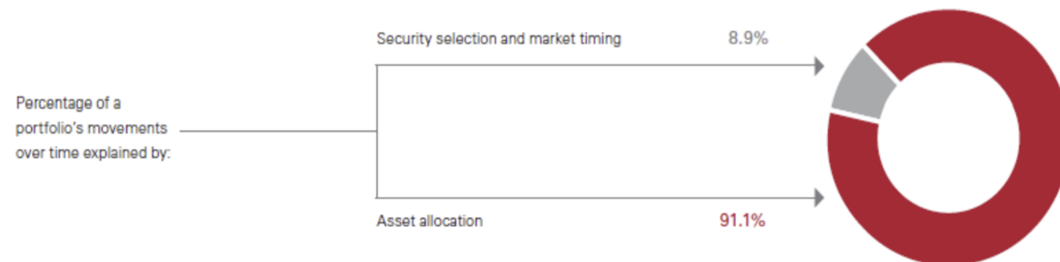
The Importance of Allocation Structure

Many Allocators Believe that Conviction on Exposures drives LT Results, When in Fact, It Adds Virtually no Benefit over Longer Periods of Time. Especially in the Current Environment, Focus on the Structure.

That's Why the Structure of the Asset Allocation is so Important

- When building a portfolio to meet specific objectives, it is critical to select a combination of assets that offers the best chance for meeting that objective, subject to the investors' constraints. Assuming that an investor uses broadly diversified holdings, the mix of those assets will determine both the returns and the variability of returns for the aggregate portfolio.

- The theory that the "structure" is more important than the individual "exposures", is well documented in theory and in practice. For example, the seminal 1986 study by Brinson, Hood, and Beebower, showed that asset allocation decisions were responsible for 91.1% of a diversified portfolio's return pattern over time.
- Focus less on tilts.



Source: Vanguard, Data as of 9/30/2023

"Lost Decades" of the 60/40 Occur More Often Than You'd Think

- We believe that the current environment necessitates the importance of focusing on a consistent, time-tested structure.

- Most started with expensive stocks or bonds – today, both are.

- Historically, negative stock/bond correlations have coincided with low inflation regimes and vice versa. This may not be the case moving forward, which we believe could impact long-term results of the 60/40 portfolio.

Source: Bloomberg, JPMorgan, Data as of 9/30/2023

Asset Allocation Woes

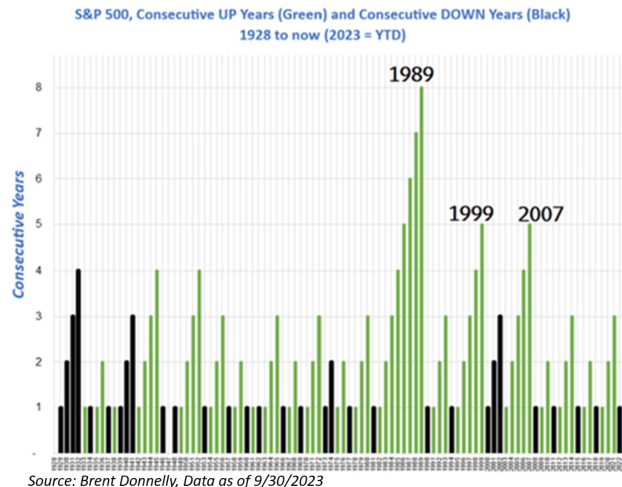
Asset Allocation Decisions Become More Difficult During Periods on Inflation.

It Pays to be a Rational Optimist

- Pessimism about the long-term does not align in any way with a historic worldview. Investors can choose to believe that right now is the beginning of the end, but that is a bet against all of human history and against human nature itself. As has always been the case, progress occurs against an inevitable backdrop of catastrophe. Always has, always will. Invariably, you can always find what you go looking for and your investment results will probably mimic that worldview.

Many Investors Have Been Caught Offsides

- Investors entered '23 with a lot of pessimism in market and its future path of returns, which should not be a surprise, given that the 60/40 portfolio had just had its worst year since 1937. Unfortunately, the factors that worked last year, have lagged this year.

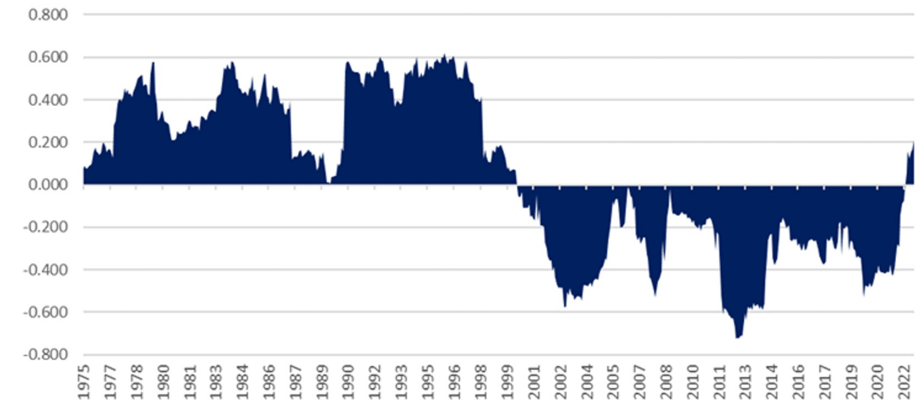


Source: Brent Donnelly, Data as of 9/30/2023

Portfolio Volatility as Correlations Rise

- Historically, negative stock/bond correlations have coincided with low inflation regimes and vice versa. We're mindful of the disinflationary impulse from a probable credit contraction due to stress in the U.S. banking system but we remain of the view that inflation will be above the Fed's target (i.e., > 2.0%) for longer than expected.

- Therefore, although there are certainly catalysts for disinflation in the near-term, over the long-term we believe inflation will be stickier than what the consensus expects, creating an environment where risk parity correlations could be positive.



Source: Aptus, Bloomberg, Data as of 8/31/2023

Asset Allocation Hot Spots

Taking Advantage of the Current Environment

Diving into Yield

- Moving forward, given current market dynamics, we believe that dividend yield will contribute more to total return than what is has over the last decade.
- Historically, yield has contributed to 34% of total return. Yet, in the 2010s, it only contributed 14%. It's not the fact that we believe yield will be the sole contributor to performance itself, but because the other two components of total return, earnings growth and valuation, appear to be a difficult area for potential appreciation in the near future.

Decade	Yield +	Earnings Growth +	Valuation Change =	Annual Returns
1900s	3.9%	4.7%	0.9%	9.5%
1920s	4.2%	2.0%	-2.9%	3.4%
1920s	3.7%	5.6%	4.6%	13.9%
1930s	3.1%	-5.7%	1.6%	-1.0%
1940s	4.2%	9.9%	-6.4%	7.8%
1950s	4.1%	3.9%	10.1%	18.1%
1960s	3.1%	5.5%	-1.2%	7.3%
1970s	3.4%	9.9%	-8.0%	5.3%
1980s	3.4%	4.4%	8.6%	16.4%
1990s	1.7%	7.7%	8.2%	17.6%
2000s	1.5%	0.6%	-2.9%	-0.8%
2010s	1.9%	10.6%	0.7%	13.3%
2020s	1.5%	11.1%	-5.1%	7.6%
Avg. Contribution to Return	**3.1%**	**5.4%**	**0.6%**	**9.1%**
% Contribution to Return	**33.6%**	**59.4%**	**7.0%**	**100.0%**

Source: Aptus Capital, John Bogle & Robert Shiller, Data as of 9/30/2023

There is an Alternative to Stocks & Long Bonds

- For the first time in a long time, the treasury market is giving investors some sort of yield. In fact, we believe that there is going to be a competition for capital, as the percentage of stocks with yields greater than the 10YR Treasury is returning to it's pre-GFC levels. Less than 20% of the stocks in the S&P 500 have a yield > 10YR Treasury.
- The recent banking crisis has jump started this tectonic shift as investors continue to pour cash into US money market funds. During the month of March, capital flooded into these vehicles, making it the biggest month of inflows since the depth of the COVID crisis.

Largest Money Market Funds 7-Day Yield
Today vs. Start of Current Fed Hiking Cycle v. 10Yrs Ago

Ticker	Fund Name	Today	Start of Hiking Cycle (3/16/22)	September 2013
SWVXX	Schwab Value Advantage Money Fund	5.67%	0.0%	0.0%
VMFXX	Vanguard Federal Money Market Fund	5.37%	0.0%	0.0%
MVRXX	MSILF Gov't Portfolio	5.34%	0.0%	0.1%
FGTXX	Goldman Sachs Financial Square Gov't Fund	5.31%	0.1%	0.0%
OGVXX	JPMorgan US Gov't Money Market Fund	5.31%	0.0%	0.0%
FIGXX	Fidelity Gov't Portfolio	5.31%	0.0%	0.0%
DGCXX	Dreyfus Gov't Cash Management	5.30%	0.0%	0.0%
SPAXX	Fidelity Gov't Money Market Fund	5.07%	0.0%	0.0%
FDRXX	Fidelity Gov't Cash Reserve	5.07%	0.0%	0.0%
GOSXX	Federated Hermes Gov't Obligations Fund	5.05%	0.0%	0.0%

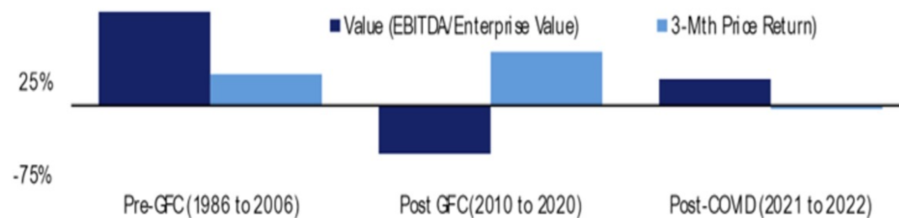
Source: Bloomberg, Aptus, Data as of 9/30/2023

Is There Certainty in Positioning?

There's a Lot of Certainty in an Environment Where There is a Lot of Uncertainty

A Generation of Investors Trained on "Price Predicts Price"

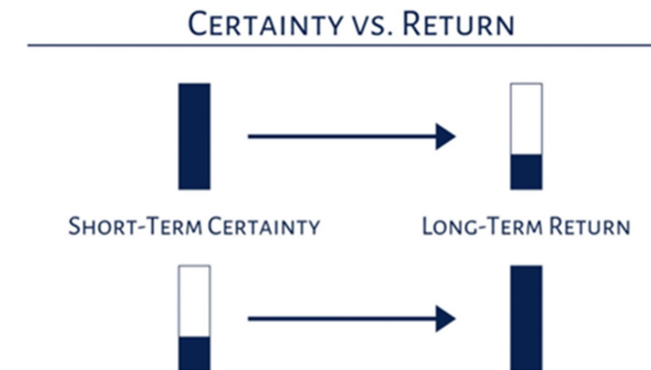
- Most investors have seen a period during which momentum and technical factors have driven the largest gains. But outperformance of price momentum factors was likely driven by a liquidity-fueled multi-decade period of falling interest rates, globalization and central bank stimulus that resulted in high serial correlation across price returns.
- Prior to the Global Financial Crisis (GFC), ***valuation was a far better signal than using past price returns to predict future price returns***. As we transition into a more "restrictive" policy phase, we would imagine that valuation be a better predictor of future returns.



Source: BofA, Data as of 9/30/2023

Invest Unemotionally for Better Long-Term Results

- The more certainty you seek from your portfolio in the short term, the lower your long-term returns will be. It's obvious that the lower your long-term returns are, the probability of achieving your investment goals will decrease in lockstep.
- What happened to all the could-have-been billionaires? Why do more investors not reap the benefits of compounding? We believe that the reason has little to do with wars, recessions, financial crisis, inflation, etc. The stock market's return includes all of these terrible things. Yet, the market has compounded wealth to the point where every $1 invested in the S&P 500 in 1922 and left untouched would be nearly $13,800.
- *Our Conclusion*: It is not adverse market conditions that derail compounding; it's investors' reaction to them. In short, ***investor behavior derails compounding***.

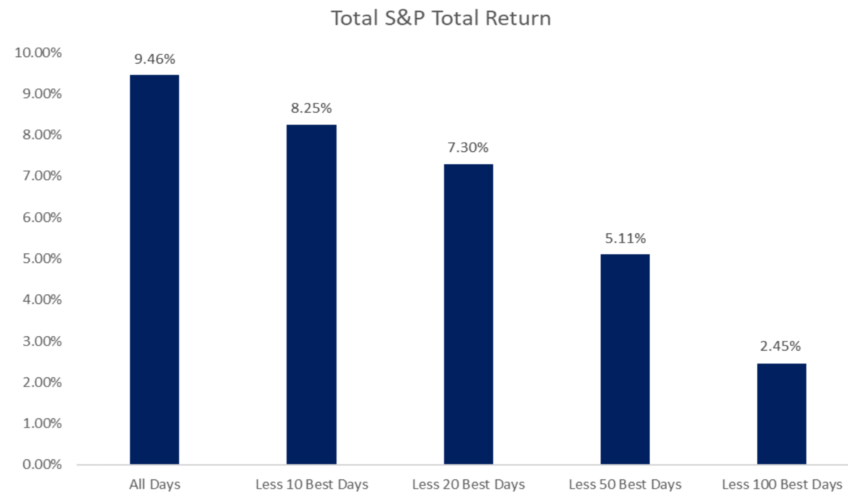


Source: Money Visuals, Data as of 9/30/2023

Consistent Behavior Breeds Winners

Failure to Stay Invested

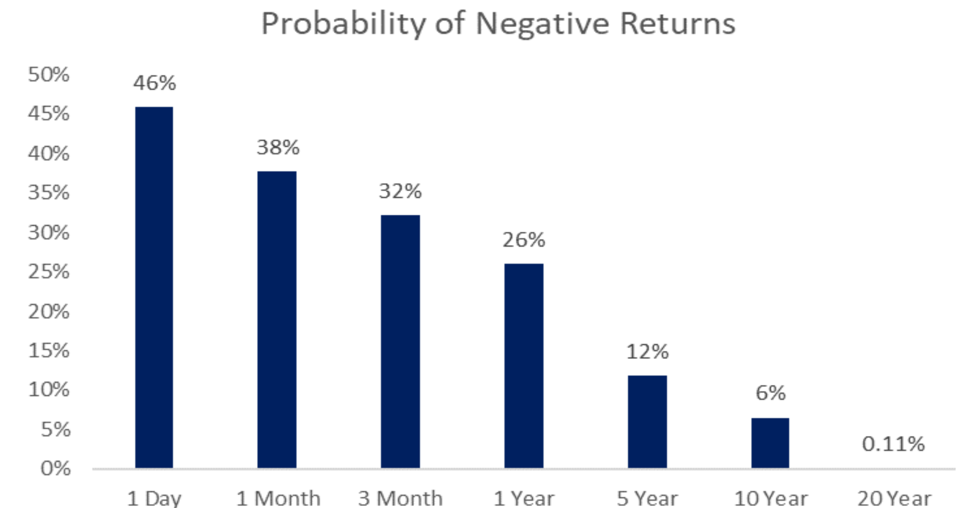
- *It Pays to Stay Invested* - The US stock market has been resilient through its history. Stocks routinely recovered from short-term crisis events to move higher over longer time periods.
- *Timing the Market* - By trying to predict the best time to buy and sell, you may miss the market's biggest gains. Attempting to guess short-term swings make it very difficult to produce consistent results. The best method for loss avoidance is to expand your time horizon.
- *Behavior Gap* - We have found the shorter time frame you choose the more apt you are to get whiplash and trade excessively. This behavior challenge often leads to emotions driving decisions over your goals.



Source: Aptus Capital Advisors, Data as of 09/30/2023

Remember to Expand Your Time Horizon

- No one ever knows that the market is going to do – especially on a daily basis – we know that volatility tends to breed more volatility – whether it's up or down.
- In our view, investors also tend to focus too much on the short-term "noise" in the market. There is usually great deal of variability in the day-to-day, with different economic, geopolitical, and company-specific news constantly moving markets.
- We believe the best method for loss avoidance is to expand your time horizon.



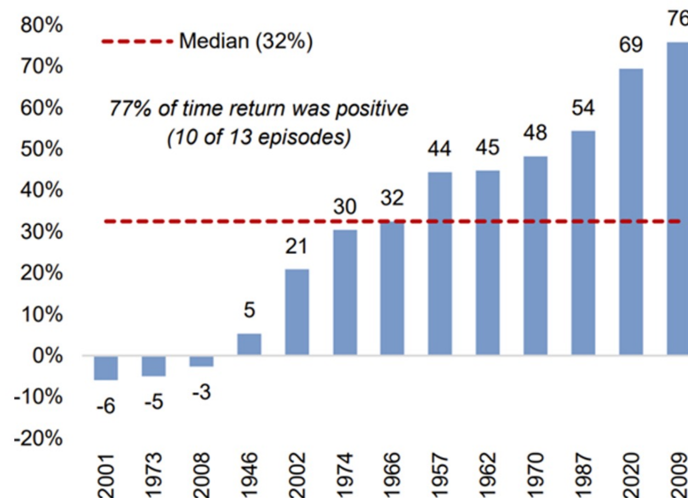
Source: Aptus Capital Advisors, Data as of 09/30/2023

Staying Focused on a LT Goal

We Continue to Advise That Clients Stay Invested

Don't Let Pullback Scare Investors

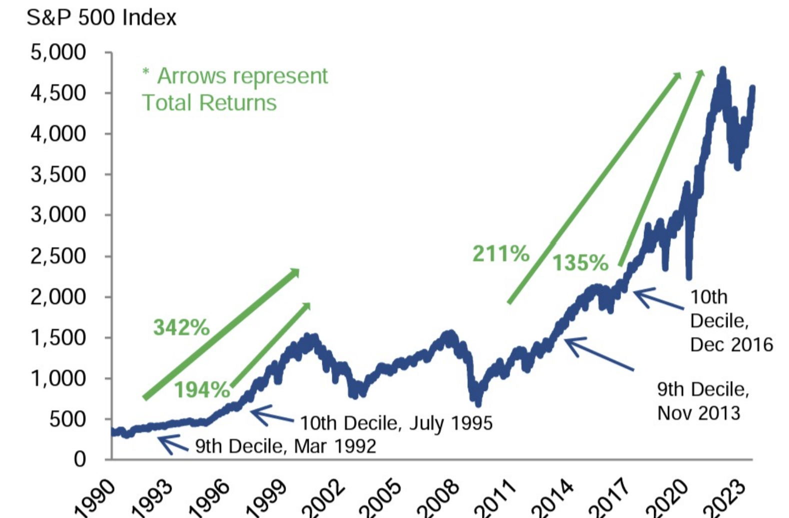
- Occasional pullbacks are normal even in bull markets and statistically unavoidable in any asset class with 15% annual volatility. Note that a 5% or greater pullback occurred two-thirds of the time at some point during the last 5 months of past years with strong first half performance, but those 5-month periods still managed to generate a 5% average gain, as any losses were more than recouped by year end.
- The below chart plots S&P returns in the 24 months that followed a selloff of at least 20%. there's zero local relevance to this analog, but the big picture moral of the story is clear - *buy major pullbacks when the stock market gives them to you*



Source: Goldman Sachs, Data as of 9/30/2023

Valuation is Not a Standalone Reason to Not Invest

- Although valuations are elevated — standing in their 10th historical decile — high absolute valuations have not been a reliable timing signal in the past. As seen in the below photo, previous periods where the market entered the 9th or 10th valuation decile still saw substantial subsequent returns, highlighting the penalty for exiting equities prematurely based on valuation alone.



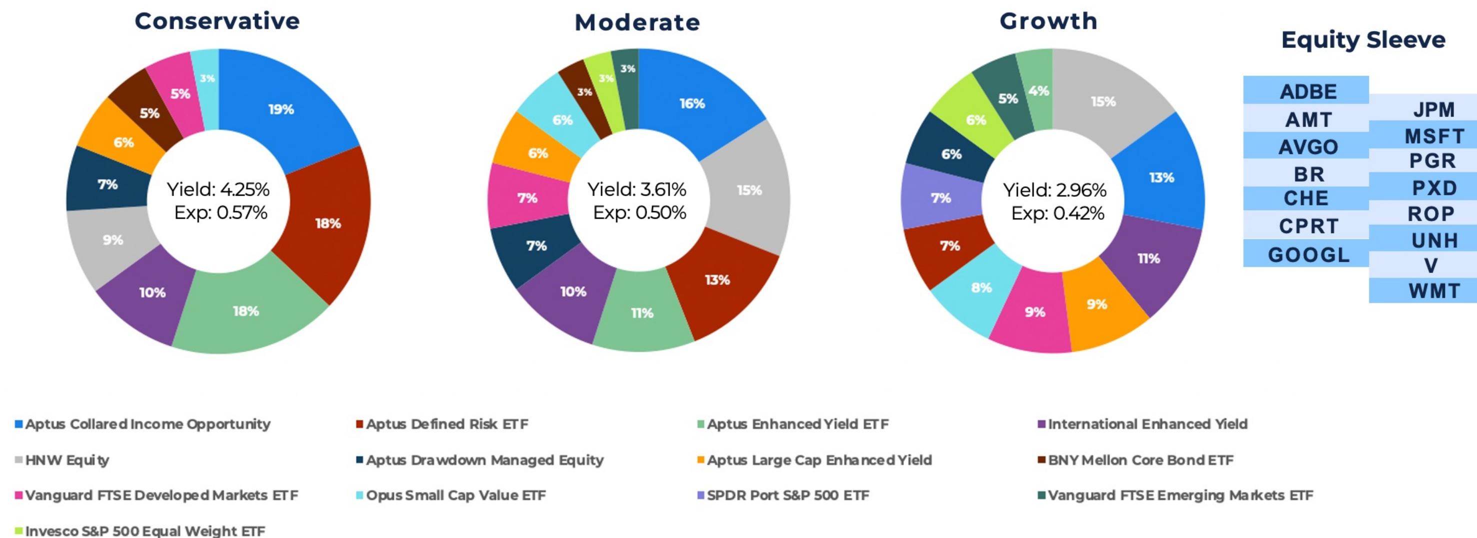
Source: Goldman Sachs, Investment Strategy Group, Data as of 9/30/2023

Client-Specific Growth & Income Targets

Conservative Allocation: Designed with the primary objective of stability and protection, plus opportunity for appreciation. Reducing drawdown is the foundation, with lower exposure to traditional equities.

Moderate Allocation: Designed with flexibility to dynamically adjust exposure as risks & opportunities change. Balancing the reduction of both drawdown and longevity risk is the goal, designed to capture market returns while mitigating significant declines. Nearly half of the equity exposure contains some form of explicit hedging.

Growth Allocation: Designed to accumulate wealth through equities. Reduced drawdown remains a feature, but with a greater emphasis on reducing longevity risk by harnessing the compounding power of stocks.



Holdings as of 9/30/2023

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Projections or other forward-looking statements regarding future financial performance of markets are only predictions and actual events or results may differ materially.

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The 2 Year Treasury Rate is the yield received for investing in a US government issued treasury security that has a maturity of 2 year.

The 10 Year Treasury Rate is the yield received for investing in a US government issued treasury security that has a maturity of 10 year. The 10 year treasury yield is included on the longer end of the yield curve. Many analysts will use the 10 year yield as the "risk free" rate when valuing the markets or an individual security.

This is not a recommendation to buy, sell, or hold any particular security. The holdings shown above are target portfolio weights and do not reflect the entire portfolio. The holdings are sorted by target portfolio percentage weight then alphabetized within each asset range. Actual portfolio investments will vary when invested. A complete list of holdings is available upon request.

Information presented on this presentation is for educational purposes only and offers generalized speech. It is for informational purposes only and does not constitute a complete description of our investment services or performance. Information specific to the underlying securities making up the portfolios can be found in the Funds' prospectuses. Please carefully read the prospectus before making an investment decision. All investments involve risk and unless otherwise stated, are not guaranteed. Be sure to consult with an investment & tax professional before implementing any investment strategy.

The Nasdaq Composite Index measures all Nasdaq domestic and international based common type stocks listed on The Nasdaq Stock Market. To be eligible for inclusion in the Index, the security's U.S. listing must be exclusively on The Nasdaq Stock Market (unless the security was dually listed on another U.S. market prior to January 1, 2004 and has continuously maintained such listing). The security types eligible for the Index include common stocks, ordinary shares, ADRs, shares of beneficial interest or limited partnership interests and tracking stocks. Security types not included in the Index are closed-end funds, convertible debentures, exchange traded funds, preferred stocks, rights, warrants, units and other derivative securities.

The Consumer Price Index (CPI) measures the change in prices paid by consumers for goods and services. The CPI reflects spending patterns for each of two population groups: all urban consumers and urban wage earners and clerical workers.

The Dow Jones Industrial Average is the most widely used indicator of the overall condition of the stock market, a price-weighted average of 30 actively traded blue chip stocks, primarily industrials. The 30 stocks are chosen by the editors of the Wall Street Journal (which is published by Dow Jones & Company), a practice that dates back+A70 to the beginning of the century. The Dow is computed using a priceweighted indexing system, rather than the more common market cap-weighted indexing system.

Treasury Inflation-Protected Securities, or TIPS, provide protection against inflation. The principal of a TIPS increases with inflation and decreases with deflation, as measured by the Consumer Price Index.

The Bloomberg Barclays US Aggregate Bond Index is a broad-based flagship benchmark that measures the investment grade, US dollar-denominated, fixed-rate taxable bond market. The index includes Treasuries, government related and corporate securities, MBS (agency fixed-rate pass-throughs), ABS and CMBS (agency and non-agency).

The MSCI EAFE Index (Europe, Australasia, Far East) is a free float-adjusted market capitalization-weighted index that is designed to measure the equity market performance of developed markets, excluding the United States and Canada. The MSCI EAFE Index consists of the following 21 developed market countries: Australia, Austria, Belgium, Denmark, Finland, France, Germany, Hong Kong, Ireland, Israel, Italy, Japan, the Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland and the United Kingdom.

The MSCI Emerging Markets Index is a free float-adjusted market capitalization-weighted index that is designed to measure equity market performance of emerging markets. The MSCI Emerging Markets Index consists of the following 26 emerging market country indices: Argentina, Brazil, Chile, China, Colombia, Czech Republic, Egypt, Greece, Hungary, India, Indonesia, Korea, Malaysia, Mexico, Peru, Philippines, Poland, Qatar, Russia, Saudi Arabia, South Africa, Taiwan, Thailand, Turkey and United Arab Emirates.

Non-investment-grade debt securities (high-yield/junk bonds) may be subject to greater market fluctuations, risk of default or loss of income and principal than higher-rated securities.

Investment-grade Bond (or High-grade Bond) are believed to have a lower risk of default and receive higher ratings by the credit rating agencies. These bonds tend to be issued at lower yields than less creditworthy bonds.

The S&P 500® Index is the Standard & Poor's Composite Index and is widely regarded as a single gauge of large cap U.S. equities. It is market cap weighted and includes 500 leading companies, capturing approximately 80% coverage of available market capitalization.

S&P International Corporate Bond Index is an investable index of non-U.S. Dollar corporate bonds issued by non-U.S. investment grade issuers. The index seeks to measure the performance of corporate bonds issued in the non-U.S. Dollar G10 currencies.

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