GCM Quarterly Report

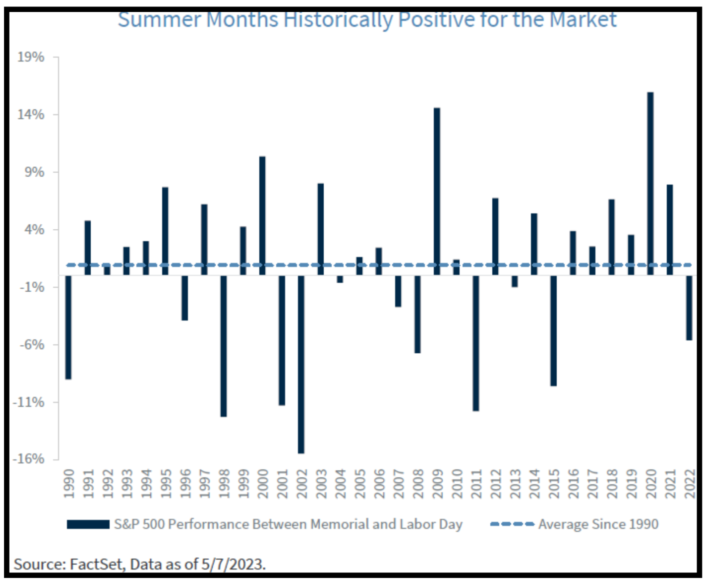
Spring 2023

A welcome start to the year

Capital markets have started off 2023 with a nice rebound. Through the end of April, the S&P 500 large-cap index is up about 9% and the Bloomberg Aggregate bond index is up about 3.5%. Although this recovery has been shaky and volatile thanks to a banking crisis and some uneven economic data, it's still a nice reprieve. What is the state of markets today and how might things unfold? Read on…

Corporate earnings season for Q1 of 2023 is nearly finished. A few big names remain, but the bulk (about 85%) of the S&P 500's weight have reported. Among those, Amazon and Meta (the artist formerly known as Facebook) were notable winners. Amazon reported a profit of $0.31 per share versus estimates of $0.21 per share, and versus a loss of $0.38 per share last year. Why does Amazon earn so little profit when they sell hundreds of billions of dollars worth of products and services? Management plows almost all of the company's revenue into growing the business.

Zooming out, results across the S&P 500 constituents in aggregate are negative compared with last year, but considerably less negative than analysts feared. In fact, the number and magnitude of positive earnings surprises versus analysts' expectations are above long-term averages. If earnings season finished today, results would be down about 2.2% versus the first quarter of last year. At the end of March, analyst estimates were for a decline of nearly 7%. Revenue growth for the quarter was actually narrowly positive, indicating that inflationary pressures on the prices of input materials are still stressing bottom lines. Interestingly, companies which derive a greater percentage of their revenues from overseas are reporting weaker earnings growth (meaning a greater decline versus last year) compared with companies which do most of their business in the US. This is a trend that has reversed course over the past few years, likely due to the turmoil in Ukraine, Europe's energy security issues, and a rate of inflation which is more persistent over there than it is here. Looking forward to the full calendar year, earnings and revenues are both forecast to be positive with low single digit growth compared to calendar year 2022. (Data cited in the prior two paragraphs from Factset)



Sell in May and go away? Not so fast…although volatility tends to be higher in the summer, the market has averaged about a 1% rate of return from May to September since 1990. Chart from Raymond James

The recent rebound in the stock market coupled with a decline in earnings growth has prompted valuations (as measured by the price-to-earnings,

Market Statistics	April '23	YTD	2022	3-Year Annl.	5-Year Annl.
S&P 500	1.56%	9.17%	-18.11%	14.52%	11.45%
Dow Jones Ind. Avg.	-1.15%	2.91%	-14.04%	14.25%	8.55%
Russell 2000 (Small Cap)	-1.82%	0.76%	-20.76%	11.50%	3.75%
MSCI EAFE (Foreign)	2.82%	11.53%	-14.45%	11.68%	3.63%
MSCI ACWI (Global)	1.44%	8.85%	-18.36%	12.04%	7.03%
MSCI Emerging Mkts.	-1.13%	2.78%	-20.09%	4.33%	-1.05%
Barclay's Aggregate Bond	0.61%	3.59%	-13.01%	-3.15%	1.18%
iShares Gold ETF (GLD)	0.11%	9.25%	-0.77%	4.78%	8.16%

Source: Morningstar, as of 4/30/2023

or P/E, ratio) to rise toward longer-term averages; the P/E ratio for the S&P 500 is currently about 17.5, right between its 5- and 10-year averages. This may suggest that stock prices don't have much room to go higher, but historically valuations have expanded during recessionary periods as investors anticipate the end of the recession and the return to growth. According to FactSet, the consensus forecast for the S&P over the next 12 months is a rise of about 15% from current levels. There are, of course, no guarantees, but if that target were proven true, it would put the index very close to the all-time highs we enjoyed at the end of 2021 and would be consistent with the average recovery time from a bear market loss of around 2 years.

Inflation, the economy, and the Fed

April's Consumer Price Index (CPI) report showed inflation increased by 4.9% over the prior 12 months. This was the smallest increase in two years and the tenth month in a row of slowing inflationary pressure. Notably, grocery prices actually fell during the month.

The economy is still expanding, but at a muted pace. GDP growth for the first quarter, as estimated by the BEA, was 1.1%, well under expectations of around 2%. Raymond James's chief economist expects a formal "recession" (defined by the National Bureau of Economic Research as two consecutive quarters of negative GDP growth) in the second half of this year, albeit a mild and short one. For the full calendar year, he's forecasting GDP growth to be around 1%. Given the weaker than expected result for the first quarter, we would not be surprised to see these forecasts adjusted downward as the year plays out.

The Federal Reserve raised their target rate again in May to 5.00 - 5.25%. The accompanying statement was cryptic, but suggested the Fed may be finished raising rates for the time being. While the labor market remains strong, it's clear from the data cited above that inflation is beginning to subside and the economy is showing signs of slowdown. Absent a significant surprise in economic data released over the next couple of weeks, we expect the Federal Reserve will announce no rate increase in June with a statement that indicates they are on hold. Historically, the Fed does not raise rates again after going on hold and has typically begun cutting rates within about 9 months. The end of an increasing rate cycle has historically been good for stocks and bonds alike.

Washington

The primary issue in Washington is the debt ceiling. The debate between Congress and the president is heating up now that Treasury Secretary Janet Yellen indicated the government may be unable to pay their bills as soon as early June. Both parties have their heels dug in rather firmly, but we believe a deal will be done – or the can will get kicked down the road again – at the very last minute. Expect market volatility to increase if it looks like a deal may not be done in time. Expect volatility to increase even more if a deal is not done in time. Quite frankly, a US default is unprecedented and we don't know exactly how markets will respond. The next month on Capitol Hill will be interesting to say the least.

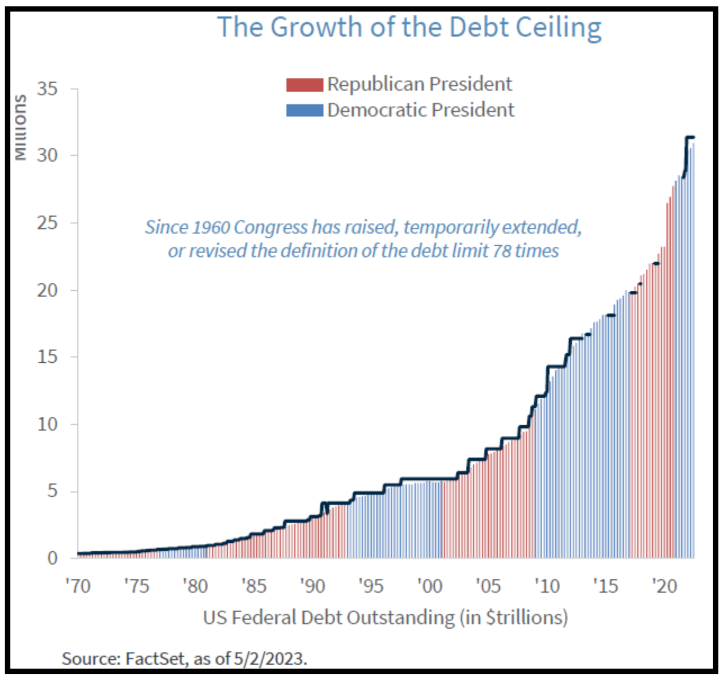


Illustration from Raymond James. Read "Ben's Corner" in our prior newsletter for more color on the debt ceiling issue.

Banking

Finally, a few words on the recent banking crisis. The collapse of SVB, Signature, and, more recently First Republic, has given many investors flashbacks to the 2008 financial crisis. Although the collapse of any bank is worrying, it's important to note that specific failures of risk management and prudent investment guidelines precipitated the demise of these institutions. Fortunately, it appears that the FDIC system has fulfilled its mission by protecting depositors and facilitating the reorganization of these failed institutions. We do not believe this is a contagion event like 2008, but we cannot be sure that additional dominos may not fall either, especially among smaller banking institutions with greater exposure to commercial real estate loans (possibly auto loans as well). Whoever you bank with, we highly encourage you to ensure your deposits fall below FDIC limits. Visit the FDIC's webpage if you'd like to learn more.

Ben's Corner

As I hinted in a recent edition of our newsletter, my column this quarter tackles the question of whether Daylight Savings Time and the biannual time change serve a beneficial purpose. As a minor note of clarification at the outset, the phrase "daylight savings" is often used colloquially as a reference to the changing of the clocks twice a year. Technically speaking, however, Daylight Savings Time (DST for short) is the time system we follow from March to November. I will do my best to avoid imprecise language in this editorial by following common parlance: Daylight Savings Time, a proper noun, refers to the time system itself whereas "daylight savings" refers to the changing of the clocks.

I'm going to fast-forward through the history of daylight savings in the interest of brevity but I encourage you to at least read the Wikipedia article. No, Benjamin Franklin did not invent it. And no, it was not adopted for the benefit of farmers (cows don't wear watches). The time system we all know today originated with the Standard Time Act of 1918 with modifications provided in the Uniform Time Act of 1966. These laws standardized our time system into two distinct periods: Standard Time (which we follow in the winter) and Daylight Savings Time (which we follow in the summer). The laws do not require individual states to adopt DST, but states that do not must follow Standard Time only. Hawaii and Arizona are the only two states in the union that do not change their clocks, but a number of states have "trigger laws" in place to formally adopt DST permanently if the federal law ever changes. Internationally, a little more than a third of the globe follows a biannual time system. Among the major industrialized (or industrializing) nations, Japan, China, and India are notable exceptions.

The primary argument in favor of two time systems is energy savings. Changing the clocks allows for more daylight hours in the evenings and reduces energy consumption because we're awake and active while the sun is up. Studies on this topic have produced conflicting results. A 2017 study published in *The Energy Journal* analyzed 44 different research papers on the subject. This "meta-study" found that, on average, countries which follow biannual time changes experience average energy savings of 0.34%. As you might expect, countries farther from the equator (those with greater variation in their sunlight hours) experienced more savings. Another study, performed by researchers from Yale, analyzed energy usage in Indiana both before and after the state started changing the clocks in 2006. They found that energy usage was actually 1% greater after adoption. I am not a professional statistician, but I'm not sure the results from either study meet the threshold for statistical significance.

Additional arguments in favor of daylight savings are cited in this article. It suggests that golfers and the Chamber of Commerce support the time change. Golfers get more sunlight to golf (ok fine, I can buy that one) and evidently small businesses think that more people will stop on their way home from work to shop if it's light out. That may have been true 50 years ago when people would stroll along Main Street, but I can't believe that it makes any difference today.

The argument against shifting the clocks is simple: it messes with people's routines. These three studies found that there were more fatal traffic accidents, workplace injuries, and poorer stock market performance in the days following the time changes (the spring one in particular because ***nobody*** likes losing an hour of sleep). Perhaps most worrying, this study, found an 18% increase in medical errors (meaning your doctor was tired and made a mistake) in the 7 days after the spring time change and a 5% increase in the 7 days following the fall time change. There are plenty of other similar studies, but I'll stop there.

Just because most of the industrialized world has adopted DST doesn't mean anybody actually likes it. The European Union conducted a survey in 2018 in which 84% of respondents said they did not want to change the clocks anymore. A 2021 Associated Press survey in the US found that 75% of respondents wanted to do away with time changes but were split on whether we should permanently adopt Standard Time or DST. A bill called the Sunshine Protection Act, which would permanently adopt DST, floated through Congress in 2021, passing unanimously in the Senate but dying in the House right before the legislative session ended. In this era of toxic bipartisanship in Washington, I can think of no better way for Chuck Schumer and Kevin McCarthy to reach across the aisle in their respective houses and put this issue to bed for good. Personally, I don't care whether we stick with Standard Time or Daylight Savings Time. Just pick one.

Interesting sports news of the quarter

It's been reported that the Washington Commanders football team has been sold for a little over $6 billion, the highest price ever paid for a sports team anywhere in the world. Soon-to-be previous owner Daniel Snyder has been a controversial figure in the league and in the minds of long-suffering Commanders fans, so perhaps new ownership can breathe some new life into the franchise. Let's hope they don't raise the price of concessions, but there's a decent chance taxpayers may be buying the team a new stadium in the near future.

Peter's summer reading recommendation

Going a step beyond your financial health.

This is a new one for us, however, summer is upon us and this year a fascinating new book has hit the stands. It's called *Outlive, The Science & Art of Longevity* by Peter Attia, MD, who focuses much of his burgeoning practice on research-based care for not only increasing lifespan, but maybe more importantly health span. What is refreshing about his book is that it is incredibly approachable. He focuses his energy first on identifying and explaining in layman's terms the "Four Horseman", which are the diseases that make up the highest proportion of mortality and/or are responsible for ill-health in our waning years. These are heart disease, cancer, metabolic dysfunction (high blood pressure and triglycerides, diabetes, etc.) and neurodegenerative disease (Alzheimer's disease). Each is meticulously presented via relevant research-based findings, explained via science, while identifying misnomers or misunderstandings typically promoted by the conflict laden media. Another piece of the puzzle is findings from the centenarian communities of the world, inasmuch his main objective is to try and prepare you for the "Centenarian Decathlon". He presents the tactics, not prescriptions, that can help us achieve the things that are important to each of us to live a long and healthy life. Each of us will be unique in what we want to do in our 80s, 90s and yes even 100s. By defining these today we can begin to work on and train to the levels necessary to offset our inevitable decline. While it can't be reversed completely, working toward these goals paves the way for a longer, healthier life.

The third part of the book helps to guide you through the process of establishing the framework or tactics for combating disease, such as:

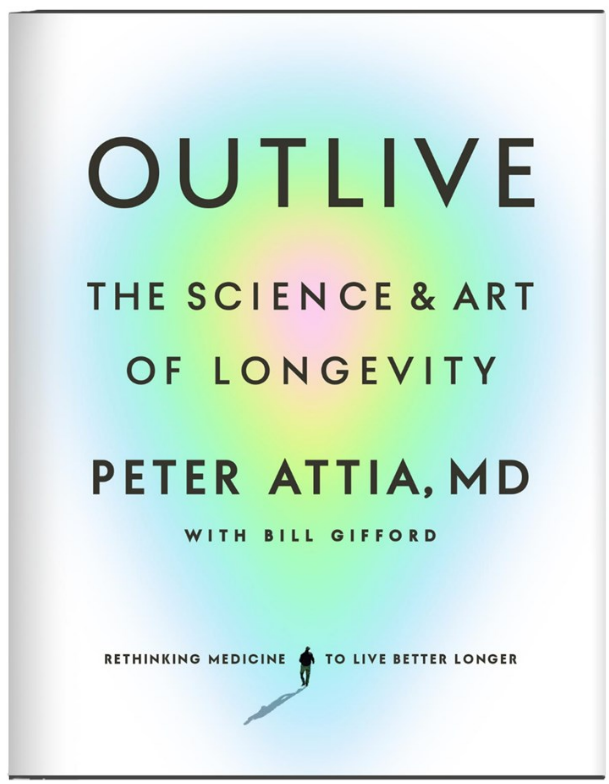
- Exercise: aerobic efficiency and capacity, strength
- Stability: moving without injury
- Nutrition: not a diet; an understanding of biochemistry and why it matters; Alcohol, Carbohydrates, Protein, and Fat….oh my!
- Sleep: What it is, why it matters and suggestions on how to get more of it
- Emotional Health: A bit of his personal journey, with relevant focus for us all

Each of these weaves its way through the earlier established "Four Horseman". It's not a one-off prescription but establishes a comprehensive approach and understanding of what actually matters and what really doesn't. You might be more surprised at what doesn't. Lastly, if you don't want to take a financial guy's word for it, how about…….

"Dr. Peter Attia is someone I trust with my life. What separates him from others is his pursuit of quality of life from all angles – physical, emotional, mental, relational, and spiritual health. This incredible book is a call to action, it will arm you with the tools you need to live a long, meaningful, and fulfilling life." - Hugh Jackman (star of the film *Wolverine,* among many others)

While this may not be the newest Marvel superhero blockbuster, it just might enhance and prolong the time we have here with loved ones. Enjoy your Summer. Please let us know if you're interested in giving this a read.

Please note I am not a doctor and do not endorse any of the recommendations presented by Dr. Attia. Consult your healthcare professional before making changes to your lifestyle.



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