MARKET OUTLOOK Q3 2023
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Hi everyone, I am your portfolio manager, Rajiv Dixit. Welcome to the market outlook for Q3 2023.

Introduction

It is amazing how quickly half a year just flew by, and we find ourselves in the middle of a beautiful summer season. It feels like winter was just here, doesn't it? I don't know about you, but when I think about summer, one of the things that comes to my mind is long family road trips – they are simply memorable.

Driving through the summer breeze, the anticipation of the final destination, the laughter, the music, the junk food at the rest stops, the traffic jams, the bad weather... okay, maybe not the traffic jams and the bad weather, but still there is something amazing about long summer road trips.

I would submit to you that investing for the long term is actually very similar to taking a long family road trip. We have a destination in mind, one that we plan to get to in the most efficient and safe way. What we usually don't do on a road trip is drive at the same speed all the way to the destination. We adjust our speed and our route based on elements like weather, traffic patterns and alternative routes.

That is very similar to active long-term investing, where we adjust our risk levels based on economic and market conditions. We avoid markets that would be volatile and choppy and invest in markets that can provide a better, safer pathway to our destination. Just like a road trip.

Recap

If you have been following our outlooks for the past couple years, you know that since January of 2022 we have been cautious about the elements. We have slowed down and reduced our risk significantly because we were concerned about things like the rising tide of inflation, aggressive Fed action aimed to combat that inflation, the consecutive bank failures which were unintended

consequences of the Fed rate hikes, and last but not least, the debt limit crisis that could have thrown the global financial markets into turmoil to the likes of 2008.

My point is that there was good reason to be cautious for the past 18 months, to slow down our journey and wait for better weather. To drive a bit slower.

The Road Ahead

Today I am here to inform you that, in our view, those above-mentioned bearish sentiments are quickly starting to dissipate. The clouds of bad weather are clearing away, and it might be time to start picking up some speed and increase our exposure to equities in the coming quarters. Let me explain to you what I mean by discussing each one of my previous concerns in a bit more detail.

Dissipating Concerns

Inflation

The rise of inflation in 2021 and 2022 was our first red flag that made us more cautious about the financial markets, but a lot has changed since mid-last year. The consumer price index has been clearly falling from a peak of 8.9% last year to just 4.1% today. It is true that we have not reached the Fed's intended target of 2%; however, we believe that target might not be reached for an extended period of time and, more importantly, this has already been priced into the market.

Banking Crisis

Our primary concern with the recent banking crisis was the potential for over-regulation of the small and mid-size banks. This concern has quickly started to subside. Regulators in both the Treasury Department and Federal Reserve have publicly expressed their reluctance to adding additional regulations to small banks with the fear of reducing their lending capacity. This is a very good sign and has produced many opportunities in the banking sector. We believe that while optimum regulation levels are important to keep the industry and consumers safe, over regulation of the banking sector can reduce banks' lending capacity and thus strain the overall economy.

Debt Limit Crisis

The possibility was always remote, but the fact that the political environment raised the probability of the United States defaulting on its debt was a scenario worthy of caution. Thankfully, the cooler heads in Washington reached an agreement and this storm is behind us without disrupting our journey ahead.

Federal Reserve Rate Hikes

In our opinion, this is the primary reason for continued volatility in the equity markets. While the Federal Reserve has slowed down its aggressive rate hike program of 2022, even bringing it to a complete pause in June, Federal Reserve officials continue to talk about their plans for rate hikes in the future. It is our opinion that the Fed has found itself at an impasse.

What I mean by that is, they realize that they no longer have the power to raise rate as aggressively as before without breaking down the banking system but yet they also want to reduce inflationary pressure to their mandated target rate of 2%, thus they are doing the only thing they can do, trying to influence the market with talks of future rate hikes.

To be very clear, it is possible the Fed will raise rates by a quarter point or so in the future, but the era of consecutive 75 basis point rate hikes seems highly unlikely to return.

Potential Roadblocks

While the above concerns have started to diminish in the past quarter, the financial media and market pundits still seemed to express concerns about a few things. In our contrarian opinion, that is a positive sign. History shows that markets usually perform best when they are climbing a wall of worry.

While much in media can be marked as noise, some of those concerns are worthy of a conversation. So, let’s quickly explore our views on them.

The ″Impending Recession″

This recession must be the most talked about, the most anticipated recession in the history of recessions. In the world of finance, you cannot go a day without someone bringing up the recession. It has been discussed so much in the past 12 months, that our own Meg Prokop made a video about how recessions can be a good thing! Worth viewing by the way if you missed it.

But in all seriousness, our view on this topic has not changed yet. We believe those that are calling for a strong recession due to aggressive Fed rate hikes are missing a key piece of data: never has the federal government showered 5 trillion dollars into the economy 2 years before a recession. The mere fact that most of the federal pandemic stimulus and corporate grant money is still in our system, makes the likelihood of a hard-landing recession moot.

The good news is that last year, with worries of a recession, markets priced in a hard-landing scenario and now, as they realize that the recession is less likely to occur, the equity markets are starting to adjust upward in accommodation of this miscalculation.

S&P500 & Nasdaq's Recent Runup – Has the Bus Already Left?

On the surface, this is a very reasonable concern. After all, the S&P500 index is up 16% for the first half of this calendar year. The Nasdaq is up about 29%. It is reasonable to question whether it makes sense to be bullish in a market that has run up so much already.

But the real answer lies in the details within. While the S&P500 index, comprising of 500 different companies, is up 16%, more than 300 of those companies are still either flat or negative in their year-to-date return. You see this is not yet an "all boats rise" kind of market. Companies like Amazon, Google, Facebook, Nvidia and others have risen tremendously in the past 6 months, some over 50% in value, and those companies have carried the overall performance of these indexes in the first half. They are the market leaders.

I would argue that there is still a lot of value left in the market and there is a lot of potential for future gains in the latter part of this year.

We expect that as these clouds of concerns continue to disappear and brighter economic conditions emerge, those lagging companies will catch up to this market and move the market higher. In some cases, even companies that have shown stellar performance in the first half of the year show potential for even more growth due to innovations and demand in their internal business sectors.

A Word About Our Bond Portfolio

As you know, we installed a new bond portfolio in the first quarter of this year. The primary reason for this allocation, if you recall, was the fact that bonds had

one of the worst years in history in 2022, which led to very attractive yields with the potential for capital appreciation in the long term once the rate environment normalizes.

There are a few things I want to highlight about this bond portfolio:

- All of the intended bond allocations are now complete. This simply means that we have allocated the bonds to the portfolio based on your risk profile and do not intend to add any more bond positions.
- If you review the performance of this portfolio for the past 6 months, you will find that the portfolio has not shown any growth to date. We do not expect the bond portfolio to grow while there is uncertainty relating to the rate environment. It is also important to note that while the portfolio is not growing yet, it is providing us with a healthy yield distribution of over 4 percent.
- Lastly, what is also important for you to know is that we currently hold short to intermediate term bonds. These are the type of bonds that mature in 2-10 years. Sometime in the near future, as the rate environment settles more, we plan to start replacing these bond positions with more long-term bonds to lock in the yield for a much longer time. If you have questions about this, please don't hesitate to ask us during our reviews.

Our Portfolio Strategy

Our current approach is simple: we believe that the reasons for staying defensive in this market are starting to dissipate. While the primary goal of the strategy still remains "**lose less than the market when markets are down**," it is also important to capitalize on long term opportunities and capture growth as the overall economic environment improves.

Nevertheless, we also believe that this is not an "all boats rise" kind of market. Rather, this is more of a stock-pickers market in which some companies and sectors will have great performance while others will continue to lag due to overarching concerns. For that reason, we plan to move away from buying broad baskets of stocks like ETFs and focus more on individual companies that provide potential for long-term growth in our portfolio.

Segments of equity markets where we see the most potential for growth are technology stocks for their innovative growth potential, the banking sector for its overly undervalued conditions, emerging markets for potentially weaker dollar and COVID recovery, electric vehicle stocks for the growing demand and expanding capacity, travel stocks and some consumer retail stocks. Of course, as you know this list is ever changing based on market conditions and their respective technical chart setups.

Speaking of charts, you know we can't end this outlook without looking at the longer-term chart of the macro market. Let's use the same one we have been using for some time now.

This is the long-term chart of the small cap index. We have been looking at this chart for a few years now. This is the chart that has helped us know when to drive faster and get more aggressive in October of 2020, and give us warning signs of bumpy roads ahead and raise cash in January of 2022. Most of you know this by now, but it's important to point out: I use the small cap index chart as a barometer of the overall market because it is my belief that small cap stocks provide the best insight into the direction of the economy and thus the financial markets. That is simply because smaller companies feel and reflect the subtle changes in the economy a lot quicker than large cap companies.

In any case, let's look at this chart. As you can clearly see, month after month the index continues to hold this line of resistance we drew back in January of 2022.

In fact, in the past couple of months it is showing strong signs of bouncing off this line, something that shows great technical support. In the coming months as the weather in our journey of long-term investing clears, we believe this chart has the potential of coming back and at least testing this resistance line. There is a lot of room for overall growth in this market if things continue to line up as we expect.

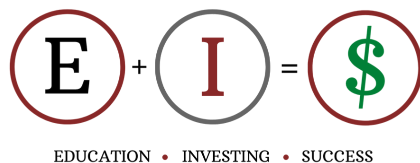
Yes, we've hit some potholes and have weathered some pretty extreme storms, but we've made it through, and clearer roads seem to be ahead. As you can tell by now, we are excited about the future and the prospects it holds for all of us in our financial journey.

Closing

I want to remind you again: the purpose of this update is not to predict the future. No one can do that. The purpose of this update is to inform you of what we are seeing and how we are preparing for it. Of course, if things were to change between now and the next update in 3 months, we would be reporting about those changes and how we adapted to them in the next update or during our next conversation.

We cannot close this piece without highlighting one obvious fact: the above view of the markets and the narration of the events is a general view. You know that every portfolio in Parks Capital is managed based on who you are; thus, they all look a bit different based on your risk tolerance and your individual goals. Please keep that in mind.

We are looking forward to talking with each of you in your quarterly meetings. Remember, education plus investing equals success!



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