P3 Parks Capital

MARKET OUTLOOK Q4 2023
October 2023

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Hi everyone, I am your portfolio manager, Rajiv Dixit, and welcome to the market outlook for Q4 2023. Considering the recent market volatility, I want to structure this outlook a bit differently from my previous outlooks.

A Tale of Two Markets

Today, I want to start out by discussing with you two completely different financial markets. To keep the discussion simple and without any preconceived biases, I plan to keep the names of these markets secret till the end of this section. So, bear with me for a few minutes; it will be well worth your time.

Let's start with Market A:

This market has been on a multiyear run-up (Ex. A). A resilient, long-term trend that has provided consistent positive returns to a long-term investor.

Exhibit A

But if you look a bit closer at this chart (Ex. B), you will find that it hasn't really gone anywhere in the past couple of years. An even closer look tells you that if you invested in this market during the lows of September 2021, you are at the same level as you started. In other words, the 2-year return for this market is approximately 0% in an environment where inflation has had a roundtrip to almost 9% and back, with current inflation levels at around 3%.

Exhibit B

It is fair to mention that even though in the past two years this market index did not provide any return in price, it did give an average dividend yield of over 2%, so the long-term investor did get something for their time in this market in the past two years. It's a moot point, but still worth mentioning in all fairness.

But my primary concern with this market isn't so much that we didn't get much of a return in the past two years. My concern is that we haven't lost much in this market in the past two years. That's a strange concern to have, right? We didn't lose much.

Well, if the economic environment in the country and globally were to become much worse, as some market participants predict, this is the place where there is the most room for downside. In other words, the probability of losing more is higher here than in other markets.

If there is anything you know about our investment style, you know that we make most of our market-related decisions based on charts, indicators, and patterns. They have served us well in the past in keeping up with our primary goal of *losing less than the markets when markets go down.*

When analyzing these charts, we look for signs of weakness and strength in the market. One of the signs of a weak market is the emergence of a Double Top Pattern in price. Market A has recently started showing this sign, signaling more volatility in the future. Now, many other things need to happen for us to predict that more downside is to come conclusively. However, the emergence of this signal is worthy of some caution.

There are other signs that I will mention later in the outlook that also point to potential downside in this market. But for now, in summary, you have just reviewed a market that has had a long-standing record of positive returns but looks weak in the near term, with its only fault being it's not really down that much ... keep that in mind.

Now let’s look at Market B:

Market B is a completely different story altogether (Ex. C). God help those that decided to invest heavily in Market B in September of 2021. If you invested in Market B two years ago, you are down approximately 42%. Wow, that is not a story to write home about.

Exhibit C

In all fairness, Market B also provided some dividend yield of about 2% over the past two years. The yield changes often, so the 2% number is just an estimation. In any case, if you lost 42% in a market in two years, dividend yield is the last thing you are concerned about.

What is also worth noting about Market B is that it is trading at the same level as *March of 2009* (Ex. D). For reference, March of 2009 is the bottom of the Great Recession of the 2008-2009 era.

Exhibit D

So, in other words, Market B is pricing in an economic environment as bad as the Great Recession!

Oh, I forgot to tell you that both markets, A and B, are in the same economy, which means they are exposed to the same economic environment, Federal Reserve, and inflation data. Yet one is pricing in an economy similar to **September of 2021** while the other is pricing in the bottom of the **Great Recession**.

You must be asking yourself: how can this be? How can two efficiently run markets – major markets, I might add – be so different in their valuation of the same economic environment?

No one can say with certainty why this is happening. Or, for that matter, can be certain which market is more correct in its valuation of economic conditions.

What I do know is that the probability of economic conditions becoming worse than in September of 2021 is much higher than the probability of economic conditions becoming worse than in March of 2009. Having managed portfolios in both periods, I can say that with some certainty. Well, this business never has any certainty, but you understand what I mean.

I guess it is time to now tell you that **Market A is the S&P 500 index** (ETF: SPY) and **Market B is the US Long Term Treasury bonds index** (ETF: TLT).

Market Recap

The equity and bond markets have had a rollercoaster in the last quarter. While the equity markets rose significantly in the month of July, as we had predicted in our previous outlook, the months of August and September saw significant corrections in the equities and the bond markets, leading to the following quarterly returns:

- The S&P 500 total return index (comprised of 500 large cap companies) was down **-3.27%**
- The Barclay Aggregate Bond index was down **-3.23%**
- The Small Cap Growth index Russell 2000 was down **-7.32%**

Being down 3% might not seem dramatic given that the S&P 500 is still up for the year, but what concerns me is that in the third week of September, many technical signs emerged pointing to the possibility of much further weakness in the overall equity markets.

One of those signs is the breakdown in the weekly chart of the **Small Cap stock index** (Ex. E):

Exhibit E

In this weekly chart, you can see that the weekly uptrend that started in mid-March of this year broke down significantly in the 3rd week of September.
The monthly chart of the same index has also reversed its uptrend and is now aggressively moving down to retest the support line we drew back in January of 2022, signaling the possibility of further weakness.

Another key barometer of risk is the **volatility index** of the equity market (Ex. F):

Exhibit F

In this monthly chart of volatility index, you also see that the previous downtrend was broken in September, and the volatility is beginning to trend upwards, signaling more turbulence.

The above-mentioned red flags and many other telling signs show that the probability of lower prices in equities is possible. As the primary goal of our active management investment strategy is to *lose less than the market*, **we started to reduce our exposure to equities and move towards cash starting in mid-September.**

While we have reduced our exposure to equities wherever warranted and continue to do so as markets deteriorate, we have chosen *not* to do the same with our bond exposure. This is primarily because of the explanation I discussed in the previous section of *a tale of two markets*.

Our view is that even though there is pain in the bond market right now, the probability of extensive downside, in the long run, is much lower for bonds than it is for equities. In fact, the bond market could be presenting us with an investment opportunity of a lifetime that should be capitalized on for long-term success.

By no means does this mean the pain in the bond market is over – it is not. This market is currently as volatile as the equity market, if not more at times. However, as long-term investors, we must learn to look past the near-term pains and focus on the probability of longer-term success.

The bond markets can also provide us with a healthy dividend yield that helps us buffer our losses and help with the cash flow, even when the bond markets are going through a correction.

The last point regarding our market outlook is that not all is bad in the equity markets. Some parts of the equity markets have the potential to provide enormous growth opportunities to long-term investors. Sectors like artificial intelligence, technology, electric vehicles, and even some large-cap mega names have the potential to grow. Over the past couple of years, we have been building a portfolio of such companies along with exposure to the general markets.

We plan to preserve that portfolio as much as we can in this potential downturn; thus, the selling you will see or have seen in your portfolio will come from the overall exposure to equity funds and not from individual names in general. We believe this correction will provide us with additional opportunities to add more exposure to such companies to help us achieve our financial goals.

Forward-Looking Strategy

Our forward-looking strategy is simple. Since the third week of September, we have transitioned into a defensive mode. We have raised cash wherever warranted and continue implementing our risk mitigation strategies as market conditions deteriorate.

In meantime, we plan to park our excess cash position in the short-term bond fund ETF that yields a healthy dividend yield (30-day sec yield of 5.14% as of 09/26/2023) and comes with very little volatility.

Rest assured, we are actively monitoring these turbulent markets and looking for signs of further weakness and pockets of opportunities.

I know we are all a little tired of the back and forth within the markets over the past two years. But as long-term investors, we also know we get rewarded for our patience through turbulent times. In such times, we need to focus on our long-term goals, staying safe, and staying disciplined with the investment strategy that helps us achieve financial success. Most of us have gone through these market turbulences together before and have emerged successful on the other side. And having seen this before, we know immense opportunities come from market corrections. I want you to remember that.

As always, I am here to answer your questions or address your concerns. Please don't hesitate to reach out directly to me.

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!***

E + I = $

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