GRANT STREET ASSET MANAGEMENT, INC.
QUARTERLY LETTER
3rd QUARTER 2023
OCTOBER 13th, 2023

Despite talk of a pending recession following the Federal Reserve's aggressive 2022 rate hikes, the fundamental economic data for the third quarter continued to build on strength from the first half of the year. Strength was again driven by a resilient consumer and a historically tight labor market. Inflation has eased off its peak from one year ago, and there are still scores of jobs available for those looking. We are starting to see signs of slowdown in the consumer, and as we look to the final quarter of 2023 and beyond, the data we track supports a case for economic growth over the next 12 months, albeit at a slower pace.

The inflation battle remains the top priority for the Federal Reserve (the Fed). It continues to work on lowering the Consumer-Price-Index (CPI) from its current 3.7% level to the central bank's 2% target. We believe this reduction will prove to be more difficult going forward because just a few components of the CPI continue to drive the elevated top line inflation number. The shelter index (housing-related) was up 7% year-over-year in September, and fuel costs jumped 11% month-over-month in August. We believe the bulk of the interest rate increases are behind us, but we do not think that the Fed is completely done yet. As the Fed paused hikes in June and September, it seems the cadence may be a small hike "every other" meeting, while they allow the effects of the 2022 rate hikes to make an impact. Investors have shifted their attention to the two remaining meetings left in 2023, seeking any indication of when potential rate cuts may be on the horizon.

Housing, which makes up over 30% of the inflation measurement, remains one of the stickiest components of inflation, and changes to pricing are likely to happen slowly. The supply of homes (or lack thereof) in the United States continues to support high median home prices. The sale price of existing homes has increased 3.9% in the last 12 months, and the overwhelming majority of homeowners who have a current mortgage rate of less than 4% have been much less inclined to sell their home when the current 30-year mortgage rate is approaching 7%. In many regions of the U.S., it is significantly cheaper to rent than to buy a home today, and this dynamic does not appear to be changing any time soon.

As we take a look at the U.S. consumer, we continue to see evidence of high spending on services and experiences at the expense of goods. An estimated 50 million Americans traveled during fourth of July weekend, surpassing the previous record weekend set in 2019. Travel has rebounded exponentially in the past two years, and demand remains particularly elevated as Americans continue to try and make up for lost time in 2020.

However, we are starting to see cracks in the consumer's ability to maintain this rate of spending. Slower income growth in recent months has led to a drop in the U.S. savings rate to 3.5% from 4.3%. The steady spending is not just reducing savings, but it is also being financed with credit. Credit overdue by thirty days recently reached an 11-year high, and availability of credit for consumers has also started to dry up. Credit card applicants are being rejected at the highest rate in five years, and the average annual percentage rate (APR) on a new credit cards is 24.37%, a level not seen in decades. Perhaps surprisingly, we expect to see consumer spending continue to grow, but at a very modest pace as lending standards and high rates suppress available cash.

A primary driver of sustainable consumer spending is the strength of the labor market. While we have started to see some signs of softening, the overall picture remains much stronger today compared to economists' projections from a year ago. The headline unemployment rate ticked up slightly in August to 3.8%, but it remains well below its 50-year average of 6.2%. There is still a significant imbalance across supply and demand in the labor market. This dynamic leads us to believe that there are at least a few quarters before that relationship approaches equilibrium or starts to deteriorate, and this presents an ongoing challenge for the Fed in trying to control inflation.

Switching gears from the economic data to capital markets, the performance tables shown below summarize that the third quarter proved to be a hiccup for capital markets in an otherwise positive 2023.

Equity Index	**3Q 2023**	**YTD thru 9/30/23**
S&P 500 (Large Companies)	-3.3%	13.1%
S&P 500 Equal-weight Index	-4.9%	1.8%
Nasdaq 100 (Technology-heavy)	-2.9%	35.4%
S&P 400 (Mid-sized Companies)	-4.2%	4.3%
Russell 2000 (Small-sized Companies)	-5.1%	2.5%
MSCI EAFE (Europe, Australia & Far East)	-4.1%	7.1%
MSCI Emerging Markets	-2.9%	1.8%
MSCI ACWI (All Country World Index)	-3.4%	9.3%

Source: Morningstar Direct

Equity markets took a bit of a breather in the third quarter, particular the latter half, after a very strong first half of the year. The S&P 500 index followed a strong June with another month of solid gains in July (+3.2%). However, the momentum quickly faded as the index finished down in August (-1.6%) and suffered a sell-off in September (-4.0%).

While market-cap weighted S&P 500 is still posting double digit returns, this index does not reflect broad equity performance this year. The bulk of the S&P 500 performance has been derived from a select few well-known technology names that were recently dubbed "The Magnificent Seven": Apple, Microsoft, Amazon, Google, Nvidia, Tesla, and Meta. They make up nearly 30% of the index weight and account for nearly 90% of the YTD return. Diversification outside of those seven stocks has been a drag on performance when comparing to that benchmark. The S&P 500 equal-weighted index contains the same 500 stocks, just equally weighted. The differential in performance is 11.3%, a historically high level not seen since 1999 and following the covid 2020 rebound. Only 27% of S&P 500 stocks have outperformed the entire index, which is the lowest percentage seen in 25 years. This is important when evaluating performance because most stocks globally have posted mid-single-digit returns year-to-date and not the double digit returns of the Magnificent Seven.

Fixed Income Index	**3Q 2023**	**YTD thru 9/30/23**
Morningstar US Core Bond	-3.2%	-1.2%
U.S. 10-year Treasury	-5.1%	-3.5%
ICE BofA 1-3 Yr. U.S. Treasury	0.7%	1.7%
U.S. 3-month T-Bills	1.3%	3.6%
ICE BofA U.S. High Yield	0.5%	6.0%
ICE BofA 7-10 Yr. Municipal Bond	-3.4%	-1.7%
Credit Suisse Leveraged Loan Index	3.4%	9.9%

Source: Morningstar Direct

Shifting to fixed income, traditional bonds saw yields grind slowly higher throughout the quarter as inflation remained elevated and employment strong. Investors realized the Fed was likely not done hiking rates, and as a result, bonds provided minimal relief as a diversifier. The aggregate bond index finished in the red for each month, totaling a -3.2% loss for the third quarter. The index is now in negative territory for a second year in a row. Floating rate bank loans have been one of the best performing sectors across fixed income in 2023. The Credit Suisse Leveraged Loan Index is up +9.9% year-to-date, significantly outpacing high yield bonds by almost 4%, beating the U.S. aggregate bond index by over 10% and outperforming the majority of individual stocks. Despite near-term pricing pressures, traditional fixed income is finally providing investors with a yield that outpaces inflation (CPI).

GSAM's investment committee has been active within the defensive side of client portfolios recently, and we continue to seek attractive entry points into intermediate-term bonds. The investment committee took advantage of the increase in the 10-year Treasury yield, as it eclipsed 4%, to reduce short-term bond exposure and increase duration with additional intermediate-term bonds. For the first time in over a year, intermediate-term bonds now account for the majority of our defensive side of the portfolio. We believe the bulk of the Fed's interest rate hikes are behind us, and that there are more ways duration may benefit the portfolio, rather than detract from it going forward. Within GSAM's equity allocation changes have been minimal, other than shifting some large and small value index investments to active strategies investing in companies generating high cash flows. Portfolios remain overweight U.S. large cap relative to mid-cap, small-cap and international stocks. Healthcare stocks have struggled this year, but our conviction in the sector theme remains intact for the long-term due to consistent demand and currently reasonable valuations.

We expect economic growth to continue, however we anticipate weakening economic data through 2024 as the consumer and businesses acclimate to higher interest rates. On the inflation front, we are monitoring energy and housing prices specifically, which could provoke the Fed to continue raising rates. Fixed income should provide protection in an equity pullback, with higher yields to lean on, and performance across equities is likely to broaden away from the Magnificent Seven. The GSAM investment committee remains committed to our diligent evaluation and analysis process as long-term investors, and we thank you for your continued confidence in our team.