Kenneth A. Gilpin CFP

Sound Investments Inc.

3rd Quarter 2023

DJIA 33,507 S&P 500 4,328 Nasdaq 13,377

Summary

It's the first time in 10 years that one could get a decent return from interest income. Rates on certificates of deposit or CD's guaranteed by the government, are now approximately 5.6% per year for 9 months. We are looking to get back to a more traditional 60 / 40 portfolio (ie 60% equities / 40% bonds). This portfolio is less volatile so investors are more likely to stay the course.

Employers added 336,000 jobs in September, the strongest gain since January, and up sharply from the prior months gain of 227,000. The job growth data shattered investors expectations. It is the latest sign of accelerating economic momentum and it sparked concern that interest rates may have to be raised again to slow the economy and keep inflation in check.

Corrections are a normal and unavoidable part of market life, and while we don't know if this one is over, it's been fairly mild so far. We are watching earnings reports this quarter, which are expected to be flat, but increase in 2024. There are many head- winds facing the market. At some point we'll have a recession but I don't expect one in 2023 and most likely not in 2024, either.

This investment letter is mailed quarterly to our clients and friends.

Sideways Walk

In our last client letter, we discussed how narrow the market was, meaning only a hand full of high teck stocks account for most of the gains. The S&P equal weight index, as it's name implies, weighs all stock the same and was down 1.3% year to date. The weight or normal index was up 13%. Meanwhile, the Dow-Jones and small-cap Russell 2000 are basically flat, year to date. Higher interest rates brought the marketdown 6%

Another way to look at it is to look at the price of the stock divided by its earnings, known as the Price / Earnings ratio. The S &P 500 which represents 500 companies, has an average price / earnings ratio of 21.4 times earnings. The 10 largest teck companies have a high multiple of 27.5 and the remaining 490 companies ratio is 10 points lower at 17 times times earnings. The balance of this letter addresses how the economy is doing and the factors currently influencing the market.

Doing Better Than We Thought

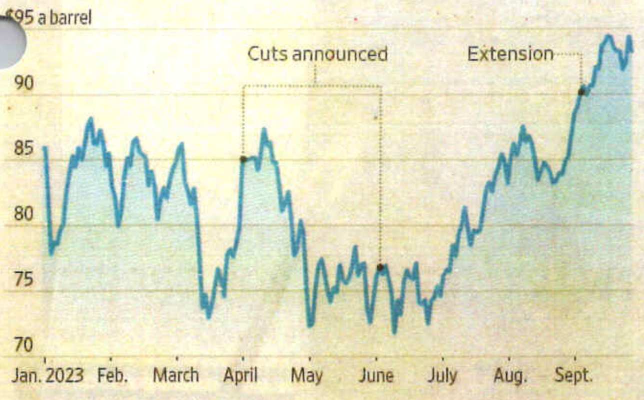
Given the current challenges, it's impressive that the economy is still growing. The US economy maintained a solid pace of growth in the 2nd quarter. It has been improving since the Covid downturn, but there is a disconnect. A Harris poll found that most Americans believe the economy is in bad shape, that wages are falling and unemployment is high. This is despite the fact, the economy is improving, wages are growing faster than inflation and the unemployment rate in August was near a 50 year low.

The Labor Markets Remarkable Run

Employers added 336,000 jobs in September, the strongest gain since January, and up sharply from the prior months gain of 227,000. The job growth data shattered investors

Sound Investments Inc. / Kenneth A Gilpin CFP
913.908.4366

Brent crude-oil futures, most active contract

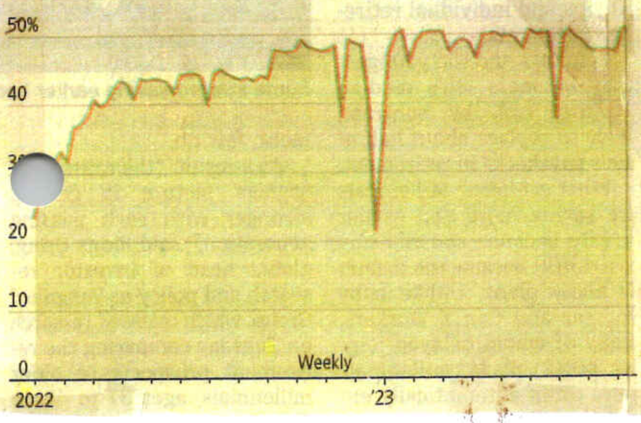


Government budget balance, quarterly

$40 billion

The 2 WARS in the URKAINE and ISRAEL-GAZA have pushed up oil Prices. The United States is the biggest producer in the world, so it may be a good thing. Gasoline is predicted to remain in the $3.25 - 350 a gallon range

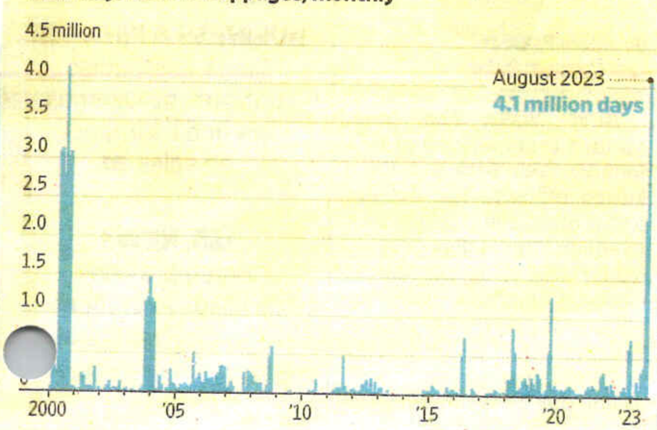
Percentage of workers returning to office compared with pre-pandemic, 10-city average*



New York's office return rate ranges from about 25% to 65%.

According to this chart only 50% of employees have returned to the office. With a shortage of workers employers have compromised so that workers come in 2/3 days a week and work the balance at home.

Workdays lost to stoppages, monthly



Note: Calculated by multiplying the number of workdays lost each month in a stoppage by the estimated number of workers involved. Stoppages include strikes and lockouts. Data for 2023 are preliminary.
Source: Labor Department

With higher inflation employees want higher wages.

We think working folks are going to get a bigger slice of the American Pie.

We are alert to the above issues.

expectations. It is the latest sign of accelerating economic momentum and it sparked concern that interest rates may have to be raised again to slow the economy and keep inflation in check.

Another sign of a hot economy, is that in August, the US has lost more workdays to labor unrest than any year since 2000. (see chart) **Other issues are higher oil prices** (see chart). We feel the economy will continue to do well but it may not translate into a robust stock market due to competition with higher rates on short term CD's and bonds.

Mankind's Greatest Invention

Sam Brofman, who started out managing a bar in northern Ontario, eventually established the spirits company, Seagrams, and finally owned 20% of Dupont.which employed over 50,000 people at the time. He was asked what mankind's greatest invention was. He paused for some time and finally blurted out .... interest rates.

From 1982 to Jan 2022 Interest Rates fell from 18% to 2.74% on a 30 year mortgage. (see chart). Since then, rates have shot up sharply to over 7.4% for the same 30 year mortgage. This turn of events resulted in not only the worst bond market ever but has far-reaching effects. For instance, the major expense of say a 50 story office building is interest. With rates more than doubling and people working from home, a building like this now has negative cash flow. Banks that hold these mortgages may be underwater as well. Higher interest rates are just starting to work their way through the economy. (see chart). Sectors of the economy that have a high debt load, and will be most affected are utilities, airlines, real-estate, auto loans, credit card companies etc.

The chart on the back shows whether it's better to invest in bonds or stocks and it has a fancy name; the **equity risk premium.** It's worth a look.

Asset Allocation and Conclusion

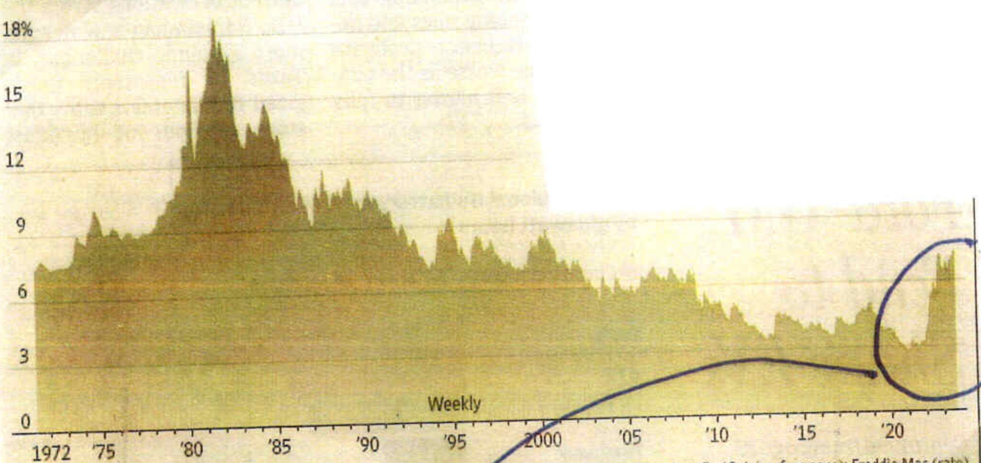
In our last client letter we expressed how this was the first time in 10 years that one could get a decent return from interest income. Rates on certificates of deposit or CD's guaranteed by the government, are now approximately 5.6% per year for 9 months. We are looking to get back to a more traditional 60 / 40 portfolio (ie 60% equities / 40% bonds). This portfolio is less volatile so investors are more likely to stay the course.

Corrections are a normal and unavoidable part of market life, and while we don't know if this one is over, it's been fairly mild so far. We are watching earnings reports this quarter, which are expected to be flat, but increase in 2024. There are many head-winds facing the market such as inflation, ongoing wars, and possible higher interest for much longer, so we are taking a cautious approach. At some point we'll have a recession, but I don't expect one in 2023 and most likely not in 2024, either.

We welcome your calls.

Kenneth A Gilpin CFP, Sound Investments Inc. 913-908-4366

Average rate on a 30-year fixed mortgage



*August 2023 data is preliminary.

Sources: National Association of Realtors (existing-home price); FactSet (performance); Freddie Mac (rate)

~8%

A spike in interest Rates.
We Think Rates can come down To the 5-6% Range.

S&P 500 earnings yield and yield on 10-year Treasury

Equity Risk Premium.

The difference between the estimated Real Return on stocks and estimated Real Return on safe bonds.

When the 2 indexes are wide Apart Equities or stocks do better.

When 2 indexes ARE closer Together bonds Tend To do better.

Note: Through Oct. 6

Sources: Dow Jones Market Data; FactSet; Tradeweb ICE