3rd Qtr. 2023 Investment Counsel Report

Market Summary

Equity markets belied weakness over the 3rd quarter of 2023, with most all stocks and benchmarks heading lower. The range of returns was broad, and overall for the full year-to-date stocks stood in generally positive territory. Rising interest rates are starting to have a heavy bearing on everything from the stock market, to bond prices, and on the economy itself.

For the third quarter of 2023, the large stocks of the S&P 500 Index fell -3.3% after beginning the quarter positively. For the 9 months thus far into 2023, the S&P 500 Index remains at a very healthy +13.1%. This above average result suppresses the general experience of broader market averages, and also should be considered in the context of the -18% fall incurred during 2022. From January, 2022 through September, 2023, the S&P 500 Index was -7.3% - still underwater for this period.

Considering other benchmark's performance can also add context beyond the "Magnificent 7" stocks that heavily dominate the S&P 500. We have written about this narrow phenomenon in prior communiques, where essentially the largest 7 stocks of the S&P 500 Index are up 50% on average this year, and the other 490 near flat. The smaller stocks of the Russell 2000 Index fell -5.1% for the prior 3 months, and stood at a comparatively meager +2.5% for the YTD. Foreign stocks measured in the EAFE Index retreated -4.0% for the recent quarter, and clocked in at +7.6% for the year thus far.

Aurora Perspective

Coming back to the topic of interest rates, the importance and impact of the rising trends are being felt most everywhere. We have noted the rising government spending and deficit turmoil in prior reports, which we view as causal. The credit rating of US Treasury debt has received minor downgrades as a result, and has led to increased pressure on Congress (with increasingly fractious argument leading to government shutdown proximity and a Speaker of the House recall). Inflation, Fed Policy, higher rates are all making it harder for corporations to increase profits- hence the negative influence on the stock market. Rising rates also create competition for the stock market in the form of attractive returns in fixed income markets and even from safe short term money market alternatives.

Further impacts of higher rates seem to be more slowly working into the economy at large. Consumer spending has not been noticably slower- with signs of caution in discretionary goods purchases like boats and cars and some housing weakness. Corporate spending is slowing, and it is here that we are actively choosing to avoid the most capital intensive businesses and actively seeking out companies with stronger balance sheets and self funding cash flow. Up to now, there aren't many specific indications that companies are stuggling to fund their operations, but our concern is that liquidity from credit markets is drying up and the higher rates will stifle companies that are debt reliant.

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In prior writings, we have sounded a small warning around the weaker conditions for the stock market as a whole. This caution seems to have played out for the broader market averages, excepting the S&P 500 and its increasingly narrow dominance by a few very large tech companies. This narrow weighting and narrow positive performance is a sign of weakness in our view. In past market cycles, this narrow strength genrally gets corrected with a reversal of investor favor, which is why we have avoided these expensive stocks.

The flip side to this equation is that there are increasing numbers of cheap stocks elsewhere- especially relative to the earnings growth of our recommended holdings. By remaining focused on our Growth At a Reasonable Price (GARP) discipline and avoiding the higher leveraged companies exposed to higher interest rates, we gather some confidence that appreciation opportunities remain at an acceptable level of risk. Despite our wariness described above, we are finding solid growing companies at cheap valuations- giving us confidence in these stocks' ability to deliver adequate returns.

Aurora Outlook

With the economy weak and possibly approaching recession, and with rising rates and inflation visible- we view the next few months with caution. Having said this, Aurora invests in the stock market for long term returns, and for appreciation to overcome inflation burdens on our clients' future spending. We have invested in and through many economic cycles and recessions successfully by staying true to our Growth At a Reasonable Price (GARP) approach. We remain confident in this approach, and that the lower prices of some stocks today provide adequate compensation for the short term risks present.

Aurora's investment discipline is geared towards achieving adequate long term equity returns, while avoiding excess risk. In years past (and in the year 2022), we have aided clients by achieving less negative returns when the overall market was weak. We believe that being a price conscious investor allows our clients to be rewarded for the short term risks the stock market presents, with lower volatlity. By steering clear of market fads and euphoric pricing trends, we trust clients can enjoy repeat long term results.

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