Capital Markets Commentary and Quarterly Report: 3rd Quarter 2023

Capital Markets Highlights

The S&P 500®[1] declined by -3.27% in the third quarter. The pullback was largely a reaction to sharply higher interest rates in the quarter, with the yield on the 10-year Treasury rising by 0.73% to 4.57%, its highest level since 2007, and 30-year fixed mortgages above 7%, its highest rate since 2000[2].

Adding to investors' worries were data suggesting that the economy is slowing, ongoing labor strikes, the unknown negative impact from the resumption of student loan bills for approximately 43.5 million people in October after a 3.5-year hiatus[3], and a budget impasse that threatens to shut down government services and paychecks for millions of workers.

The S&P 500's return for the first nine months of the year was up +13.04%. After a narrow market rally in the first half of the year that was dominated by a small number of mega-cap growth stocks, returns were more balanced in the third quarter. The Growth and Value Indexes[4] had similar returns in the quarter, each down a little more than -3%. The equally weighted S&P 500 Index was down -4.90% in the quarter and up +1.69% for the year through September 30.

During the third quarter, the Federal Reserve raised interest rates by another 0.25%, increasing the Fed Funds rate at their July meeting to 5.25%-5.50%. The Fed left the Fed Funds rate unchanged at their September meeting but left open the possibility of one more interest rate hike before year-end. Their comments about keeping interest rates higher for longer rocked the bond market. Interest rates rose across the yield curve and led to a late September stock market sell-off.

Our Thoughts Going Into Q4

The U.S. economy has been surprisingly resilient in the face of higher interest rates. Businesses have adapted well to changing circumstances and corporate earnings have generally met or exceeded expectations so far in 2023[5].

Looking ahead, despite some challenging near-term economic and political headwinds, we think a tight labor market with a national unemployment rate that has been below 4% for the past 19 months[6] should provide a good cushion against the deceleration in growth we think is coming.

On the plus side, we anticipate that earnings and dividends will be higher in 2024. Progress on inflation is likely to continue, and interest rates should stabilize soon and then begin to move lower

---

[1] All references to the stock market are the S&P 500® unless otherwise noted.
[2] Source: Freddie Mac, Forbes, Curios
[3] The Motley Fool 9/26/2023
[4] Russell 1000 Growth & Value Indexes
[5] Matrix proprietary earning analysis with data from S&P 500® and Bloomberg.
[6] Bureau of Labor Statistics

sometime next year. In that scenario, the current attractive valuations for many high-quality companies should lead to good future returns for equities.

In our view, the greatest near-term challenge for the stock market is the rapid move higher in interest rates and the Fed's belief that "the process of getting inflation sustainably down to 2% has a long way to go[7]". The market is worried that the Fed is continuing to misread the trajectory of inflation. They were behind the curve in the early days, missing obvious signals when it was well underway in 2021, and now may be making the mistake of staying the course on higher rates for too long and doing unnecessary damage to the economy.

Interest rates are now at the highest levels since 2008 and they are starting to bite. Recent economic data clearly show how higher rates are slowing economic growth. Corporations are closely watching expenses and slowing hiring. If the Fed keeps rates high for too long, consumers will be forced to cut back on their spending and the economy will inevitably slow, in our opinion.

Many households and businesses have fixed loan rates from a few years ago that are much lower than current rates. Until now, many have been unaffected by the jump in interest rates over the past 18 months. But higher rates are impacting new purchase activity by consumers and investment spending by businesses.

We believe that the Fed will soon see enough evidence of an economic slowdown caused by higher rates that they will end their interest rate increases by the end of this year and reluctantly move to lower them sometime next year. Their forecast in September implies one more rate hike this year and then two rate cuts next year.

The Fed's forecast looking one year out has been notoriously inaccurate[8]. While the market has reacted very negatively to the higher for longer comments and the forecast for very modest rate cuts in the upcoming year, we think that the Fed could lower rates more aggressively if inflation progress continues and the current economic headwinds slow the economy more than currently anticipated. It is currently in the Fed's interests to sound as hawkish as possible in their commitment to fight inflation until they pivot and move toward a more dovish policy.

We think that good corporate profitability, improving inflation and a reaccelerating economy in 2024 should drive the next market rally after the recent pullback. An encouraging sign for equities is that M&A activity and new IPOs have had a resurgence recently. This is frequently an indicator that business owners and managers are more confident in their own businesses and the business environment overall.

The near-term wild cards are the length of labor strikes and a possible government shutdown, but both will eventually be resolved, and the risk of regional escalation of the war in Israel.

Large Cap Value Strategy

After a strong start to the year, Matrix's Large Cap Value Portfolio (LCV) was down modestly in the third quarter of 2023, declining less than the pullbacks in the S&P 500 and the Russell 1000® Value Indexes. For the first nine months of the year, the LCV portfolio is up low double digits,

---

[7] Transcript of Chair Powell's Press Conference September 20, 2023
[8] CNBC September 20, 2023, *Trader Talk: Take the Fed forecast with a grain of salt. It has a terrible track record.*

trailing the technology-heavy market cap weighted S&P 500 but nicely ahead of the equally weighted S&P 500 and the Russell 1000 Value Indexes.

The portfolio continues to be led by many of last year's weakest stocks and sectors, although more stocks and sectors have contributed to the portfolio's performance since the beginning of June as the market rally broadened.

In addition to last year's fallen angels in Technology (Apple, Amazon, Google, Meta, Microsoft), stocks in a variety of other sectors and industries contributed to the portfolio's results: Booking Holdings in Consumer Discretionary, Comcast in Communication Services, JPMorgan in Financials, FedEx in Industrials and Fiserv in Tech/Financials.

Looking forward, we expect 2023 leadership areas like Consumer Discretionary, Technology, and Communications Services to move higher but at a slower pace, and laggards like Financials and Health Care to drive the portfolio higher.

In Q3, we started a new position in RTX Corp., formerly Raytheon Technologies, an aerospace and defense company that provides advanced systems and services for commercial, military and government customers worldwide. The company was formed in 2020 through the combination of Raytheon Company and the United Technologies Corporation aerospace businesses. We had previously owned United Technologies and were impressed with their CEO, Greg Hayes, now the CEO of RTX. The opportunity to purchase RTX came after the company disclosed a problem with an engine component that will result in a significant charge to inspect and replace. This is a fixable issue requiring time and money, but we believe the price decline provided a good opportunity to start a position in this highly profitable, well-managed company.

We trimmed FedEx and sold Booking Holdings as they became oversized and/or approached fair value. We increased holdings in L3Harris and UnitedHealth Group, and began to rebuild the position in Zimmer, as the stock had a meaningful decline since our scale back in June.

On September 30, the average P/E multiple of the LCV portfolio was 15.6x and 13.9x on 2023 and 2024 estimated earnings, well under the S&P 500's 19.4x and 17.3x estimated P/Es. The average embedded appreciation potential of the portfolio was at 49.9%, well above its long-term average.

Overall, the companies in the portfolio showed strong operating performance vs. expectations in their recent quarterly reports, impressive against frequent descriptions of the current economic environment as "tough."

We believe that the LCV portfolio is well-positioned to consolidate and add to its 2023 gains, as its holdings continue to perform well even as the general business and financial environment has become more uncertain. We think our stocks trade at very attractive valuations that can expand as the market recognizes their solid performance. We look for many of the stocks that lagged in the first part of the year to emerge as the new leaders going forward.

Dividend Income Strategy

Since June 1, the market's rally has broadened beyond its very concentrated strong performers and MDI's relative performance has improved. In the third quarter, the MDI portfolio was down modestly and outperformed the S&P 500 and the Russell 1000 Value Indexes. Performance was in line with or better than the dividend indexes.

However, this relative progress was not enough to offset the slow start to the year. The Dividend Income (MDI) portfolio has lagged the Russell 1000 Value Index this year and is well behind the S&P 500 but has performed in line with other dividend indexes[9] through September 30.

The key reason for MDI's significant lag is that very few of the stocks responsible for the market's strong results in 2023 to date are dividend payers, and thus are not even candidates for inclusion in the Dividend Income portfolio. It is important to note that even with the lag this year, the Dividend portfolio has modestly outpaced the S&P 500 and is in line with the Russell 1000 Value Index since the start of the decline on 12/31/21, with a lot less volatility.

In the third quarter, the portfolio sectors contributing most to results (sector weighting times sector performance) were Health Care and Communication Services. The largest detractors of performance were the Technology and Utility sectors.

Looking forward, we expect gains in Technology, Financials, and Health Care to drive portfolio returns. We are also rebuilding our Utility exposure, as we believe the significant 2023 underperformance has positioned the sector for strong gains going forward.

During the quarter, we started a new position in NextEra Energy (NEE), the owner of Florida Power & Light (FPL), a regulated utility, and NextEra Energy Resources, the largest unregulated alternative power producer (wind, solar, battery) in the United States. FPL has benefitted from Florida's population and business growth. In addition, Florida's regulators have been business-friendly and allowed the utility to raise rates, earn a good profit, and build out its infrastructure. As a result, NextEra has historically shown earnings and dividend growth above the Utility group average. On September 30, the current dividend yield was 3.3%.

NEE disclosed some business setbacks after our initial partial purchase causing the stock price to decline further. We are very comfortable that they have a best-in-class franchise, and we are slowly continuing to build our position into the stock price weakness. We are upbeat about NextEra and the utility group in general after its poor performance this year.

We trimmed Amgen as its strong performance created an overweight position and sold Unilever to fund more compelling opportunities. We made incremental purchases in American Electric Power, Pfizer, and Texas Instruments.

In the third quarter, four holdings increased their dividends by an average of 6.5%. So far in 2023, 17 of our companies have announced dividend increases, with an average raise of 6.8%. We expect six more companies to raise their dividends before year-end. During a period of increasing

[9] Vanguard High Dividend Yield (VMY) and SPDR S&P Dividend ETF (SDY).

economic uncertainty, the number and size of the increases are notable, demonstrating their desire and ability to return capital to shareholders via attractive dividend policies.

On September 30, the portfolio had a 3.35% dividend yield, which compares favorably with the 1.61% yield on the S&P 500 and the 2.47% yield on the Russell 1000 Value.

Companies in the Dividend Income portfolio had another strong quarter of operations. Though our stocks' performance generally has not reflected the business' operating performance in the short term, we strongly believe this dichotomy is unlikely to persist for an extended period. Consequently, we are very upbeat about the portfolio's prospects for the balance of the year and going forward.

On September 30, the Dividend Income portfolio was very attractively priced, with average P/E multiples of 15.1x and 14.2x estimated 2023 and 2024 earnings, well under the S&P 500's 19.4x and 17.3x estimated P/Es. The embedded appreciation potential of the portfolio was at 44.7%, significantly above its long-term average.

Summing up, MDI was modestly down through the first nine months in 2023 and well behind the S&P 500 in the current year but because of our modest losses in last year's bear market the Dividend Income strategy's performance since the beginning of 2022 is slightly ahead of the S&P 500 Index with much less volatility. Also, the majority of the portfolio's holdings have raised their dividends again in 2023 and we expect more to do so in the fourth quarter. These are two of the strategy's goals: be more protective than a tumultuous market while generating strong and growing current income.

Bonds

Bond returns were mostly flat or down in the third quarter as interest rates rose across the yield curve. Only very short-term bonds had a positive return for the three-month period and the year-to-date through September 30. The yield on the 10-year Treasury rose to 4.57% in the quarter versus 3.84% at the end of the second quarter and 3.88% at the start of the year.

We believe that the Federal Reserve is nearing the end of its rate hiking cycle even as it continues to talk tough about keeping rates higher for longer. Though inflation is still higher than the Fed's longer-term goal and another interest rate hike is possible this year, we believe the combination of more progress on inflation and slower economic growth is in the cards, setting up a better outlook for bonds in 2024.

With that in mind, after the recent increases in rates this quarter and after a long period of concentrating bond investments in short-term securities of two years or less we began extending maturities in the third quarter to two-four years. Looking ahead, if interest rates stay at these levels or move higher, we anticipate extending maturities further to four-seven years. After a long period of very low rates, fixed income investors are finally getting paid a reasonable interest rate for investing in bonds.

As a result of changes in the yield curve and rates in different fixed income areas, for taxable accounts in higher tax brackets where municipal bonds are part of their investment mandate, we are also buying more municipal bonds when their current yield equivalent is nicely higher on an after-tax return than a Treasury with a similar maturity.

Matrix's fixed income positioning has been very conservative in recent years, focusing on high-quality corporates, U.S. Treasuries, agencies, and municipals with nearer-term maturities. This has served our clients well in the 2022 bond market sell-off and so far in 2023. The recent movement in interest rates along the yield curve and among various fixed income asset classes has created an opportunity not seen in years, and we are making portfolio changes to capitalize on this opportunity. We expect to be more active in fixed income portfolios than we have been in some time.

Our taxable and municipal bond portfolio returns were modestly positive in the quarter and for the first nine months of the year and results were generally in line with or better than our benchmarks and compare favorably to the overall bond market.

Balanced Accounts

After a difficult 2022 for both stocks and bonds, 2023 has been a mixed bag for balanced portfolios. Parts of the stock market have been strong, but the equally weighted S&P 500 was only marginally positive through September 30 while bonds are having another challenging year as interest rates have moved higher.

From here we are upbeat in our outlook for balanced portfolios. As fixed income rates have moved significantly higher this year, we are increasingly upbeat about the prospects for fixed income portfolios in the near and intermediate term. After years of looking at fixed income as a placeholder and a way to lower overall portfolio volatility, we think bonds should be a nice positive contributor to returns.

We are also very upbeat about the prospects for stocks and continue to overweight equities in balanced portfolios. Many areas of the stock market are very attractive after significant pullbacks, while earnings and dividends should be higher next year compared to 2023.

After a prolonged period where both stocks and bonds have had sub-par returns, we look for both asset classes to show good performance in upcoming periods.

****

Thank you for the trust you have placed in us. Please contact us with any questions you have about the information in this commentary or your portfolio.

Disclosure:

The information provided is for demonstrative and academic purposes and is meant to provide valuable insight into market cycles, NOT a recommendation to buy or sell any security. Any investments referenced above may currently be held or traded by Matrix Asset Advisors. Investment Advisory Services are offered through Matrix Asset Advisors, an SEC Registered Investment Adviser. No offer is made to buy or sell any security or investment product. This is not a solicitation to invest in any investment product of Matrix Asset Advisors. Matrix Asset Advisors does not provide tax or legal advice. Consult with your tax advisor or attorney regarding specific situations. Opinions expressed are subject to change without notice and are not intended as investment advice or to predict future performance. Investing involves risk, including the potential loss of principal. No investment can guarantee a profit or protect against loss in periods of declining value. All information is believed to be from reliable sources; however, we make no representation as to its completeness or accuracy. The Securities identified and described do not represent all of the securities purchased, sold, or recommended for client accounts. Actual portfolio holdings may vary for each client and there is no guarantee that a particular client's account will hold any or all of the securities identified. The reader should not assume that an investment in the securities identified was or will be profitable. Opinions and projections are as of the date of their first inclusion herein and are subject to change without notice to the reader. As with any analysis of economic and market data, it is important to remember that past performance is no guarantee of future results. The securities identified and described herein may not represent all the securities purchased, sold, or recommended for client accounts. The reader/viewer should not assume that an investment in the securities identified was or will be profitable.
All data is through (or as of) 9/30//2023 unless otherwise noted.
For more information about Matrix Asset Advisors, please visit our website at www.MatrixAssetAdvisors.com. Our website includes our firm's Client Relationship Summary document.

Definitions:

S&P500 ® Index *is a broad-based unmanaged index of 500 stocks, which is widely recognized as representative of the equity market in general. You cannot invest directly in an index.*
Russell 1000® Value Index *measures the performance of those Russell 1000® Index companies with lower price-to-book ratios and lower forecasted growth values.*
Fixed Income *type of investment security that pays investors fixed interest or dividend payments until their maturity date.*
Inflation *is a sustained increase in the general level of prices for goods and services.*
Treasury Securities *often simply called Treasuries, are debt obligations issued by the United States Government and secured by the full faith and credit (the power to tax and borrow) of the United States.*
Interest Rate *is the amount a lender charges a borrower and is a percentage of the principal—the amount loaned.*
Fed Funds Rate *is the interest rate at which depository institutions lend reserve balances to other depository institutions overnight on an uncollateralized basis. Reserve balances are amounts held at the Federal Reserve to maintain depository institutions' reserve requirements.*
P/E Multiples *the ratio for valuing a company that measures its current share price relative to its per-share earnings.*
The Yield Curve *is a curve on a graph in which the yield of fixed-interest securities is plotted against the length of time they have to run to maturity*
Market Valuation *is the value of an asset based on the price that would be paid for it if it were sold at a certain time.*
Unemployment *when someone can work and wants to work but is unable to find employment. The Bureau of Labor Statistics (BLS) specifically defines unemployed persons as those who don't have a job but are available for work and have looked for work in the past four weeks.*
Dividend Yield *is a financial ratio that tells you the percentage of a company's share price that it pays out in dividends each year.*
Earnings per Share (EPS) *is a company's net profit divided by the number of common shares it has outstanding. EPS indicates how much money a company makes for each share of its stock and is a widely used metric for estimating corporate value.*
Municipal Bond *is a bond issued by state or local governments or entities they create such as authorities and special districts. In the United States, interest income received by holders of municipal bonds is often, but not always, exempt from federal and state income taxation.*

Financials *a section of the economy made up of firms and institutions that provide financial services to commercial and retail customers.*
Health Care *all businesses involved in the provision and coordination of medical and related goods and services.*
Information Technology *businesses that sell goods and services in electronics, software, computers, artificial intelligence, and other industries related to information technology (IT).*
Consumer Discretionary *an economic sector classification of non-essential consumer goods and services.*
Communication Services *includes companies that sell phone and internet services via traditional landline, broadband, or wireless. The communications sector also includes companies that create and produce of movies, television shows, and other content.*
Growth Strategy *a collection of business initiatives that seek the maximization of a company's value within a period.*
Operating Results *measures the amount of profit realized from a business's operations after deducting operating expenses such as wages, depreciation and cost of goods sold.*
US Governments *(Treasuries) are debt obligations issued by the United States Government and secured by the full faith and credit (the power to tax and borrow) of the United States.*
Agencies *a low-risk debt obligation that is issued by a U.S. government-sponsored enterprise (GSE) or other federally related entity.*
Federal Reserve *is the central banking system of the United States. It was created on December 23, 1913, with the enactment of the Federal Reserve Act, after a series of financial panics led to the desire for central control of the monetary system in order to alleviate financial crises.*
Economic Growth *an increase in the production of economic goods and services, compared from one period of time to another*
Dividend Income Large Cap Core *- the largest U.S. companies, or those with market capitalizations of $10 billion or more, where neither growth nor value characteristics predominate.*
Large Cap Growth *- shares of the largest U.S. companies, or those with market capitalizations of $10 billion or more, that are projected to grow faster than other large-cap stocks.*
Large Cap Value - *shares of the largest U.S. companies, or those with market capitalizations of $10 billion or more, that are considered underpriced based on fundamental analysis.*
companies that pay out regular dividends.
Value Strategy *investment strategy that involves picking stocks that appear to be trading for less than their intrinsic or book value.*
Balanced Accounts *combines asset classes in a portfolio in an attempt to balance risk and return. Portfolios are divided between stocks and bonds, either equally or with a slight tilt, such as 60% in stocks and 40% in bonds. Balanced portfolios may also maintain a small cash or money market component for liquidity purposes.*
Embedded Appreciation *Matrix's measure of potential upside of a stock from its market price to our estimate of its fair/intrinsic value.*
Geopolitical *the study of how geography and economics have an influence on politics and on the relations between nations*
Energy Sector *is the totality of all the industries involved in the production and sale of energy, including fuel extraction, manufacturing, refining and distribution.*
Utility Sector *companies that provide electricity, natural gas, water, sewage, and other services to homes and businesses.*
Manufacturing *the making of goods by hand or by machine that upon completion the business sells to a customer.*
Distribution Logistics *combines all the moving parts that drive retail. It is a combination of processes that efficiently move goods through the fulfillment process, from warehouse to end customer.*
10-year Treasury Yield *the yield that the government pays investors that purchase the specific security.*
Equal Weighted Index *a stock market index – comprised of a group of publicly traded companies – that invests an equal amount of money in the stock of each company that makes up the index. Thus, the performance of each company's stock carries equal importance equity is in determining the total value of the index.*
Hawkish *a financial advisor or policymaker who believes that monetary policies should maintain high-interest rates to curb inflation. They are primarily interested in high-interest rates as they relate to Fiscal policy.*

Dovish *tend to support low interest rates and an expansionary monetary policy because they value indicators like low unemployment over keeping inflation low. If an economist suggests that inflation has few negative effects or calls for quantitative easing.*

Balanced Accounts *combines asset classes in a portfolio in an attempt to balance risk and return. Portfolios are divided between stocks and bonds, either equally or with a slight tilt, such as 60% in stocks and 40% in bonds.* ***Balanced portfolios*** *may also maintain a small cash or money market component for liquidity purposes.*
Taxable accounts *are accounts where the normal IRS tax rules apply. In a taxable account, you pay taxes on interest, dividends, and capital gains, in the year in which you earn them.*
Corporate Profitability *a measure of an organization's profit relative to its expenses.*
Mergers & Acquisitions (M&A) transactions *in which the ownership of companies or their operating units — including all associated assets and liabilities — is transferred to another entity.*
IPO *a company's ownership is transitioning from private ownership to public ownership. For that reason, the IPO process is sometimes referred to as "going public."*
Volatility *the degree of variation of a trading price series over time, usually measured by the standard deviation of logarithmic returns.*