HFG | TRUST

MARKET REVIEW

› 3rd QUARTER 2023

EXECUTIVE SUMMARY

- The stock market underperformed in Q3, while bonds experienced mixed results based on maturity.
- Inflation continues to trend downward, decreasing from 9.1% y/y peak last June to 3.7% y/y in August of this year.
- The Federal Reserve did not increase rates during the September Fed meeting and signaled rates may stay higher for longer than was expected.

Quarterly Market Review

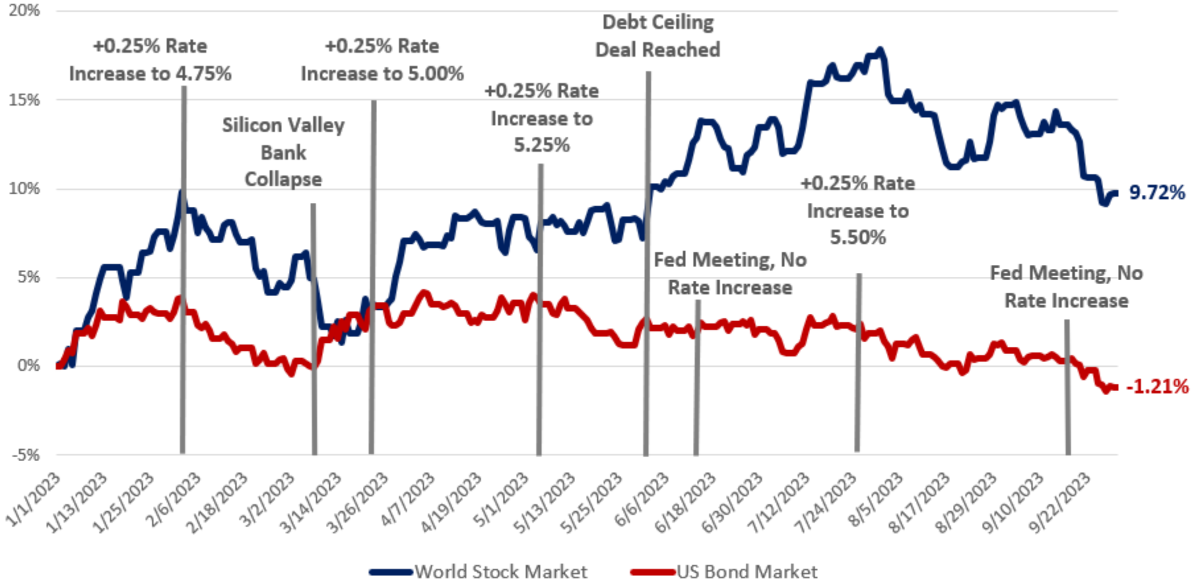
3rd Quarter 2023

Kevin Floyd
CFA, CFP®, AIF®
Director of Investments

"Successful investing is about managing risk, not avoiding it." – Benjamin Graham

The US economy continues to be resilient against a widely forecasted recession. Furthermore, the Federal Reserve's GDP model is expecting an acceleration of GDP for the third quarter of this year, all while inflation continues to soften. Both these observations strengthen the case for a "soft landing", but we're not out of the woods yet. Tailwinds from consumer spending are likely to fade as consumers' surplus savings is dwindling and interest rates continue to be elevated.

The third quarter moderated the strong market returns during the first half of this year by posting negative returns for both stocks and bonds as the Federal Reserve signaled interest rates will most likely be "high for longer". The world stock market (MSCI ACWI All Cap) returned -3.3% for the third quarter, while still returning 9.7% for the year. The US bond market (Bloomberg US Aggregate Bond) returned a similar -3.2% and is down -1.2% overall for the year.



Source: Morningstar Direct

- Overview:
  - Q3 in Review
  - Portfolio & Market Review
  - Economic Update
  - When Value Delivers
  - Stock Market Performance
  - Global Valuations
  - Quarterly Asset Class Market Summary
  - Long-Term Market Summary World Asset Classes

QMR – Portfolio & Market Review

3rd Quarter 2023

HFG | TRUST

Stocks – The stock market traded in a relatively tight range, with the highs for the quarter at +3.9%, and the low at -3.8%, all while finishing -3.3% for the quarter. This was primarily driven by a combination of elevated interest rates (for longer), and an expected decline in corporate earnings year-over-year for the fourth consecutive quarter.

US large growth stocks continue to be the top performing asset class in 2023, still led by the “Magnificent Seven” (Amazon, Alphabet, Apple, Meta, Microsoft, Nvidia & Tesla). Growth type companies remain trading at high multiples compared to value companies. For example, the price-to-earnings (P/E) for US growth companies are trading at 32x, compared to value at 15x. The distinction is even larger if price-to-book (P/B) is observed where growth is valued at 10, compared to value with a P/B of 2.

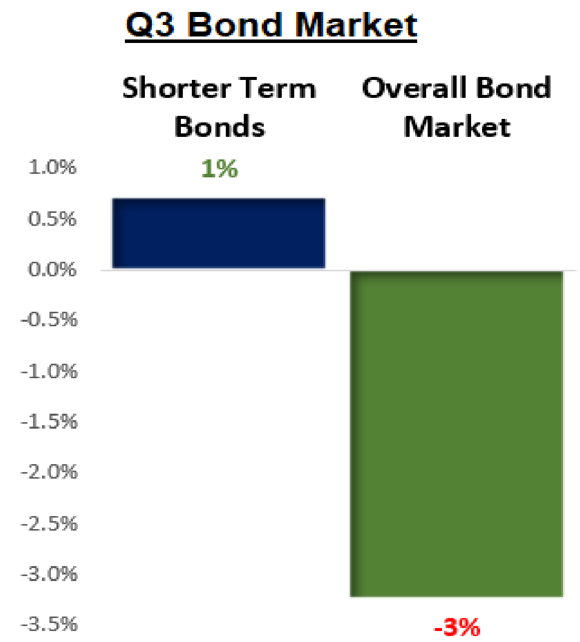
Bonds – The overall US bond market was negative for the quarter as the Federal Reserve communicated, to the disdain of the markets, that rates will be higher for longer. Investors tilted toward shorter term bonds would have avoided much of this drawdown and have had roughly a flat return for the quarter and a positive +1% for the year.

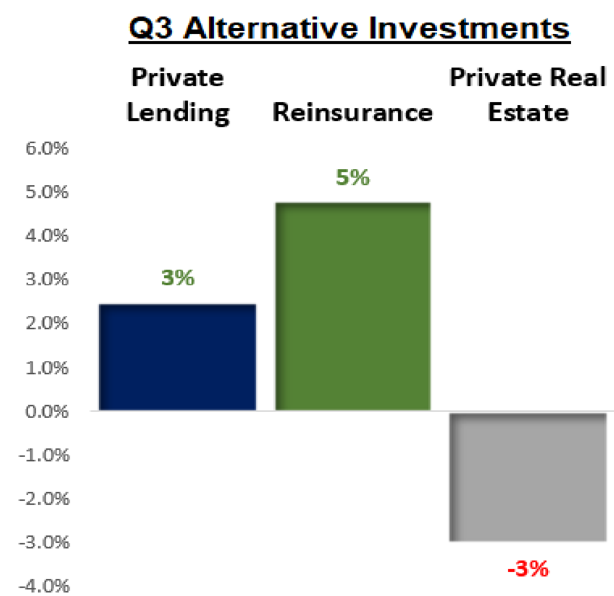
The rate difference between corporate and government bonds (i.e. credit spreads) remain at the lower end of historic levels at a 1.2% average spread. Credit spreads are an indicator of the markets perceived risk between corporate bonds and the “risk-free” nature of government bonds. For example, during the Great Recession in 2008 spreads increased to 6.5% and 4% in March of 2020.

Alternatives – Private lending and reinsurance have continued to produce strong returns in 2023 thus far. Private lending returns have ranged between +6% and +9% year-to-date due to strong underwriting selection of borrowers and a robust pipeline of loans as traditional lending has slowed.

Reinsurance has continued its strong returns for the year, up +4.8% in the second quarter and +16.1% year-to-date. Generally, for reinsurance we’d expect an average annual return between +5% and +10%. The significant outperformance so far for this year has been driven by favorable repricing of reinsurance premiums.

Private real estate provided a negative quarter down -3% and -9% for the year. Even though rents are increasing, appraisers have been adjusting valuations modestly downward due to the market coming to terms that interest rates will be higher for longer than originally anticipated. Generally, vacancy continues to be low in desirable metro areas as the work force continues to head back to the office.





QMR – Economic Update

3rd Quarter 2023

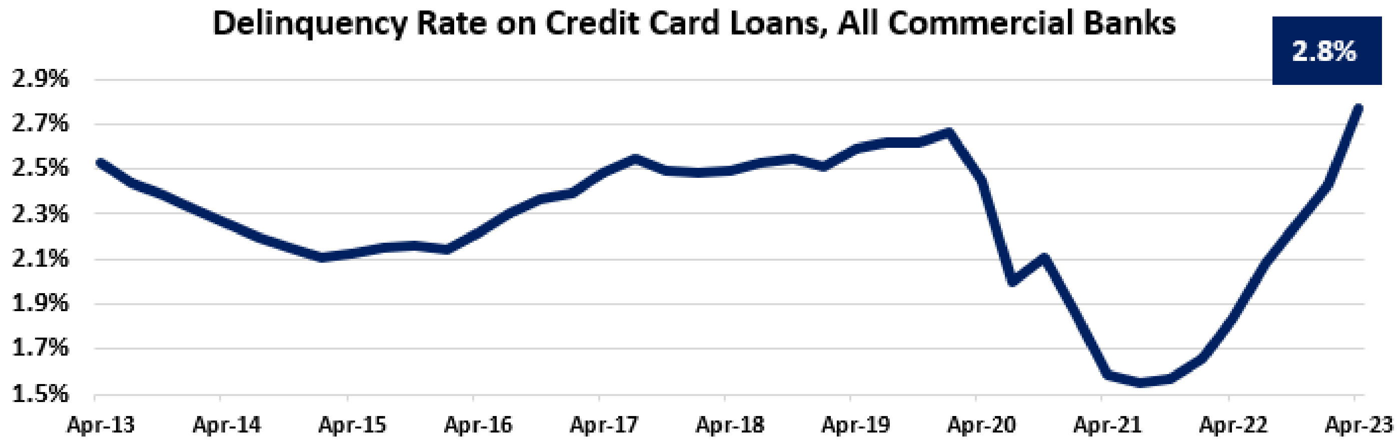
HFG | TRUST

Rates – As illustrated below, 5- to 20-year rates abruptly increased in the third quarter. Strong economic data on the US economy continued to concern intermediate term bond market investors that rates will stay elevated longer than originally anticipated.

Shorter-term rates continue to remain higher than intermediate and longer-term rates. However, over time this will revert to normal levels as the Federal Reserve marches to their Fed Funds target of 2.5%. Historically, there has been an average wait of eight months between the last rate increase and the first rate cut. If this relationship holds true, rate cuts would start Springtime of next year.

Rate	9/30/2023	3M Ago	6M Ago	12/31/2022	1Y Ago	2Y Ago	3Y Ago	5Y Ago
2 Yr Treasury	5.0%	4.9%	4.1%	4.4%	4.2%	0.3%	0.2%	2.8%
5 Yr Treasury	4.6%	4.1%	3.7%	4.0%	4.0%	1.0%	0.3%	2.9%
10 Yr Treasury	4.6%	3.9%	3.6%	3.9%	3.8%	1.6%	0.6%	3.1%
20 Yr Treasury	4.9%	4.1%	3.9%	4.1%	4.0%	2.0%	1.2%	3.1%

Delinquencies – During COVID, consumers' savings accounts were padded by the unprecedented amount of stimulus that was provided by the government. In turn, consumer spending has been strong. However, in the second quarter of 2023, consumer credit card debt surpassed $1 trillion for the first time as savings have depleted and consumers are relying more on credit to fund purchases.



Source: https://fred.stlouisfed.org/series/DRCCLACBS

When Value Delivers

3rd Quarter 2023

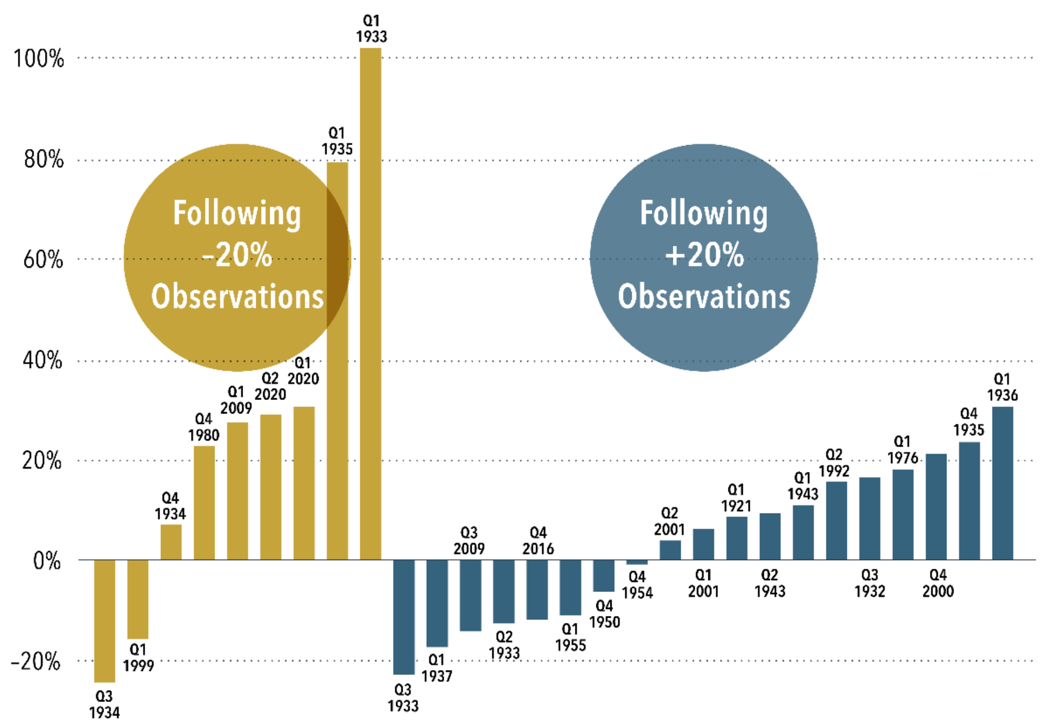
The first half of 2023 marks the tenth time since 1926 that value stocks have underperformed growth stocks by more than 20 percentage points over a two-quarter period. More often than not, value has responded like the hero in an action movie, beating growth over the following four quarters in seven of the nine previous instances and averaging a cumulative outperformance of nearly 29 percentage points.

The sample size may be small, but a positive average value premium following a large negative period is not too surprising. In fact, looking at the other side of the value performance distribution, there have been 19 two-quarter periods with the value premium exceeding positive 20%. In 11 of these, value outperformance continued over the next four quarters. The average premium across all 19 was 3.6%.

It's notoriously challenging to find an indicator that consistently predicts negative value premiums. Regardless of value's recent performance, investors should expect positive value premiums going forward. That's a strong incentive for investors to maintain a disciplined stance to asset allocation, so they can capture the outperformance when value stocks deliver.

Comeback Kid

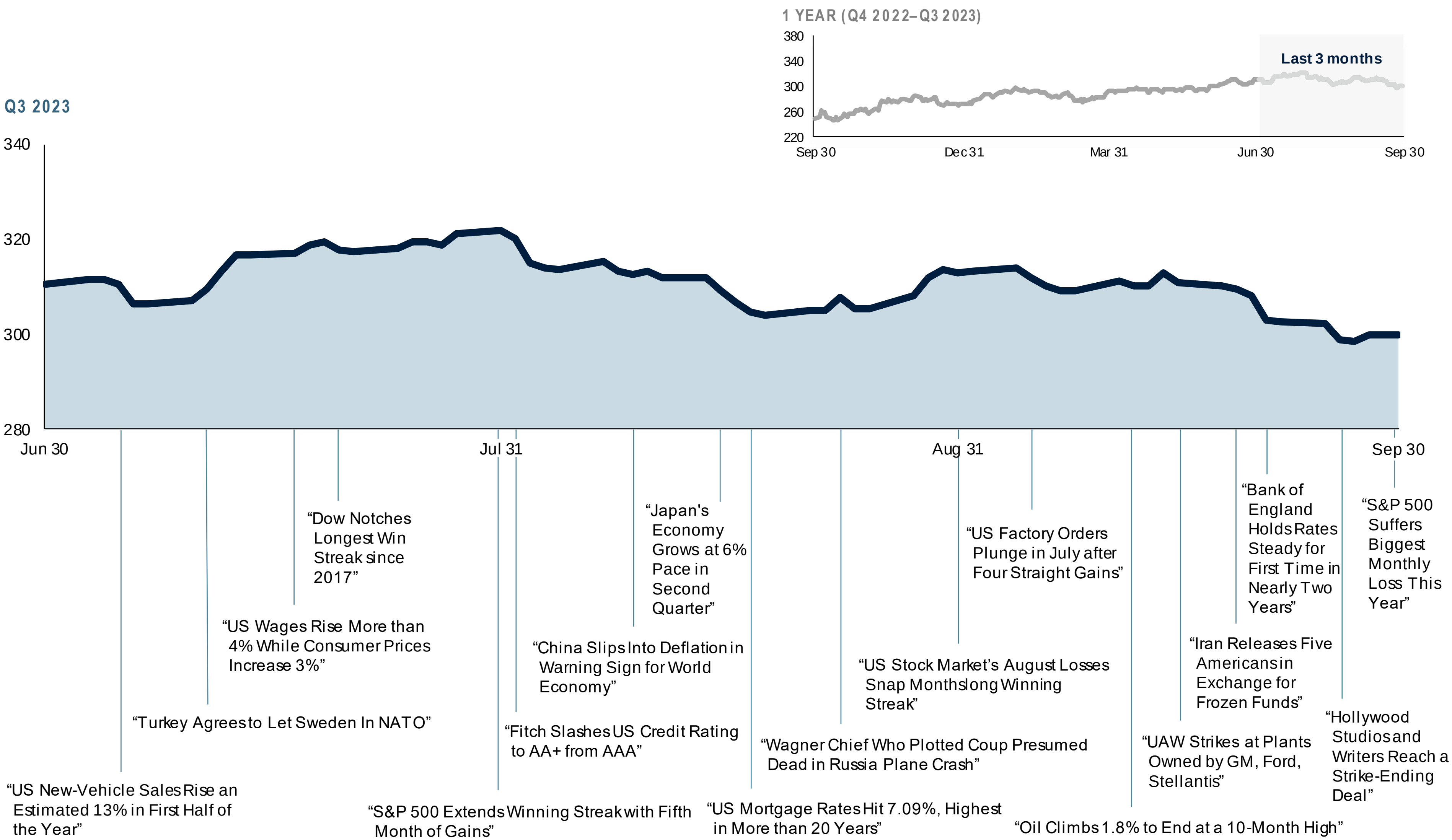
Cumulative return difference for value minus growth in US stocks over the four quarters following two-quarter periods during which value underperformed by –20% or outperformed by +20%.



World Stock Market Performance

MSCI All Country World Index with selected headlines from Q3 2023

HFG | TRUST



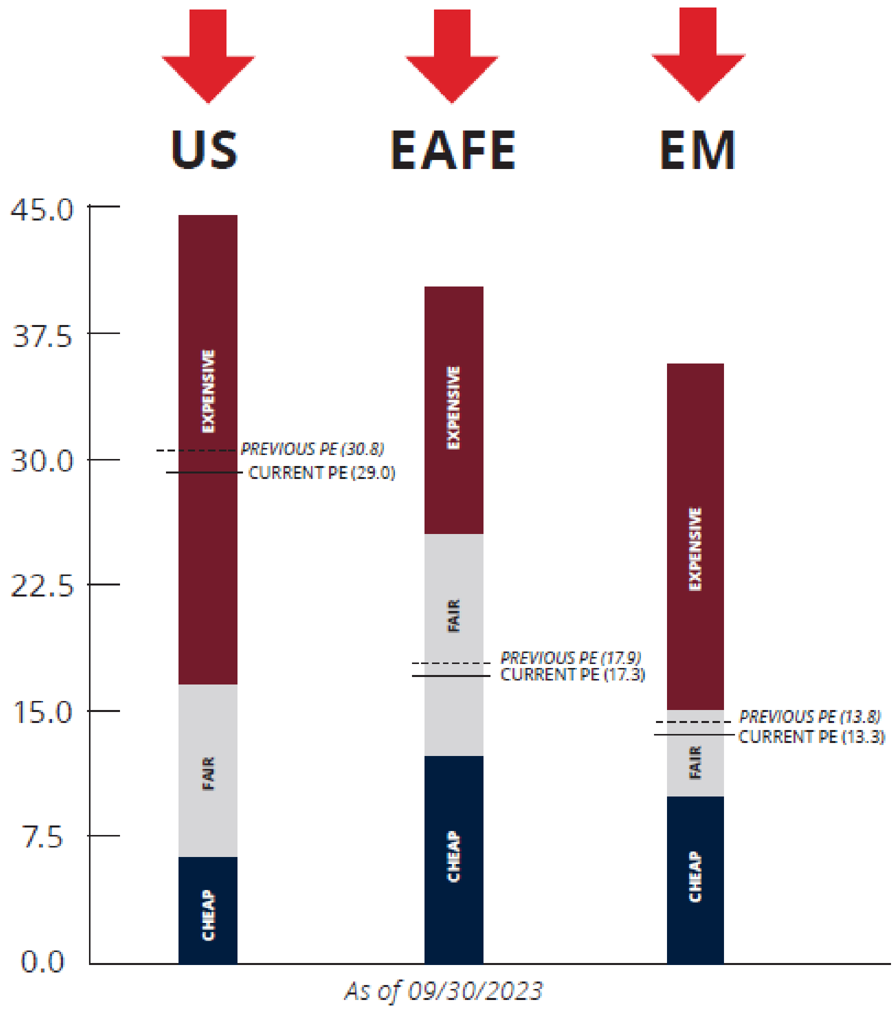
These headlines are not offered to explain market returns. Instead, they serve as a reminder that investors should view daily events from a long-term perspective and avoid making investment decisions based solely on the news.

Global Valuations

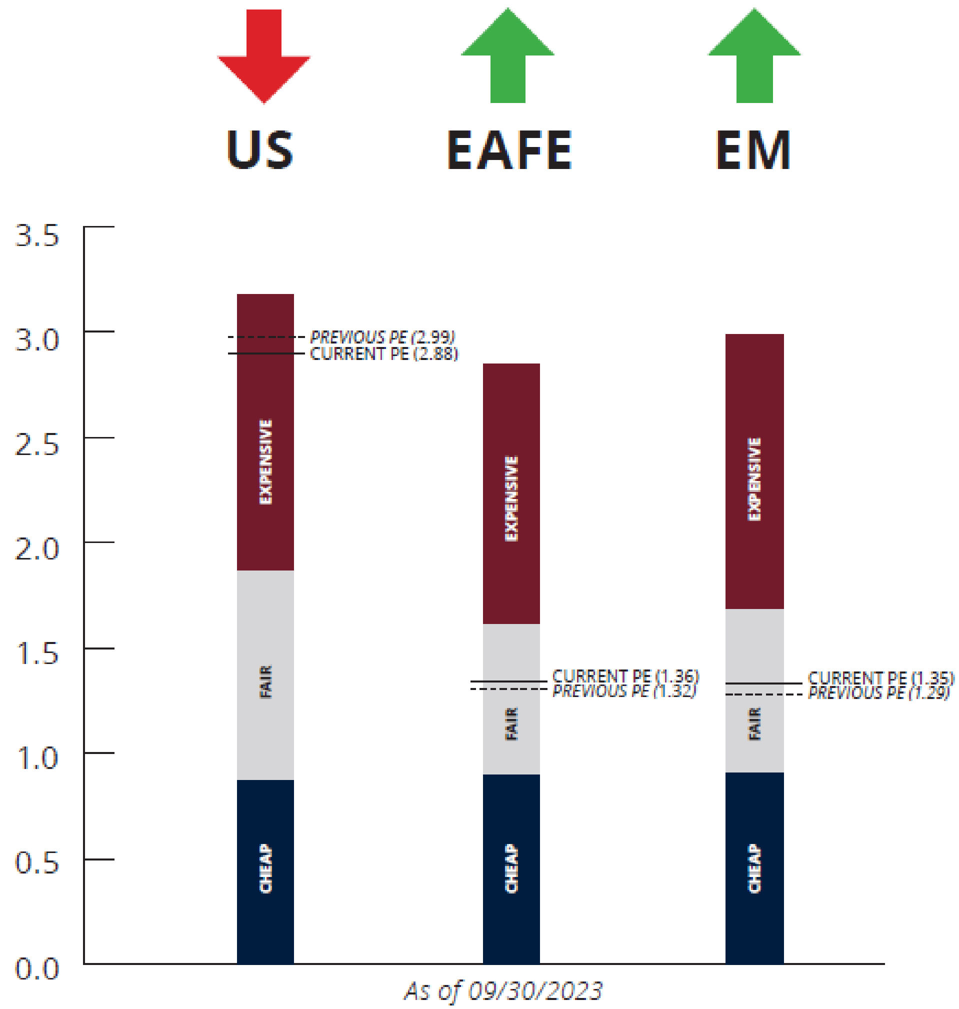
What is the Investment Climate?

HFG | TRUST

Price-to-Earnings (CAPE)



Price-to-Book Value



Cyclically Adjusted Price-to-Earnings or "CAPE" is a valuation metric, where the current market price is divided by the last ten years of average earnings (adjusted for inflation). The price you pay is what you get, and by utilizing average earnings over a longer period(10 years), we can put into perspective whether the current market price is trending toward expensive, undervalued, or fairly valued historically.

Quarterly Market Summary

Index returns

	US Stock Market	International Developed Stocks	Emerging Markets Stocks	Global Real Estate	US Bond Market	Global Bond Market ex US
Q3 2023	STOCKS				BONDS	
	-3.25%	-4.10%	-2.93%	-6.49%	-3.23%	-0.78%
Since Jan. 2001						
Average Quarterly Return	2.2%	1.5%	2.4%	2.1%	0.9%	0.9%
Best Quarter	22.0%	25.9%	34.7%	32.3%	4.6%	4.6%
	2020 Q2	**2009 Q2**	**2009 Q2**	**2009 Q3**	**2001 Q3**	**2008 Q4**
Worst Quarter	-22.8%	-23.3%	-27.6%	-36.1%	-5.9%	-4.1%
	2008 Q4	**2020 Q1**	**2008 Q4**	**2008 Q4**	**2022 Q1**	**2022 Q1**

Long-Term Market Summary

Index returns as of September 30, 2023

	US Stock Market	International Developed Stocks	Emerging Markets Stocks	Global Real Estate	US Bond Market	Global Bond Market ex US
	STOCKS				BONDS	
1 Year	20.46%	24.00%	11.70%	2.03%	0.64%	2.99%
5 Years	9.14%	3.44%	0.55%	0.01%	0.10%	0.83%
10 Years	11.28%	3.84%	2.07%	3.12%	1.13%	2.30%

Past performance is not a guarantee of future results. Indices are not available for direct investment. Index performance does not reflect the expenses associated with the management of an actual portfolio.