INVESTMENT INSIGHTS

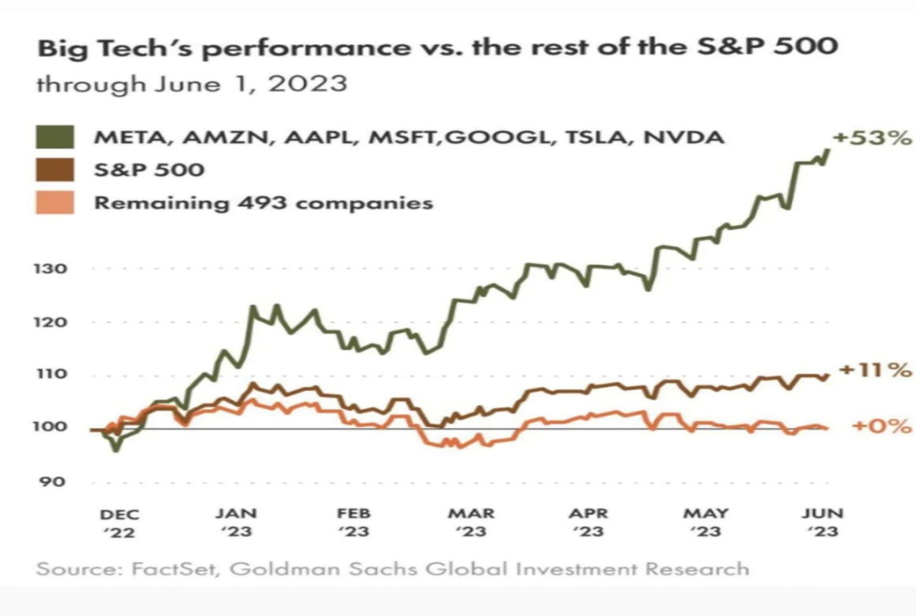
Market Outlook

July 2023

The Market

The equity market continued to rally during the second quarter, led by large-cap technology stocks, homebuilders and leisure cruise lines. The S&P 500 Index has risen 15.9% thus far in 2023 with seven stocks accounting for the lion share of the gains. The NASDAQ, led by NVDIA, Facebook and Tesla, each of which posted triple-digit gains, rose by 31.7% in the first half of the year; the most since 1983. The shift into select large-cap technology stocks and artificial intelligence (AI) shares gained momentum following the banking crisis with price gains accruing to a handful of names, while the NASDAQ 100 composite grew by $5T.

Technology, homebuilders and cruise lines had some of the best performance in the first half of 2023.



Seven stocks have accounted for almost all of the performance in the S&P 500 Index year-to-date.

Otherwise, the companies that historically provide dividend income to equity portfolios lagged significantly. The financial, real estate, health care, energy and utility sectors constitute 48% of the S&P Index and, collectively, are slightly negative year-to-date, reflecting the disparity in returns. Likewise, mid-cap and small-cap stocks lagged their mega-cap counterparts. Bonds were largely invisible for the quarter with the Bloomberg U.S. Aggregate Bond Index falling 0.84%.

The Economy and the Fed

The U.S. economy is proving to be more resilient than expected at the start of 2023, with GDP estimates being revised upwards for the second quarter and the remainder of this year. The unemployment rate remains at a low, 3.7% level, following ten interest rate hikes by the Federal Reserve since March 2022. Peering under the surface of the current GDP estimate reveals a two-speed economy where demand for services and personal travel remains strong, while demand for manufactured goods and retail purchases is waning. The Index of Leading Economic Indicators has been in decline since April 2021 and the Institute of Supply Managers (ISM) Manufacturing Index has been contracting for eight months as distributors and retailers work off excess inventory. Bed, Bath & Beyond, Tuesday Morning and Jenny Craig are among retail chains that have filed for bankruptcy this year due to changes in spending habits, which are also leading to challenges for many shopping malls. Airports and cruise ships, meanwhile, remain busy.

> Demand for services and personal travel were strong, while demand for manufactured goods and retail purchases have weakened.

The Federal Reserve has raised the Fed Funds rate by five percentage points from 0.25% to 5.25% in its effort to bring inflation under control with a target of 2% inflation annually. In summary, the most aggressive growth in money supply in U.S. history from 2020 through 2021 has been met now with the most aggressive tightening in the history of the Fed.

> The Goldman Sachs Commodity Index dropped 11.4% year-to-date reflecting slowing demand.

Our Outlook for the Fed

The Fed paused hiking interest rates at their June meeting in order to allow for the impact of their prior action to work its way through the economy. The Personal Consumption Expenditures Price Index (PCE) is a primary measure of inflation utilized by the Fed. The latest reading for May indicated that PCE rose 3.8% annually. In similar fashion, the Consumer Price Index peaked in July 2022 at a 9.1% inflation rate and has now dropped to 4.1%. Although inflation has abated, it remains well above the Fed's long-term target and we anticipate, at minimum, one more rate hike.

> Inflation has cooled since last year's peak of 9.1%, but there is still a long way to go to get it down to the Fed's target of 2%.

Our Outlook for the Economy

As noted in our March letter, we expect the trend of economic growth to slow later this year and into 2024. Historically, a rise in unemployment claims lags a credit tightening cycle by six-to-nine months. We view the banking crisis that occurred in March as a credit tightening event at the margin, and anticipate that tighter credit will work its way into rising unemployment claims by late 2023. On balance, many economists have pushed their forecast of a U.S. recession beyond 2023 and into 2024.

> Consumer spending may slow by year end as a result of tighter lending standards.

Our Outlook for the Market

The magnitude of the relative performance within a narrow group of mega-cap growth stocks was a surprise to us and many long-time market observers, especially as momentum stocks typically lag other sectors in a period of tighter money supply. We do not subscribe to some viewpoints that a major correction is at hand.

We do, however, expect some consolidation among the recent leaders and for market performance to broaden out somewhat in the months ahead. We view that we are close to the end of the Fed Funds rate increases and that will allow for equities to digest gains and normalize within a range. On the other hand, we do not expect the Fed to signal a reduction in rates until inflation has settled and maintains a level that is closer to their target.

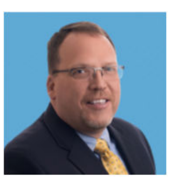
> The S&P 500 Equal-Weighted Index is up 6.0% year-to-date vs. the market-cap weighted S&P 500 Index gain of 15.9%.

Our Position

While we have exposure either directly, or indirectly, to some of the stocks that enjoyed large gains during this quarter, we remain broadly diversified and are not as concentrated in the technology sector as the S&P 500 is, at 29%. There are periods where this lack of concentration in a particular group may cause performance to lag, while at other times, it can work to mitigate losses such as during the sharp drop in 2022.

> Discipline and diversification are important in markets with narrow leadership.

Overall we seek to balance risk while working towards reaching your goals. Please reach out to us in the event there are questions, changes or updates that you wish to discuss.



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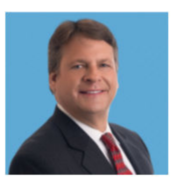

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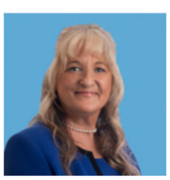

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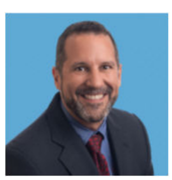

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