QUANTITATIVE ASSET MANAGEMENT, LLC
Investment & Advisory Services

July 11, 2023

Quarter Ending June 30, 2023

Quarterly Performance	Q2 Index	YTD	Close
Dow Jones Industrial Average	3.41%	3.80%	$34,643.00
NASDAQ Composite Price	13.25%	30.76%	$13,787.92
Standard & Poor's Averages	8.74%	16.89%	$4,450.38

Stock market indices continued their strong performance during the second quarter. The S&P 500 finished the first half of 2023 up 16.89%, the best start since 2019. The technology heavy NASDAQ finished up a staggering 30.7%. The Dow Jones Industrial Average lagged in comparison, climbing a modest 3.8%. The positive start to 2023 has been celebrated by investors and eased some fears on Wall Street of a long-awaited downturn. That said, some of the performance numbers are a little misleading and very reminiscent of some market fallacies we pointed out over the last few years.

First, some of the 2023 outsized returns can be attributed to an economic term, "regression to the mean". Considering the dismal market performance in 2022 (NASDAQ -33%, S&P 500 -19.4%, Dow Jones -8.8%), it would be expected that markets would self-correct as they begin to retrace earlier losses. Our value-based investment approach held up extremely well during 2022. Focusing on valuations and fundamentals allowed us to avoid some of the major market pitfalls experienced by the broad-based markets. Remember, a stock that goes down 50% needs to go up 100% just to break even.

Second, and this is a theme we focused on from 2020-2022, the overall market performance is not a true reflection of what is going on in the economy. These outsized performance numbers are being generated by a very small group of mega-cap technology names. This variance is due to the S&P 500 being capitalization weighted…the bigger the company, the bigger its representation. Sound familiar? To put this into context, close to 100% of the gains this year in the S&P 500 have been driven by seven stocks (Microsoft, Facebook, Apple, Amazon….). Ironically, these were the same stocks that caused the dismal market performance of 2022. To compare, the S&P 500 equal weight index (every company gets same weighting) was up 7% year-to-date, a drastic difference. Lastly, recent numbers would suggest otherwise, but over a 2-year period, the S&P 500's performance is flat when excluding dividends.

As of the end of June, there have been no significant signs of a major U.S. recession. The U.S. economy and labor markets have held up much better than expected. Inflation remains much higher and stickier than the Federal Reserve would like. In turn, the Fed has continued to raise interest rates in hopes of slowing down the U.S. economy. Recent market performance suggests investors are not concerned about what lies ahead. At QAM, we continue to take a much more cautious approach as we sift through the economic data.

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The Conference Board's Leading Economic Indicators Index has long been lauded as a reliable leading indicator of recessions. Through May, the index went through its 14th straight monthly decline (and 15th of 17). This is the longest streak of declines since the banking crisis, which saw 22 straight months of declines from June 2007 to April 2008.

The yield curve also hit a milestone during the second quarter, it has now been inverted for a full 12 months. According to the San Francisco Fed, a yield curve inversion has only provided a false signal of forthcoming recession once since 1955.

Bankruptcy filings in the U.S. jumped markedly in the first months of 2023. A slowing economy, higher interest rates, and inflation are some of the issues businesses are currently facing. The May filings brought the five-month total to 286 bankruptcy filings, the most since 2010, more than double the filings for the same period in 2022. And it even outran the 262 filings in the same period in 2020 when some companies faced enormous stress.

Moving forward, we expect growth in the U.S. economy to continue to slow down. Massive rounds of fiscal stimulus fostered the surge in corporate earnings and profits. As it stands today, there is no artificial stimulus to support demand. Interest rates are substantially higher, which should continue to impact personal consumption. Consumer credit card debt has risen 17% over the last year and it is approaching $1 trillion. A recession is not a certainty; however, the economy is returning to a slow growth environment.

As you are probably aware, we do not put much "stock" in the opinion of many Wall Street analysts/strategists. With that said, we wanted to finish this letter with the results from a CNBC survey. CNBC asked strategists to provide their year-end S&P 500 price targets. The highest call was 4,575 or about 3% above where the index is trading. The lowest call was 3,900 or 12% BELOW current levels. The average of all the strategists surveyed, 4,255 or 4% below where the index closed at the end of the second quarter. In short, according to Wall Street, there is not much upside remaining.

Enjoy the rest of your summer!

Regards,

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