MARKET REVIEW & OUTLOOK

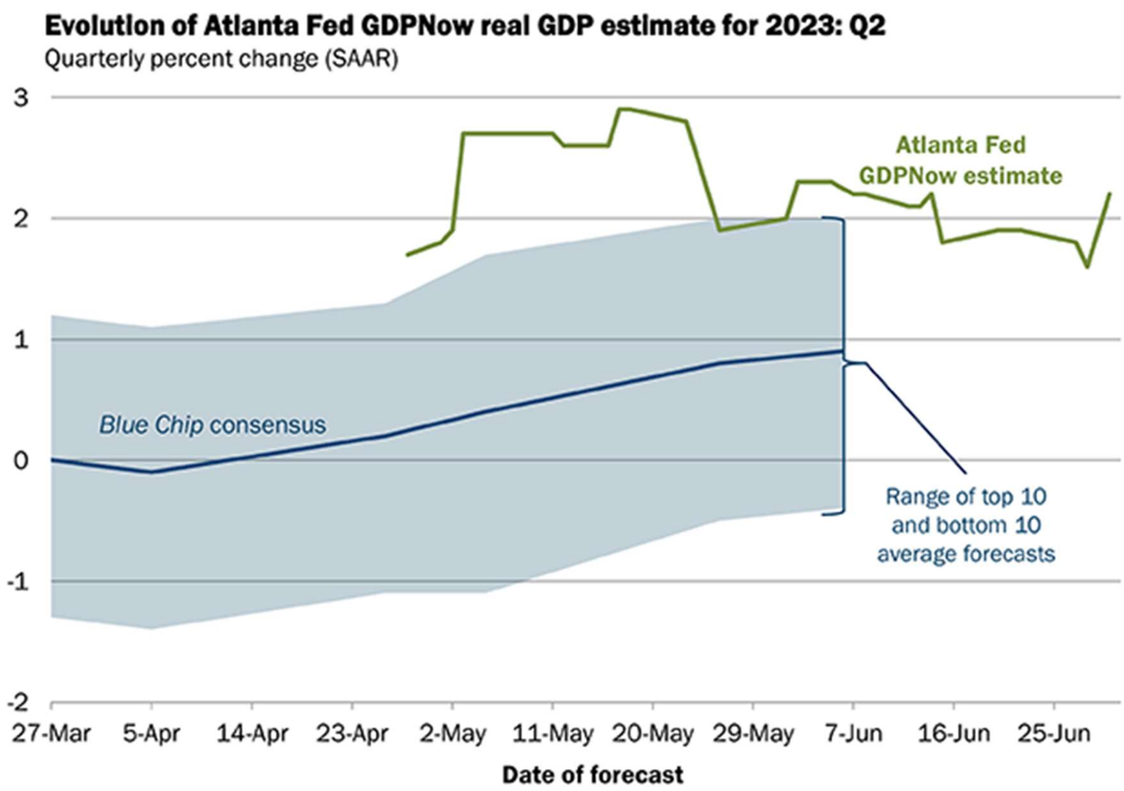
JUNE 2023

KEY TAKEAWAYS

- The equity markets broke out of the lull and had strong gains for the month.
- The bond market had a slow persistent selloff that resulted in moderately higher yields, but a tight range.
- Crude oil continues to trade in a tight range, though on the lower end this month.

The U.S. Economy

The final report for 1st quarter GDP came in at 2.0%, up substantially from the first revision print of 1.3%. Most of the bump up was attributed to bigger export numbers and smaller import numbers. Further, core PCE, the imbedded inflation measure, was revised slightly lower at 4.9%. The 2nd quarter GDP estimate from GDPNow has been oscillating around the 2% growth rate which would match the revised 1st quarter GDP number, while the Blue-Chip consensus has moved up to almost 1% from 0%, as shown in the chart below. The economy continues to have good growth, inflation is steadying, and employment is robust. The economy is not following the Fed's hoped for path of moderating toward a mild recession to finish off the inflation demons. In two weeks, we will hear the Fed's next move.



Sources: *Blue Chip Economic Indicators* and *Blue Chip Financial Forecasts*
Note: The top (bottom) 10 average forecast is an average of the highest (lowest) 10 forecasts in the *Blue Chip* survey.

Source : https://www.frbatlanta.org/cqer/research/gdpnow

Stocks and Bonds

Interest rates traded in a tight range of 3.60% - 3.85%, with a methodical walk up in yields. The tight range can be attributed to the strength of the economic data, supporting yields, with the fear that eventually all these rate hikes will lead to a recession and rate cuts. We think ultimately the rate hikes will have a more visible negative effect on the economy. It seems that the severe negative real rate of interest continued providing more support than most expected/realized. Now that real rates are creeping into positive territory, the "real" bite may just be starting. If that is the case, it may well be that we make it through 2023 without the long-feared recession. Though that puts early 2024 in the crosshairs of the recession timing. The Fed meets in a couple of weeks and has been actively talking about more rates hikes for 2023, probably 2, and no rate cuts until late 2024 at the earliest. The modest increase in yields created a headwind for High Quality fixed income, which as measured by the iShares US Aggregate Bond ETF eased -0.36% for the month. The U.S. 10-year Treasury bond yield ended the month at 3.82%, up from May's close of 3.64%.

The Dow Jones Industrial Average increased +4.56%, the S&P 500 jumped +6.47%, and the small cap Russell 2000 soared +7.95%. The international markets traded relatively in line with the U.S. The MSCI EAFE iShares Core International Developed Markets ETF Index rose +4.28%, and the MSCI Emerging Markets iShares Core ETF Index gained +4.22%.

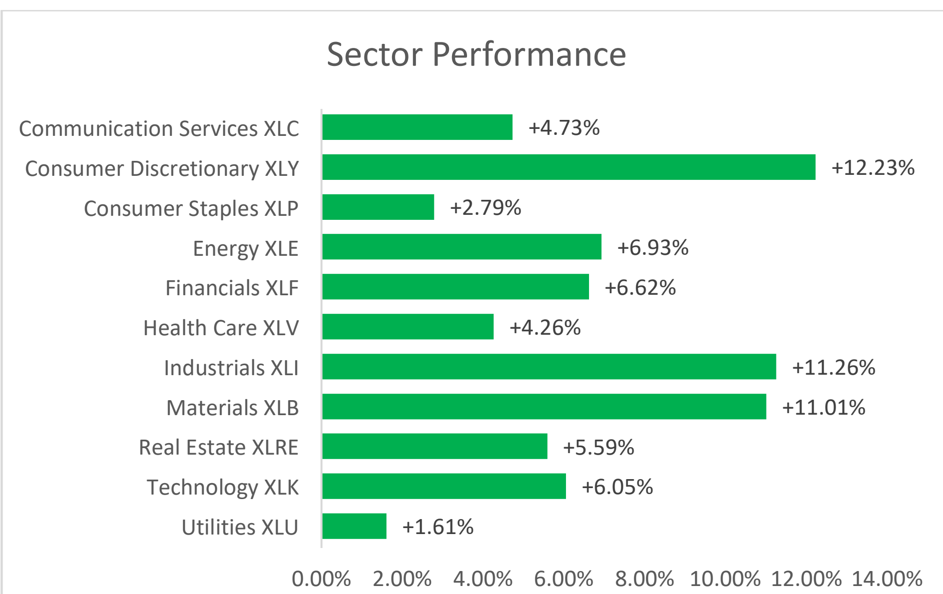
May's performance was to own early economic cycle winners and equity in general.

The best performers were…

- Consumer Discretionary: +12.23%
- Industrials: +11.26%
- Materials: +11.01%

The "worst" performers were…

- Utilities: +1.61%
- Consumer Staples: +2.79%
- Healthcare: +4.26%



Source: https://www.morningstar.com

Oil Report

The oil market traded plus/minus $3 around the $70 mark, in a tight range for the month. Prices continued to battle around the current waning demand, vs. the future expectation of insufficient supplies. China's growth continues to disappoint, and the "hated" oil industry refuses to put big money into future capacity as governments around the world are threatening to have them shut down by 2030. The current NYMEX WTI Crude Oil futures settled at $70.45 posting a gain of just over 3% from the prior month's close of $68.09 a barrel. The increase in crude oil helped RBOB gasoline, as RBOB gasoline finished with a gain of almost 4% vs May's close. The current 7-month range bound trading remains intact, with this being the tightest month range we can recall. Once this range sustains a break, expect prices to move substantially as both sides are likely heavily positioned. If their side fails, the rush to the other side of the boat is likely to be dramatic!

The Rest of the Data

The May ISM Manufacturing Index decreased modestly to 46.9 from April's reading of 47.1. Additionally, the ISM Services Index decreased to 51.5 in May, from April's print of 51.9. The prices paid component for Services decreased to roughly "normal" levels and Manufacturing prices had a meaningful drop moving to softening levels. Any reading below 50 generally indicates deteriorating conditions and any reading above 50 generally indicates improving conditions. Consumer confidence jumped to 109.7 in June, which compares to an upwardly revised figure of 102.5 in May. The unemployment rate jumped to 3.7%, while the economy added a robust 339,000 jobs in May, which crushed expectations of 195,000 jobs and even the highest estimate calling for 252,000 jobs, was the 14th straight month beating expectations. The Consumer Price Index for All Urban Consumers (CPI-U) increased +0.1% in May, on a seasonally adjusted basis. Over the last 12 months, the All-Items Index rate dropped further to +4.0% on a non-seasonally adjusted basis. The CPI ex Food and Energy, eased to 5.3% over the last year. The economic data is good, the employment data is good with a minor blemish in this month's unemployment rate bump, the stock market is great, and inflation is still relatively high. The Fed has continued to talk about a couple of more rate hikes and no rate cuts until late 2024 at the earliest. So far economic activity doesn't suggest a need to deviate from that course. We will continue to monitor economic activity along with inflation reports and how that may impact Fed policy.

Summary

The broad markets joined the mega cap US Tech names in rallying strongly for the month of May. The continued good economic activity with continued signs of moderating inflation seemed to be the boost. The Fed talked about more rate hikes and higher for longer, but risk assets apparently were tuned into a different channel. Or maybe they are just looking across the valley, i.e., the recession caused by the rate hikes, to the eventual rate cuts when the recession starts. The earlier discussion about the duration of economic strength being supported by negative real interest rates, even with all the Fed hikes, likely serves as the most plausible explanation. Meaning, the equity markets are pricing in the recovery and missing the potnential inflection point of the economic bite from real rates finally moving into positive territory, i.e. it took 15 months to get monetary policy out of the accommodative stance and into a restrictive stance. If this theory has merit, then we can expect economic weakness that starts to weigh on equity prices and valuations. The severity of economic weakness and the impact on dampening inflation will likely dictate whether The Fed maintains higher for longer. The market is still being led by the few, but this month the laggards joined the party.

As always, the markets can be emotional, so we retain our focus on what we can control, which is the amount of equity risk that is taken in a clients' portfolio in concert with the clients' risk tolerance and long-term goals. The markets will always face different "worries", today it is inflation/war vs. waning growth expectations, tomorrow it will be something else. We have built our asset allocation models with dynamic features and quarterly rebalancing, both in fixed income and equities. The equity rally garnered strength resulting in the Mid-Cap strategy shifting back to equity exposure. The tactical Fixed Income allocation finished shifting into High Yield bonds.

If you have specific questions about your portfolio or financial situation, we are here to help. Long-term financial planning is designed to deal with uncertainty like those we discussed above. Our portfolio management process is to design a prudent allocation across many asset classes. Equities are for long-term growth and several vehicles that we utilize offer defensive mechanisms to mitigate equity market declines.

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