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Dear Clients of MacDougall Financial, July 26, 2023

Fortune is the mistress of one half of our actions, and yet leaves the control of the other half, or a little less, to ourselves. Machiavelli, 'The Prince' 16th Century

Luck is an overlooked part of politics and economics and we have been blessed with a surfeit of good fortune in the first half of 2023. To begin with, from the second half of 2021 thru 2022, nearly all economists forecast a recession in the USA occurring in the first half of 2023. It was the most anticipated recession ever and yet has failed to materialize….so far. GDP growth in Q1 was almost 2% and there are no material declines in sight. Ditto for Europe where the forecasts were even bleaker due to the war, stratospheric gas prices, and failing industries. A recession may exist in Europe but it has been very mild and is not yet widespread. Next, we sidestepped a debt default which was treated as a given due to the extreme polarization of our political parties. Both parties emphasize their narrow interests, like prize fighters, and have lost sight of the "greater good". Our all too human tendency to focus only on negative news has meant that most positive developments have gone unheralded. China quickly walked back their zero covid stance and have so far avoided a surge in deaths. Against all odds, Ukraine has held the Russians at bay for 1.5 years and few forecast this determination.

Despite a 'rising tide' in the 2nd quarter, consumer sentiment and confidence are near all-time lows. In general, people's outlook is bleak, and yet when asked about their personal situation, they will answer in the positive. There seems to be a fundamental contradiction in our core beliefs – "life may be good but we are going to hell…rapidly"! Despite the many trials and tribulations that we face, never underestimate the forces of good, look for the positive news, and be firm in the belief that in America at least, the glass is half full! We remain a beacon of freedom to the rest of the world even as some try to diminish the 'wattage' of this message!

The markets were another exceptional surprise for the broad averages are all up thru 6/30/23 - S&P 500 +16.9%, DOW +4.8%, NASDAQ +38%. Better still, in the months from Dec 22 to June 2023, the average P/E multiple for S&P 500 stocks has risen by 26%. After a tumultuous 2022 with large declines across all asset classes, the 2023 ytd gains have been unexpected and welcome! The concentration of returns among 10 or so high flying stocks has been well documented in the press and at 32%, their weight in the index has never been higher. The performance of the 11 S&P sectors was mixed, varying from above +33% returns for the Tech, Communication Services and Consumer Discretionary sectors, to modest gains in Industrials and Materials (7-10%), to anemic/negative gains in Energy, Financials, Health Care, Real Estate, Utilities, & Consumer Staples. Growth outperformed value continuing a long trend, but there are tentative signs that value, especially international value stocks, are finally gaining traction. Bonds had their worst year in decades in 2022 and there was little recovery in the first half of 2023 with most bond funds showing total returns of -0.5 to +0.5%. At least cash is finally earning a decent rate of interest (4.5-5%+) but the reality is that we are still negative in terms of real interest rates. The higher beta bond sectors such as junk bonds, preferred shares, convertibles, etc. now sport yields north of 6% so it is well worthwhile to increase one's allocation to these 'alt' bond sectors. Likewise, it is a good time to add duration to one's bond portfolio as rates seem to be nearing a peak. The widely anticipated earnings recession has yet to materialize but the year is young and profits may be significantly lower by Q4. However, there are still many stocks that carry reasonable valuations. This fact is supported by the widest 'valuation dispersion' for the S&P 500 stocks in years which is normally around a 12X multiple and this now stands at 17.3X. This breadth of opportunity from a large number of low priced stocks to a fewer, but still sizable, number of high momentum plays is what drives the markets and investors.

Truly, the market reflects the economy and here too, the positive surprises have been evident. Housing was strong coming out of the pandemic and the declines in 2023 have been modest and limited to the highest values in the market. Inventories of homes for sale continue to be very low as few want to sell if their mortgage rate will double. Offsetting this weakness in "used homes" is a glut of new home construction. Home builder's face strong demand and their stocks have been on a tear. Ditto for vehicle sales, both new and used, which are at or above historical norms. The just released June inflation figures showed some moderation in car prices indicating that the interest rate hikes are modestly affecting demand. The Labor markets are strong with unemployment rates at record lows and the participation rate rising above 83% for the key 24-54 year old demographic. There are roughly 1.8 available jobs for every unemployed person! Labor markets remain tight which is one reason why Central Banks are raising global rates. Nearly all of the key economic statistics are circa their long term averages: $ volume of business and residential investment, car sales, inventory to sales ratios, oil prices, copper, etc. The Consumer is healthy and spending their way out of the 'pandemic' blues. Banking margins are under pressure due to 'financial disintermediation' but they have weathered these cycles before. Unions are flexing their muscle with UPS about to strike; but with only 6% of private sector workers unionized, the price impact from strikes will be sporadic. Approximately 35% of public sector workers are in unions so the wage pressures will be first felt by the Federal, State, and Local authorities. Inflation remains a 'sticky' bugbear but there are clear signs of moderation across the spectrum of prices. The most recent YoY monthly CPI & PPI figures are declining helped by oil, which remains rangebound between $70-80. A surge in US production has offset the OPEC production cuts. Many key commodity prices are at or below their 2019 levels including most food products. Yes, inflation remains well above the 2% target but there is a truism about inflation – 'it's the direction, not the level'. While there are always reasons for pessimism and black swans are likely, in general the economic outlook worldwide is favorable meaning GDP growth rates in the positive 1.5-4% range. Not too hot, not too cold, just how we like our porridge!

Turning now to the performance of all our mutual funds, bonds and stocks. What stands out in the first half is the absence of negative returns. In 2022, there was nary a positive return across the universe of our funds and within 6 months, the opposite is occurring. We have not made up the losses incurred in 2022, especially in the bond portfolios, but we are much closer to our previous high water mark than anyone predicted last December. It was roughly true that our value, small cap and international funds did as well as or better as the passive averages, whereas our growth funds lagged. The latter was due to the concentration of returns in only a few growth stocks (MSFT, META, APPL, AMAZ, NVDA & GOOG) which meant that you were fine if you owned them and lagged if you did not. The dispersion of returns was evidenced most clearly in the Russell 1000 Growth index rising 30% and the Russell 1000 Value index only 5%. Thus, the allocations determined the returns you received. It was a case where a 'rising tide' did not lift all ships equally but such effects have a history of quick reversals. You can see this in small cap stocks where the S&P 600 small cap index lost 2% in May, was down ytd, and then gained 8% in June. This is one more example of why timing the market is so difficult. Better to set an allocation that allows you to sleep at night and then go about your daily business. Our bond fund returns were all positive falling in their normal 1-4% range. The good news is that the Feds have ended the ZIRP policies and their tools of financial repression so that rates can ideally stabilize in the 3.5%-6% range. At present, it appears that rates will stay higher for longer in order to truly 'squash' the inflation genie. In sum, examining all the economic and market facts apparent right now, we see promise. Investing is about building portfolios that can balance risk and return over the long term. It is too soon to call this a new bull market, but it is far from a bear market. There will be uncertainty producing volatility but equities can grind higher, bonds can provide stability, recession or no recession. Note that our performance reports are as of May 31, 2023, not June 30, 2023 due to our transition to Pershing. This will be completed by Labor Day. We thank you for your cooperation and patience. Please contact us with any questions.

Best, Lanny