MARKET OVERVIEW

Second Quarter 2023

OPAL WEALTH ADVISORS

Economic Overview

After raising the Federal Funds rate another 25bps in May, the Federal Open Market Committee (FOMC) "skipped" in June and left rates unchanged at a target range of 5.00% - 5.25%. Despite this decision, Federal Reserve officials' public comments remain decidedly hawkish. Fed Chair, Jerome Powell indicated the FOMC used its June meeting to assess the impact of cumulative tightening that began in March of last year, and concluded further tightening is warranted. Although inflation trends are gradually moving in the right direction, they are still well above the Fed's 2% long-term target. According to the BEA, the overall PCE inflation rate was 3.8% on a year over year basis ending in May. Core PCE inflation, which excludes food and energy, increased 4.6%. Headline was the lowest since April 2021 while the core reading was the lowest since October 2021. Of the 18 FOMC members, nine see rates ending the year between 5.5% - 5.75%, while three see rates above 5.75%. Thus, the median FOMC member expects two more rate increases this year. Fed funds futures prices are currently pricing in over a 90% chance that the Fed approves a quarter-point increase at the July 26th meeting. Thanks in part to higher interest rates, consumers have increased their personal savings rate to 4.6%, up from 4.3% in April. The post-pandemic consumption trend of shifting spending on goods to services has continued. Outlays for services rose $52 billion in May, while they fell $33 billion for goods.

Real gross domestic product increased at an annual rate of 2.0% in the first quarter, a resilient reading but still a deceleration from 2.6% in the fourth quarter. Most economists have been forecasting recession based on leading economic indicators, the inverted yield curve, and tightening credit conditions. Others are painting a picture of a resilient economy thanks to healthy private sector balance sheets, limited (so far) spillover effects from last quarter's banking stresses, high levels of cash/savings, persistent consumer spending, and a healthy labor market. Recent economic surprises have turned marginally positive in the housing sector and the availability of private credit and modest overall leverage has muted the impact of tightening credit conditions thus far. Although current 30-year mortgage rates are hovering near 7.0%, many homeowners bought or refinanced before 2022 at much lower rates and maintain fixed rate mortgages. Homeowners are reluctant to sell and reenter the housing market, which has pushed inventory levels to record lows, fueling competition among homebuyers in certain markets, which is keeping prices from dropping off too severely, despite depressed overall demand. Despite the calls for recession, and amid pockets of weakness in certain industries, overall, the economy is reasonably stable.

Constructive Observations

- Resilient U.S. GDP despite restrictive monetary policy and high inflation.
- Consumer balance sheets and strong labor market are supportive of the consumption-oriented U.S. economy.
- Excessive business, consumer, and economists' pessimism.
- Averted default risk from federal debt ceiling / budget negotiation crisis.
- Fed emergency lending programs seem to have managed banking sector risks relatively well.

Cautious Observations

- Restrictive monetary policy still in the early innings of impacting behavior.
- Stubborn and elevated inflation suggests tight policy may persist for longer than markets are currently anticipating.
- Tight lending standards threat to commercial real estate and businesses.
- Inverted yield curve suggests a recession is likely.
- Elevated geopolitical risk (Russia, China, Middle East).

Macro Overview

Investment angst surrounding the debt ceiling was palpable this quarter, but Congress approved legislation in early June that suspends the debt ceiling until January 1st, 2025. Although Congress

agreed on modest spending concessions, their economic impact will be modest. The resolution of the debt ceiling crisis, in conjunction with softening inflation, boosted consumer sentiment. The Conference Board Consumer Confidence index increased to 109.7, up from 102.5 in May. The Present Situation Index, which measures consumers' views of current business and labor market conditions, increased from 148.9 to 155.3. The University of Michigan Consumer Sentiment Index rose 9% in June, from 59.2 to 64.4.

Based upon the Fed's quarterly Summary of Economic Projections, slightly better economic growth is expected this year relative to March's figure. GDP is expected to grow 1% this year; the estimate was 0.4% previously. A slight uptick to 1.1% is currently forecast for 2024 and 1.8% is the current estimate for 2025. Back in March the Federal Reserve expected the fed funds rate to peak at 5.1% this year, declining to 4.3% next year. Fed funds are now expected to hit 5.6% this year, falling to 4.6% in 2024. Core inflation this year was revised from 3.6% to 3.9% and is expected to fall to 2.6% next year, and 2.2% in 2025. Unemployment is expected to rise to 4.1% this year, lower than March's 4.5% forecast, and is expected to rise to 4.5% next year and remain at that level through 2025. The U.S. unemployment rate increased in May from 3.4% to 3.7% but is in line with levels seen at the end of 2019 and lower only in the early 1950's and briefly in 1969. The Fed remains worried about this labor market tightness, as well as the resilience of consumer spending.

Sales of new single-family homes topped expectations in May at a seasonally adjusted annual rate of 763,000. This is 12% above the revised April rate and 20% above the May 2022 estimate of 636,000. Inflation has been moderating and the global economy appears resilient despite higher interest rates.

In addition to the Fed's May rate hike, the European Central Bank (ECB) raised interest rates twice this quarter, taking the main refinancing rate to 4.0%. Growth data showed the Eurozone experienced a mild technical recession over the winter, with GDP declines of -0.1% in both Q4 2022 and Q1 2023.

Markets Overview

Equities

Heading into first quarter earnings season, analysts set the bar lower by aggressively downgrading estimates. This paved the way for a strong earnings beat rate and an earnings surprise rate that reached a multi-quarter high. Seventy-seven percent of S&P 500 companies surpassed EPS expectations relative to estimates. Corporate management teams have been preparing for recession for some time, so guidance at the start of the year may have been overly conservative. The first quarter earnings season saw the S&P 500 index record an EPS growth rate of -2.2% and a revenue growth rate of 4.1%.

Global equity markets climbed higher in the second quarter, with most of the gains made in the month of June. U.S. large-cap stocks, the dominant segment, returned 8.7%. U.S. mid-cap and small-cap stocks returned 5% this quarter. International developed stocks returned 3% and emerging markets returned 1%. China was the laggard among emerging countries, declining almost 10% this quarter. China's economic recovery, following the country's reopening after the Covid 19 pandemic, has been anemic. Officials may soon feel the need to reluctantly implement stimulus measures. Factory output has slowed in China with weak consumer spending. Tensions between the U.S. and China have been a contributing factor as well. Other Asian stock markets did well this quarter as it appears money flows came out of China and migrated to countries like Japan, Korea and India which all had strong performance for the quarter and year-to-date. Central European markets began to anticipate rate cuts as inflation eases. Hungary cut rates in June and year-to-date the MSCI Emerging Markets Eastern Europe index is up over 25%. Greece, Hungary, Czech Republic, and Poland have led emerging markets with year-to-date equity market returns of 44%, 32%, 28%, and 23% respectively.

For both the quarter and year-to-date, domestic growth stocks have dramatically outperformed value stocks. The Russell 1000 Growth index returned 13% for the quarter and is up 29% year-to-date. The Russell 1000 Value index returned 4% for the quarter, and 5% year-to-date. Growth stocks' dominance over value stocks has been evident across all size segments of the economy as well.

Technology was the strongest sector this quarter, returning 17% as U.S. chipmakers forecast higher-than-expected sales stemming from enthusiasm surrounding the prospects for Artificial Intlelligence (AI). The Nasdaq has returned over 32% year-to-date, its best first half in 40 years. Consumer

Discretionary stocks returned 15% this quarter and Communication Services stocks rose 13%. Energy and Utilities stocks were slightly negative this quarter and are the laggards (-6% each) year-to-date.

The level of concentration among this year's outperforming stocks is remarkable. The market cap.-weighted S&P 500 has returned 16.9% this year, but the equal-weighted index has returned less than half as much: 7.0%. The top 10 stocks in the S&P 500 currently represent 31.7% of the index's market capitalization; higher than their prior peak during the dot-com bubble levels and well above the relative weighting over much of the past decade. Apple's and Microsoft's combined weight in the S&P 500 is now over 14%, nearly double the weight of the entire Energy and Materials sectors, combined. The so-called "Magnificent 7" stocks: Apple, Microsoft, Amazon, Nvidia, Google, Tesla and Meta account for 77% of the S&P 500's year-to-date returns and exhibit forward P/E ratios almost 50% higher than the remaining stocks in the S&P 500. The unifying theme among these companies is their first-mover advantage in AI and the prevailing optimism regarding its transformational potential on almost every sector and industry. The ability to analyze vast amounts of data and make predictions with a high level of accuracy is only just beginning to take hold in a meaningful way as the technology becomes increasingly less abstract and more approachable for mass adoption. AI's promise of augmenting human decision-making, automating repetitive tasks, and uncovering elusive patterns has the potential to enhance decision-making, streamline processes and provide competitive advantages, leading to improved profitability across a wide range of industries.

Fixed Income

After a relatively uneventful April, yields steadily rose in May and June as the debt ceiling debate affected the Treasury Bill market. Yields on short-term Treasury Bills increased over 50bps during the quarter; 3-Month T-Bill yields rose from 4.85% to 5.43%. The entire yield curve shifted higher this quarter, with most of the increases in the shorter maturities. The magnitude of yield curve inversion, where short-term rates exceed long-term rates, is currently at multi-decade extremes not seen since the early 1980's. 3-month T-Bill rates currently exceed 10-year Treasury Bond rates by approximately 140 bps. The New York Federal Reserve's recession forecast model, which uses the yield curve to calculate the probability of a recession in the next 12 months, is showing a 67% chance the U.S. economy will experience a downturn within the next year. An analysis of prior yield curve inversions suggests that a recession typically begins approximately one year after the inversion first occurs. The 3-month / 10-year US yield curve inverted in early November 2022, suggesting that a hard-landing is still a possibility.

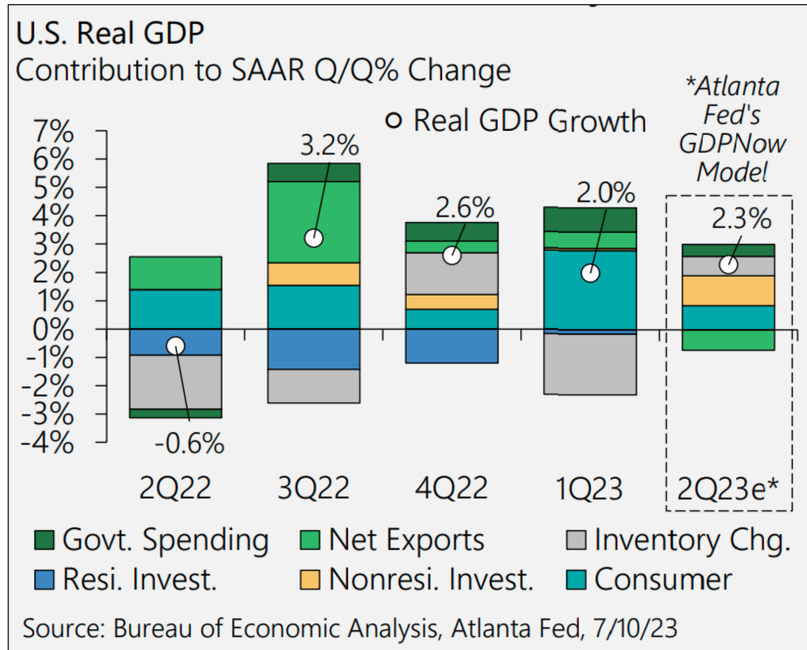
The uptick in rates, accompanied by hawkish Fed official comments, resulted in negative returns across most of the fixed income market this quarter. The Bloomberg Barclays Aggregate Bond index fell a little less than 1% this quarter, with most of that occurring in June. The Aggregate index is up a little over 2% year-to-date. All U.S. Treasury maturities decreased in value this quarter with the returns falling most with longer maturities. 1-3 Year maturities fell 0.6%, 3-5 year maturities decreased 1.3%, 5-7 year maturities were down 1.6%, 7-10 year maturities dropped 1.8% and long-dated (20+ years) U.S. Treasuries depreciated a little over 2% this quarter. Investment-grade corporate bonds were flat for the quarter, and have returned about 3% year-to-date with yields now exceeding 5%. Lower quality fixed income assets, such as high-yield corporate bonds and leveraged loans, posted gains of 2% and 3%, respectively, this quarter, in part due to their shorter-duration profiles. These asset classes have risen about 5-6% this year, although outflows have exceeded $10 billion in each case as investors take profits and brace for a possible economic slowdown.

Real Assets

The U.S. dollar traded within a narrow range this quarter and rose a modest 0.4%. Broad commodity indices declined about 3% during the quarter. Industrial metals were the worst performers, declining over 10% in aggregate. Aluminum (-11%), copper (-7%), nickel (-14%) and zinc (-17%) prices were all sharply lower. Within energy, crude oil and heating oil declined approximately 4-5%, while prices for natural gas (+2%) and unleaded gasoline (+4%) rose modestly. Agricultural commodities were a mixed bag this quarter with prices rising for cotton (1%), sugar (8%), cocoa (19%), soybeans (5%), hogs (5%) and cattle (12%), but declining for coffee (-3%), corn (-11%) and wheat (-8%). In precious metals, gold (-3%), silver (-5%) and platinum (-8%) all declined in value this quarter.

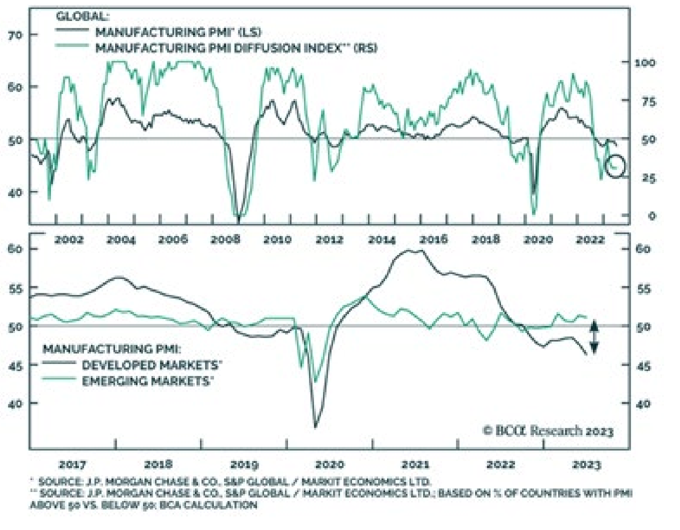
Charts of the Quarter

Economic Growth Proved Resilient on the Back of Strong Consumption



Source: Sit Invest.

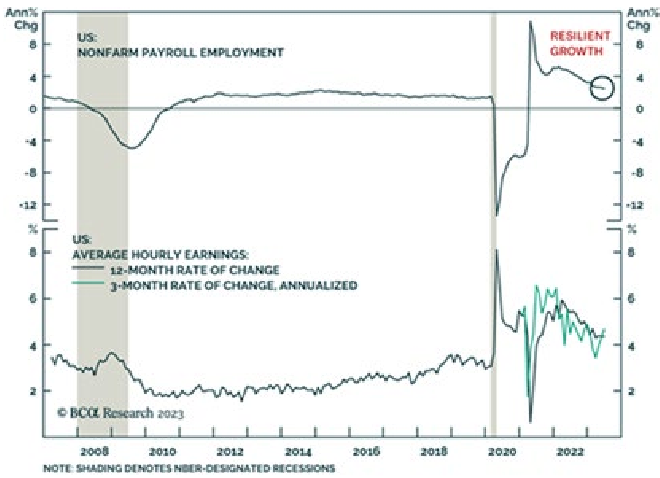
Signs of Slowing Are Evident in Soft (Survey) Data Globally. However, Hard Data Has Been Surprisingly Resilient.

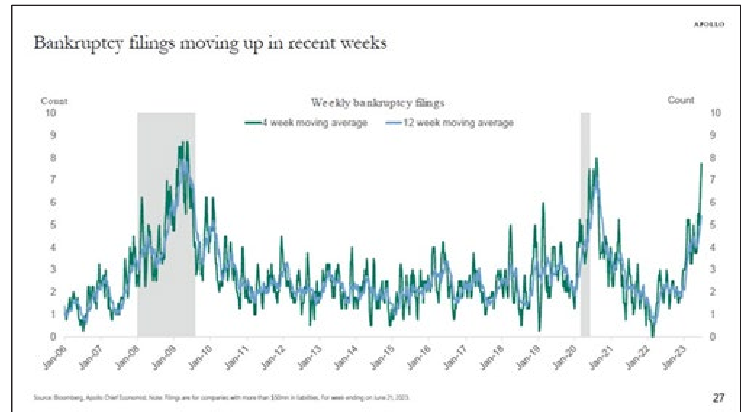


Source: BCA Research, Bloomberg.

Charts of the Quarter

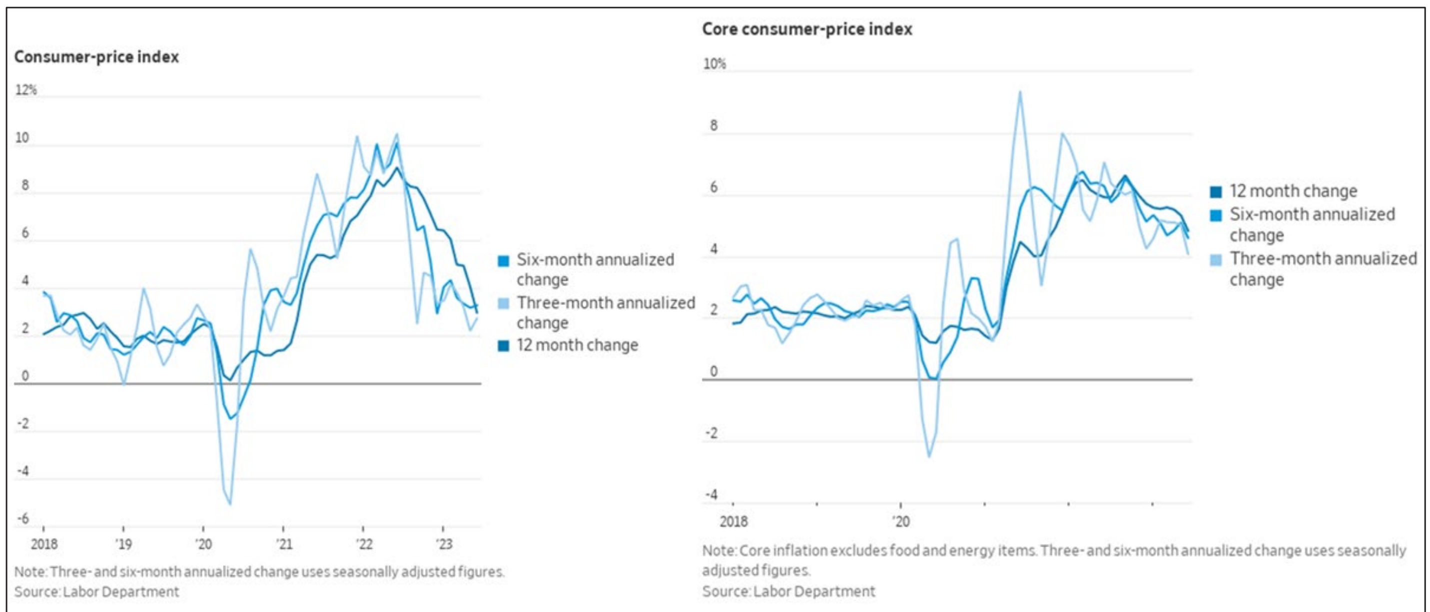
US Labor Market Indicators Are Losing Steam While Bankruptcy Filings Climb





Source: BCA Research, Apollo.

Inflation Data Continues to Cool But Remains Above Fed Comfort Levels



Source: WSJ.

Charts of the Quarter

The Bear Market Officially Ended in the Second Quarter

S&P Bear Markets*

Start	End	% Change	Days
9/16/29	11/13/29	-44.6%	58
4/10/30	12/16/30	-44.3%	250
2/24/31	6/2/31	-32.9%	98
6/26/31	10/5/31	-42.5%	101
11/9/31	6/1/32	-61.8%	205
9/7/32	2/27/33	-40.6%	173
7/18/33	10/19/33	-29.4%	93
2/6/34	3/14/35	-31.8%	401
3/10/37	3/31/38	-54.5%	386
11/9/38	4/11/39	-24.4%	153
10/25/39	6/10/40	-31.9%	229
11/7/40	4/28/42	-34.4%	537
5/29/46	5/19/47	-28.5%	355
6/15/48	6/13/49	-20.6%	363
8/2/56	10/22/57	-21.6%	446
12/12/61	6/26/62	-28.0%	196
2/9/66	10/7/66	-22.2%	240
11/29/68	5/26/70	-36.1%	543
1/11/73	10/3/74	-48.2%	630
11/28/80	8/12/82	-27.1%	622
8/25/87	12/4/87	-33.5%	101
3/24/00	9/21/01	-36.8%	546
1/4/02	7/23/02	-32.0%	200
10/9/07	11/20/08	-51.9%	408
1/6/09	3/9/09	-27.6%	62
2/19/20	3/23/20	-33.9%	33
1/3/22	10/12/22	-25.4%	282
	Average	-35.1%	286
	Median	-32.9%	240

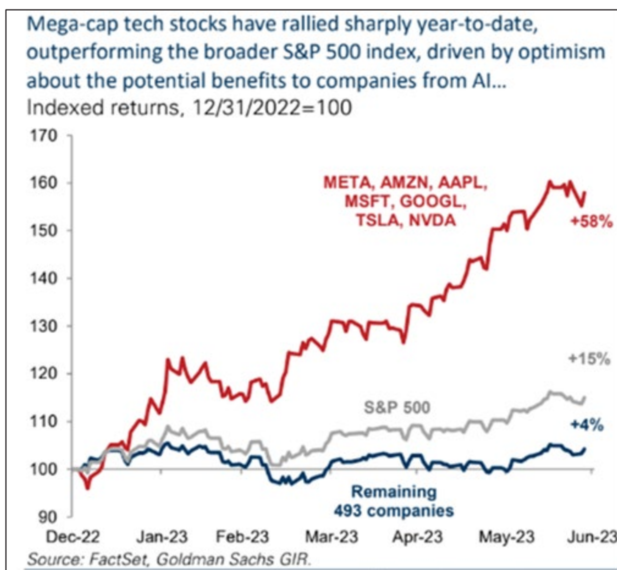
S&P Bull Markets*

Start	End	% Change	Days
11/13/29	4/10/30	46.8%	148
12/16/30	2/24/31	25.8%	70
6/2/31	6/26/31	25.8%	24
10/5/31	11/9/31	30.6%	35
6/1/32	9/7/32	111.6%	98
2/27/33	7/18/33	120.6%	141
10/19/33	2/6/34	37.3%	110
3/14/35	3/10/37	131.6%	727
3/31/38	11/9/38	62.2%	223
4/11/39	10/25/39	26.8%	197
6/10/40	11/7/40	26.7%	150
4/28/42	5/29/46	157.7%	1,492
5/19/47	6/15/48	23.9%	393
6/13/49	8/2/56	267.1%	2,607
10/22/57	12/12/61	86.4%	1,512
6/26/62	2/9/66	79.8%	1,324
10/7/66	11/29/68	48.0%	784
5/26/70	1/11/73	73.5%	961
10/3/74	11/28/80	125.6%	2,248
8/12/82	8/25/87	228.8%	1,839
12/4/87	3/24/00	582.1%	4,494
9/21/01	1/4/02	21.4%	105
7/23/02	10/9/07	96.2%	1,904
11/20/08	1/6/09	24.2%	47
3/9/09	2/19/20	400.5%	3,999
3/23/20	1/3/22	114.4%	651
10/12/22	6/30/23	24.1%	261
	Average	114.4%	1,011
	Median	76.7%	522

**Bear markets defined as 20%+ declines that were preceded by a 20%+ rally.*
**Bull markets defined as 20%+ rallies that were preceded by a 20%+ decline.*

Source: Bespoke.

Not All Stocks Participated in the Rally This Year



Annual S&P 500 Contribution of 10 Largest Weights During Positive Performance Years

Year	Top 10 as % of Total	S&P 500 % Perf.
2007	78.7%	3.5%
2023 YTD	**76.9%**	**15.9%**
2020	58.9%	16.3%
1999	54.5%	19.5%
2021	45.0%	26.9%
1998	36.8%	26.7%
1996	33.9%	20.3%
2017	33.3%	19.4%
2019	32.8%	28.9%
1991	28.6%	26.3%
2006	27.6%	13.6%
2016	26.6%	9.5%
2003	23.6%	26.4%
1995	22.3%	34.1%
2014	22.2%	11.4%
2004	21.1%	9.0%
2005	20.5%	3.0%
2010	19.6%	12.8%
2012	19.2%	13.4%
1997	19.1%	31.0%
2013	17.6%	29.6%
2009	15.5%	23.5%
1992	14.9%	4.5%
1993	12.2%	7.1%

Source: Goldman Sachs, Strategas.

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