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osaic

Market View Quarterly

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Although seemingly forgotten now, the second quarter of 2023 was almost derailed by debt ceiling concerns. However, as expected, in the 11th hour, a deal was reached, allowing the government to pay its bills for now. From a market perspective, this deal should be viewed as unquestionably positive as it takes the debt ceiling issue off the table until 2025. Outside of the debt ceiling, the US economy has defied expectations and ongoing calls for a recession. The average forecast by analysts tracked by Bloomberg called for a decline of the S&P 500 in 2023, the first time the aggregate prediction of Bloomberg analysts has been negative since 1999.[1] However, the S&P 500 has rallied over 27% from its October 2022 low, and optimism is once again in the air.[2] The market's resilience is largely due to the continued strength of the labor market, which still boasts an unemployment rate of 3.7% — near multi-decade lows — and healthy wage growth of 4.3%.[3] In fact, US wages outpaced inflation on a year-over-year basis in May by 0.2%, ending the streak of 25 consecutive months of negative real wage growth.[3] We're now back on the path to prosperity, a great sign for the American worker.[2]

Domestic Equities

Not only is the American consumer taking home more of their paycheck, but they are also reaping the benefits of a rising stock market. The S&P 500 was up +8.74% for the second quarter and is up 16.89%[4] year to date through the end of June. The rally has been solely driven by the Information Technology (Tech) sector (represented by the NASDAQ Composite Index). During the sharp sell-off in 2022, there were many comparisons to the March 2000 dot-com bubble. The severe downturn took the market nearly 17 years to recover to its peak. But this time, it took less than 16 months for the Tech sector to recover, with a much smaller drawdown along the way (-34% vs. -82% after the 2000 peak).[2] Diving further into the Tech sector, it is what Wall Street has dubbed as the "magnificent seven" that have driven stock market gains. Apple (up 49% this year), Microsoft (42%), Alphabet (35%), Amazon (55%), and current stock market darling Nvidia, which has surged 189% on AI-related excitement. Meta (138%) and Tesla (112%).[3] If you remove these seven stocks, the S&P 500 would be slightly underwater for the year, with a total return of -0.23%.[4] With this in mind, the spread between large-cap growth and value should be no surprise; the Russell 1000 Value index returned 4.07%[4] for the second quarter versus 12.81%[4] for the Russell 1000 Growth index. Lastly, although lagging behind their larger-cap peers, both mid and small-cap stocks are also positive. Small caps returned 5.21%[4] for the second quarter versus 4.76%[4] for mid-caps and 8.58%[4] for large-cap equities. As we move into the second half of the year, we expect market gains to broaden and value stocks to perform better on a relative basis to growth once the threat of a recession moves out of investors' minds.

International Equities

International developed and emerging market equities returned 2.95%[4] and 0.90%[4] for the second quarter, respectively, lagging the S&P 500. There are two main reasons international developed markets are underperforming domestic markets this year. For one, while the Federal Reserve has paused rate hikes for the time being in the United States, most internationally developed economies continue to raise rates. In June, Switzerland, the UK, and the European Central Bank all hiked rates again between 25 and 50bps.[3] Second, most foreign economies are cyclical in nature, defined by prominent, traditional manufacturing sectors and a few high-tech, growth companies. Amidst the surge in interest in high-flying technology and growth stocks (many commanding hefty weights within U.S. benchmarks), international markets and their more value-oriented composition have moved out of favor. Emerging markets face all of these same headwinds but are also more impacted by the fluctuation of the dollar. The DXY index, which measures the value of the dollar against six major currencies, has moved sideways this year, leading to lackluster returns for the broader emerging markets index.

Fixed Income

Similar to the equity market uptick in the first half of 2023, the bond market is now also in positive territory. The Federal Reserve (Fed) kept rates unchanged during its June meeting, moving to the sidelines after a 14-month tightening campaign that lifted the Fed funds rate to a target range of 5.0% to 5.25% — the highest since August 2007.[3] The Fed felt comfortable pausing primarily because of the continued downward trend in inflation. The May CPI report showed a decline in the headline inflation rate to 4.0%. This was the 11th consecutive decline in the year-over-year rate and the lowest level since March 2021. Core inflation (which excludes volatile segments like Food/Energy) moved down to 5.3%, the lowest since November 2021.[3] While inflation is still above the Fed's target rate of 2.0%, the significant progress warranted a pivot by the Fed. However, despite not raising rates in June, the Fed did indicate that two more rate hikes are likely in the cards before the summer comes to a close. During the last 30 years, core inflation averaged 2.4% at the time that the Fed shifted to the sidelines and paused rates. Today, it's at 5.3%, suggesting the Fed may need to restart the rate-hike engine.[3] The threat of additional rate hikes, coupled with the volatility that was sparked by a potential debt-ceiling-induced default on government bonds, caused yields to push higher during the second quarter. The US 10-year yield increased from 3.41% to 3.84%[3], with the two-year rising from 4.02%3 to 4.90%.[3] Higher yields push bond prices lower as the two move inversely to one another. As a result, the fixed income market, as measured by the Bloomberg Barclays US Aggregate Bond Index, returned -0.84%[4] in the second quarter but still remains up 2.09%[4] for the year. There is a silver lining in higher rates for both retirees and investors. The more cash you have stashed away in a savings account as interest rates rise, the more you stand to benefit from higher income earned. With higher interest rates on savings accounts or other savings vehicles (think a certificate of deposit or money market account), you may earn a little more for every dollar. If you're trying to leverage the way interest rates affect retirement plans, this can go a long way toward meeting your retirement savings goals.

Alternatives and Real Estate

The biggest story within alternatives is that oil markets have reversed course since last year. After surging more than 63% last year, the Fidelity® MSCI Energy ETF (FENY) is down -5.30% through the first half of 2023.[4] This is in large part due to more subdued oil prices. WTI Crude prices came into the year at over $80/barrel and now sit at just above $70/per barrel.[3] This is after spiking to a 13-year high of $130/barrel in 2022.[3] However, the recent drop in oil prices has benefitted the American consumer, as the average price for a gallon of gas is down to $3.58/gallon from last year's peak of over $5.00/gallon.[3]

In the real estate market, US Existing Home Sales fell 20% over the last year, the 21st consecutive year-over-year decline. That's the longest down streak since 2007–2009. The reason for the housing shortage is due to higher interest rates; 62% of US mortgage holders have a rate below 4% and 92% have a rate below 6%. With current mortgage rates at close to 7%,[3] many existing homeowners are staying put. Given the rapid appreciation in home prices (40% in three years) and more than doubling of the mortgage rate, affordability is still an issue.[3] However, the Case-Shiller 20 City Home Price Index, which seeks to measure the value of residential real estate in 20 major U.S. is down -1.7% over the last year, only the second year-over-year decline since 2012, a welcome sign for a stagnant housing market.

Conclusion

Ultimately, we believe markets are showing signs of a rolling recession — implying that some sectors may be heading into a downturn, while others are stabilizing and rebounding. For example, the

housing industry was the first to suffer a tailspin after the Fed began sending interest rates sharply higher 15 months ago. As mortgage rates nearly doubled, home sales plunged. Manufacturing soon followed. And while it hasn't fared as badly as housing, factory production is down -0.3% from a year earlier.[3] However, at the same time, consumers ramped up their spending on travel and entertainment venues, buoying the economy's vast service sector and offsetting the difficulties in other sectors. Lastly, it is important to remember that the markets are "forward-looking," and tend to anticipate what might happen in the future, whereas much of the economic data reported in the news (like inflation or GDP) are "backward-looking," meaning that they are outcomes of what's already happened. This is all to say you can't predict market performance by looking at economic data alone. For Q2 2023, the estimated earnings decline for the S&P 500 is -6.5%. Should this come to fruition, it would mark the third straight quarter of negative earnings contraction, signaling we are well into an earning recession. However, markets seem to be shaking this off and looking to forward earnings growth, which is estimated at 0.8% for Q3 and 8.2% for Q4. As we turn the page to the second half of the year, we remain cautiously optimistic about the prospects for the market.

Economic Definitions

Unemployment Rate: The unemployment rate tracks the number of unemployed persons as a percentage of the labor force (the total number of employed plus unemployed). These figures generally come from a household labor force survey.

CPI (headline and core): Consumer prices (CPI) are a measure of prices paid by consumers for a market basket of consumer goods and services. The yearly (or monthly) growth rates represent the inflation rate.

GDP: Gross domestic product (GDP) measures the final market value of all goods and services produced within a country. It is the most frequently used indicator of economic activity. The GDP by expenditure approach measures total final expenditures (at purchasers' prices), including exports less imports. This concept is adjusted for inflation.

Existing Home Sales: This concept tracks the sales of previously owned homes during the reference period. Total existing home sales include single-family homes, townhomes, condominiums and co-ops. All sales are based on closings from Multiple Listing Services. Foreclosed homes are only counted in the inventory if the bank is working with a realtor. Foreclosed homes that sell via auction (or other closings outside of the Multiple Listing Services) are not included.

Mortgage Rate: A mortgage rate, or mortgage interest rate or interest rate, is part of what it costs to borrow money from a lender. Instead of paying your mortgage lender a lump sum, the interest is paid as part of your monthly payment for your home loan.

The Federal Reserve System: The central bank of the United States. It performs several general functions to promote the effective operation of the U.S. economy and, more generally, the public interest.

West Texas Intermediate (WTI): West Texas Intermediate (WTI) is crude stream produced in Texas and southern Oklahoma which serves as a reference or "marker" for pricing a number of other crude streams and which is traded in the domestic spot market at Cushing, Oklahoma.

Index Definitions

S&P 500: The S&P 500® is widely regarded as the best single gauge of large-cap U.S. equities and serves as the foundation for a wide range of investment products. The index includes 500 leading companies and captures approximately 80% coverage of available market capitalization.

NASDAQ: The NASDAQ Composite Index is a broad-based capitalization-weighted index of stocks in all three NASDAQ tiers: Global Select, Global Market and Capital Market. The index was developed with a base level of 100 as of February 5, 1971.

Dow Jones Industrial Average: The Dow Jones Industrial Average is a price-weighted average of 30 blue-chip stocks that are generally the leaders in their industry. It has been a widely followed indicator of the stock market since October 1, 1928.

Russell 1000: The Russell 1000® Index is a subset of the Russell 3000® Index that includes approximately 1,000 of the largest companies in the US equity universe. Constructed using a transparent, rules-based methodology, the Russell 1000 Index is designed to provide unbiased representation of the large cap segment of the US equity market.

Russell 1000 Value: Russell 1000 Value Index measures the performance of those Russell 1000 companies with lower price-to-book ratios and lower forecasted growth values. The index was developed with a base value of 200 as of August 31, 1992.

Russell 1000 Growth: Russell 1000 Growth Index measures the performance of those Russell 1000 companies with higher price-to-book ratios and higher forecasted growth values. The index was developed with a base value of 200 as of August 31, 1992.

Russell Mid-Cap: Russell Midcap Index measures the performance of the 800 smallest companies in the Russell 1000 Index, which represent approximately 25% of the total market capitalization of the Russell 1000 Index.

Russell 2000: The Russell 2000 Index is comprised of the smallest 2000 companies in the Russell 3000 Index, representing approximately 8% of the Russell 3000 total market capitalization. The real-time value is calculated with a base value of 135.00 as of December 31, 1986. The end-of-day value is calculated with a base value of 100.00 as of December 29, 1978.

MSCI EAFE: The MSCI EAFE Index is a free-float weighted equity index. The index was developed with a base value of 100 as of December 31, 1969. The MSCI EAFE region covers DM countries in Europe, Australasia, Israel, and the Far East.

MSCI EM: The MSCI EM (Emerging Markets) Index is a free-float weighted equity index that captures large and mid-cap representation across Emerging Markets (EM) countries. The index covers approximately 85% of the free float-adjusted market capitalization in each country.

Bloomberg Barclays US Agg Bond: The Bloomberg Barclays US Aggregate Bond Index is a broad-based flagship benchmark that measures the investment grade, US dollar-denominated, fixed-rate taxable bond market. The index includes Treasuries, government-related and corporate securities, MBS (agency fixed-rate pass-throughs), ABS and CMBS (agency and non-agency).

Fidelity MSCI Energy Index ETF: The Fidelity MSCI Energy Index ETF is an exchange-traded fund whose returns that correspond, before fees and expenses,

generally to the performance of the MSCI USA IMI Energy 25/50 Index. The MSCI USA IMI Energy 25/50 Index is a modified market capitalization-weighted index that captures the large-, mid-, and small-cap segments of the USA market. All securities in the index are classified in the Energy sector according to the Global Industry Classification Standard (GICS®0).

Case-Shiller 20 City Home Price Index: The S&P CoreLogic Case-Shiller 20-City Composite Home Price NSA Index seeks to measures the value of residential real estate in 20 major U.S. metropolitan areas: Atlanta, Boston, Charlotte, Chicago, Cleveland, Dallas, Denver, Detroit, Las Vegas, Los Angeles, Miami, Minneapolis, New York, Phoenix, Portland, San Diego, San Francisco, Seattle, Tampa and Washington, D.C.

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1 https://www.bloomberg.com/news/articles/2022-12-01/this-year-s-sour-stock-market-made-wall-street-bearish-for-first-time-since-1999#xj4y7vzkg

2 https://bilello.blog/2023/the-week-in-charts-6-18-23

3 Data Obtained from Bloomberg as of 6/30/2023

4 Data Obtained from Morningstar as of 6/30/2023

5 https://www.advisorperspectives.com/dshort/updates/2023/06/27/s-p-case-shiller-home-price-index-continued-gains-in-april

6 https://insight.factset.com/topic/earnings

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