MONTHLY MARKET UPDATE
June 2023

Highlights:

- The S&P 500 Index continued its advance in May, but with only eight companies contributing most of the advance for the year.
- Congress relieved investor anxiety by passing debt ceiling legislation.
- Equity and fixed income markets continue to provide conflicting signals about the prospects of a recession.

While the headline news in May centered on the debt ceiling crisis, investors seemed to better read the tea leaves by largely ignoring the noise. By the end of the month, the resolution in Washington seemed to confirm the indifference, leaving the S&P 500® Index nearly flat for May with a 0.4% advance, making for a 9.7% gain year-to-date. Despite some volatility in short-term notes, the bond market also largely shrugged off the possibility of default. Of more import to investors was the disposition of the Federal Reserve, with futures leaning for another rate hike in June while still anticipating rate cuts before the end of the year.

In the meantime, we continue to see rifts in the economy caused in part by sticky inflation and in part by the sharpest Federal Reserve rate increases in history. In previous months, we discussed the results on a small number of leveraged banks. These overall stresses have contributed to a sharp disparity of returns. In May, just three S&P sectors were positive, with an outsized return for Technology followed by Communication Services and Consumer Discretionary, while value and defensive indices were negative. Smaller stocks, generally considered to be more economically sensitive, were also negative in May. Signs that the overall economy is beginning to stutter included a slowdown in bank lending, a continuing contraction of the money supply, and recent reports that manufacturing orders are down.

From our perspective, the most important aspect of the stock market in May and the year, in general, has been the continued narrowness of the advances. A handful of large technology firms have been the main drivers of the gains, most recently behind the frenzy over AI (Artificial Intelligence). The equal-weighted S&P 500 dropped -3.8% in May, with a year-to-date return of -0.6%. Just five stocks were responsible for 85% of the Index's 9.6% gain through May. This makes the current market the narrowest since the Nifty Fifty era in the early 1970s and is reminiscent of the more recent tech boom of the late 1990s into 2000. Both cases signaled high risk and potential trouble for investors overly concentrated in the market's darlings. This may prove to be a largely overlooked risk for index investors as well.

PORTFOLIO MANAGER Q&A - PATRICK RYAN

How do you explain a U.S. stock market that continues to rise despite a decline in earnings for two quarters in a row?

Patrick Ryan, CFA
Head of Multi-Asset Solutions,
Portfolio Manager

The S&P 500 is up over 9.5% at the end of May, which is much better than anyone expected. As you mentioned, earnings growth has not been there for the last couple of quarters; it has declined. When you pull it apart and look at what's happening behind the scenes, you see some signs of stress. In the first five months of this year, only three sectors are positive - the big growth sectors. It's really just a handful of stocks that are driving the market higher and higher. If you compare the market cap-weighted S&P 500 with the equal-weight S&P 500, there's a performance gap of about 10%. Everyone's hearing about the AI craze. Nvidia added almost $200 billion in market cap in a single day.

The underperforming sectors are the ones that tend to be more cyclical and economically sensitive. Energy is underperforming. Small caps, which have been tied into the banking crisis earlier in the year, are underperforming. There are signs that things are not altogether healthy, reflecting that decline in earnings we're seeing more broadly. Certainly, some very unique things are happening, and we are starting to see some signs of recession.

Outside the U.S., we're seeing the opposite, a significant increase in earnings in Europe and other foreign countries. For some of us, this is counterintuitive given the Russia-Ukraine war and arguably bigger inflation problems. What's driving earnings growth outside of the U.S.?

Eight months ago, if you looked at Europe, you might have seen a disaster in the making. From an energy crisis and the war in Ukraine, all of those events were coming to a head. But Europe had a very warm winter, so they didn't need as much energy as they thought they would, and prices declined. So some of that was savings on the cost side, Europe is a much more industrialized economy than the U.S., so they benefit from declining commodity prices. And then you also had China reopening. Europe is much more tied to China in terms of manufacturing, and that reopening helped stimulate many of Europe's economies. It's also important to remember that earnings are a nominal number, so the fact that Europe's inflation was so high was actually propelling those nominal earnings higher.

As Head of Multi-Asset Solutions, your team is looking across all asset classes. From where you sit today, what risks do you think are under-appreciated across the markets right now?

Sticking with Europe, I think the Ukrainian situation is not improving; more recently, it seems like it's actually accelerating a bit. Everyone's anticipation over the last six to eight months has been that the Ukrainian war would settle down and, eventually, there would be some type of peace agreement. We're still not even talking about peace. There have been some pretty significant events that look like the war could actually accelerate or jump into a broader conflict.

Another big factor at a macro level is the disconnect between what the market believes the Federal Reserve will do with interest rates and what the Federal Reserve feels they need to do to bring inflation down. We're looking at a two-thirds probability that they raise interest rates in a couple of weeks. While the Fed continues to believe they need to raise interest rates, there is a belief in the markets that the Fed will be quick to pull back on the measures they've been putting in place over the last year plus. So, with the markets marching up another 10% this year, we fear that the Fed will not actually cut rates until something significant breaks and we tumble into a more severe recession than the market expects.

Flipping the coin, when looking across all asset classes, where does your team see the most opportunity or value today?

We've seen the most value in the safest areas. So, we've been looking at high quality bonds. When you think about the environment we just went through, investors were getting paid close to nothing for over ten years in the fixed income markets. Today, high quality intermediate-term corporate bonds are yielding anywhere from 5-5.5%. And to us, that's quite attractive when looking at an S&P 500 that is trading at 18 plus times forward earnings with a very uncertain economic environment. Even on the front end of the yield curve, you're getting paid well in safe Treasury investments, up over 5% for a year. We look at balancing out the positions on the yield curve between how long those short-term rates will be around and locking in something like 5-5.25% in a more benign interest rate environment on those higher-grade corporates.

We are cognizant of the recession fears and what might lie ahead for the equity market. But you don't have to take that much risk because there are safer instruments that offer a good return for a set period of time. For us, bonds are still the most attractive. Within the equity markets, we are looking at some of the more beaten-down areas with emerging markets and other equity investments tied to the resource and commodity shortages we think are coming down the road.

U.S. EQUITIES (%)

	May	YTD	1 Year	3 Year	5 Year	10 Year
DJ Industrial Average	-3.2	0.2	2.0	11.3	8.5	10.6
S&P 500	0.4	9.6	2.9	12.9	11.0	12.0
Russell 1000	0.5	9.3	2.4	12.5	10.6	11.8
Russell 1000 Value	-3.9	-1.4	-4.5	11.6	6.8	8.4
Russell 1000 Growth	4.6	20.8	9.5	12.8	13.8	14.8
Russell Midcap	-2.8	0.6	-4.5	10.2	6.9	9.3
Russell 2000	-0.9	0.0	-4.7	9.2	2.7	7.4

U.S. EQUITY CHARACTERISTICS - S&P 500

	May	2022
Price/Earnings Ratio	22.1	19.1
Weighted Avg. Market Cap ($B)	640.6	417.5
Dividend Yield (%)	1.6	1.7

U.S. EQUITY SECTORS - S&P 500 (%)

	May	YTD	Weight
Communication Services	6.2	32.8	8.8
Consumer Discretionary	3.2	18.7	10.2
Consumer Staples	-6.1	-1.9	6.9
Energy	-10.0	-11.4	4.2
Financials	-4.3	-6.8	12.5
Health Care	-4.3	-5.6	13.7
Industrials	-3.2	-1.0	8.2
Information Technology	9.5	34.0	28.0
Materials	-6.8	-3.0	2.4
Real Estate	-4.5	-1.7	2.4
Utilities	-5.9	-7.2	2.7

INTERNATIONAL EQUITIES (%)

	May	YTD	1 Year	3 Year	5 Year	10 Year
ACWI	-1.1	7.7	0.9	10.1	6.8	7.8
ACWI ex USA	-3.6	4.8	-1.4	7.2	2.2	3.8
MSCI EAFE	-4.2	6.8	3.1	8.5	3.2	4.6
Emerging Markets	-1.7	1.1	-8.5	3.5	-0.7	1.9
China	-8.4	-9.1	-14.7	-8.8	-7.0	1.9
Japan	1.9	8.6	4.5	4.3	1.8	5.0
Germany	-5.6	12.0	5.5	5.5	0.2	3.1
United Kingdom	-6.6	4.4	-0.4	11.7	1.9	2.9
India	2.9	0.4	1.7	20.1	7.6	7.6

KEY ASSET PRICES

	May	2022
EUR/USD	1.07	1.06
USD/CAD	1.36	1.36
USD/JPY	140.53	132.78
GBP/USD	1.23	1.21
Bitcoin ($)	27,219.7	16,514.0
Gold ($/oz)	1,973.0	1,827.0
Crude Oil (WTI) ($/bbl)	69.5	80.4

FIXED INCOME (%)

	May	YTD	1 Year	3 Year	5 Year	10 Year
Government Bond	-1.1	2.3	-2.2	-4.4	0.6	0.9
Municipal	-0.9	1.7	0.5	-0.6	1.7	2.3
U.S. Aggregate Bond	-1.1	2.5	-2.1	-3.6	0.8	1.4
Investment Grade Corporate	-1.4	2.8	-1.6	-2.9	1.5	2.2
High Yield	-0.9	3.6	0.0	2.9	3.1	4.0

U.S. TREASURY YIELDS (%)

	May	2022
3-Month	5.5	4.4
6-Month	5.5	4.8
2-Year	4.4	4.4
5-Year	3.7	4.0
10-Year	3.6	3.9
30-Year	3.9	4.0

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The Dow Jones Industrial Average® (The Dow®), is a price-weighted measure of 30 U.S. blue-chip companies. The index covers all industries except transportation and utilities.

The S&P 500® Index is an unmanaged index of large companies and is widely regarded as a standard for measuring large-cap and mid-cap U.S. stock-market performance. Results assume the reinvestment of all capital gain and dividend distributions. An investment cannot be made directly into an index.

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International Equities Definitions
The MSCI ACWI ex USA Index captures large and mid cap representation across 22 of 23 Developed Markets countries (excluding the US) and 23 Emerging Markets countries. With 1,843 constituents, the index covers approximately 85% of the global equity opportunity set outside the US.

The MSCI EAFE (Europe, Australasia & Far East) Index is a free-float adjusted market capitalization index that is designed to measure developed market equity performance, excluding the U.S. and Canada.

Emerging Markets - MSCI Emerging Market Index – captures large and mid cap representation across 24 Emerging Markets (EM) countries. With 1,138 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country.

China - MSCI China Index - captures large and mid cap representation across China A shares, H shares, B shares, Red chips, P chips and foreign listings (e.g. ADRs).

Japan - MSCI Japan Index - is designed to measure the performance of the large and mid cap segments of the Japanese market.

Germany - MSCI Germany Index - is designed to measure the performance of the large and mid cap segments of the German market.

United Kingdom - MSCI United Kingdom Index - is designed to measure the performance of the large and mid cap segments of the UK market.

India - MSCI India Index - is designed to measure the performance of the large and mid cap segments of the Indian market.

Fixed Income Definitions
Government Bond - Bloomberg US Government Index - measures the performance of the U.S. Treasury and U.S. Agency Indices, including Treasuries and U.S. agency debentures. It is a component of the U.S. Government/Credit Index and the U.S. Aggregate Index.

Municipal - Bloomberg U.S. Municipal Index - covers the USD-denominated long-term tax exempt bond market. The index has four main sectors: state and local general obligation bonds, revenue bonds, insured bonds and prerefunded bonds.

U.S. Aggregate Bond - Bloomberg U.S. Aggregate Bond Index - is a broad-based flagship benchmark that measures the investment grade, U.S. dollar-denominated, fixed-rate taxable bond market. The index includes Treasuries, government-related and corporate securities, mortgage backed securities, asset-backed securities and corporate securities, with maturities greater than one year.

Investment Grade Corporate - Bloomberg U.S. Credit Index - measures the investment grade, US dollar-denominated, fixed-rate, taxable corporate and government related bond markets. It is composed of the US Corporate Index and a non-corporate component that includes foreign agencies, sovereigns, supranationals and local authorities.

High Yield - Bloomberg U.S. Corporate High Yield Bond Index measures the USD-denominated, high yield, fixed-rate corporate bond market. Securities are classified as high yield if the middle rating of Moody's, Fitch and S&P is Ba1/BB+/BB+ or below. Bonds from issuers with an emerging markets country of risk, based on Bloomberg EM country definition, are excluded.

Definitions
Weighted Avg. Market Cap: measures the size of the companies in which the portfolio invests. Market capitalization is calculated by multiplying the number of a company's shares outstanding by its price per share.

Price-to-Earnings (P/E) Ratio: measures how expensive a stock is. It is calculated by the weighted average of a stock's current price divided by the company's earnings per share of stock in a portfolio.

Dividend Yield: the portfolio's weighted average of the underlying portfolio holdings and not the yield of the portfolio.

A basis point is one hundredth of a percent.

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