MARKET & ECONOMIC HIGHLIGHTS

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"O, I heard it with my ears, I saw it with my eyes, and part of it fell on my tail!" "Make haste!" says Fox Lox "and all come into my den" – John Greene Chandler, The Remarkable Story of Chicken Little, 1840

June capped off an extraordinary first half of the year for equity markets. The majority of asset classes we follow for this commentary had positive returns on the month stacking with somewhat sanguine returns earlier this year. US stock indices climbed over 6% just in June, broadening the rally in large cap stocks out to include mid and small cap stocks as well. The S&P MidCap 400 (+9.16%) and Russell 2000 (+8.13%) were the top performers, while the Bloomberg US 5-7YR Aggregate (-0.77%) and US Government (-0.74%) Indices were the worst performers for the month. The NASDAQ 100 had the best start to the year ever.

For many this begs the question; where is the recession? Are economists and market bears scaring people into believing the sky is falling? Or are there real risks to prosperity that are just taking longer to mature? The real-world weather parallel that can be just as confusing and frustrating is a tornado. Meteorologists have a two-tiered system to help people measure the risk of a tornado, a watch and a warning. The watch means that conditions in the area are consistent with those in which tornados form, whereas the warning is that an actual tornado has been sighted and projected over a certain path. We have shown over the past year a variety of metrics that show the US economy is on a recession watch. Unfortunately, there has been neither a clear progression to either a recession warning or clear skies for the economy.

Like Chicken Little, we can "see" with our own eyes that interest rates are the highest they have been since before the Global Financial Crisis (GFC). We can "hear" it with our ears that consumer and business surveys have soured over the past year. We can "feel" it in our wallets as inflation has hit everything, especially food and gas prices over the last two years. Unlike Chicken Little and her friends from the 1840 version, a quick look around will show that the sky is not crashing down all around us. For instance, if gas stations are excluded from year-over-year (YoY) retail trade, sales have been slowing overall, but keeping their head above water compared to Personal Consumption Expenditure (PCE) inflation over the last year. The margin between inflation and retail sales growth has dwindled significantly compared to the last decade, especially in the last couple years, but the overall growth rate is in line with the average pre-pandemic rate from 2013 through 2019.

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This sort of mixed message is found throughout the US economy with economic metrics like housing, restraint in both monetary and fiscal policy and the labor force. The month-over-month growth in overall housing starts for May jumped the most since October 2016 while single-family starts rivaled June 2020. This reading is colossal if it bears out into a trend for a segment of the economy that drives significant consumer spending. Likewise, new supply could precipitate a quicker decline in the housing component of inflation which is about a quarter of the consumer price index. Although 30-year mortgage rates around 7% could cool consumer interest on the one hand, an influx of people moving into new homes and the spending that usually entails could keep inflation sticky on the other hand.

While the Federal Open Market Committee left short term policy rates unchanged during their mid-June meeting, their quarterly Summary of Economic Projections (SEP) indicated potential for a median of a further 0.50% in interest rate hikes. And while it is to be expected at this time in the rate hiking cycle, where there has been more ground covered already than we expect will need to be covered in the future in bringing rates to a moderately restrictive level, the minutes from the most recent meeting show more dispersion in Committee members opinions than the unanimous decision to leave rates unchanged implies.

Fiscal policy is in a bit of a lull at best and at worst could create a precarious situation for the economy before the year is up. Biden's legislative wins on industrial and infrastructure spending are slow to ramp up, while in the meantime the joint actions of the Fed and Treasury to adjust their balance sheets with quantitative tightening and replenishment of the Treasury General Account, respectively, still could put strain on liquidity. The Treasury has scheduled auctions for new issuance of $300 billion during the week of July 10th. By maneuvering through the debt ceiling debate, the US resecured the Dollar as the reserve currency and the T-Bill yield as the risk-free rate. Combining these with the roll off of securities from the Fed's balance sheet, the opportunity cost of holding more risky assets will demand a higher return for investors. This could be potential drag on other markets' liquidity and may increase the volatility of those assets in the short term, as we have seen so far in July.

The labor market continues to create net new jobs for the economy with the June employment situation reading an increase of 209,000 and unemployment ticking back down a tenth to 3.6%. Despite the downward revision to the prior two months' reports of -110,000, the 4.4% increase in YoY hourly earnings shows a still tight labor market. Likewise, initial and continuing unemployment claims

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Commentary - Continued

and job openings are stubborn to show any significant slack as the Fed had been anticipating. This is not to say there are no weaknesses in the labor market. The number of labor unions renegotiating labor contracts to better benefit their members has noticeably increased over the last year. Further, the rate of unemployment for those with less education and marginal attachment to the labor force is edging higher, which is often one of the earlier dominoes to fall as the economy slows.

Internationally, the Eurozone is in a very shallow recession due to persistent inflation and languishing consumer confidence. China likewise is seeing softness of its own sort. Growth for the first quarter came in at 4.5%, below expectations, and the People's Bank of China cut its lending rate in the face of a Fed still suggesting hikes in late June. So, a variety of economic readings are telling investors that conditions are still consistent with a recession forming but not yet occurring for the US.

If the economics is not providing a clear sign for investors, is there anything we can glean from historical cycles? Going back to the inception of the S&P 500, looking at monthly returns, there have been 120 instances where the prior six-month return for the index was greater than the prior twelve months, just like the six months of this year were much better than the last six months of 2022. Of those instances, more than half had a S&P 500 return for the following six months of more than 5.5%, or the rate of the six-month T-Bill on June 30th. The average return of those instances was 15.9%.

Only a quarter of the time was the next six month return negative (that goes down to only 18 instances since WWII) with an average drawdown of -9.5%. Most of those drawdowns happened following a recessionary trough and rarely preceded a recession starting in the following six months (with the exception of 1948). The twelve-month historical forecast suggests a more dour outcome with fifty negative instances with an average drawdown of -8.8%. The historical record's optimism for the rest of 2023 is further bolstered by NDR's Cycle Composite that combines annual, presidential and ten-year cycles. This does not portend a 15.9% surge, but at least a modest gain through the end of the year.

It is worth keeping in mind that going back to the beginning of 1928, the S&P 500 has a roughly 34% chance of being negative six months ahead at any month end. While six months is a relatively short period of time, one of the tenets of the legendary equity investors over the years is to invest for the long haul. Only a few, like Fred Astaire, like to get caught in the rain. But it is nothing compared to a tornado or the sky falling. We know markets are cloudy now and the atmosphere can shift quickly, so preparing a portfolio for eventualities is prudent. In the case of 1840 Chicken Little story, Fox Lox was well prepared to seize the opportunity he was given. This version is much more Brothers Grimm than Disney, with Fox Lox rushing the silly fowl to his den for a sumptuous, filling dinner just for him.

Prudent investors now are not stuck with a choice between the sky falling or not. The choice is not just to be invested in markets or sitting on the sidelines. As rates have increased, the differentiation of investment options has reasserted itself after a decade of zero interest rate policy. Headlines have highlighted the rising potential for artificial intelligence, the tidal wave of approaching commercial real estate maturities, and burgeoning opportunities in private credit funds as traditional banks tighten their credit standards. Each has its own risks and rewards available to investors. Using clear eyes, open ears and staying in touch with one's investment goals, cash flow needs and time horizon can keep an investor from falling in with Chicken Little's crowd and may even afford a filling dinner, like Fox Lox when the opportunity arises.

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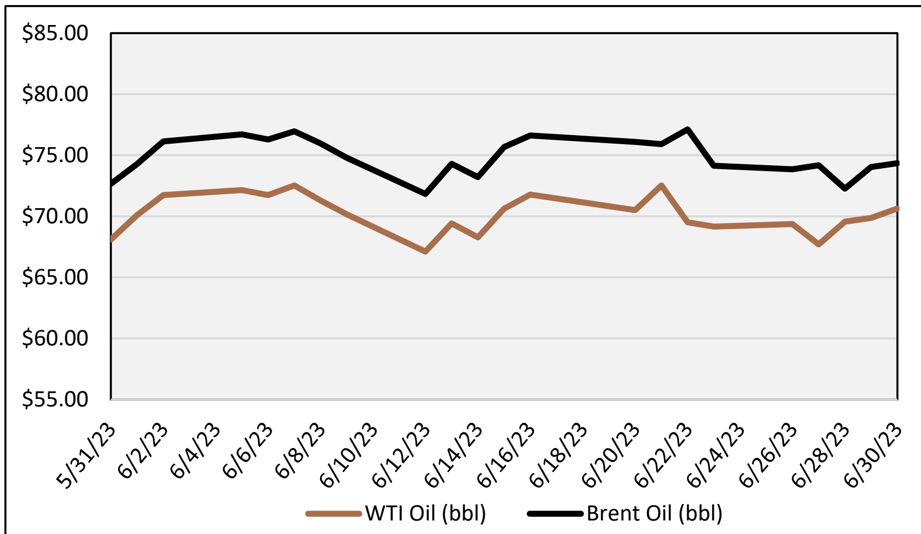
Oil and Gas Commentary

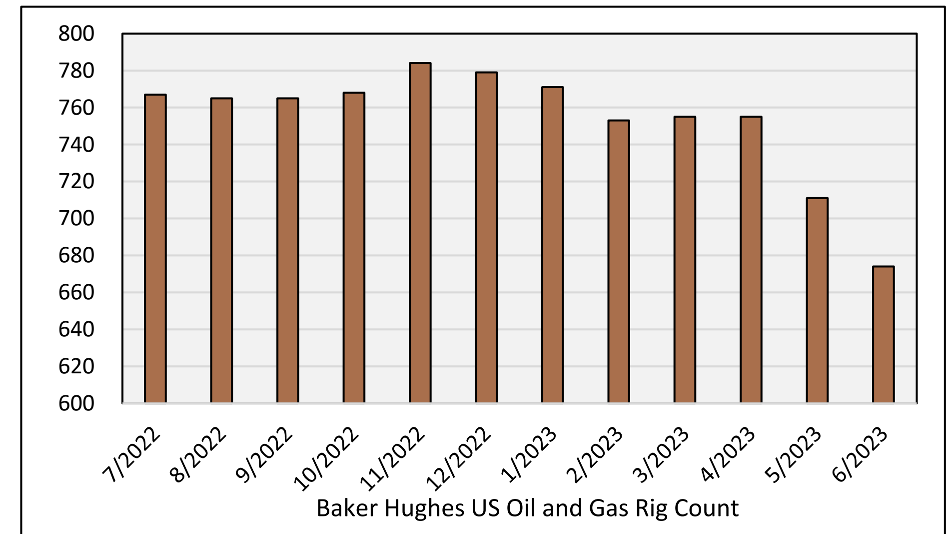
The first official month of summer did not bring the traditional boost to oil prices we have come to expect. Economic imbalances caused by inflation and fears over the corresponding rate hikes still to come have cast a seemingly never evaporating cloud over the energy complex. In Texas, we know the sky can change in an instant. There have been positive signs for both demand and supply this year, but they have been brushed aside due to the weight of global economic data. Allowing the natural tug of war between supply and demand portends a healthy market. Until that market action returns, we remain rangebound with WTI settling at $70.64/bbl in June.

While economic growth has slowed, oil demand did reach a record earlier this year. China's recovery from Covid has been slower than expected and frequently grabs headlines, but in southern Asia, India's oil demand hit a record in June. In fact, International Energy Agency (IEA) chief Fatih Birol stated that India will soon surpass China as the largest driver of global oil demand. India's oil demand has risen almost 10% in the last year, and despite the significant headwinds being felt all over the world, India's demand for all forms of refined product rose significantly including gasoline and jet fuel.

July is the first month of Saudi Arabia's additional one million barrel per day cut from their already agreed to contribution of OPEC+ cuts. They have since announced the same reduction will be made in August. Russia has also pledged a 500,000-bpd reduction in August to help counter market negativity and boost prices. There is not enough space in this commentary to dissect the Russian portion of this, but this should support higher energy prices.

Domestic rig count dropped another 5% in June according to Baker Hughes. While the lower for longer energy prices have certainly impacted this, I believe a less talked about factor is being felt as well. Longer laterals have become more prevalent in recent years, particularly in the basins where operators are the most active. What this means is that the size of land/resources being developed by one rig has increased. Operators are now able to produce from a lateral as long as three miles in some places. Only a few years ago, this same operation would have taken three rigs. There are many factors that would impact an operator's ability to do this, including the contracts negotiated by mineral owners and ownership by other operators in the area, but there should be a corresponding impact on the rig count.





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S&P 500 Sector Benchmark Returns

2023 Q2	2023 April	2023 May	2023 June	Year-to-Date
NASDAQ 12.81	DJIA 2.48	NASDAQ 5.80	S&P 500 TR 6.61	NASDAQ 31.73
S&P 500 TR 8.74	EAFE 2.28	Dollar 2.51	NASDAQ 6.59	S&P 500 TR 16.89
S&P 500 8.30	S&P 500 TR 1.56	S&P 500 TR 0.43	S&P 500 6.47	S&P 500 15.91
EAFE 4.28	S&P 500 1.46	T-Bills 0.43	DJIA 4.56	EAFE 12.10
DJIA 3.41	Gold 1.09	S&P 500 0.25	EAFE 3.60	Gold 5.73
EM 1.71	Bond Agg 0.61	EM -0.99	EM 3.45	EM 5.55
T-Bills 1.28	T-Bonds 0.52	Bond Agg -1.09	S&P GSCI 2.32	DJIA 3.80
Dollar 0.32	T-Bills 0.41	Gold -1.27	T-Bills 0.43	T-Bonds 3.72
Bond Agg -0.84	NASDAQ 0.04	EAFE -1.58	T-Bonds -0.02	T-Bills 2.47
T-Bonds -2.30	EM -0.70	T-Bonds -2.79	Bond Agg -0.36	Bond Agg 2.09
Gold -2.37	Dollar -0.90	DJIA -3.49	Dollar -1.25	Dollar -0.58
S&P GSCI -5.85	S&P GSCI -1.58	S&P GSCI -6.50	Gold -2.19	S&P GSCI -11.41

June capped off an extraordinary first half of the year for equity markets. Many asset classes had positive June returns to stack on somewhat sanguine returns earlier this year.
(Source: Ned Davis Research)

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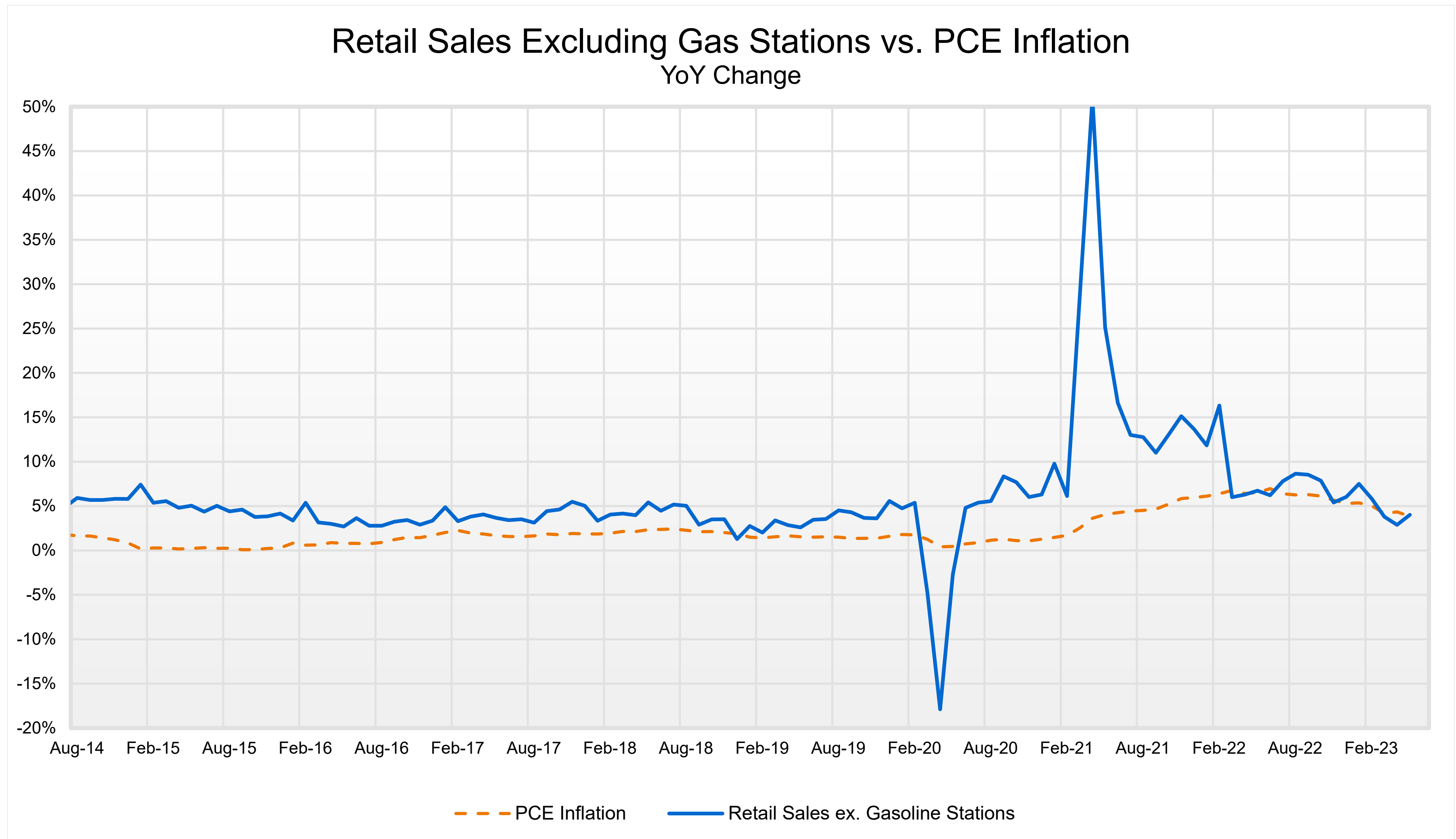

The margin between inflation and retail sales growth has dwindled significantly compared to the last decade, but the overall growth rate is in line with the average pre-pandemic rate from 2013 through 2019.
(Source: US Census, BEA)

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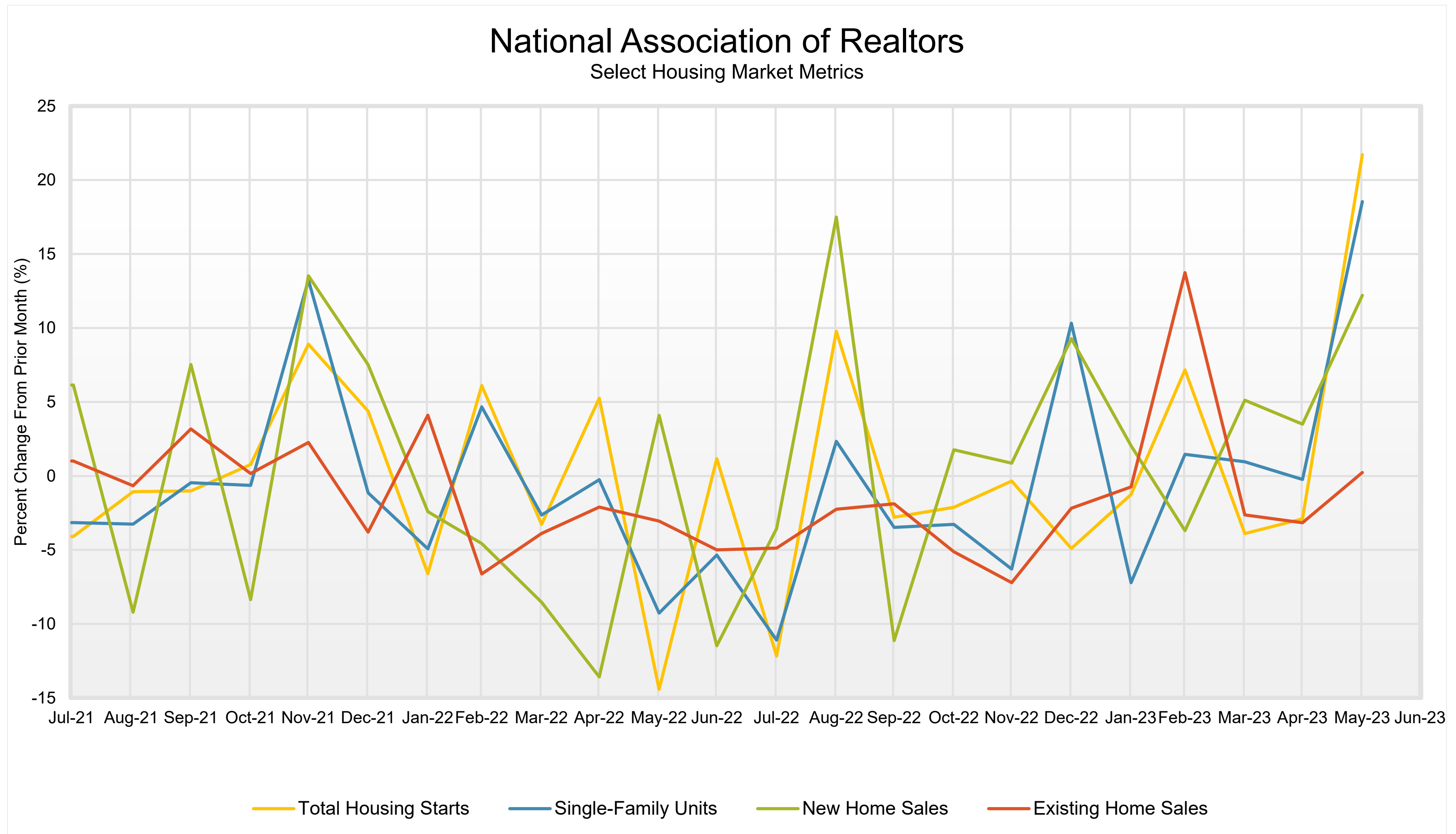

The month-over-month growth in overall housing starts for May jumped the most since October 2016 while single-family starts rivaled June 2020, though existing sales growth is tepid at best.
(Source: National Association of Realtors)

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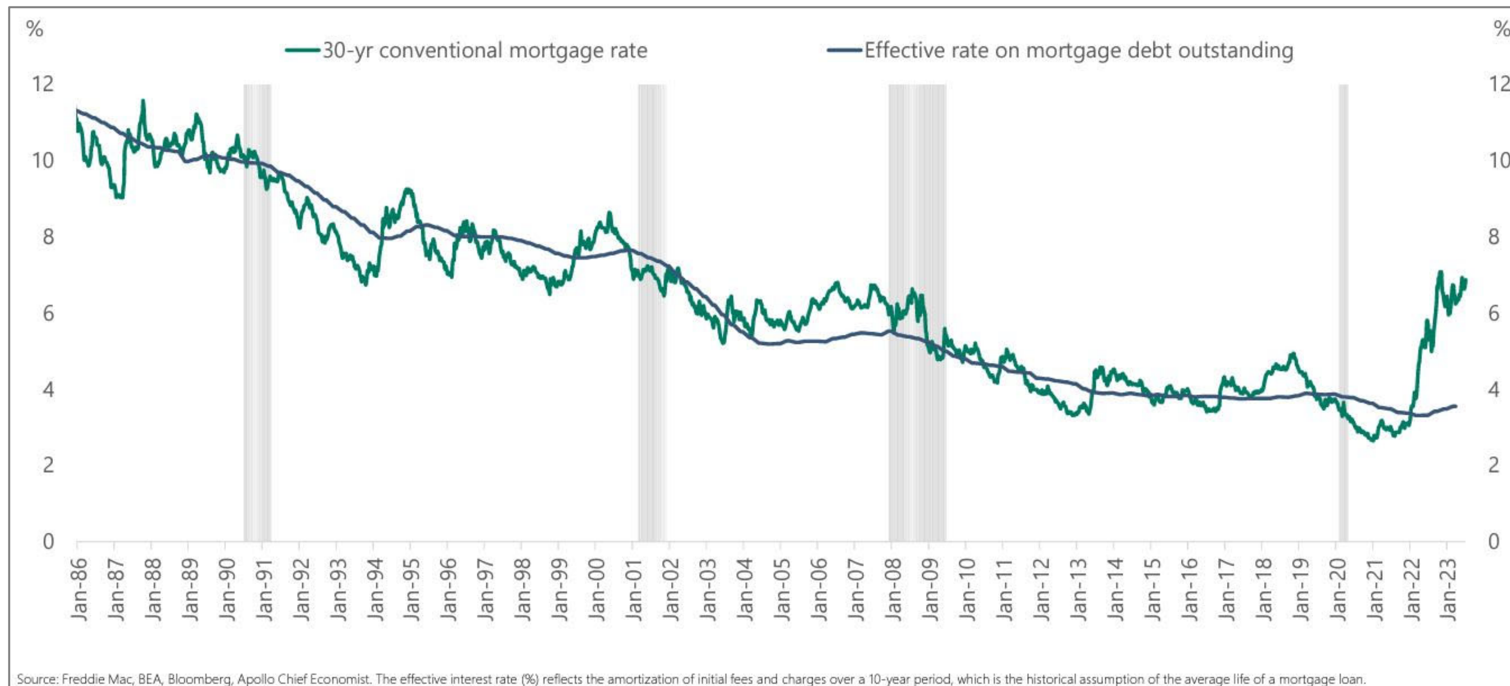

Mortgage rates have topped 7% and the average rate paid on mortgages in the US is starting to tip up after decades of a downward trend.

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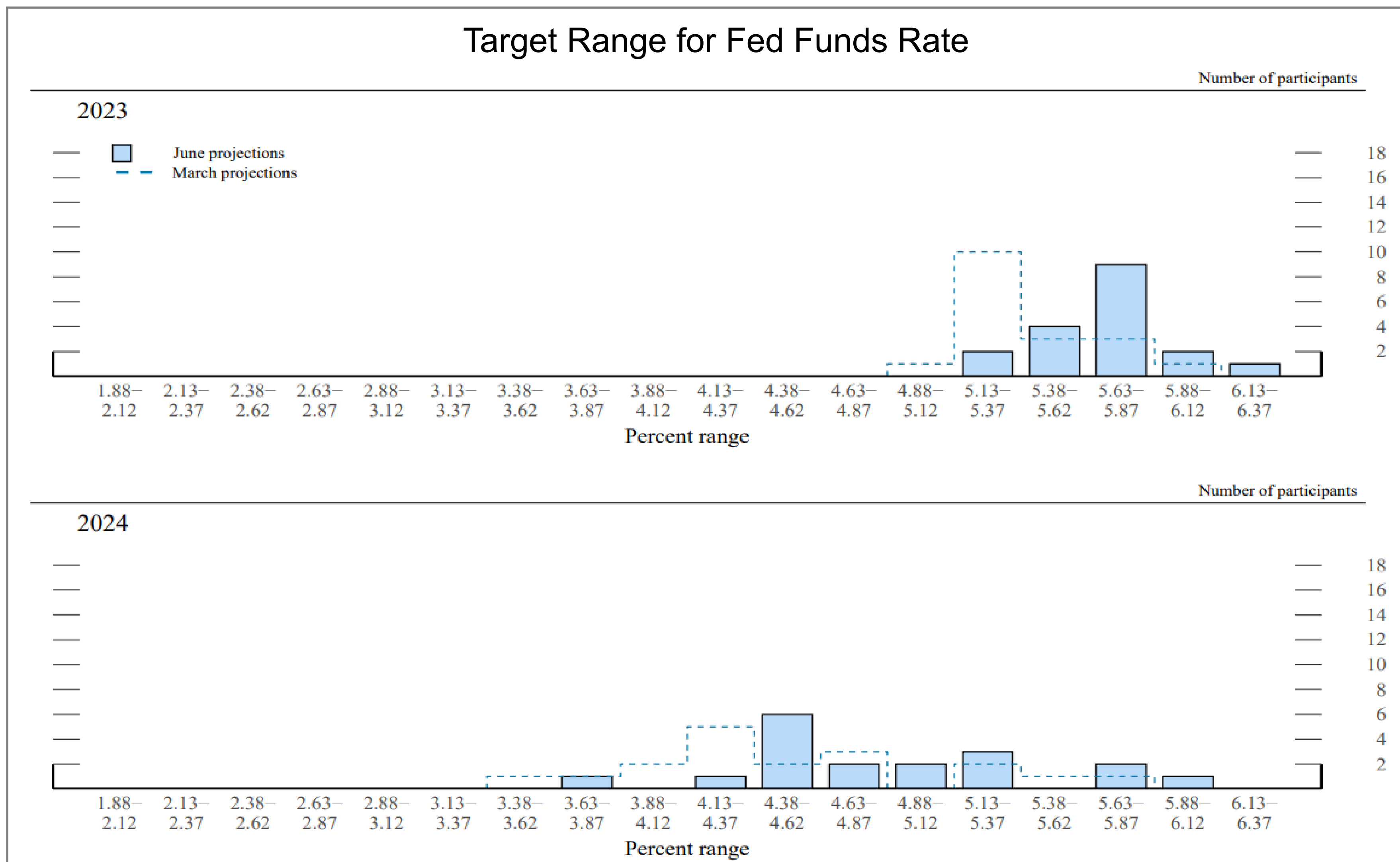
Commentary Highlights



While the Federal Open Market Committee left short term policy rates unchanged in June, their quarterly Summary of Economic Projections (SEP) suggests further rate hikes of 0.50%.
(Source: FOMC)

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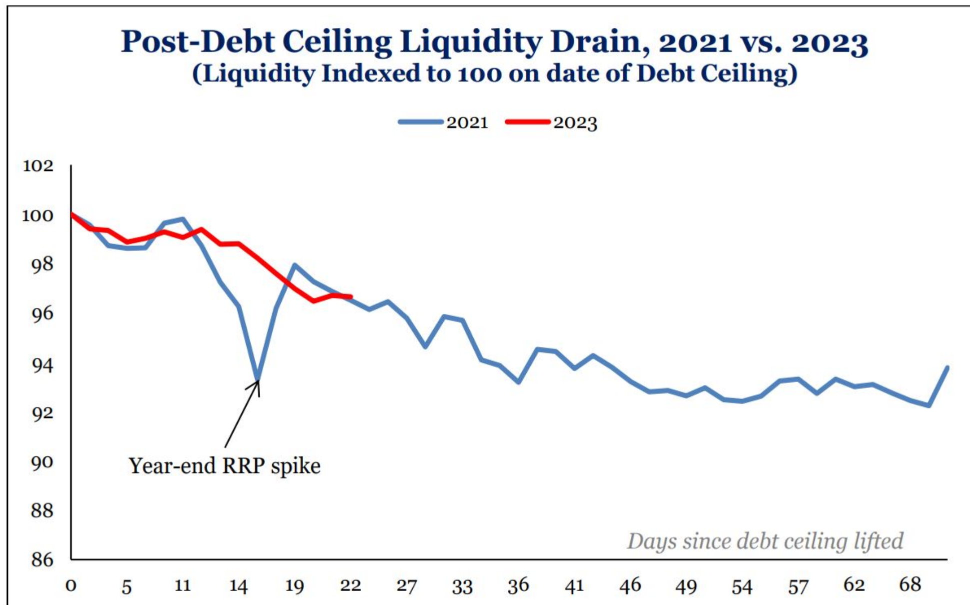

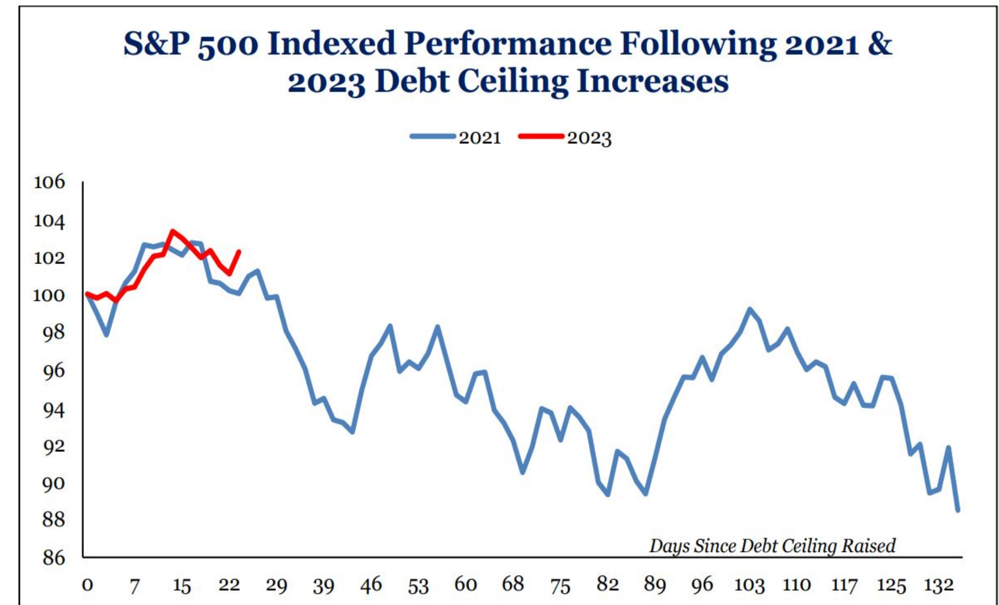

With the debt ceiling debate behind us, the impact of quantitative tightening and the Treasury building back its cash reserves, the drain in liquidity could put downward pressure on equities.
(Source: Strategas Research Partners)

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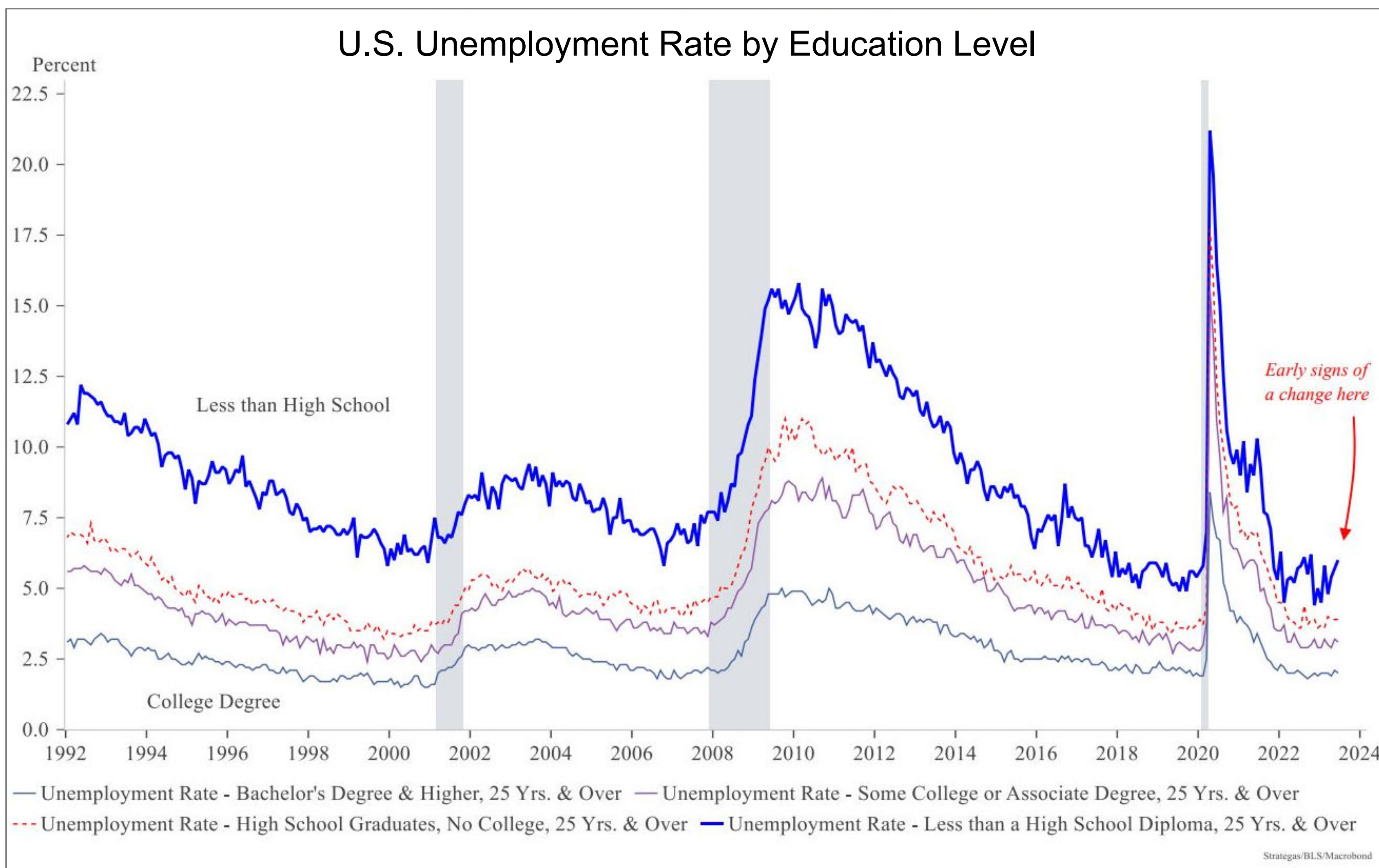

Overall, the labor market has continued to stay extraordinarily tight. But certain groups, like those with lower education levels, are starting to see unemployment tick up.

(Source: Strategas Research Partners, BLS)

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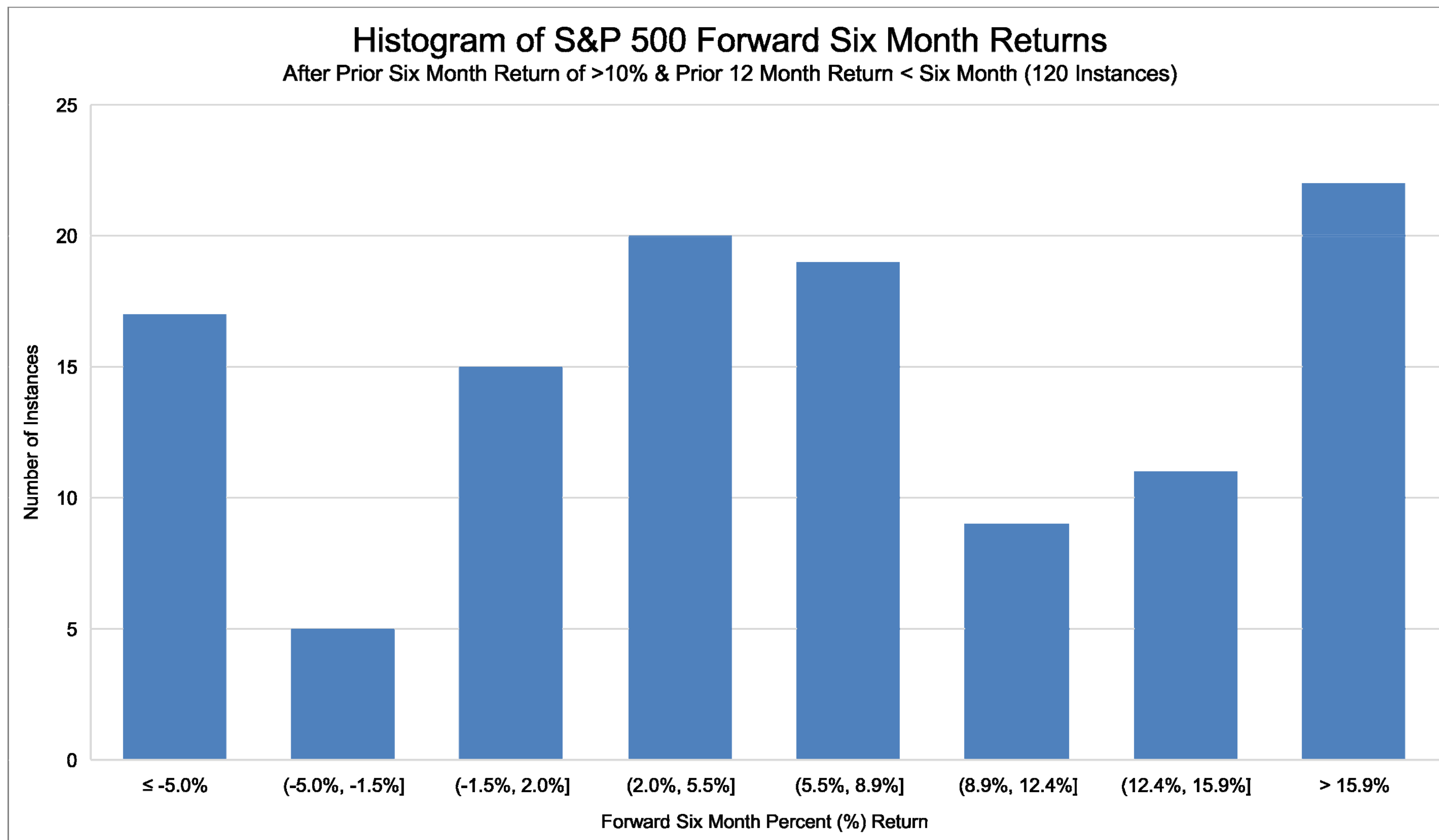

The first half of the year was impressive across equity markets. The historical record suggests the possibility for the run to continue through the end of the year.
(Source: FactSet Research Systems)

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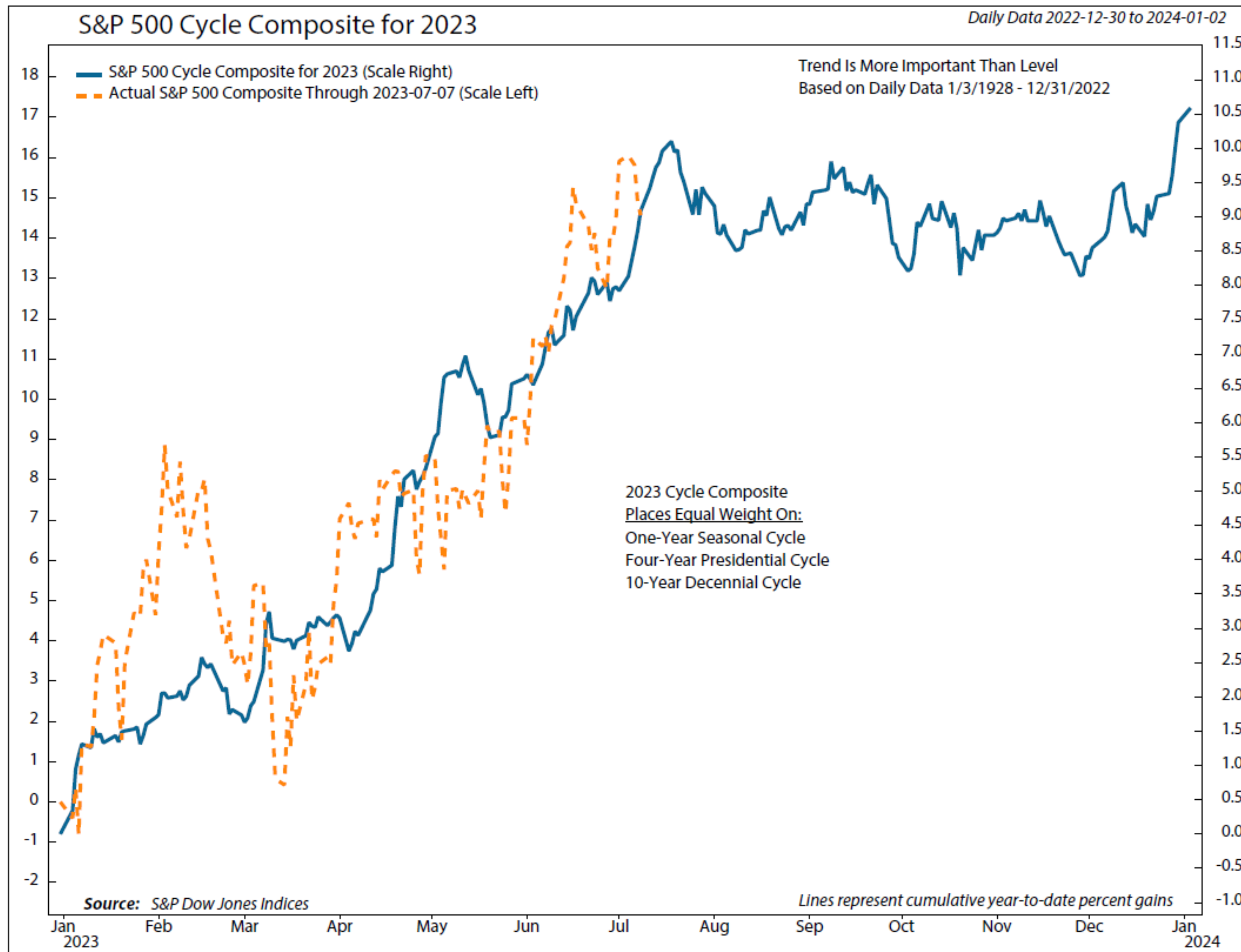

The trifecta of annual seasonality, the presidential cycle and decennial cycle likewise suggest that the first half of 2023 does not necessitate a down second half.
(Source: Ned Davis Research)

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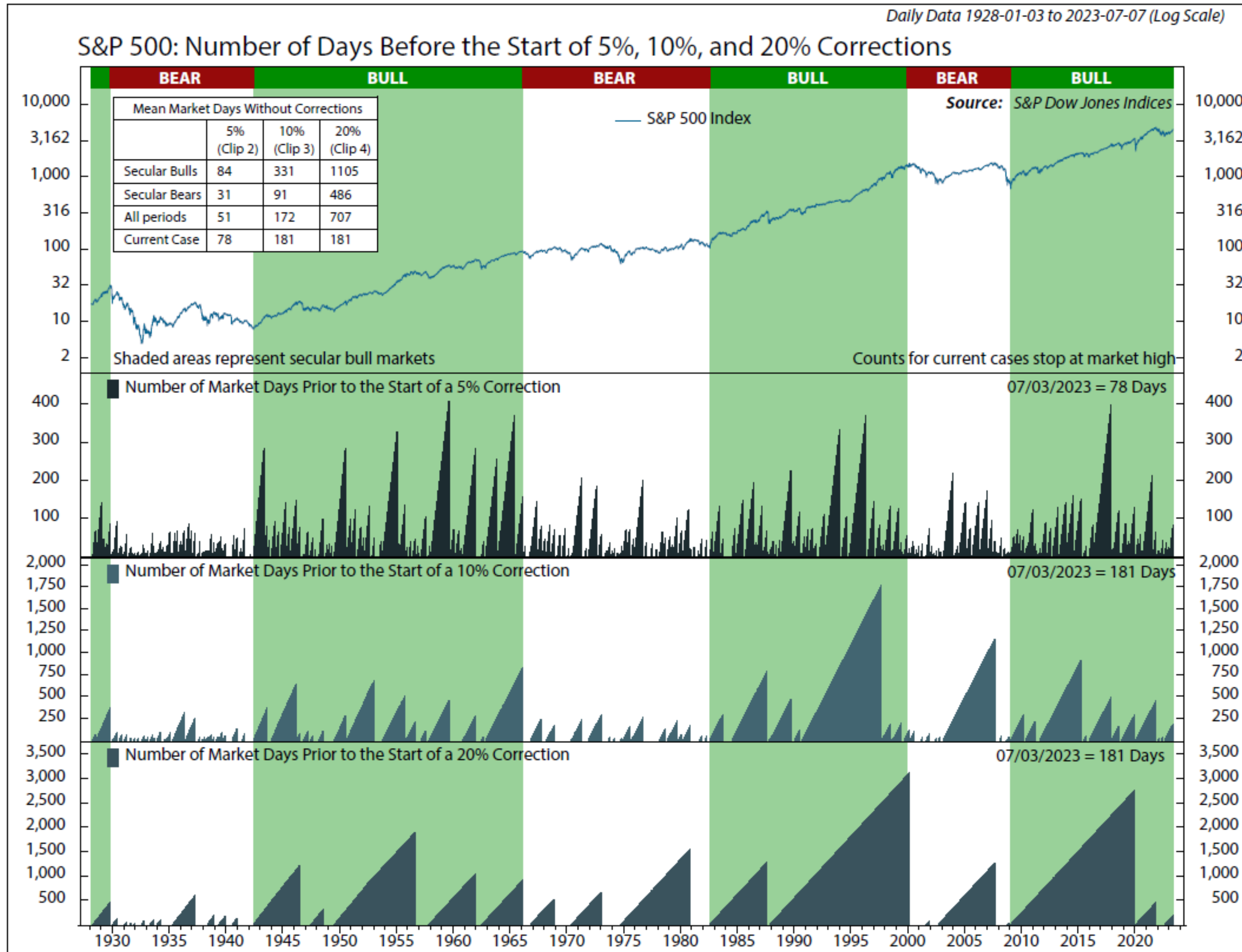

It is important to remember that corrections of various magnitudes happen regularly and are a healthy part of market activity, and that over the long-term equities have an upward returns bias.

(Source: Ned Davis Research)

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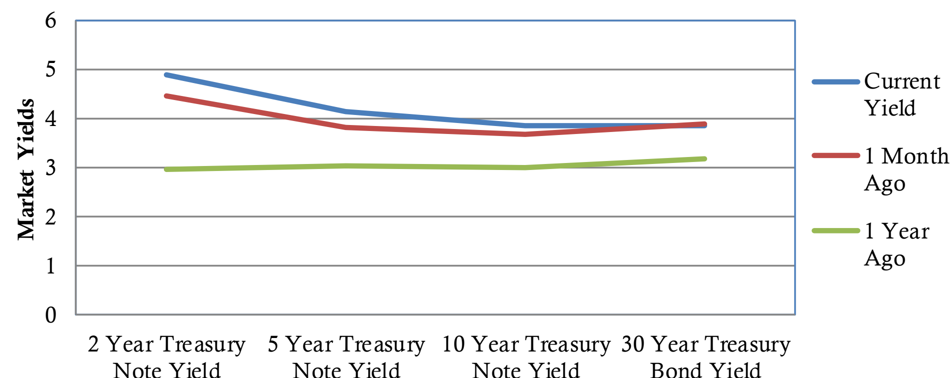
Market and Economic Snapshot

As of 07/01/23		Total Returns			
Equity Markets	**Closing Price**	**1 Month**	**3 Month**	**6 Month**	**1 Year**
Dow Jones	34407.60	4.68%	3.97%	4.94%	14.23%
S&P500	4450.38	6.61%	8.74%	16.88%	19.56%
NASDAQ	13787.92	6.66%	13.05%	32.32%	26.17%
MSCI World	682.84	5.84%	6.33%	14.26%	17.15%
Styles (Russell Indexes)					
Large Cap	2436.93	6.75%	8.58%	16.67%	19.34%
Large Growth	2770.27	6.84%	12.81%	29.01%	27.10%
Large Value	1555.64	6.64%	4.07%	5.10%	11.50%
Midcap	2919.27	8.34%	4.76%	9.00%	14.90%
Small Cap	1888.73	8.13%	5.19%	8.06%	12.27%
Small Growth	1232.98	8.29%	7.05%	13.55%	18.49%
Small Value	2111.65	7.94%	3.16%	2.46%	5.96%
International (MSCI)	2131.73	4.58%	3.19%	12.16%	19.53%
Emerging Markets (MSCI)	989.48	3.83%	0.97%	5.02%	2.12%
Sectors (S&P Indexes)					
Energy	623.56	6.65%	-0.89%	-5.55%	18.58%
Materials	521.93	11.05%	3.31%	7.74%	15.12%
Industrials	908.09	11.29%	6.49%	10.19%	25.12%
Consumer Discretionary	1330.54	12.07%	14.58%	32.97%	24.64%
Consumer Staples	778.82	3.24%	0.45%	1.28%	6.60%
Healthcare	1548.62	4.36%	2.95%	-1.48%	5.38%
Financials	561.11	6.69%	5.33%	-0.53%	9.45%
Information Technology	3085.84	6.59%	17.20%	42.77%	40.26%
Telecommunications	216.08	2.58%	13.07%	36.24%	17.28%
Utilities	332.80	1.65%	-2.53%	-5.69%	-3.68%
Commodities					
Gold	1929.40	-2.66%	-3.73%	2.98%	2.92%
Natural Gas	2.80	18.66%	0.54%	-32.79%	-36.35%
Oil	70.64	3.52%	-6.36%	-10.99%	-17.87%

		Total Returns			
Currencies	**Closing Price**	**1 Month**	**3 Month**	**6 Month**	**1 Year**
US Dollar Index	102.91	-1.36%	0.40%	-0.59%	-1.69%
Euro/$US	1.09	2.06%	0.65%	2.27%	4.05%
Yen/$US	144.31	-3.44%	-7.93%	-9.36%	-5.95%
Bitcoin	30592.81	12.23%	8.66%	82.13%	58.58%
Economic Data/Rates		**Total Returns/Change**			
GDP	2.00		-0.60	-1.20	3.60
Unemployment Rate	3.70	0.30	0.10	0.10	0.10
CPI (Core)	0.44	0.03	-0.01	0.13	-0.19
PPI (Core)	0.30	0.20	0.20	-0.20	0.20
LIBOR (3 Month)	5.55	0.05	0.37	0.78	3.26
Federal Funds Rate	5.25	0.00	0.25	0.75	3.50
30 Year Fixed Mortgage	7.15	0.02	0.31	0.49	1.32
Case Schiller Home Prices	307.43	1.68%	3.53%	1.20%	-1.70%
Home Inventory Supply	3.00	0.10	0.40	-0.30	0.40



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