INVESTMENT UPDATE

Second Quarter 2023

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MARKET REVIEW

With central banks making progress on taming global inflation and potential US crises surrounding banks and the debt ceiling not materializing, Equity markets moved higher while Fixed Income sold off during the second quarter.

US Equity markets outperformed International peers, primarily due to the phenomenal appreciation in a handful of large innovative US tech companies. Large Cap Growth generated returns more than double other major US asset classes, fueled by the oversold conditions of 2022 and exuberance about artificial intelligence opportunities. In addition, consumer services stocks did particularly well amid improving confidence and pent-up travel and entertainment demand, even if the spending was funded by dipping into personal savings. Small Cap and Value were among the weakest domestic areas, as underperforming utilities and energy hindered returns.

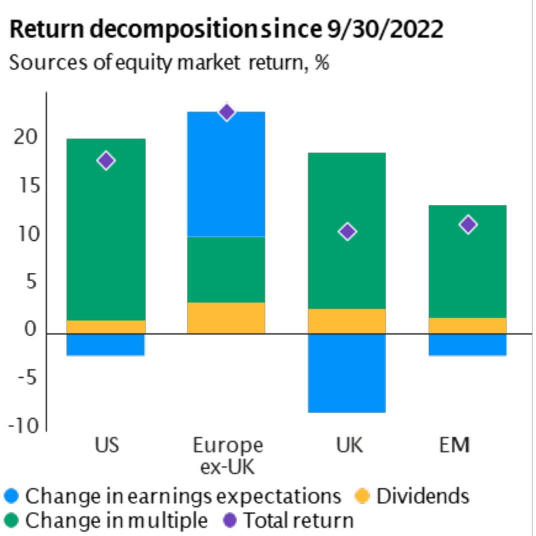
Despite relative underperformance in the aggregate, many overseas stocks actually achieved superior returns to domestic ones, boosted by encouraging economic data and earnings strength. The second largest stock market in the world, Japan's Nikkei spiked 18.5% for the quarter as investors embraced shareholder-friendly market reforms, compelling GDP growth, and attractive valuations. Emerging Markets were weak (but still positive) as strength in the Americas was weighed down by the stalling out of China's post-Covid recovery.

> *73% of the S&P 500 ytd return has come from the largest 7 companies: Apple, Microsoft, Google, Amazon, NVIDIA, Tesla and Meta.*

Notwithstanding decelerating inflation leading to a Fed pause following 10 consecutive rate hikes, Fixed Income markets fell modestly as Chairman Powell dashed investor hopes of near-term rate cuts. The short-end of the curve spiked in concert with his remarks, whereas the long-end remained largely unchanged as economic concerns persisted, thereby further steeping the inverted yield curve.

OUTLOOK

The US economy does not appear to be teetering on the brink of an imminent recession. While some leading indicators are flashing warning signs, the labor market is strong and consumers continue to spend liberally. Moreover, tightening efforts by the Fed appear to be having the desired effect (albeit with a lag) as inflation has fallen meaningfully, with recent relief coming from the important housing market.



Source: JP Morgan.

Outside the US, developed economies are experiencing positive economic momentum, surprisingly resilient despite the sustained Russian war. China appears to be an outlier to the downside as geopolitics, ongoing real estate concerns, and consumer spending reluctance have stymied what was supposed to be a robust recovery. At the same time, the second largest economy in the world is not facing the same inflationary pressures befalling other countries, thereby empowering the Chinese government to unleash economic stimulus if needed.

With respect to related portfolio implications, it is prudent to remember that positioning is a function of both business momentum and valuation. While the former has surprised positively, the latter's attractiveness has diminished as multiples have expanded but earnings have not. This suggests some degree of portfolio de-risking may be in order, be it related to rotation within risk assets and/or increasing defensive exposure.

US Large Growth names are an obvious source for risk reduction, where an ominous parallel to recent NASDAQ performance strength is 1999. For those looking to reallocate within Equities, Japan is looking particularly interesting once again for both substantive and technical reasons. For contrarian investors wanting to lean into recent performance headwinds, China may hold appeal as it offers a compelling valuation concurrent with potential geopolitical, monetary, and fiscal catalysts.

Among Fixed Income opportunities for consideration, short-term Treasuries look attractive, as yields have jumped despite decelerating inflation. And while expectations of falling rates make going out on the curve sub-optimal, investors willing and able to accept more risk may wish to explore Mortgage-Backed Securities given the strength of the consumer, the relative higher quality of the debt, and the reduced prepayment risk (amid higher mortgage rates).

Q2 Market Performance

US Large Cap	8.7%
US Small Cap	5.2%
Non-US Developed	3.2%
Emerging Markets	1.0%
Treasuries	-1.4%
Investment Grade	-0.2%
High-Yield	1.7%
Oil	-6.6%
Gold	-2.5%