Q2 2023 Market Bulletin

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Global equity markets posted another quarter of positive gains, continuing their impressive rally off the lows from last October. Excitement around artificial intelligence (AI) and better than expected corporate earnings helped US stocks outperform on a relative basis for the quarter. The S&P 500 finished up 8.7% during Q2, while international stocks, as measured by the MSCI EAFE, saw a more modest 3% return. Market performance has been strong but "top-heavy," with a handful of large technology stocks driving most of the gains. While the rally began to broaden out over the last month, the average stock has largely been left behind. If markets are going to move higher in the second half of the year, we will need to see much broader participation from small and medium-sized stocks, as well as other sectors. Fixed income markets, while slightly lower for the quarter, have bounced back after a tough year in 2022 and produced positive returns through the second quarter. Tax-exempt municipal bonds are up approximately 1.5%, while short and intermediate term taxable bonds saw gains closer to 2%. As the Fed nears the end of its rate hiking cycle, we expect rates to begin to stabilize, resulting in a more attractive environment for bonds in the second half of the year.

Reflecting on the first half of the year, one of the biggest surprises has been the strength and durability of the US economy. In the face of higher interest rates, elevated inflation, a regional banking crisis, and geopolitical tensions, GDP growth has been slow but remained steady and we have avoided a widely anticipated recession. The most recent economic data from Q2 showed better than expected results in key areas such as housing, consumer spending, and the labor market. Inflation, while still elevated, has come down from over 9% to 4%, providing hope for a soft landing. This resiliency, however, has contributed to concerns that inflation will remain uncomfortably high, and that interest rates will need to stay higher for longer. The Fed seemed to reaffirm those fears following their June meeting when they left interest rates unchanged at 5%-5.25% but signaled that more rate hikes were likely on the way. Outside the US, the global macroeconomic environment is more challenging. Europe is mired in a similar battle with inflation and the ECB has pledged to continue raising rates even as growth has flatlined. The Chinese economy, on the other hand, has experienced a pickup in growth following their re-opening from COVID lockdowns, but it has not been the strong recovery that most had hoped for. However, tensions with the US have been cooling more recently and the government is expected to unveil additional stimulus measures to help boost the Chinese economy.

Despite the recovery in asset prices, the outlook for the global economy remains highly uncertain. Whether we enter a recession or not, the risk-reward trade off across equity

markets is less compelling as valuations have become extended, particularly for US Large Cap stocks. As a result, we continue to recommend a small underweight to growth assets in favor of investment grade bonds, despite the modest underperformance we have experienced year-to-date. While it may be tempting to chase the momentum in the markets, history has shown that maintaining a disciplined approach and managing risk are the best way to reach your long-term goals.

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