Eideard Group
GUARDIANS OF PROSPERITY

Market Commentary

2Q 2023

Market Movement Highlights

Have you heard about the *"Mega Seven"* stocks or *Nvidia*? And what's up with *AI* or what is being termed *Generative AI* these days? More on that shortly!

Meanwhile, most investors have been surprised by the strength of the stock market in the face of rising interest rates, sticky inflation, a regional banking crisis and persistent geopolitical conflict. Through the first half year, US large cap stocks represented by the (S&P 500 Index) returned +16.9%, followed by developed international equities (MSCI EAFE Index) which posted +12.1% gains. Even US small cap stocks (Russell 2000), most of which have had to rely on costlier debt, delivered +8.1%, exceeding most expectations over this rather prolonged tightening cycle. And as to style investing, growth across all capitalizations is once again in the midst of outpacing value by a wide margin in a rising rate environment that is counterintuitive. Meanwhile, US municipal and taxable bonds modestly relinquished some of their earlier gains as the Fed continued its hawkish rhetoric. Notwithstanding, each posted +2.7% and +2.1%, respectively.

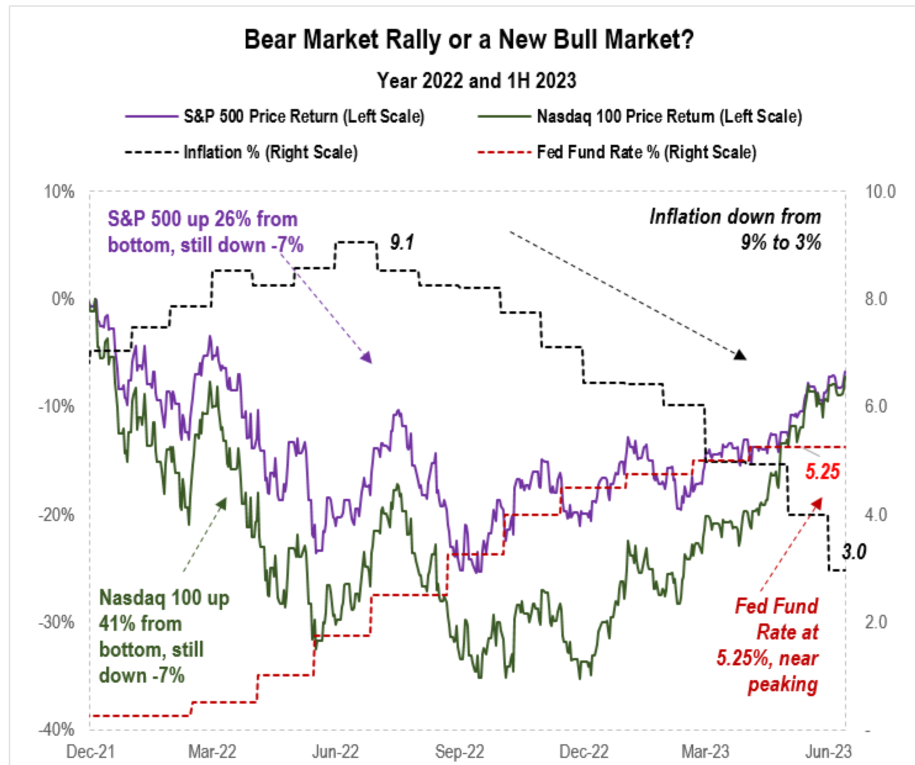
US equity gains were largely driven by the *"Mega Seven"* (table below), which accounted for some 70% of the S&P's total returns in the half year.

Total Returns of Selected US Stock Indexes	Jan to May 23	June 23	YTD 23	Year 2022
S&P 500 (US Large Cap) Index	9.7%	6.6%	16.9%	-18.2%
Contributions from Mega Seven Stocks (1)	9.9%	2.1%	12.2%	-10.5%
Rest of 493 Companies of S&P 500 Index	-0.2%	4.5%	4.7%	-7.7%
S&P 500 Equal Weighted Index	-0.6%	7.7%	7.0%	-11.5%
S&P 500 Industrial Sector ETF (XLI)	-1.0%	11.3%	10.2%	-5.6%
Russell 2000 (US Small Cap) Index	-0.04%	8.1%	8.1%	-20.4%

(1): Microsoft (+43% first half 2023), Apple (+50%), Google (+36%), Amazon (+55%), Nvidia (+190%), Tesla (+113%), Facebook (+138%) – these top 7 stocks represent 28% of S&P 500 Index based on market cap weight as of 07/16/2023. **Source: Y-Charts.**

Digging deeper, the market's breadth expanded materially in June, with stocks of all market caps displaying some of their best performance in 2023. Additionally, there was a distinct rotation into cyclical stocks, aka economically sensitive holdings, as seen in S&P 500's Industrial Sector ETF which reached new all-time highs in July. This is extraordinary and, in our minds, underscores economic resilience and broadening participation across most equity sectors.

Looking Forward; Bear Market Rally or New Bull Market?



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So as we enter the second half of 2023, here's an interesting question you might ask yourself! Are we simply witnessing what may be a short-lived bear market rally or are we on the cusp of a new bull market cycle? Well, in terms of the stock market's fundamentals and economic metrics, the answer, in this moment, is confusing if not elusive since the signaling from each appears to be at odds.

At the market level, analysts predict that corporate earnings growth is likely to re-accelerate in Q3 and Q4, from Q2's projected negative numbers. This obviously bodes well for stock price performance. At the same time, however, most economists seem steadfast in forecasting slowing GDP growth in the coming quarters due to the much feared "lag effect" that high rates typically have on economic activity. Even FED Chairman Powell reinforced this wait and see pause. And while there is increasing acknowledgement that a softer than originally anticipated landing may still be on the horizon, it may simply be pushed out to early 2024. In our minds, this view is beginning to age poorly!

Meanwhile, we know the FED's now 19 month-old campaign to corral inflation appears to have made significant progress, as June's data revealed that top-line inflation has subsided to a 3% Y-Y level. But for perhaps another couple of .25% rate increases which are likely already baked in between now and December, the chances for further tightening beyond that seem less imminent. This holds promise not only for stimulating future economic growth (if it's not already as good as we think it is), but it also enhances the prospect for once again enjoying "real" net returns, be it from stock price appreciation and dividends, bond coupons or interest on money markets and other cash equivalents.

Now enter *Generative AI,* perhaps icing on the proverbial cake of economic progress! According to Goldman Sachs research, this rapidly emerging technology could raise global GDP by as much as 7% (or $7 trillion). It is expected to transform wide swaths of businesses in short order by enhancing efficiency, boosting productivity and further increasing profit margins.

Whether it's AI, or the next ingenuous milestone thereafter, US innovation and hence market history over the long haul is rarely biased to the Bear. We know that markets are forward looking and, at least presently, they appear to be pricing in a much more optimistic outlook irrespective of what economists predict or what headline news and market pundits have been saying.

We lean toward accepting the market's prescience and believe its current trend has legs! And while retracements (nominal or otherwise) are always a possibility, prevailing winds appear to be blowing markedly at our back. Accordingly, we think it is a perfect time for investor's to review and re-affirm, or fine-tune with our assistance, their portfolios to advantage themselves of what to date has been remarkable resilience and to prepare themselves for the opportunities that lie ahead.

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