FUNDAMENTUM
INVESTMENT MANAGEMENT

2023 Q2 Market Commentary

The second quarter of 2023 continued the strong start for the year led by the comeback of beaten-down growth names, with the S&P500 Index rising 8.74% and the Nasdaq Composite Index gaining 13.05%. During the first half of the year, the S&P500 jumped 16.88%, its best six-month start since 2019 and the Nasdaq Composite leaped 32.32%, its best first half of a year performance in four decades.[1] There were several factors contributing to the robust second-quarter performance of the markets: (1) Inflation continues to fall. (2) the Federal Reserve nears the end of its interest rate tightening cycle, (3) the U.S. economy continues to avoid a recession, (4) corporate earnings and guidance coming in better than expected, and (5) the resolution of some market tail risks – the Federal Debt ceiling standoff and the regional bank turmoil.

Q1 Total Returns by Asset Class	**2nd Qtr.**	**Y-T-D[2]**
Dow Jones Industrials Index	3.97%	4.94%
S&P500 Index	8.74%	16.88%
NASDAQ Composite	13.05%	32.32%
Russell 2000 Index	5.19%	8.06%
Russell 1000 Value Index	4.07%	5.10%
Russell 1000 Growth Index	12.81%	29.01%
MSCI EAFE Index	3.19%	12.16%
MSCI EM Index	0.97%	5.02%
Bloomberg/Barclay US Bond AGG	-0.84%	2.09%
Bloomberg/Barclay US Corp. Index	-0.29%	3.21%
Bloomberg/Barclay US HY Corp. Index	1.75%	5.38%
HFRX Global Hedge Fund Index	0.64%	0.63%

Within S&P500 sectors, outperformers for the quarter were Technology +16.9%, Consumer Discretionary +14.3%, and Communications Services +12.8% while sector underperformers were Utilities -3.3%, Energy -1.8%, and Consumer Staples 0.2%.[3] Fascinated that AI (artificial intelligence) will usher in a new wave of productivity growth, Market leadership continued to be narrow with MEGA-Cap Tech extending its outperformance during the quarter with NVDA +52.3%, META +35.4%, TSLA +26.1%, AMZN +26.1%, MSFT +18.1%, AAPL +17.6%, and GOOGL +15.4%.[4] Led by these stocks, Growth investing (+12.81%) continued its dominance over Value investing (+4.07%) during 2023.

How dominant these seven "magnificent" stocks have been to performance can be seen if one excludes them from the return numbers. The S&P500 returned over 16% year-to-date, excluding the magnificent seven, the index return would have been closer to 4%.[5] Another way to look at the market is through dividends. Through midyear, the S&P500 stocks that do not pay a dividend have collectively gained about 18% compared to dividend payers, which have advanced just 4% - the worst first-half performance for dividend-payers compared to non-dividend-payers since 2009.[6]

Finally, as fears of a recession ebbed, we saw some broadening of performance as all eleven sectors in the S&P500 Index gained ground in June. At quarter end, 40% of the S&P500's new 52-week highs were Industrial stocks led by Parker-Hannifin – reaching an all-time high back to the 1964 IPO and PACCAR – an all-time high back to its 1971 IPO.[7]

On the fixed-income front, 10-year U.S. Treasuries closed at 3.81% up from March's 3.48%. Treasuries are reflecting the balancing act between the decline in overall inflation and stubbornly high core inflation. Although aiding equities, surprisingly robust economic growth, steady corporate earnings, and a strong labor market have led to increased volatility in the bond markets pushing short-term rates higher. This action has caused an inversion of the yield curve (short rates > long rates) – historically a precursor to a recession. On the inflation front - progress continues to be made. Headline Consumer Price Index (CPI) rose 0.1% in May bringing the (year-over-year) CPI gain down to 4.0% from its peak of 9.1%.[8] The Federal Reserve's preferred inflation gauge – the Personal Consumption Expenditure (PCE) slowed to 3.8% in May - the slowest monthly pace in two years. However, the core inflation numbers remained elevated at 4.6%.[9] The Federal Reserve's higher-for-longer messaging continues to be a major overhang on the markets. While the Fed did leave interest rates unchanged for June, their language was "hawkish" as the median interest rate dot-plot was raised 50bps to 5.60%. Even Chairman Powell himself mentioned the possibility of at least two more rate hikes this year – at odds with expectations.[10]

Looking forward, the road for the financial markets will be driven by two key factors: (1) the Federal Reserve's response to the direction and level of inflation and (2) the economy's path to either a soft or hard (recession) landing - impacting growth, employment, and corporate earnings. Today's historic monetary policy tightening has begun to slow economic activity and aggregate demand leading to pressures in pricing power and margins. As with all Federal Reserve restrictive monetary policies, recession risks are elevated. Through April, 236 U.S. corporations have filed for bankruptcy – on pace for the largest year of bankruptcies since 2011.[11] We believe the Federal Reserve will keep interest rates well above neutral increasing the prospects of a recession. Another area of concern is market valuation – particularly when considering the S&P500 current level of Price Earnings (PE) versus interest rates and inflation. Although year-over-year M2 money growth is negative (the 1st time on record), the level of M2 remains almost 35% higher than pre-pandemic levels – providing clear liquidity for the markets and economy.[12] Overall, the risk vs reward ratio for the equity markets is not optimistic and at best neutral. Therefore, we continue to encourage Advisors to build diversified portfolios with lower capital market returns into their client's long-term financial plans and expectations.

One final thought, strong first halves of the year are often a good sign. Since 1990, there were ten occurrences when the stock market gained more than 10% in the first half of the year and in all cases the market rose further in the second half.[13]

Fundamentum Investment Committee:

John Nichol, CFA® - Chief Investment Officer
Trevor Forbes - Investment Committee
Robert Armagno, CFA® - Investment Committee

Sources:

1. Dow Jones, June 30, 2023
2. Bloomberg Business News, June 30, 2023
3. FactSet StreetAccount, June 30, 2023
4. FactSet StreetAccount, June 30, 2023
5. Russell Investments – Global Market Outlook, June 30, 2023
6. Barron’s Advisor, June 30, 2023
7. CNBC – Stock Market Today, June 30, 2023
8. Comerica – Investment Monthly, July 2023
9. T. Rowe Price Insights, June 30, 2023
10. FactSet StreetAccount, June 30, 2023
11. Innovator Investment Playbook, July 2023
12. Comerica – Investment Monthly, July 2023
13. Edward Jones - Weekly Market Wrap, June 30, 2023

The opinions voiced in this material are for general information only and are not intended to provide specific advice or recommendations for any individual. All performance referenced is historical and is no guarantee of future results. All indices are unmanaged and may not be invested into directly.

The economic forecasts set forth in this material may not develop as predicted and there can be no guarantee that strategies promoted will be successful.

There is no guarantee that a diversified portfolio will enhance overall returns or outperform a non-diversified portfolio. Diversification does not protect against market risk.

The Russell 1000 Index consists of the 1,000 largest securities in the Russell 3000 Index, which represents approximately 90% of the total market capitalization of the Russell 3000 Index. It is a large-cap, market-oriented index and is highly correlated with the S&P 500 Index.

The Dow Jones Industrial Average is comprised of 30 stocks that are major factors in their industries and widely held by individuals and institutional investors.

The Standard & Poor’s 500 Index is a capitalization weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

The MSCI EAFE Index is a free float-adjusted market capitalization index that is designed to measure the equity market performance of developed markets, excluding the US & Canada. The MSCI EAFE Index consists of the following developed country indices: Australia, Austria, Belgium, Denmark, Finland, France, Germany, Hong Kong, Ireland, Israel, Italy, Japan, the Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland and the UK.

The MSCI EM (Emerging Markets) Index is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of the emerging market countries of the Americas, Europe, the Middle East, Africa and Asia. The MSCI EM Index consists of the following emerging market country indices: Brazil, Chile, Colombia, Mexico, Peru, Czech Republic, Egypt, Greece, Hungary, Poland, Qatar, Russia, South Africa. Turkey, United Arab Emirates, China, India, Indonesia, Korea, Malaysia, Philippines, Taiwan, and Thailand.

The Russell 2000 Index is an unmanaged index generally representative of the 2,000 smallest companies in the Russell 3000 index, which represents approximately 10% of the total market capitalization of the Russell 3000 Index.

The NASDAQ Composite Index measures all NASDAQ domestic and non-U.S. based common stocks listed on The NASDAQ Stock Market. The market value, the last sale price multiplied by total shares outstanding, is calculated throughout the trading day, and is related to the total value of the Index.

The Russell 1000 Growth Index measures the performance of those Russell 1000 companies with higher price-to-book ratios and higher forecasted growth values. Russell 1000 Value Index measures the performance of those Russell 1000 companies with lower price-to-book ratios and lower forecasted growth values.

The Bloomberg Barclays U.S. Aggregate Bond Index is an index of the U.S. investment-grade fixed-rate bond market, including both government and corporate bonds.