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Performance Reports

Q3 2023 Newsletter | Jeff Griggs, CFA

Due to the wide range of risk tolerances of our clients, some topics or asset classes may have more, less, or no importance to your portfolio. For a detailed analysis, give us a call, or request a detailed performance review.

Big Picture

Buoyed by slowing inflation and stable interest rates, stocks had a great second quarter returning 8.7%. Breadth was very narrow with returns concentrated in mega-cap tech names, excluding AAPL, MSFT, NVDA, AMZN, META, and GOOGL/GOOG, the S&P 500 only returned 4.6%. Economic growth remains stronger than expected while IMF GDP forecast upgrades led to improved equity earnings and growth forecasts. Risks, which took a backseat to optimism in the quarter, include contracting US Manufacturing PMI, sub-par growth in China, tightening US bank lending standards in response to the regional bank failures in the prior quarter, falling copper and oil prices, the still inverted yield curve, and lagged effects of monetary tightening.

The tech sector led the market returning 17.2% in the quarter. The launch of OpenAI's ChatGPT has sparked a period of Ai euphoria that continues into the third quarter. The US consumer continued to show strength propelling the consumer discretionary sector to a 14.6% return. On a factor basis, Growth retook its leadership role up 13.8%, while Quality returned 11.8%. The quality factor can be a bit misleading; the name invokes a conservative, Buffet-esque, group of reliable companies with strong balance sheets, but in reality, the factor leans heavily into mega-cap tech stocks.

On the Fridge

US Equity

US stocks trounced all other asset classes, rising 8.7% in the second quarter. Developed market stocks were second best at only a 3.3% gain.

Information Technology

After rising 22% in the first quarter, the Tech sector outperformed all others once again, rising an additional 17% in the second quarter. That puts the sector up an incredible 42.8% in the first six months of the year.

Looking Ahead

What would have been the most widely expected recession in memory, appears to have been successfully avoided and the "soft-landing" alternative, which many deemed impossible, is the consensus. For now. Supply chain pressure has sunk to one of the lowest levels on record, the Atlanta Fed's GDPNow model is forecasting 5.9% GDP growth, inflation has fallen well off its peak (at about the same rate that it rose), and this was all achieved with unemployment at pre-COVID lows. For all the negativity sent his way, barring any major disruption, Jerome Powell appears to have put on a masterclass in central banking. For the first time since the Fed began raising rates the market perceives some clarity on how and when the Fed's tightening cycle will resolve What this means for investors is that we may be transitioning out of the approximately 2-year period where inflation and rate hikes dominated every other narrative. Artificial Intelligence was the first to kickstart a new hype cycle and investors have shifted assets back into growth names in a welcome return to normalcy.

With that said, an inverted yield curve remains one of the best recession indicators we have, and despite recent enthusiasm, it has taken an average of 589 calendar days for a recession to arrive after the curve first inverts. We've only made it 300 thus far.

In the Dog House

International Bonds

International bonds fell –2.2% in the second quarter, US corporate bonds lost only –0.3%, and high-yield bonds actually gained 1.7%

Utilities

The Utilities sector, often viewed as an alternative for bonds, fell –2.5% in the second quarter. Energy was the only other sector in the red as it fell –0.9%. The 3.3% dividend yield currently being offered by the utilities sector simply isn't as attractive as it used to be compared to the high yields offered by bonds.

Links and Articles

The Global Fight Against Inflation
CME Group on the unique issues various nations face in their fight against inflation.

A Funny Kind of Recession
John Mauldin shares thoughts and insights on the economy and housing markets.

The End of an Era for Stocks
Michael Lebowitz summarizes a Fed white paper on the impact 30yrs of falling interest and tax rates have had.

AI is a Game Changer For Economic Growth
William Sterling breaks the potential for AI to seriously boost labor productivity.

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Performance

The 10yr rate rose from 3.49% to 3.81% in the second quarter, leading to negative returns for most fixed income sub-classes. International bonds fell -2.2%, most likely fueled by Europe's (and Japan's, but that is largely viewed as positive for their economy) tougher battle with inflation and a slightly stronger dollar. In a departure from recent trends, US equities dominated their international counterparts with developed markets only rising 3.3% and emerging markets just 1%. One interesting point here is the 3.7% LTM return on cash (as benchmarked by the US Treasury bill 1-3m index), as opposed to –2.1% on government bonds, 0.8% on international bonds, and 3.2% on corporate bonds.

	Benchmark Index	2023 Q2	YTD	LTM	3yr	5yr	10yr
Cash	**Bloomberg US Treasury Bill 1-3 M TR USD**	1.2%	2.3%	3.7%	2.3%	1.5%	1.0%
Fixed Income	**Bloomberg Global Aggregate TR USD**	-1.5%	1.4%	-1.3%	-5.0%	-1.1%	0.2%
Fixed Income Blend	Bloomberg Global Aggregate TR USD	-1.5%	1.4%	-1.3%	-5.0%	-1.1%	0.2%
Government	Bloomberg US Government TR USD	-1.4%	1.6%	-2.1%	-4.7%	0.5%	1.0%
Inflation Protected	Bloomberg US Treasury US TIPS TR USD	-1.4%	1.9%	-1.4%	-0.1%	2.5%	2.1%
Municipal	Bloomberg Municipal TR USD	-0.1%	2.7%	3.2%	-0.6%	1.8%	2.7%
Floating Rate	Bloomberg US Trsy Floating Rate TR USD	1.4%	2.6%	4.2%	1.6%	1.7%	0.0%
Corporate	Bloomberg US Corp Bond TR USD	-0.3%	3.2%	1.5%	-3.4%	1.8%	2.6%
High Yield	Bloomberg US Corporate High Yield TR USD	1.7%	5.4%	9.1%	3.1%	3.4%	4.4%
International Bond	Bloomberg Gbl Agg Ex USD TR USD	-2.2%	0.8%	-1.8%	-5.9%	-2.7%	-0.9%
Equity	**MSCI ACWI GR USD**	6.3%	14.3%	17.1%	11.5%	8.6%	9.3%
Equity Blend	MSCI ACWI GR USD	6.3%	14.3%	17.1%	11.5%	8.6%	9.3%
US Equity	MSCI USA GR USD	8.7%	17.1%	19.6%	14.1%	12.2%	12.8%
Developed Markets	MSCI World ex USA GR USD	3.3%	11.8%	18.1%	9.9%	5.1%	5.9%
Emerging/Frontier	MSCI EM GR USD	1.0%	5.1%	2.2%	2.7%	1.3%	3.3%
Alternatives	**Wilshire Liquid Alternative TR USD**	1.4%	2.6%	2.5%	2.7%	1.7%	1.5%
Alternatives Blend	Wilshire Liquid Alternative TR USD	1.4%	2.6%	2.5%	2.7%	1.7%	1.5%

Sector	2023 Q2	6mo	YTD	1yr	3yr	5yr	10yr
Information Technology	17.2%	42.8%	42.8%	40.3%	20.0%	21.8%	21.9%
Financials	5.3%	-0.5%	-0.5%	9.5%	15.7%	7.2%	10.1%
Health Care	3.0%	-1.5%	-1.5%	5.4%	11.7%	11.8%	12.8%
Consumer Discretionary	14.6%	33.1%	33.1%	24.7%	9.0%	10.0%	12.9%
Consumer Staples	0.5%	1.3%	1.3%	6.6%	11.9%	11.1%	9.6%
Industrials	6.5%	10.2%	10.2%	25.2%	18.0%	10.5%	11.6%
Energy	-0.9%	-5.5%	-5.5%	18.8%	35.4%	6.6%	4.4%
Utilities	-2.5%	-5.7%	-5.7%	-3.7%	8.4%	8.2%	9.4%
Materials	3.3%	7.7%	7.7%	15.1%	16.0%	9.8%	10.3%
Communication Services	13.1%	36.2%	36.2%	17.3%	7.3%	9.3%	6.5%
Real Estate	1.8%	3.8%	3.8%	-4.1%	6.2%	6.5%	7.7%

Source: Morningstar; The 1,3,5, and 10 year performance is annualized.

As mentioned, the tech sector led the market returning 17.2% in the quarter. The consumer discretionary sector was second best rising 14.6%. The Conference Board's Consumer Confidence Index rose again in July to 117, while the University of Michigan's Consumer Sentiment indicator rose to 71.6 in July, well off it's June 2022 low of 50. Year-to-date, the tech sector is up an astounding 43%, Consumer Discretionary 33%, and Communication Services 36%. Meanwhile Utilities have are down –5.7%, Energy –5.5%, Health Care –1.5%, and Financials –0.5%.

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Asset Class	Benchmark	Description
Cash	Bloomberg US Treasury Bill 1-3 M TR USD	Measures US dollar-denominated, fixed-rate, nominal debt issued by the US Treasury.
Fixed Income	Bloomberg Global Aggregate TR USD	The Bloomberg Global Aggregate Index is a flagship measure of global investment grade debt from twenty-four local currency markets. This multi-currency benchmark includes treasury, government-related, corporate and securitized fixed-rate bonds from both developed and emerging market issuers.
Government Bonds	Bloomberg US Government TR USD	The Bloomberg US Government Bond Index comprises the US Treasury and US Agency indices. The index includes US Dollar-denominated, fixed-rate, nominal US Treasuries and US agency debentures (securities issued by US government owned or government sponsored entities, and debt explicitly guaranteed by the US government).
Inflation Protected	Bloomberg US Treasury US TIPS TR USD	The Bloomberg US Treasury Inflation-Linked Bond Index (Series-L) measures the performance of the US Treasury Inflation Protected Securities (TIPS) market.
Municipal	Bloomberg Municipal TR USD	The Bloomberg U.S. Municipal Index covers the USD-denominated long-term tax exempt bond market. The index has four main sectors: state and local general obligation bonds, revenue bonds, insured bonds and prerefunded bonds.
Floating Rate	Bloomberg US Trsy Floating Rate TR USD	The Bloomberg US Treasury Floating Rate Index measures the performance of floating rate bonds issued by the US Treasury.
Corporate Bonds	Bloomberg US Corp Bond TR USD	The Bloomberg US Corporate Bond index measures the investment grade, fixed-rate, taxable corporate bond market. It includes USD-denominated securities publicly issued by US and non-US industrial, utility and financial issuers.
High Yield Bonds	Bloomberg US Corporate High Yield TR USD	The Bloomberg US Corporate High Yield Bond Index measures the USD-denominated, high yield, fixed-rate corporate bond market. Securities are classified as high yield if the middle rating of Moody's, Fitch and S&P is Ba1/BB+/BB+ or below.
International Bonds	Bloomberg Gbl Agg Ex USD TR USD	The Bloomberg Global Aggregate Index is a flagship measure of global investment grade debt from twenty-four local currency markets. This multi-currency benchmark includes treasury, government-related, corporate and securitized fixed-rate bonds from both developed and emerging market issuers. This version excludes USD-denominated debt.
Equity	MSCI ACWI GR USD	The MSCI ACWI captures large and mid cap representation across 23 Developed Markets and 23 Emerging Markets countries. With 2,477 constituents, the index covers approximately 85% of the global investable equity opportunity set.
US Equity	MSCI USA GR USD	Captures broad US equity coverage. The index includes 3,108 constituents across large, mid, small, and micro capitalizations, representing about 99% of the US equity universe.
Developed Market Equity	MSCI World ex USA GR USD	Captures large and mid cap representation across 22 of 23 Developed Market countries, excluding the United States. With 1,023 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country.
Emerging Market Equity	MSCI EM GR USD	The MSCI Emerging Markets Index captures large and mid cap representation across 23 Emerging Markets (EM) countries. With 829 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country.
Alternatives	Wilshire Liquid Alternatives TR USD	Measures the collective performance of the five Wilshire Liquid Alternative strategies that make up the Wilshire Liquid Alternative Universe, including the Wilshire Liquid Alternative Equity Hedge, Global Macro, Relative Value, Multi-Strategy, and Event Driven indices. This index is meant to provide a representative baseline for how the liquid alternative investment category performed as a whole. Constituents comprised of '40 Act mutual funds.
US Large Cap Equity	S&P 500	Widely regarded as the best gauge of large-cap US Equities. The S&P 500 is a market-weighted index that includes 500 leading companies and captures approximately 80% coverage of available market capitalization.