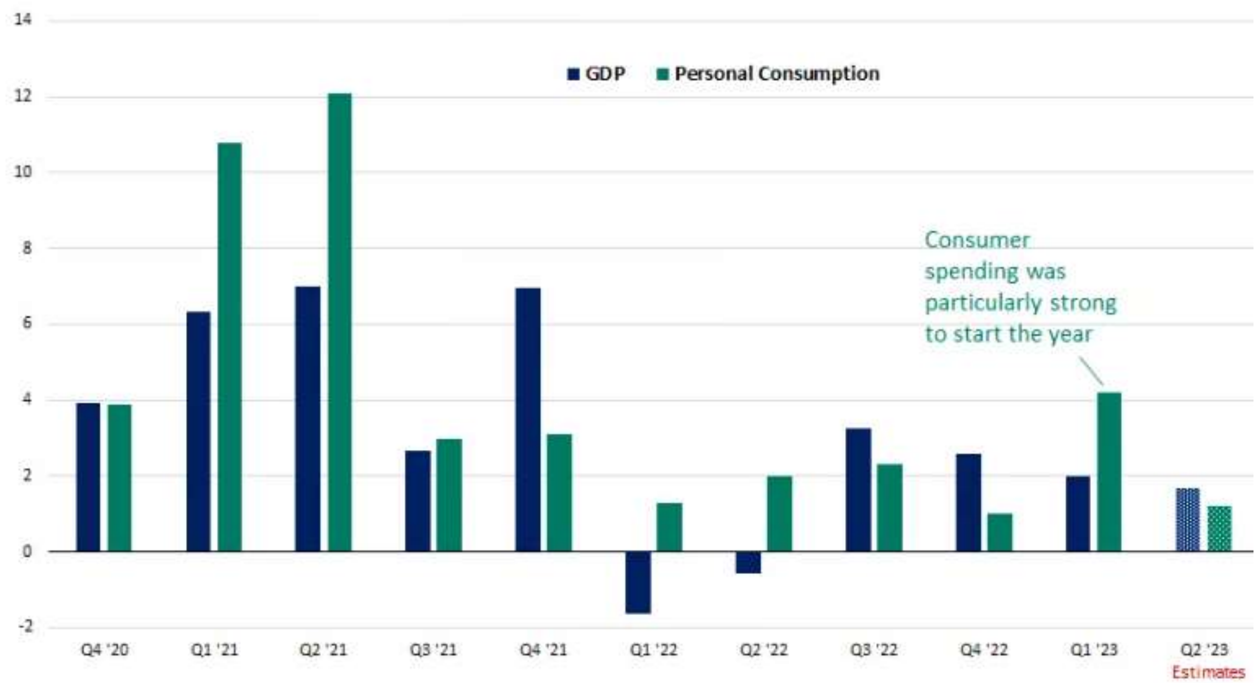
Monday July 3, 2023

SUMMARY-

I. *First half proved better than expected.*
II. *Expectations for slowing employment growth and sentiment remain.*
III. *Most of market's gain tied to ten largest stocks YTD.*
IV. *Small-caps no longer underperforming and banks pass stress tests.*

Good afternoon:

Heading into 2023 six months ago, most market strategists and economists were predicting an imminent recession after more than a year of aggressive rate hikes by the Fed. While inflation continued to decline, it remains well above the Fed's 2% target prompting further rate increases along with predictions of additional hikes if necessary. However, no such contraction materialized…at least not yet. The latest reading on first-quarter GDP was released last week, showing the economy grew by a better-than-expected 2% to start the year, powered primarily by a jump in personal consumption.

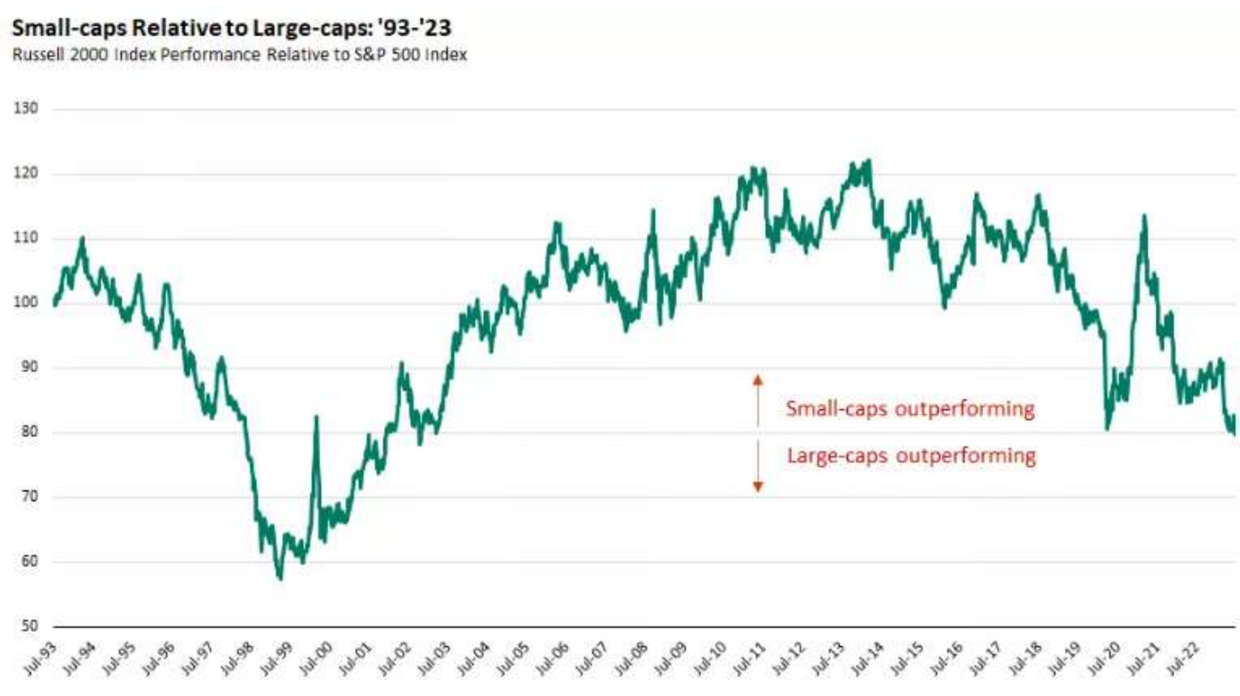


Source: Bloomberg, Atlanta Fed GDPNow Estimates

The resiliency of our economy is due to the continued strength of consumer spending thanks to the strong labor market. As we start Q3 and the second half of 2023, expectations remain high that both consumer spending and labor markets will soften at some point later this year causing GDP to decline. Time will tell whether such an economic slowdown becomes a true recession. And even if it does, the current global macro business climate does not suggest anything more than a mild contraction.

The market's first-half 2023 rebound has not resembled last year's broad-based decline. U.S. large-cap equities led all market categories due to outsized gains from a handful of mega-cap technology companies. As a market-cap weighted index, the largest 10 companies in the S&P 500 Index accounted for over 95% of the index's YTD performance. Generally better than expected earnings, ongoing financial strength, and improving investor sentiment, enabled these tech firms to see steady capital flows from investors and money managers seeking to increase their exposure to these well-known names. The increasing fascination with A.I. (Artificial Intelligence) further fueled gains in many of these companies this year.

It is widely recognized that market participation needs to broaden out to include other industries, as well as small and mid-cap companies. As the chart below illustrates, markets tend to go through multi-year phases when small-caps either outperform or underperform large-caps with lots of interim volatility in each period. Our current three-year period of small-cap underperformance suggests we may be soon reversing this trend.



Source: Bloomberg

As we start this holiday-shortened trading week, we remain focused on any new economic data that may reveal the next moves by the Fed. We also will be closely watching the upcoming Q2 earnings season for any insight about the near-term direction of the market. Last week's announcement that all 23 of the nation's largest banks passed the Federal Reserve's annual stress test should further ease investor anxiety about contagion in a downturn in our banking system and could prompt interest in the underperforming financial equity sector.

The market and our office will be closing at noon CT today, and reopen on Wednesday, July 5th. As our nation celebrates its 247th birthday, let us remember our many hard-fought rights and freedoms we all enjoy as Americans!

Have a great week and a safe holiday!

Mark and Jeff

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The companies engaged in the communications and technology industries are subject to fierce competition and their products and services may be subject to rapid obsolescence.

Market return and statistical data obtained from: https://am.jpmorgan.com/blob-gim/1383452890099/83456/weekly_market_recap.pdf?segment=AMERICAS_US_ADV&locale=en_US

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