Monday June 26, 2023

SUMMARY-

I. First half ending with most index gains due to a few stocks.

II. Fed may hike a time or two more but are close to done.

III. Economic slowdown showing more evidence in jobs market.

IV. Opportunities in undervalued sectors may be a second-half theme.

Good morning:

Stocks took a breather last week after recent gains with large-cap equity averages all declining about 1½% in a fairly uniform move lower. Although most sectors were lower, small-cap value remains the only equity category still at a loss for the year. With the economy slowing, and calls for recession still widespread, many investors remain skeptical regarding the validity of this year's market ascent. It may help to remember that markets are generally forward-looking and often rally early into an economic contraction in anticipation of the recovery to follow.

	V	B	G
L	2.2	14.2	26.3
M	1.2	4.9	11.8
S	-1.2	4.2	9.5

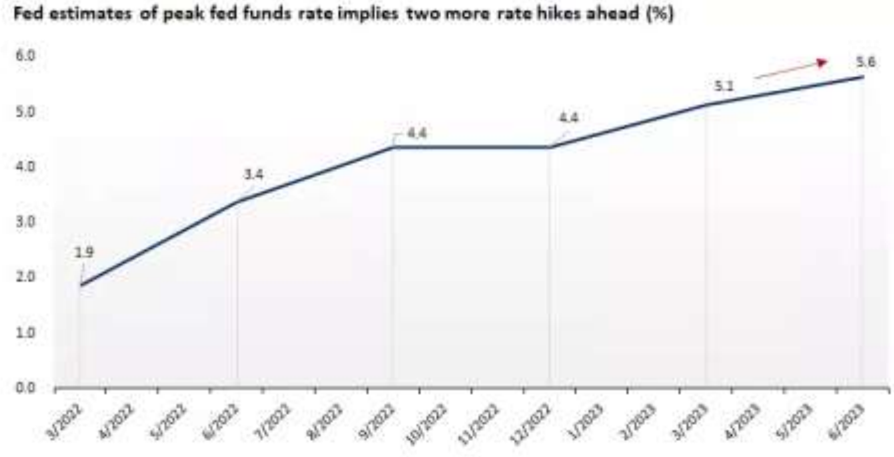
YTD

Source: J.P. Morgan Asset Management

As we start the last week of the first half of 2023, market strategists remain focused on three key themes: First, much of this year's gain of 14% in the S&P 500 is due to less than 10 mega-cap technology stocks and further fueled by recent excitement about the possibilities related to A.I. (artificial intelligence) technology. A continued market push higher would historically require a broadening out of participants to include industrials, healthcare, materials, and small-caps. Early signs of such moves may bode well for the rest of this year and beyond. However, this week may see some "window dressing" as money managers often add to recent market winners before their quarterly portfolio reports are published.

Second, while the Fed indicated they may hike a couple more times this year after this month's pause, economists recognize they are near the end of this long tightening cycle. Markets currently predict another ¼% hike in July, but the Fed themselves estimates a peak Fed Funds rate of 5.6%, implying two more hikes ahead. In either case, many strategists have already baked these hikes into their near-term calculus for both the market and economic conditions.

Fed estimates of peak fed funds rate implies two more rate hikes ahead (%)

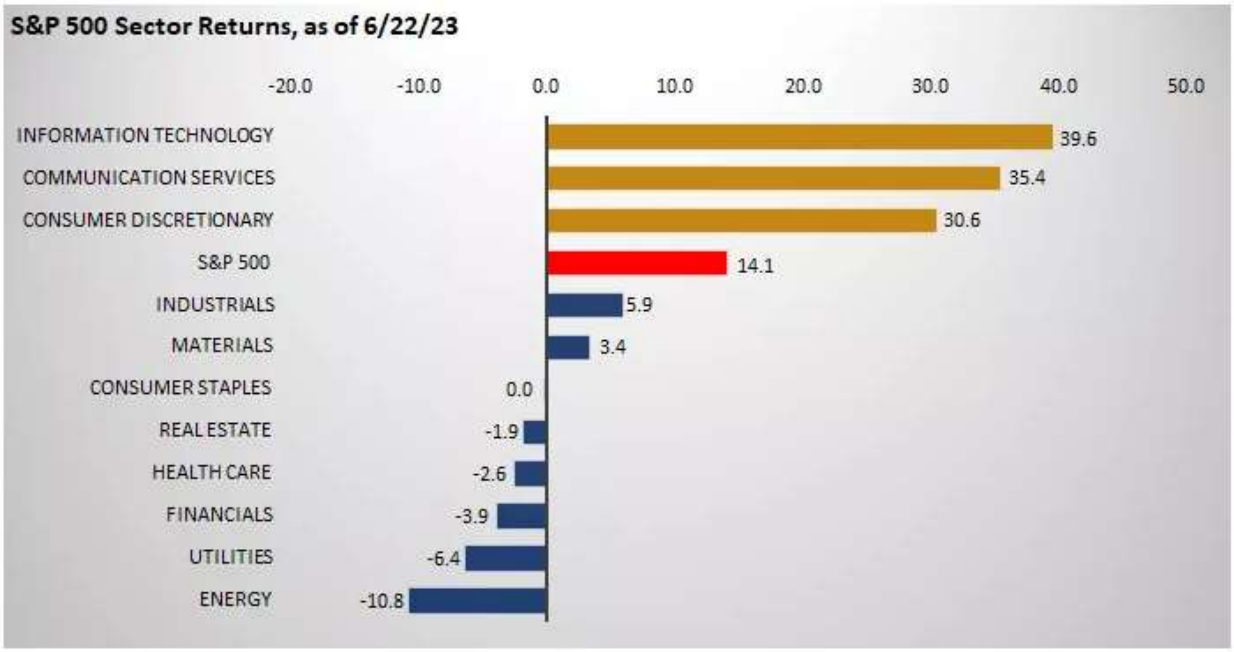


Source: Bloomberg

And third, after such a dramatic cycle of rate increases to quell the hyperinflation that emerged post-pandemic, a resulting slowdown in growth or even a contraction is to be expected. If anything, the real surprise to date is the remarkable resiliency of the U.S. economy and the consumer so far into this cycle. This is largely due to the strong labor market this year that boasts a multi-decade unemployment rate of 3.7% and healthy wage growth of 4.3%. However, some leading indicators are suggesting the labor market may be cooling. Rising jobless claims, lower quit rates, and falling job openings all point to evidence of the softening economy in the wake of 16 months of aggressive rate hikes.

Source: FactSet

This week's economic reports should further support these themes. The GDP report will likely confirm the economy's diminishing growth, and the Consumer Confidence Index report could weaken due to the softening jobs market and persistent inflation. Nevertheless, with the Fed close to a conclusion and inflation declining steadily, we believe any instances of volatility or pullbacks will be opportunities to position sidelined capital into quality equities and fixed income assets for the next broad move higher. Many sectors remain at lower valuations and are poised to potentially shrink their recent underperformance gap over time.



Source: FactSet

We continue to favor a more diversified asset allocation and sector weighting for our clients' equity exposure rather than concentrating in just the couple sectors that may be hot in one period, then drop sharply in the next.

Have a great week!

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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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