# Economic Overview

Steve Scranton, CFA, SVP, Chief Investment Officer and Economist

Despite the continued discussions around the risks of a recession, the economy appears to have generated another solid quarter of economic growth. Although we will not receive the first estimate of 2nd quarter economic growth until the end of July, the Atlanta Federal Reserve's real-time tracking index is currently forecasting 2.3% growth in the 2nd quarter. If this proves true, it will be the second quarter of 2% or higher economic growth as 1st quarter economic growth was revised to a 2% annualized rate when the final revision was released.

### Consumers

Consumers continue to be the engine that is driving economic growth. Despite the continued elevated level of inflation, continued jobs growth — and the income generated from it — has helped fuel spending. The nation added 732,000 jobs in the 2nd quarter and wage growth continued at a rate above 4% on an annualized basis. Spending on discretionary items (i.e., retail sales) recovered from the declines in the last two months of the 1st quarter.

- Retail sales fell 0.7% in February and 0.9% in March.
- Retail sales rose 0.4% in April and 0.3% in May. June data has not been released yet.

### Businesses

Business activity displayed a split personality in the 2nd quarter as construction spending rose while manufacturing spending declined.

- Construction spending
  - Private construction spending was up 1.1% on a year-over-year basis in April but slowed to a 0.0% rate in May. Residential construction spending was the drag as it fell 11.6% in May compared to rising 2.2% in April. Non-residential construction experienced a surge in spending in May. Non-residential construction rose 20.5% on a year-over-year basis in May compared to a 0.1% decline in April.
- Housing
  - Housing starts rose 5.2% in May. Multi-family housing starts led the growth as they grew 7.8% compared to single-family housing starts rising 4.8%.
- Manufacturing
  - Manufacturing activity has shown the opposite behavior as construction. Six out of the seven national and regional manufacturing activity indices are contracting.

### Government

Money from the Infrastructure Investment and Jobs Act and the Inflation Reduction Act continued to support government spending in the 2nd quarter.

### Summary

The economy has proven to be resilient so far this year. Ongoing jobs growth and the income generated from those jobs continued to support consumer spending in the 2nd quarter. All eyes will be on 3rd quarter economic data releases to see what the cumulative impact of high prices and high interest rates has on the economy. To use the old sailing analogy, everyone is waiting to see if we get a "red sky at night" (sailors delight) or a "red sky in the morning" (sailors take warning).

# Second Quarter 2023 – Wealth Management Insights

## Strategy Review

Derrick Wilson, CIMA®, VP, Portfolio Manager

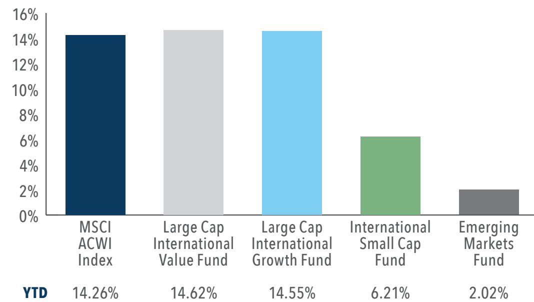
Markets continue to contend with global central bank interest rate policies and the implications those policies may have on economies while contemplating the current state or health of those economies. The 2nd quarter saw equities rise overall, and bonds had mixed results, depending on credit quality. Within the quarter, markets were a bit fickle. April saw modest gains and continuation of positive momentum from the first quarter while May brought about a reversal. Then again, June more than offset prior month losses, bringing quarterly returns positive.

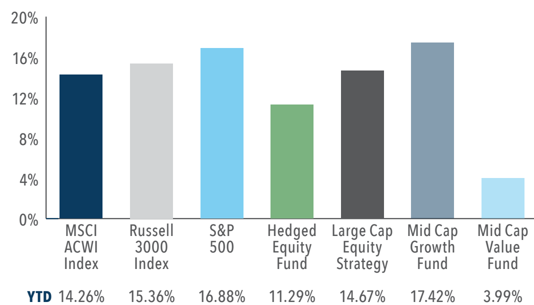
Global equities finished the quarter higher. The biggest returns came from domestic large cap equities as they outperformed developed international equity markets by two times. Broadly, larger companies outperformed smaller ones. The US economy could be viewed as the strongest when set against a global economic backdrop of slowing activity. It also has heavy technology exposures supported by the recent AI (artificial intelligence) boom relative to other regions of the world. Emerging market equities were the laggard but still finished the quarter positively.

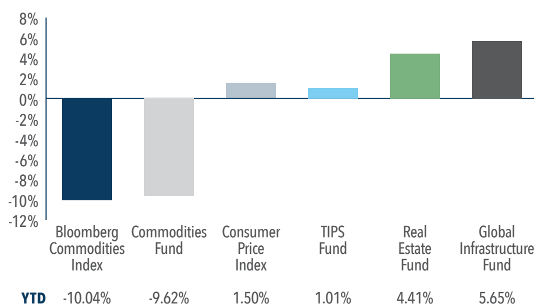
Fixed income returns varied. Relative to rating, investment grade bonds performed weaker than below investment grade issues. Within investment grade, the very short end of the yield curve saw slightly positive returns as yields dropped, helped by averting the debt ceiling deadline (but not without drama!) in early June. Short and intermediate bonds finished the quarter nearly flat. With risk on, as equities rallied so did high yield bonds. Emerging market bonds also gained over this period. Yields are healthy and helped to contribute to overall total returns.

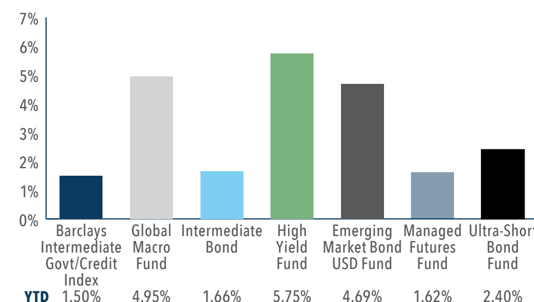
Commodities continue to decline as inflation slows. While prices remain at elevated levels relative to recent years, the declines in returns are reflecting the base effects of coming down from peaks. Real estate rebounded in the quarter over 4% higher and infrastructure followed with smaller gains. Other alternative strategies experienced gains as well — in both managed futures trend-following and global macro — with returns landing somewhere between stock and bonds.

It is important to remember that the market is not the economy, and there seems to be a bit of a conundrum going forward. Economic data suggests some slowing has occurred over time, yet the jobs market remains strong, and consumers are still standing at this point. It's these key areas to watch in the quarters ahead, along with inflation and the Federal Reserve.



# Domestic Equities

Gayle Sprute, VP, Senior Portfolio Manager

After the bear market low in late September 2022, the major domestic indices have been on an upward journey — which continued in the 2nd quarter. This marks the third consecutive quarter of positive performance for the Dow Jones Industrial Average (Dow), S&P 500, and Russell 2000. Although the Nasdaq Composite posted only its second consecutive quarter of gains, its rally was stellar, up 13.0% during the quarter. This compares to +4.0% for the Dow, +8.7% for the S&P 500, and +5.2% for the Russell 2000. Notably, the Nasdaq posted its strongest first half since 1983. The sudden acceleration in the race toward artificial intelligence (AI) was a standout driver for this robust performance. A new group, named the "Magnificent Seven," provided outsized performance leadership during the quarter. The stocks are: Apple (AAPL), Alphabet (GOOGL), Tesla (TSLA), Amazon.com (AMZN), Microsoft (MSFT), Meta Platforms (META) and Nvidia (NVDA).

Style performance (i.e., growth and value) variance was a standout. Last year value outperformed growth by a significant margin. However, growth regained leadership in early February. That trend continued in the 2nd quarter, as growth rose by 10.6% while value gained 6.6%.

With a "risk on" rotation occurring during the quarter, it is not surprising that the cyclical sectors provided leadership: information technology, +17.2%; consumer discretionary, +14.65; and communication services, +13.1%. Conversely, the classic "defensive" sectors were at the bottom of the pack with utilities, -2.5%; energy, -0.9%; and consumer staples, +0.4%.

Positive sentiment during the quarter was fueled in part by hopefulness that the Federal Reserve (Fed) might pause in its interest rate increase campaign (despite its continuing message that more increases are likely), speculation that inflation might have peaked, better-than-feared 1st quarter earnings, and discussion about the possibility of an economic soft landing or "no landing." Heading into the 3rd quarter, it remains to be seen whether these topics continue to fuel positive sentiment or if they become headwinds. The first focal point will be 2nd quarter earnings season, which ramps up in mid-July. Earnings results relative to expectations and management outlook commentaries will be important amidst the elevated price/earnings (P/E) multiple of 18.9X, 2023's consensus estimate. Next up will be the Fed's July policy meeting — and its updated messaging about future rate increases.

# Fixed Income

Brian Brill, CFA, VP, Senior Portfolio Manager

Since the banking crisis that was precipitated by the collapse of Silicon Valley Bank in March and the takeover of First Republic Bank by JP Morgan in May, we have heard little of banking stresses. The relative calmness has let investors resume what we experienced before the banking crisis — that is, a Federal Reserve (Fed) posturing on being vigilant about inflation.

Even though the survey-based economic data continue to indicate worries that the economy will slow down, the hard economic data (data that shows actual results and not expectations) paints a picture of a resilient economy that is allowing the Fed to maintain its contractionary monetary policy. Besides the data, this message is also being conveyed by the corporate bond markets as the spread over Treasuries (a measure of credit risk) has been declining throughout the quarter.

The Fed raised the fed funds rate 25 basis points in May to the new target range of 5.00% - 5.25% but paused at its next meeting in June. The main point of the June meeting conveyed to investors via the quarterly economic projections report was that even though they paused, the terminal high rate for this cycle may be higher than what was previously expected and that rates may stay higher for longer. Currently that rate may be as high as 5.75%.

The combination of firm hard economic data, sticky inflation, and a focused Fed led interest rates higher this quarter. Short maturities increased as much as 88 basis points for the 2-year Treasury note while the long maturities still have one eye open for that expected slowdown. Their yields rose just 21 basis points.

Market expectations still see the cumulative impact of the rate increases as contractionary, but the time for that bite to hit the market has been pushed out further into the future.

With the higher yields, fixed income indices gave up some of their strong gains from the 1st quarter with year-to-date performance ranging between 1% to 4%, based on maturity and credit rating.

# Second Quarter 2023 – Wealth Management Insights

# International

Matt Clarke, CIMA®, VP, Senior Client Portfolio Manager

It's been an interesting ride for the global markets so far this year. To briefly recap, we saw the worst banking crisis since Lehman Brothers, another debt ceiling debate, a lackluster Chinese economic recovery, renewed strength in crypto currencies and more recently, an unprecedented surge in artificial intelligence (AI).

What hasn't changed, however, is a backdrop that continues to be heavily defined by **global monetary policy**. Inflationary pressures continue to weigh on many areas of the world. In response, both the European Central Bank (ECB) and the Bank of England (BoE) hiked rates in May and June, bringing their main refinancing rates to 4.00% and 5.00%, respectively. The BoE surprised the markets, however, by hiking rates by 50 basis points (bps) in June as opposed to 25 bps, which was widely expected by investors. Notably, both the ECB and the BoE have indicated that additional hikes are likely this year. The Bank of Japan (BoJ) held its first policy meeting in April under their new central bank governor, Kazuo Ueda, and kept rates unchanged and still very accommodative at only 0.1%. China moved in the opposite direction by cutting their one-year loan prime rate (LPR) by 10 bps to 3.55% in an effort to help their flailing post-pandemic recovery. Turkey was a standout and for a very different reason. Following Recep Tayyip Erdoğan's re-election and subsequent appointment of its new finance minister, their central bank embarked on a monetary policy U-turn by hiking rates by 6.5% to 15%. While it was Turkey's first hike following several counterintuitive cuts, it underwhelmed investors who were expecting rates to move as high as 20%.

Over the 2nd quarter, **international stocks lagged domestic** but still ended on a positive note. Majority strength came from the developed areas while emerging markets trailed behind. The MSCI Europe, Australasia, and Far East (EAFE) index closed the quarter higher by 3.19% and year to date up 12.16%. At the same time, the MSCI emerging markets index finished the quarter higher by 0.97% and up 5.02% year to date. In Asia, China finished the quarter lower due to concerns about their weaker-than-expected recovery. Japan, however, proved to be a standout. Optimism about corporate governance reforms helped to push stocks to a 33-year high with the Nikkei hitting 33,700 yen in June and closing out the quarter up 18.48%. With a backdrop of rising rates around the world, global bonds lost some footing. The Bloomberg Global Aggregate (measure of global investment grade debt) closed out the quarter down -1.53%.

**As we consider the 3rd quarter, we believe that global inflation, central bank policy and rising geopolitical tensions** will continue to remain in focus. As always, we will remain disciplined in our approach with a focus on the long term, while looking to the benefits of diversification, active management, and strategic allocation.

*Additional and expanded information to this newsletter discussion may be obtained by contacting your relationship manager. We will be happy to expand our discussion with you to meet your individual requirements as a client of Wealth Management & Advisory Services.*

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