Market Summary: 2nd Quarter 2023

It was a positive quarter for almost all sectors of the stock market as investors looked past a decline in earnings and instead focused on the hope of strong future growth and a drop in interest rates. Actual earnings for the quarter are expected to decline by -6.8% and will mark the largest decline since March of 2020 when the pandemic started. Though the indices have posted positive returns, it is important to note that over 95% of the gains have come from a handful of mega Large Cap Growth companies who are leading the charge in “AI” (Artificial Intelligence) development. Thus the performance gap between Growth and the rest of the market widened even further during the quarter. With earnings falling and prices rising, the P/E ratio continues to rise, now at 18.9, and well above its five and ten year average. Meanwhile, the Bond market had a rough quarter with rates rising/prices falling as investors have had to reconcile with the Fed’s stated policy that rates will likely continue to rise and stay higher for longer. In sum, there is strong divergence in expectations of future growth, earnings and interest rates.

Index Returns:	QTD	YTD		QTD	YTD		QTD	YTD
US Blend Equity (Equal Weight)	3.92%	6.93%	U.S. Growth	15.1%	35.25%	U.S. Short Bond	-0.65%	1.27%
Foreign Developed	3.13%	12.08%	U.S. Value	2.93%	2.88%	Intermediate Corp Bond	-1.29%	2.06%
Emerging Equity	1.04%	5.20%	Small Blend	5.26%	8.09%	High Yield Bond	0.73%	4.48%

Market Outlook: Inflation and expectations of future earnings will dictate the direction of both the Bond and Stock markets. Though inflation has declined to near 4.6%, it still remains well above the Fed’s target of 2%. The main sources of inflation are the structural tightness in the labor market, continued pressure on shelter costs due to a tight housin market, and the aftermath of the huge amount of liquidity (over $4 trillion) poured into the economy. It will take years to unwind these imbalances, and means rates will likely stay higher for longer while growth remains muted. The Fed realizes this and has revised their GDP forecast downward to only 1.1% in 2024 and 1.8% in 2025. Despite this subdued forecast and the fact that the cost of capital is 500bpts (5%) higher than anytime over the last 10 years, the stock market is expecting earnings to rebound by over 11% in 2024. Call me crazy, but the current market set-up is balancing on fragile expectations at best. In other words, a lot of good news has already been priced in, and thus the market is vulnerable to disappointment. A further rise in interest rates or lower earnings could cause a significant adjustment lower in price of both stocks and bonds.