July 2023

Economic Update

A Review of Second Quarter 2023

The U.S. stock market continued to surge during the second quarter. The economy is holding up better than many expected it would, as corporate earnings have been stronger than expected, the labor market has held strong, and inflation has continued to moderate. In other positive news, an agreement on raising the debt ceiling was reached and the banking crisis appears to be over, at least for now.

Inflation continues to move in a positive direction, albeit slower than many had initially hoped. Prices in some components of inflation, such as energy, have moved down quickly and substantially, while others, such as transportation services, have seen much stickier prices. This has caused the Fed to be more hawkish than many observers had originally expected, which will likely continue until all components of inflation pressure have abated.

U.S. Economy

Ever since the Fed started to raise rates in March 2022, there has been a significant difference between what the Fed has projected for rate increases and what the market has expected, with the Globex treasury futures market having consistently expected the Fed to reserve course sooner all along the way. This gap has now finally narrowed, with the Fed predictions having been proven to be the more accurate ones during this cycle, at least.

The current Fed rate range now sits at 5.00 to 5.25%. The Fed expects that range to increase to 5.50 to 5.75% by the end of the year before they eventually begin to cut rates in 2024 and beyond.

Inflation readings will continue to drive that decision. After peaking at 8.9% year over year in June 2022, inflation has been in a sustained downtrend ever since. The most recent reading as of May was 4.1%. Still, this is a higher number than the Fed's long-term target of 2.0%, so expect Fed rates to stay relatively high as long the U.S. economy can tolerate it.

While the labor market has loosened a little as of late, it continues to defy expectations of a slowdown overall. Per the Bureau of Labor Statistics, the U.S. economy added 217,000 net jobs during April, 306,000 in May and 209,000 in June. They also reported that the total number of unemployed persons is 6.0 million and the unemployment rate is 3.6%. The participation rate for adults aged 25-54 is now fully recovered to pre-pandemic levels. The participation rate for adults aged 55+ has remained low, but that likely is due to our aging baby-boomer population, as it continues to permanently leave the workforce.

Still, employers have remained pessimistic. The Institute for Supply Management Manufacturing PMI registered 46.0 in June. Readings below 50.0 represent a suggestion of future economic contraction. The Manufacturing PMI has now been below that 50.0 level for seven straight months.

Consumers also remain relatively pessimistic. While the latest reading of University of Michigan Consumer Sentiment was up to 64.4 in June, this still represents a fairly low reading by historical

standards as it is well below the 100.0 level normalized in December 1964. On a positive note, Joanne Hsu, director of the survey, indicated that “uncertainty over both short- and long-term inflation expectations have declined considerably” as compared to last month.

International Economy

Similar to the U.S., other developed international economies have also been subject to recent rate hiking from central banks and have managed to persevere despite those headwinds. Strong consumer spending has maintained some slight growth in both the UK and the Euro area. Per Eurostat, European Union GDP is estimated to be up 0.1% during the first quarter of 2023, which is 1.0% higher as compared to the first quarter of 2022. Similarly, employment is up 1.6% during the same time period.

Unemployment in the eurozone was 6.5% as of May, which continues to be a record low. This tight labor market has been a boon for wages in the area. Wage growth remains close to all-time highs, registering 5.0% during the first quarter of 2023. This should support continued consumer spending and thereby lessen the odds of a European recession for the near future.

China appears to be back on the growth path after COVID restrictions had severely hampered that country’s economy over the last three years. Travel and leisure spending, in particular, have bounced back strongly, which should be supportive of growth in neighboring countries as well.

The U.S. Dollar Index, which is a measure of the dollar exchange rate to a combination of the Euro, Pound, Yen, Canadian Dollar, Swedish Korner, and Swiss Franc, reached a 20-year high last September, but has now pulled back roughly 10% since that time. A weakening dollar is generally good for international stock performance, as stocks gain from the currency conversion as well.

Markets

Developed equity markets had a strong second quarter. U.S. large-cap equities, as represented by the S&P 500 Index, gained 8.74% during the quarter. Developed international equity markets, as represented by the MSCI EAFE Index weren’t up as much. That index was up 2.95% for the quarter. Similarly, the Wilshire REIT Index gained 3.31% during the last three months.

Bond indexes were mixed. The Barclays U.S. Aggregate Bond Index was down 0.84% in the last three months, while the Barclays Global Aggregate Bond Index eked out a 0.06% gain during the period, owing to a weakening dollar during that time. Moderating inflation expectations resulting in a 1.42% loss for the Barclays U.S. Inflation-Linked Bond Index during the period.

The MSCI Emerging Markets Index trailed developed markets, but still finished the quarter up 0.90% overall. Commodities, however, continued to post negative results. The Dow Jones UBS Commodity Index lost 2.56% for the quarter.

Through July 6, 2023

% Return	Quarter-to-Date	Year-to-Date	1-Year	3-Year	5-Year
T-Bills	1.29	2.46	4.22	1.54	1.63
Bloomberg US Agg Bond Index	-0.84	2.09	-0.94	-3.96	0.77
Bloomberg Global Agg Bond Index	0.06	2.96	0.52	-2.88	0.93
Bloomberg US Infl Linked Bond Index	-1.42	1.87	-1.40	-0.12	2.49
S&P 500 Index	8.74	16.89	19.59	14.60	12.31
MSCI EAFE Index	2.95	11.67	18.77	8.93	4.39
MSCI Emerging Markets Index	0.90	4.89	1.75	2.32	0.93
Bloomberg Commodity Index	-2.56	-7.79	-9.61	17.82	4.73
Wilshire REIT Index	3.31	6.74	-0.31	8.55	4.40

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Outlook

Markets have been strong through the first two quarters of 2023, particularly in the U.S. The U.S. market has now significantly outperformed comparable developed international markets over the last five years. But part of that outperformance can be attributed to the strength of the dollar, and it is currently unclear as to whether that trend will continue given the likelihood that the Fed appears to be close to its end point for rate increases, while other central banks still have a way to go.

In addition to this potential currency impact, both valuations and near-term growth prospects are also currently looking relatively more attractive overseas. As always, we continue to recommend a diversified portfolio containing a reasonable amount of equity exposure for any investor with a long enough time

horizon. However, this might be a good time for investors to make sure that their portfolios have not drifted too far away from their original foreign versus domestic targets and rebalance accordingly if needed.

Bloomberg US Aggregate Bond Index: The Aggregate Bond Index is a broad-based benchmark that measures the investment grade, dollar-denominated, fixed-rate taxable-bond market, including Treasuries, government-related and corporate securities, MBS (agency fixed-rate and hybrid ARM pass-throughs), ABS and CMBS. The Aggregate rolls up into other Bloomberg flagship indices such as the multi-currency Global Aggregate Index and the Universal Index, which includes high-yield and emerging markets debt. The Aggregate Index was created in 1986, with index history backfilled to Jan. 1, 1976.

Bloomberg Global Aggregate Bond Index: The Global Aggregate Index provides a broad-based measure of the global investment grade fixed-rate debt markets. The Global Aggregate Index contains three major components: the Aggregate (USD 300mn), the Pan-European Aggregate (EUR 300mn) and the Asian-Pacific Aggregate Index (JPY 35bn). In addition to securities from these three benchmarks (94.0% of the overall Global Aggregate market value as of Dec. 31, 2010), the Global Aggregate Index includes Global Treasury, Eurodollar (USD 300mn), Euro-Yen (JPY 25bn), Canadian (USD 300mn equivalent) and Investment Grade 144A (USD 300mn) index-eligible securities not already in the three regional aggregate indices. The Global Aggregate Index family includes a wide range of standard and customized sub-indices by liquidity constraint, sector, quality and maturity. A component of the Multiverse Index, the Global Aggregate Index was created in 1999, with index history backfilled to Jan. 1, 1990.

Bloomberg Global Inflation-Linked Index: The Global Inflation-Linked Index (Series-L) includes securities that offer the potential for protection against inflation as their cash flows are linked to an underlying inflation index. All securities included in the index have to be issued by an investment-grade-rated sovereign in its local currency. The list of eligible currencies is the same set of currencies eligible for inclusion in the Global Aggregate Index. The Global Inflation-Linked Index (Series-L) represents a stand-alone multi-currency index exposed to the real yield curve for each relevant currency. As such, the index does not contribute to the Global Aggregate Index. The Global Inflation-Linked Index (Series-L) was created on Oct. 31, 1997.

S&P 500® Index: A market capitalization-weighted index of 500 widely held stocks often used as a proxy for the stock market. It measures the movement of the largest issues. Standard & Poor's chooses the member companies for the 500 based on market size, liquidity and industry group representation. Included are the stocks of industrial, financial, utility and transportation companies. Since mid-1989, this composition has been more flexible and the number of issues in each sector has varied. The returns presented for the S&P 500 are total returns, including the reinvestment of dividends each month.

MSCI EAFE Index: The MSCI EAFE® Index (Europe, Australasia, Far East) is a free float-adjusted market capitalization index that is designed to measure developed-market equity performance, excluding the U.S. and Canada. As of April 2002, the MSCI EAFE Index consisted of the following 21 developed market country indices: Australia, Austria, Belgium, Denmark, Finland, France, Germany, Greece, Hong Kong, Ireland, Italy, Japan, the Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland and the United Kingdom.

MSCI Emerging Markets Index: The MSCI EMF (Emerging Markets Free) Index is a free float-adjusted market capitalization index that is designed to measure equity market performance in the global emerging markets. As of April 2002, the MSCI EMF Index consisted of the following 26 emerging-market country indices: Argentina, Brazil, Chile, China, Colombia, Czech Republic, Egypt, Hungary, India, Indonesia, Israel, Jordan, Korea, Malaysia, Mexico, Morocco, Pakistan, Peru, Philippines, Poland, Russia, South Africa, Taiwan, Thailand, Turkey and Venezuela.

Bloomberg Commodity Index: Bloomberg Commodity Index℠ and Bloomberg Commodity Index Total Return℠ the DJ-UBSCI℠ family includes both the BSCI℠, which is calculated on an excess-return basis, and the BSCITR℠, a total return index based on the BSCI℠. The former reflects the return of underlying commodity futures price movements only, while the latter reflects the return on fully collateralized positions in the underlying commodity futures.

Wilshire US REIT Index: Introduced in 1991, the Wilshire REIT index is intended as a broad measure of the performance of publicly traded real estate equity securities. The index is market-capitalization weighted of publicly traded real estate securities, such as Real Estate

Investment Trusts (REIT), Real Estate Operating Companies (REOC) and partnerships. The index is composed of companies whose charters are the equity ownership and operation of commercial real estate.

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