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Investment Insights Monthly

From The Desk of Bill Hornbarger, Chief Investment Officer June 2023

Bull or Bear?

The S&P 500 is now up more than 20% from its October lows, pushing it further into what is widely considered bull market territory, and raising hopes that the stocks will not revisit last year's lows this cycle. This strong upward thrust has been led by the mega-cap tech names and technology sector as evidenced by the strong performance of the S&P 500 and Nasdaq relative to other segments of the markets such as the Russell 2000 and Dow Jones Industrial Average.

Recent Index Return Comparison

Index	Return 10/12/22 – 6/8/23	YTD (as of 6/8/23)
S&P 500	21.41%	12.68%
NASDAQ	27.91%	27.01%
Russell 2000	12.54%	7.47%
Dow Jones Industrial Average	17.59%	3.12%
MSCI EAFE	31.06%	10.74%

Source: Bloomberg

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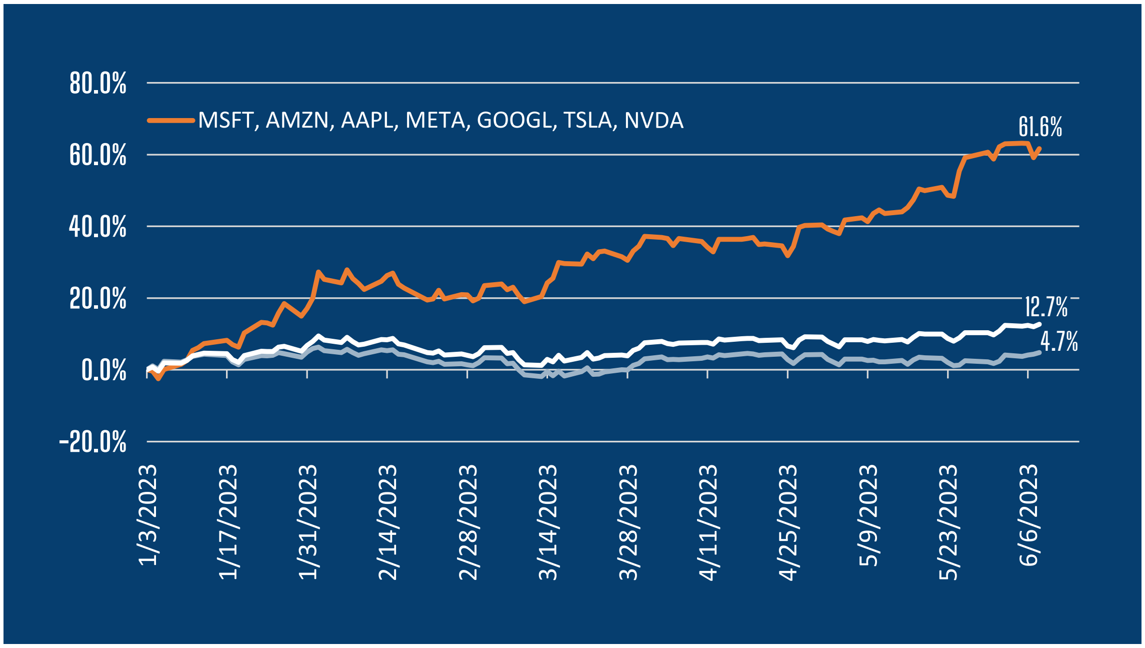
The very strong performance of some of the mega-cap tech stocks has resulted in the S&P 500 becoming somewhat "top heavy" in terms of both performance and concentration. So far in 2023, the S&P 500 (which is cap-weighted) is outperforming the equal-weighted S&P 500 by over 9% indicating narrow participation in the rally so far this year and the top seven names in the S&P 500 (accounting for more than 27% of the index) are significantly ahead of both the overall index and the next 493 stocks (see chart).

Mega-Caps Leave Peers Behind



*Source: YCharts *As of 01/01/2023 - 06/08/2023*

Is this relative outperformance of tech necessarily a 'bad thing,' and more importantly, what happens next? We have a simple model that combines several metrics such as price/book, price/sales, etc. and then looks at them relative to history across size and style and the S&P 500 sectors. The strong performance of the tech sector has resulted in the S&P 500 in general and the tech sector in particular looking expensive relative to history. However, many other areas of the market are trading at more attractive valuations, which is no surprise considering last year's weakness and the fact that they haven't fully participated in the recent rally. Small and mid-cap in particular are trading at below average historical valuations. These have faced pressure in recent months on a variety of factors including concerns over small and mid-cap financials and recession fears.

Those recession fears seem to be receding. That, coupled with the interest in anything related to artificial intelligence, has been a tailwind in the first half of the year. Going forward however, questions remain about the sustainability of the rally and the ability for it to broaden.

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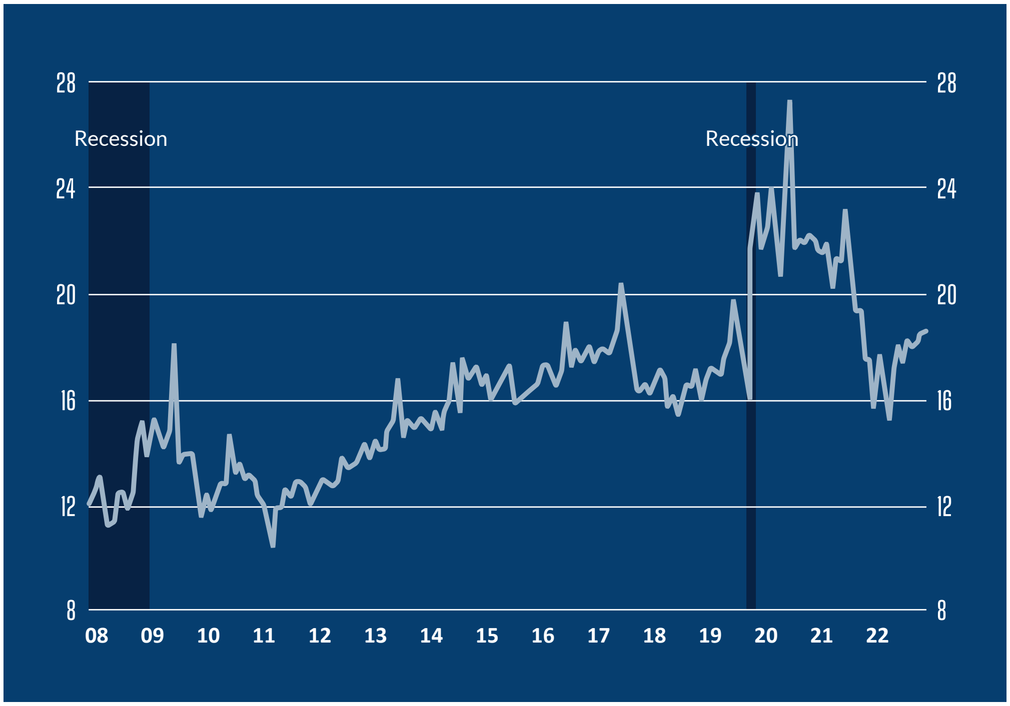
In terms of the economy, the low unemployment rate and declining inflation argue that the economy may be able to avoid recession. However, concerns remain as evidenced by soft manufacturing survey data, 13 consecutive months of negative leading economic indicators, and a deeply inverted yield curve. Adding to the concerns about the economy are record high levels of credit card debt (over $988 billion, up 17% from last year) amid signs that more consumers are using their cards for non-discretionary items due to inflation. We have previously used the term rolling recession and still think it is appropriate.

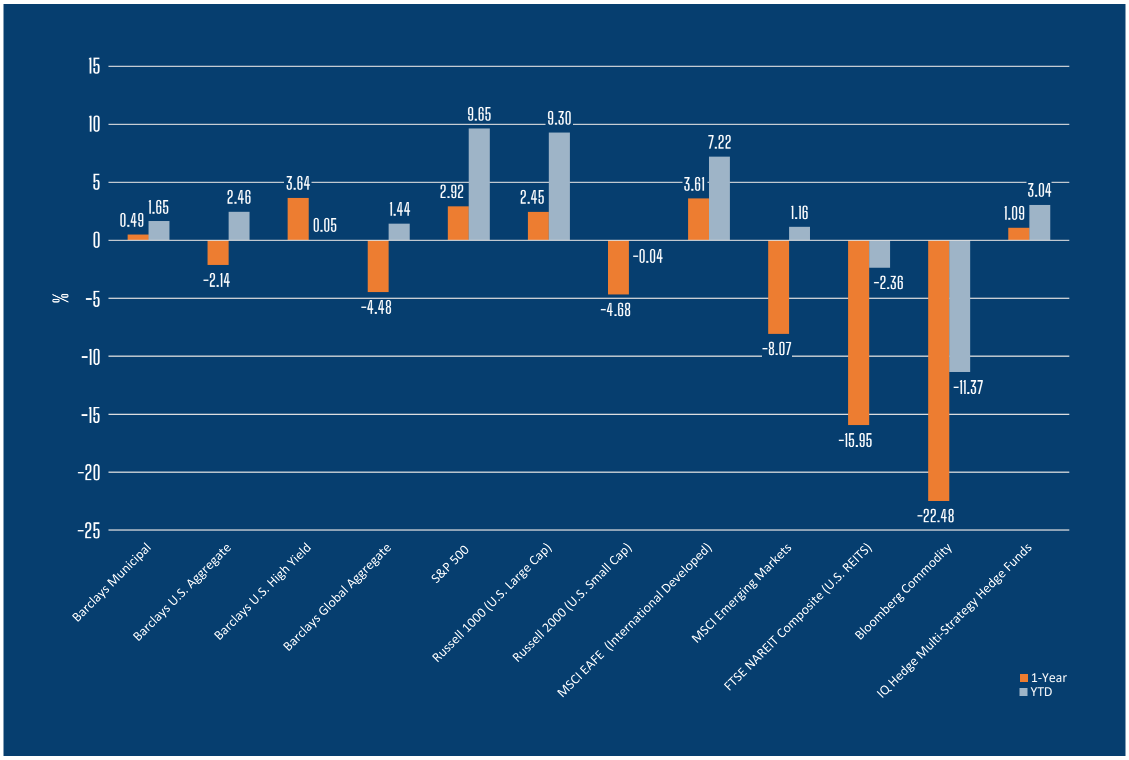
Like many, this rally in equities caught us by surprise due to its magnitude. First quarter earnings, while negative, were better than expected and have raised hopes for the full year. We have seen full year earning estimates for the S&P 500 recently in the $223.13 range, which would represent a less than half of 1% decline from full year 2022. That puts the index's PE ratio at roughly 18.5 times 2023 projected earnings (see chart) and suggests to us that the market is nearing a top for the time being and that the second half of the year will be much more muted. Previously, we had thought the market might see new lows, below last October. We still see that as a possibility but believe that with the Fed nearing an endpoint and the inflation data poised to continue to decline the next several months, the markets will be uninspiring and rangebound with the current level the top end as we head into the second half of 2023.

S&P 500 Composite: Forward P/E Estimate [Current +3 Quarters] Ratio



Source: Standard & Poor's/Haver Analytics

Asset Class Returns as of May 31, 2023
Comparing Recent 1-Year and Year-to-Date Total Returns



Source: Conway Investment Research

Fixed Income

- Yields backed up a bit in May, leading to broad losses in core fixed income and municipal bonds.
- Credit exhibited weakness last month with spread widening that was unable to offset the benefits of higher carry. Credit has still been one of the stronger performers YTD.
- Bonds outside the U.S. were hit by the strong U.S. dollar rebound in May, along with a slight move higher in yields.

Equities

- The story in 2023 continues to be that mega-cap growth/tech stocks are powering equity markets higher.
- Growth trounced value in May, and large caps outperformed small caps.
- The Nasdaq has led the way this year with a gain of nearly 24%. Six to seven companies are responsible for most of the performance contribution in May and 2023.
- For the first time in several months, non-U.S. equities lagged their U.S. counterparts.
- The MSCI EAFE was dragged down by weakness in Europe. Japan posted positive gains in May.
- In international developed markets, growth beat value, and there was little difference between small caps and large caps.
- U.S. dollar strength was the biggest driver of non-U.S. weakness.

Real Assets

- REITs suffered through a difficult month as concerns for commercial real estate continue to grow.
- Commodity prices were very weak in May on concerns for the global economy.

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May 31, 2023	MTD	QTD	YTD	1-Year	3-Year	5-Year	10-Year
Fixed Income Indices							
Barclays U.S. Treasury Bill 1-3 Month	0.40%	0.79%	1.89%	3.34%	1.17%	1.48%	0.91%
Barclays Municipal	-0.87%	-1.09%	1.65%	0.49%	-0.64%	1.65%	2.28%
BBgBarc U.S. Govt/Credit Intermediate	-0.31%	0.03%	1.54%	0.22%	-0.68%	1.22%	1.01%
Barclays U.S. Aggregate	-1.09%	-0.49%	2.46%	-2.14%	-3.65%	0.81%	1.39%
Barclays U.S. High Yield	-0.92%	0.07%	3.64%	0.05%	2.90%	3.10%	3.98%
S&P/LSTA Leveraged Loan	-0.18%	0.87%	4.12%	5.91%	5.92%	3.69%	3.77%
Barclays Global Aggregate	-1.95%	-1.52%	1.44%	-4.48%	-4.68%	-1.17%	0.08%
JPM GBI EM Global Diversified	-1.58%	-0.73%	4.39%	3.06%	-2.31%	-0.92%	-1.29%
U.S. Equity Indices							
DJ Industrial Average	-3.17%	-0.68%	0.25%	1.96%	11.27%	8.49%	10.61%
S&P 500	0.43%	2.00%	9.65%	2.92%	12.92%	11.01%	11.99%
NASDAQ Composite (Price)	5.80%	5.84%	23.59%	7.07%	10.88%	11.69%	14.11%
Russell 1000	0.47%	1.71%	9.30%	2.45%	12.45%	10.61%	11.76%
Russell 1000 Growth	4.56%	5.59%	20.76%	9.55%	12.85%	13.84%	14.76%
Russell 1000 Value	-3.86%	-2.41%	-1.43%	-4.55%	11.63%	6.78%	8.42%
Russell Mid Cap	-2.79%	-3.31%	0.61%	-4.51%	10.19%	6.88%	9.31%
Russell 2500	-1.75%	-3.04%	0.25%	-5.34%	10.31%	4.97%	8.37%
Russell 2000	-0.92%	-2.70%	-0.04%	-4.68%	9.23%	2.74%	7.36%
Russell 2000 Growth	0.02%	-1.14%	4.86%	2.68%	4.62%	2.74%	7.90%
Russell 2000 Value	-1.97%	-4.41%	-5.04%	-11.50%	13.60%	2.09%	6.43%
Non-U.S. Equity Indices							
MSCI World	-0.92%	0.87%	8.81%	2.61%	11.50%	8.34%	9.17%
MSCI ACWI	-1.00%	0.47%	7.95%	1.38%	10.59%	7.30%	8.38%
MSCI ACWI Ex-U.S.	-3.54%	-1.79%	5.09%	-0.87%	7.75%	2.71%	4.31%
MSCI EAFE	-4.10%	-1.30%	7.22%	3.61%	9.08%	3.71%	5.06%
MSCI EAFE Growth	-3.03%	-0.59%	10.55%	6.50%	6.52%	4.82%	6.10%
MSCI EAFE Value	-5.19%	-2.02%	3.99%	0.80%	11.36%	2.20%	3.77%
MSCI Europe	-5.68%	-1.61%	8.95%	5.35%	11.11%	4.69%	5.30%
MSCI Japan	1.87%	2.24%	8.77%	4.96%	4.67%	2.16%	5.34%
MSCI AC Asia	-0.46%	-1.65%	3.37%	-3.30%	3.64%	0.60%	4.47%
MSCI EAFE Small Cap	-4.07%	-2.07%	2.88%	-4.20%	5.63%	0.74%	5.89%
MSCI ACWI Ex-U.S. Small Cap	-2.69%	-1.20%	3.56%	-4.09%	8.57%	1.80%	5.26%
MSCI Emerging Markets	-1.65%	-2.75%	1.16%	-8.07%	3.86%	-0.29%	2.27%
MSCI EM Asia	-1.03%	-3.35%	1.34%	-7.77%	3.34%	0.06%	4.12%
MSCI China	-8.42%	-13.14%	-9.05%	-14.60%	-8.71%	-6.88%	2.10%
MSCI EM Eastern Europe	-4.29%	7.24%	11.73%	8.83%	-34.83%	-22.08%	-11.38%
MSCI EM Latin America	-0.73%	1.96%	6.08%	-3.19%	14.56%	2.22%	-0.59%
MSCI EM Small Cap	1.14%	1.85%	5.86%	-2.47%	15.88%	3.06%	3.59%
MSCI Frontier Markets	-0.52%	0.02%	3.20%	-9.17%	3.97%	-0.04%	2.21%
Hedge Fund Indices							
IQ Hedge Long/Short	-0.07%	0.51%	0.51%	-7.20%	3.28%	2.30%	--
IQ Hedge Multi-Strategy	-0.52%	-0.01%	3.04%	1.09%	1.17%	1.27%	2.33%
Real Assets Indices							
FTSE NAREIT Composite	-4.20%	-3.86%	-2.36%	-15.95%	5.18%	4.05%	5.76%
Alerian MLP	-0.52%	1.20%	5.34%	7.84%	25.47%	4.97%	0.80%
Bloomberg Commodity	-5.64%	-6.35%	-11.37%	-22.48%	17.15%	3.17%	-1.86%
S&P Global Infrastructure	-5.53%	-3.06%	0.76%	-6.72%	9.10%	5.09%	6.12%
Other							
Oil Price Brent Crude	-3.11%	-3.38%	-10.29%	-36.66%	29.69%	-0.11%	-2.80%
CBOE Market Volitility (VIX)	13.69%	-4.06%	-17.21%	-31.50%	-13.28%	3.06%	0.96%

Source: Morningstar

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