The Beckmann Marlow Nuelle Wealth Management Group 2023 Mid-Year Market Commentary

"*Money is better than poverty, if only for financial reasons.*" – Woody Allen

I. Seeking Stability

Our team concluded 2022 with expectations of additional Federal Reserve (Fed) intervention, weakening earnings, and a looming possibility of a recession at some point during the calendar year. We advocated, as we often do, for prudent asset allocation and careful stock selection. Coming into this year, our overall premise was that the ability to navigate rising costs would likely give way to clear winners and losers in the stock market. Fortunately, the downward trend in inflation we started to see at the conclusion of 2022 has continued in the first half of 2023. According to the latest report in June, the U.S. Inflation Rate (measured by the Consumer Price Index, or CPI), measured at 3.0%, down from 4.1% in the prior month, and down from the peak of 9.1% in June of 2022 (Trading Economics). A deeper look at the components of CPI indicate the slowdown is largely attributed to a much slower pace of increase in both energy and food costs. At the Fed meeting in May of this year, the Federal Reserve increased the policy rate for the 10th time, moving Fed Funds to a range of 5.0 - 5.25%. (Bureau of Economic Statistics). In his comments following their June meeting, Fed Chair Jay Powell noted two more quarter-point hikes were likely before the end of the year. Additionally, he anticipates CPI will not reach the Fed's long-term target of 2% until at least 2025. Once this milestone is reached, he believes rate cuts in an effort to stimulate the economy become a real possibility. To his credit, Jay Powell has provided consistent transparency and leaves little room for guesswork when it comes to the present and future actions of the Fed. Time will tell what the total degree of impact their aggressive course of action will have on both the domestic and global economy.

As a result of Fed tightening, shorter term treasury yields are up 0.25% year-to-date, and the rest of the yield curve remains virtually unchanged. Overall, interest rates remain at levels not seen since the early 2000s. As a group, we continue to see opportunity in shorter term fixed income. Generally money markets, short-term treasuries, agency, and investment-grade corporate bonds continue to make sense for our more income-oriented investors.

II. Challenges in 2023

Thanks to a stark mismatch between assets and liabilities, we saw the swift collapse of three regional banks in March of this year. Silvergate, Silicon Valley, and Signature Bank all failed within days of each other after depositor concerns over the banks' liquidity rose sharply. The overwhelming majority of its depositors were uninsured by the FDIC. Another, First Republic Bank, closed its doors in May under similar circumstances. At the onset of the crisis, market volatility ensued as fears of global contagion in the banking sector became a very real concern. In response, three of the major U.S. bank regulators announced extraordinary measures would be taken and all depositors at the failed banks would be made whole. To further contain the situation, global bank regulators joined forces to provide additional liquidity. By mid-March, large interbank flows of funds occurred to shore up bank balance sheets in an effort to mitigate the crisis. In our opinion, the worst of the banking crisis seems to be behind us, but Q2 earnings reports from the banking sector will give some insight into any remaining weakness.

Another major point of discussion in 2023 is the wide performance disparity among equity styles. The S&P 500, the major market proxy for stock investors, is a market-cap weighted index whose performance has been largely dominated by technology companies. More than any other sector, these companies stand to benefit greatly from the current revolution in artificial intelligence. To further illustrate this point, a useful comparison can be made between the market cap-weighted index and an equally-weighted index, which views every constituent company equally and does not assign greater weight to those outsized companies within the index. Through the first half of the year, the S&P 500 surged nearly 14%. By comparison, the equal-weighted version of the same index was up around 6% over the same time frame. Value stocks, our major dividend-payers that typically grow earnings at a lower rate than the overall market, stand to benefit less from advancements in AI. As a result, these companies have lagged in comparison to the growth counterparts on a year-to-date basis. When we dig a little deeper into performance attribution, the main driver of performance year-to-date has been overall multiple expansion. Said differently, investors have been willing to pay a more substantial premium for the future earnings of companies in the tech space. Assuming the consensus forecast for weakening earnings holds true, this group of stocks could face somewhat of a challenging backdrop in the second half of 2023.

Though this year's performance disparities are more drastic than what we typically see, they are certainly nothing we haven't seen before. What we often see is a form of mean reversion, where the pendulum will eventually swing in the opposite direction, and, in this case, favor value stocks over growth. This is why proper diversification and active rebalancing is key to any successful investment strategy. Where appropriate, we view this as an opportune time to take profits from any meaningful overweight in technology instead of chasing performance.

III. Recession Possibility

A relatively recent survey of economists by Bloomberg indicated a recession is more likely than not by the end of the year. This is not hard to fathom with the backdrop of a sluggish consumer, potentially weaker earnings, turmoil in the banking sector, and geopolitical uncertainty. Perhaps most importantly, the impact of the Fed's aggressive tightening is likely to be felt more meaningfully in the second half of 2023. Volatility is likely to remain elevated. Our team's overall opinion aligns with the general consensus in that any upcoming recession will likely be in the range of mild. If inflation continues to fall, the Fed will have the option to pivot to a policy of rate cuts at some point in the future if economic conditions deteriorate. Historically, this is always a significant tailwind for the market.

If we're correct about the direction of the economy, intentionally reallocating assets among equity styles and market caps is of the utmost importance. We continue, as we always have, to perform rigorous due diligence of our selected managers in both the separate account and mutual fund areas.

IV. What's New with the Team?

Once again, the Beckmann family is on baby watch with the upcoming birth of Brad's second child in September. Big brother Louis is excited to take on his new role, and is antsy to see if his newest pal will be a boy or girl. This will be the third grandchild for Bob and Jackie.

All is well with everyone else. The summer months have kept us very busy. We hope you've been able to enjoy some time with family and friends!

As always, we continue to appreciate your business and friendship! Please don't hesitate to get in touch with any questions or concerns regarding your portfolio.

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Past performance is not indicative of future results.

The Standard & Poor's 500 Index is a capitalization-weighted index that is generally considered representative of the U.S. large capitalization market.